



FOREWORD BY THE CHAIRMAN



Eddy Wymeersch

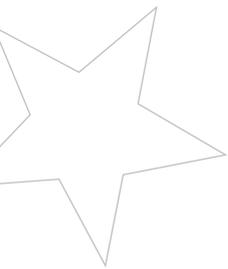
The year 2007 will not easily be forgotten in the history of financial markets, including their supervisors and CESR. The year was characterised by a watershed between the first half that developed without significant occurrences, at least on the surface, and the second half that required us to mobilise all our forces to cope with the strong headwinds blowing from over the Ocean (and which were still at full strength at the moment of writing). Although the work at CESR continued apace during the whole year on the basis of a longer term work programme, during the second half of the year several workstreams were started that directly related to the unfolding turmoil. Most of these have not reached their final stage at the moment of presenting this report, although the subjects are now well identified.

The role of credit rating agencies (CRAs) in relation to structured products was already the subject of a CESR public market consul-

tation in June 2007, immediately before the beginning of the turmoil. It was felt that additional research was called for in this field, as some of the actions undertaken by the CRAs seemed rather inconsistent and perhaps in need of additional follow-up. The work on structured products was further extended by a request from Commissioner McCreevy, inviting CESR to consider whether the recent developments within structured finance would cause CESR to change its view on whether to regulate CRAs. CESR's position in the past has closely followed that of the International Organisation of Securities Commissions (IOSCO) which has adopted a broadly framed and internationally accepted code of conduct, the revision of which took place with the contribution of several of the CESR Members. Taking into account the work undertaken by IOSCO to adapt the code to the needs of the markets in turmoil, CESR is considering pursuing this convergent approach while identifying the specific needs of the European

markets. Both the substance of the code as well as the monitoring and enforcement regimes will be specifically addressed in CESR's advice to the European Commission.

The second major workstream in which CESR played an active role relates to the Review of the Lamfalussy framework as mandated by the European institutions. Together with the two other Level 3 Committees, CESR developed a number of suggestions that led to a common 3L3 position on the needs and priorities of the review. CESR contributed significantly to the reflections on the topics under discussion, and gave its advice to the Inter-institutional Monitoring Group, to the Financial Services Committee and to the European Financial Committee. These different positions reflect decisions taken by the ECOFIN on 4 December 2007, which are likely to change significantly the functioning and the role of the Level 3 committees, by making them able to respond more



“The formulation of practical interpretations of the existing directives by way of recommendations, guidance and standards, contributes to CESR’s role as a centre of knowledge and expertise in the field of securities regulation.”

effectively and more rapidly to the needs of the evolving financial market of today, especially in the present difficult situation. At the same time there was a clear call from the European institutions to evolve towards more convergence in regulation. Over time, and provided a certain number of prerequisites are met, the Committees are likely to become the main centres giving guidance on the implementation of European regulation, by means of the so-called ‘Level 3’ work.

On 1 November 2007 the MiFID entered into force. No big bang occurred, but the effects of this crucially important new regulatory framework will be felt over time. The first changes are, however, already visible: new trading venues have been created, or announced, triggering a host of new issues and related developments. Investors have been confronted with numerous questions from their banks or brokers, guaranteeing better-adapted investment services. Transaction reporting covers all financial instruments admitted to trading on regulated markets, whether or not transactions are executed on these markets. CESR played a crucial role in organising the reporting network that started operating on 1 November, which allows the 29 national supervisors to monitor transactions throughout the EU.

A significant evolution was started with the announcement by the US Securities and Exchange Commission on the introduction

of a regime of mutual recognition for certain financial transactions, intermediaries or markets. This development took place against the background of changes in US regulation allowing foreign companies to deregister and hence put an end to the application of US disclosure laws, and allowing non-US issuers to state their accounts in IFRS without further restatements or reconciliations to US GAAP. Both initiatives are a testament to the strong focus of US authorities on the increasing internationalisation of the securities markets and the importance of the EU markets. CESR intends to play a significant role in this process, and contribute to the widening and deepening of Europe’s capital markets.

CESR intends to work further on co-ordinating the actions of the national securities supervisors in Europe with a view to creating an increasingly integrated European securities market, based on more and more convergent regulation. The formulation of practical interpretations of the existing directives by way of recommendations, guidance and standards, contributes to CESR’s role as a centre of knowledge and expertise in the field of securities regulation. It will be complemented by initiatives contributing to a better and more efficient functioning of the markets, by collecting information or putting this at the disposal of its Members, or more generally of the markets. This network of securities regulators and supervisors will offer an original answer to the needs for conver-

gence and co-ordination of Members whose action remains rooted in their national laws.

Finally, I would like to take this opportunity to thank those Members who left CESR during the course of the year. In particular, I warmly thank Arthur Docters van Leeuwen, my predecessor as Chairman of CESR and Kaarlo Jännäri, former Vice-Chairman, who both left their national Authorities in 2007. Under their enlightened guidance CESR made its first steps and achieved important successes; this represents stimulation and a constant example for our future activities of CESR. I also welcome all new Members with whom we will together share the responsibility of contributing to the success of CESR.

Last, but certainly not least, a special thank you goes to Fabrice Demarigny, the former Secretary General, who left CESR at the end of 2007 after having served six years in that position. CESR is grateful for his dedication to the ‘European cause’ and for receiving his insights during those years. Carlo Comporti was appointed as Secretary General of CESR as of 1 January, 2008.

LIST OF COMMONLY USED ACRONYMS

A	All	Alternative Instrument Identifier
	AMLTF	Anti Money Laundering Task Force
	AUM	Assets under Management
	ARC	Accounting Regulatory Committee
	ASBJ	Japanese Accounting Standard Board
	AuRC	Auditing Regulatory Committee

B	BSC	Banking Supervisory Committee
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C	CAD	Capital Adequacy Directive
	CEBS	Committee of European Banking Supervisors
	CESAME	European Commission's Clearing and Settlement Advisory and Monitoring Expert Group
	CESR	Committee of European Securities Regulators
	CEIOPS	Committee of European Insurance and Occupational Pensions Supervisors
	CDD	Customer Due Diligence
	CDO	Collateralized Debt Obligations
	CFTC	Commodity Futures Trading Commission
	CGFS	Committee on the Global Financial System
	CLO	Collateralized Loan Obligations
	CPI	Consumer Price Index
	CPMLTF	Committee for Prevention of Money Laundering and Terrorist Financing
	CRAs	Credit Rating Agencies
	CRD	Capital Requirements Directive

E	EAD	Eligible Assets Directive
	ECB	European Central Bank
	ECBC	European Covered Bond Council
	ECOFIN	Economic and Financial Affairs Council
	ECON	Economic and Monetary Affairs Committee of the European Parliament
	EEA	European Economic Area
	EECS	European Enforcers' Co-ordination Sessions
	EFC	Economic and Financial Committee
	EFCC	European Financial Conglomerates Committee
	EFRAG	European Financial reporting Advisory Group
	EGAOB	European Group of Auditors' Oversight Bodies
	ESC	European Securities Committee
	ESCB	European System of Central Banks
	ESME	European Commission's European Securities Markets Expert Group

F	FCD	Financial Conglomerates Directive
	FESE	Federation of European Stock Exchanges
	FASB	Financial Accounting Standards Board
	FSC	Financial Services Committee
	FSF	Financial Stability Forum
	FST	Financial Stability Table

G	GAAP	Generally Accepted Accounting Principles
	GDP	Gross Domestic Product

I	IA	Impact Assessment
	IAS	International Accounting Standards
	IASB	International Accounting Standards Board
	IFIAR	International Forum of Independent Audit Regulators
	IFRIC	International Financial Reporting Interpretations Committee
	IFRS	International Financial Reporting Standards
	IIMG	Inter Institutional Monitoring Group
	IOSCO	International Organisation of Securities Commissions
	IPO	Initial Public Offering
	IWCFC	Interim Working Committee on Financial Conglomerates

K	KII	Key Investor Information
	KID	Key Information Document
	KYC	Know-Your-Customer

L	LBO	Leveraged Buy Out
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M	MAD	Market Abuse Directive
	M & A	Mergers and Acquisitions
	MIFID	Markets in Financial Instruments Directive
	MS	Member State
	MSCI-indices	Indices maintained by Morgan Stanley Capital International
	MoU	Memorandum of Understanding
	MTF	Multilateral Trading Facility

N	NRSRO	Nationally Recognized Statistical Rating Organization
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O	OAM	Officially Appointed National Mechanism
	OFC	Non-cooperative Jurisdictions
	OTC	Over-The-Counter

R	RIAs	Retail Investor Associations
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S	S & I Group	Surveillance & Intelligence Group
	SEC	Securities and Exchange Commission
	SFBC	Swiss Federal Banking Commission
	SP	Simplified Prospectus

T	TD	Transparency Directive
	TOD	Takeover Bids Directive
	TREM	Transaction Reporting Exchange Mechanism

U	UCITS	Undertakings for Collective Investment in Transferable Securities (Directive)
	UIG	Urgent Issues group

V	VAT	Value Added Tax
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X	XBRL	xtensible Business Reporting Language
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'Our co-operation gives us a panoramic view on the market place'



01 OVERALL MARKET TRENDS AND RISKS

This chapter gives a brief overview of major economic trends and risks between January 2007 and January 2008, which can be interpreted as having had a significant impact on the performance of European securities markets.

Introduction

The global economy continued to expand in 2007. However, the downside risks to the global growth outlook increased in 2007 and global GDP growth is projected to decelerate further in 2008. The key downside risks to the outlook were the tighter global financial market conditions and the impact of the slower US economic growth on the rest of the world. Global financial market conditions deteriorated significantly in 2007.

As a result of problems in the US subprime mortgage markets, financial markets first saw a short period of stress in February/March 2007 when there was a sell-off of the credit derivative indices tracking the US subprime mortgage markets and concerns over subprime exposures spread more widely to other assets. Concerns over the extent of exposures to the US subprime mortgage markets resurfaced in July/August and investor risk aversion rose, leading to significant financial market dislocation and effective closure of some securitisation markets.

Liquidity conditions tightened as banks concerned about subprime exposures became increasingly reluctant to lend each other money and money market rates rose to record levels. After five central banks announced coordinated action to reduce pressures in the money markets on 12 December, funding pressures began to

lessen and money market rates fell. However, the financial market dislocation is still ongoing and credit conditions are now significantly tighter than they were a year ago, meaning that the risks to the outlook for the global economy and financial markets have increased.

Output growth

During 2007 the world economy continued to expand above 5%, reaching 5.2% according to IMF projections. The Asian economies were the main contributors to such growth, namely China with a double-digit increase of 11.5% and India expanding 8.9%. Emerging and developing countries counterbalanced the moderate growth of GDP in other countries, in particular the United States. The second half of the year was marked by the subprime crisis in the US housing market with spill-over effects to Europe and other markets around the globe.

The Euro area is expected to have attained a 2.5% growth rate, slowing from the 2.8% figure of last year. The available seasonally adjusted quarterly data, shows sizeable growth differences between euro area countries, with Slovenia, Finland and Ireland exhibiting higher year-on-year third quarter growth rates of 6.3%, 4.1% and 3.9%, respectively.

The overall results suggest that the cyclical peak has been surpassed despite signs of increased resilience to the global disturbances. On the upside there is evidence that private consumption recovered from both the adverse effects of the VAT increase in Germany in the beginning of the year and difficult financing conditions that

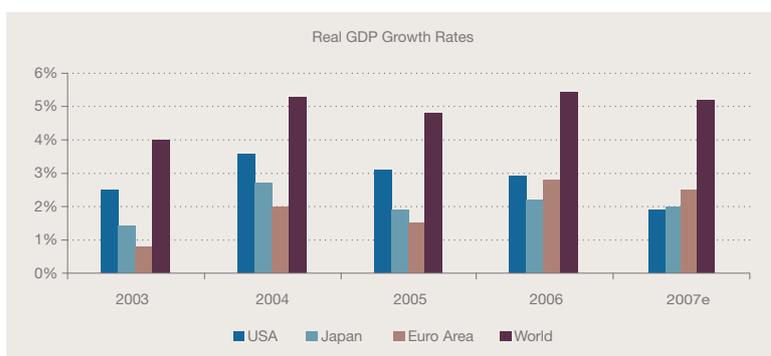
affected investors' confidence in the second half of the year. Gross fixed capital formation increased along with corporate profitability, the latter benefiting from moderate increases in labour costs and a rise in labour productivity. As for foreign demand, there was a shift from the geographic composition of trade partners towards Asian and oil exporting economies, offsetting the slowdown in the economic activity of more traditional destinations such as the US. Hence in 2007 the effects of the appreciation of the euro have been contained.

While there was a slowdown in economic activity in the US, growth is expected to have remained robust in 2007, at 1.9%. Real GDP had a 1.2% growth in the third quarter of 2007 when compared with the previous quarter and 2.8% on a year-on-year basis. The crisis of the subprime mortgage market and the turmoil in the money and credit markets remained relatively contained in 2007, maintaining an increase in consumer spending and benefiting from the trade deficit retraction on the back of a weaker dollar and rapid economic growth in many export markets. For the first time since 1995 net exports contributed to GDP growth.

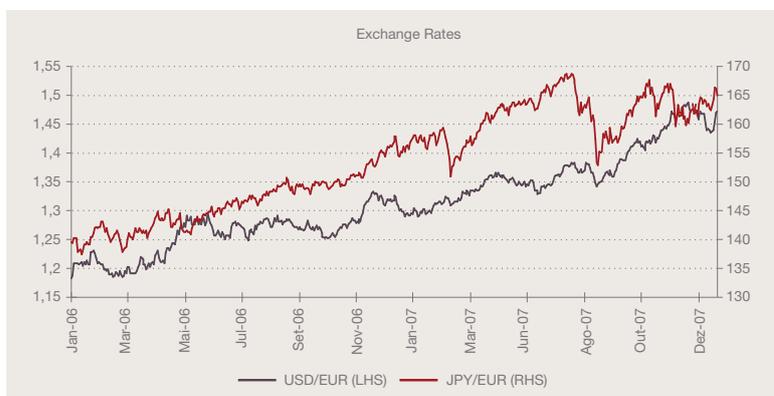
The Japanese economy is expected to have grown 2% in 2007, down from the 2.2% expansion of 2006. GDP third quarter results show a 2% increase when compared with the same quarter in the previous year. Although household consumption increase is expected to be sluggish, net exports remain dynamic and contributed to almost half of GDP expansion in the first half of the year.

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Looking ahead, the effects on the real economy of the disruptions in the financial markets, repricing of credit risk, increased volatility, loss of market liquidity and uncertainty about the magnitude of off-balance-sheet exposures of financial institutions are still to be fully assessed as corrections to the housing market develop. The forecast for 2008 show a deceleration of the growth rates of most economies, with a 2.1% forecasts for the euro area but maintaining the 1.9% figure for the US¹.



Source: IMF



Source: Bloomberg

Exchange rates

During the course of 2007 the euro strengthened against most of the currencies of the euro area's trading partners, gaining momentum in the last three months of the year, driven by the turmoil in credit markets and expectations of a widening of interest rate differential between Europe and the US. The year-end nominal effective exchange rate was 6.3% higher than in the beginning of 2007 while the CPI-deflated real effective exchange rate had a 5.9% appreciation in the same period.

The uncertainty regarding the exposure of the European economies to the US subprime market and the increase in risk aversion led to a weakening of the euro against the dollar felt in July and beginning of August. Thereafter the trend was inverted, driven by repositioning of risk assessment by market participants fuelled by soft data in the US housing and labour markets, a wide US current account deficit, moderate economic growth and also the lowering of the federal funds target. The single currency peaked in November against the dollar, trading at 12.9% above the exchange rate of the beginning of the year.

As for the Japanese yen, the euro sustained an appreciation trend that peaked in July; this can be explained by a low risk perception by market participants, favourable for carry trade business, in which the Japanese currency is attractive as a funding instrument due to the low levels of interest rates, implied volatilities and investor risk aversion. A period of broad base appreciation of the yen followed, driven by the turbulence in global financial markets, increased risk aversion and widespread repricing of risk by global investors. As tensions in financial markets tended to recede, the euro rebound against the Japanese currency and ended the year with a 5.1% appreciation.

¹ World Economic Outlook of IMF (October 2007).

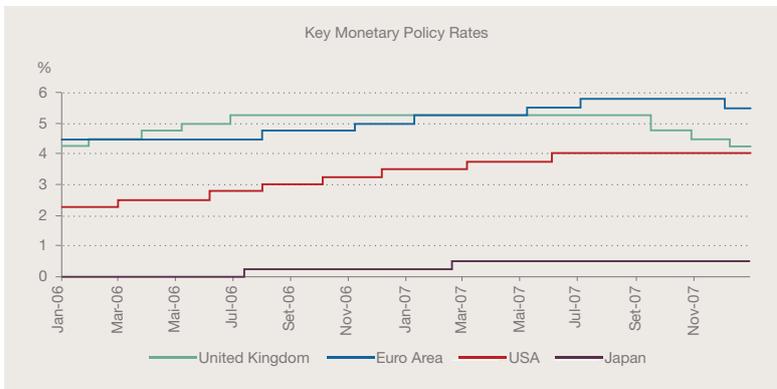
Inflation and interest rates

Prior to the turmoil in financial markets, central banks were targeting inflationary pressures by pushing up policy rates. However, the course of events in the second half of 2007, with the worsening performance of the US mortgage and structured markets, led to a decline in US Treasury bill yields, reflecting a flight to quality and changed expectations about the path of monetary policy. The liquidity squeeze that followed prompted the central banks in the euro area, US, UK, and Australia to stabilise overnight

interest rates through open market operations in August, on a scale unseen since 1998.

While the ECB kept its main refinancing rate at 4%, concerns on the cooling of economic activity outweighed the inflationary risk in the US and the Federal Reserve cut its key federal funds rate from 5.25% at the end of August to 3.50% five months later. Despite some relief in the financial markets following the central banks' measures, credit markets remain vulnerable, with the full impact of losses yet to be assessed.

Inflationary risk has risen in recent months, reflecting strengthened domestic demand and an escalation in commodity prices, namely food product prices and imported energy, from gasoline to home heating oil. In the euro area and the EU, annual inflation was, respectively, 3.1% and 3.2% in December 2007 (December 2006: 1.9% and 2.2%), well above the 2% convergence target. While in Japan prices have essentially been flat, in the United States annual inflation was 2.3% in November and food and energy costs rose in 2007 at their fastest rates since 1990, posing a dilemma to the Federal Reserve on whether to cut rates further to boost economic growth at the risk of higher inflation.



Source: Bloomberg



Source: Datastream

Equity Markets

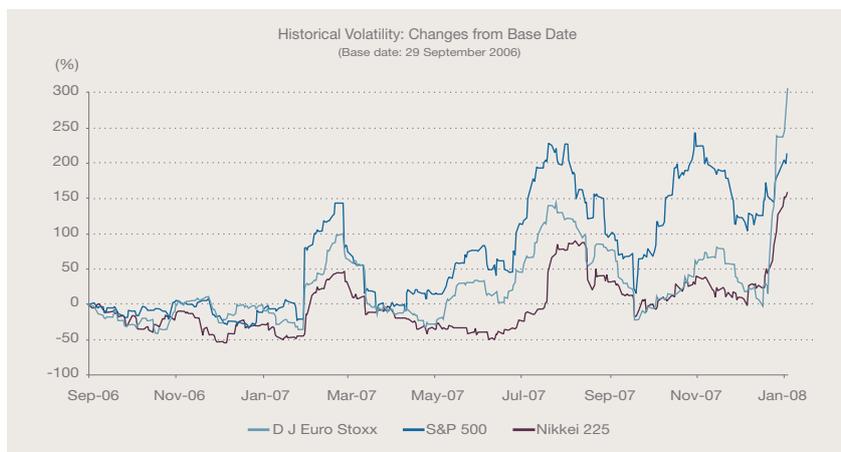
In spite of the difficulties posed by the economic and the financial environment, most equity markets around the world closed the year with a positive annual index growth. In the main industrialised areas, the Japanese market was the most important exception to this pattern, with a decrease of 11.1% in the Nikkei 225 index. The DJ Euro Stoxx and the US S&P 500 indices achieved increases of 6.8% and 3.5% respectively, although a remarkable dispersion was observed within the major EU stock exchanges: local index growth ranged from negative (Mib 30) to more than 20% (Dax 30). Emerging equity markets, including those located in the new EU Member States, showed considerable resilience before the worsening in the overall economic and financial conditions and they enjoyed again a high performance in terms of asset price growth.

Focusing on the behaviour of the major markets (EU, the US and Japan), the year began with the continuation of the rally initiated in November 2006. The upward trend was based on improved expectations about the US economy, better than expected earnings reports and high M&A activity. Volatility remained at low levels. At the end of February, the rally was shortly interrupted by an intense sell-off which began in the Chinese market, with a loss of 9% in

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just one day. The fears of a cooling in the Chinese economy and a recession in the US, together with an upturn in oil prices, led to massive sales in nearly all the major markets, giving rise to significant index losses.

At mid-March, the turbulence was over and the markets resumed the rally. The price rise was vigorous, especially in the European and the US markets, up to the point that both the DJ Euro Stoxx and the S&P 500 attained six-year highs at the end of May. Despite expectations of interest rate increases, the volatility returned to low levels during this period. At the beginning of June, the rally came to an end and the markets entered a stage characterised by the absence of a clear direction in the behaviour of the indices and a substantial rise in volatility, against a background of increasingly negative news about the housing markets in the US and some European countries.



Source: Datastream

The outbreak of the US subprime mortgage crisis in July prompted a generalised selling round in the main international markets, with strong losses in prices that removed much of the gains accumulated in Europe and the US and brought the Japanese market below the end-2006 levels. Almost all the sectors were affected by the crisis but banks, building companies and other housing sector listed firms were hit with particular intensity. Together with the concerns on the sectors more affected by the crisis, the sales were driven by an increased perception of risk

about the performance of the whole economy, which was reflected by a sharp volatility rise.

The situation did not change until mid-September, when the Federal Reserve cut interest rates to restore investors' confidence. Following this intervention, the major international equity markets experienced a new rally that lasted until mid-October. The upturn helped the DJ Euro Stoxx and the Nikkei 225 to contain the losses induced by the summer crisis, while the S&P 500 reached an all-time high. However, in November the markets entered once more a phase of price decline fuelled by concerns about the financial sector and the performance of the overall economy. The end of the year saw a partial recovery of prices following another official interest rate cut in the US, but new turbulences arose in January fuelled by the uncertainties inherited from 2007.

With the beginning of the new year, the indices followed again a downward path. The decline was moderate in daily terms until 21 January, when the Asian and the European markets experienced dramatic losses over the course of a single day, which coincided with a holiday in the US. Even though there was no clear explanation for the collapse at that point, the Federal Reserve moved quickly on the next day to cut its official interest rate. The measure helped to contain the losses in the reopening of the US markets and gave some air to the European and the Asian markets, but it was not sufficient to change the mood of the markets. The end of January 2008 saw a sharp rise in volatility, fed by bad news at macroeconomic and company level, including the disclosure of the Kerviel/Société Générale case. January 2008 losses amounted to 6.1% for the S&P 500, but they were well above 10% for the DJ Euro Stoxx and the Nikkei 225.

From a sector perspective, the performances of the MSCI sector indices suggest that the drop in prices was generalised and intense in January 2008. Between August and December 2007, most sectors had suffered losses too, with the financial sector and some cyclicals topping the ranking; but there were some exceptions,

the most remarkable being Utilities, a sector with high M&A activity throughout the year. In January there were no exceptions to the trend. All the sectors yielded a negative aggregate return for that month, with IT and energy heading the losses.



Source: Datastream

The course of the markets in January 2008 suggests that investors are increasingly focusing on macroeconomic risks rather than on the specific concerns about the financial sector, even though the latter are still important. The most recent macroeconomic data have raised fears of an American recession and of a substantial reduction of global economic growth. The fact that the massive selling witnessed in January made no distinction across sectors could be an indicator of that qualitative change in the perception of the causes of risk. The disclosure of audited financial information for the financial sector companies, which is expected to be completed no later than March 2008, will help to reduce some of the current uncertainties, but may not ensure an overall improvement for the markets. The course of the real economy will have a decisive impact on the performance of the markets for the next few months.

MiFID

As expected, the Markets in Financial Instruments Directive (MiFID) came into effect in most EU countries in 2007. This development opens a new era for the European equity markets as it implies important changes with regard to the scope of trading platforms under regulation and the specific requirements designed to enhance transparency and investor protection. A particularly important feature of the MiFID is that it recognises that transparency and investor protection must be enforced in a complex setting, where different providers may compete in the supply of trading services for the same security. An accurate and consistent enforcement of the MiFID principles, in particular those related to pre- and post-trade transparency and the best execution principle, will be essential to guarantee more efficient markets and to promote investors' confidence.

Initial Public Offerings (IPOs)

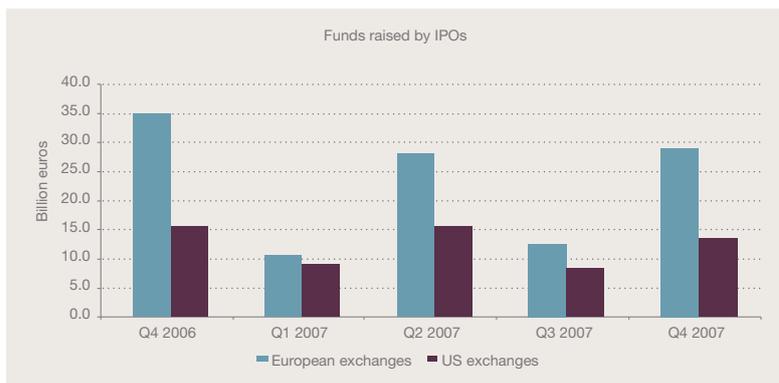
IPO activity on the European exchanges remained at a high level in 2007. Including investment companies, there was a total of 801 IPOs which raised €80.3bn². In comparison with 2006, these figures imply a decrease of 2.2% and 9% respectively, but it should be noted that 2006 was an exceptional year in terms of IPO activity. Nevertheless, after the summer a slowdown was observed, both in the number and the amount of deals, when it became clear that the markets faced a more difficult environment.

As in 2006, Europe outperformed the US in terms of IPO activity. The latter experienced a sharper decrease, raising €46.7bn through 275 IPOs. In contrast with the reduction in both Europe and the US, IPO activity

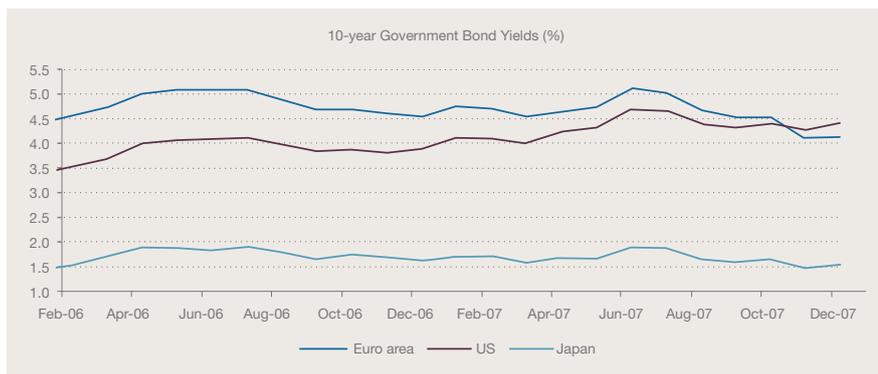
² Unless otherwise indicated, figures are based on the PriceWaterhouse IPO Watch Europe Survey.

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experienced again a substantial growth in the Asian exchanges. In particular, 125 IPOs were launched in the Chinese exchanges (Shanghai and Shenzhen) which raised €47bn, while Hong Kong saw 86 IPOs with €31bn.



Source: Price Waterhouse



Source: ECB and International Financial Statistics

A remarkable feature regarding last year's IPO activity was that Europe also outperformed the US in international IPOs. The European exchanges saw a total of 135 offerings by international companies, which raised €21.5bn. In comparison, the US exchanges attracted 45 international IPOs, which raised €9.7bn.

In Europe, the more active sectors regarding the number of IPO were investment companies (18.5%), industrial goods and services (17.5%) and technology (10.9%). However, according to Thomson Financial, the financial sector was the leader in terms of the amount raised with 26% of the total, followed by the industrial sector (18.9%) and energy and power (13.2%).

Bond Markets

Bond markets in the euro area were also affected by the US subprime-related market turmoil during the second half of the year. Although, in contrast to money markets or some segments of credit markets, their liquidity remained high, near-term uncertainty in the government bond market increased markedly. This was reflected in the sharp rise in implied bond market volatility in July/August 2007. Yields were generally rising during the first half of the year but during the market turmoil they fell back as investors sought a safe haven for their funds.

The yield curve, which was mostly downward sloping in 2006, remained relatively flat in 2007. During the summer months of 2007 various indicators, including macroeconomic fundamentals, started to signal growing downside risks to euro area government bond yields in the forthcoming period.

The growth rate of the amounts outstanding of long-term government bonds continued to decline in 2007 to historically low levels of around 2.5 %, a level last seen in early 2001. This trend of the last 3 years may reflect improvement in fiscal positions of the euro area governments which have been to some extent supported by a generally favourable macroeconomic development.

A favourable macroeconomic environment, on the contrary, has stimulated issuance of long-term debt securities by non-monetary financial corporations, which exceeded a 20 % growth rate during 2007. Outstanding amounts of long-term bonds of financial institutions grew around 10% in 2007 in line with a trend of the last few years.

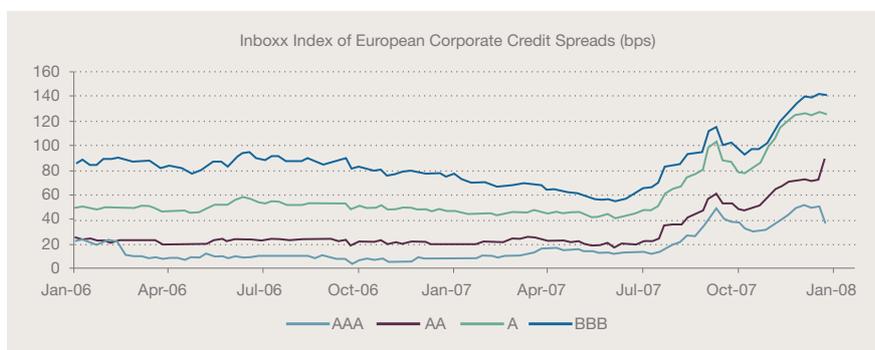
The general weakness in credit markets, which resulted from contagion triggered by the US subprime crisis, manifested itself in marked widening of lower-rated corporate bond spreads in the euro area from previously low levels. The increase in spreads was pronounced, especially for bonds

issued by financial firms. The impact on spreads of non-financial corporate bonds was smaller due to continued low default rates, strong profit growth and the lack of direct exposure of non-financial corporations to the US subprime market or associated securitised products.

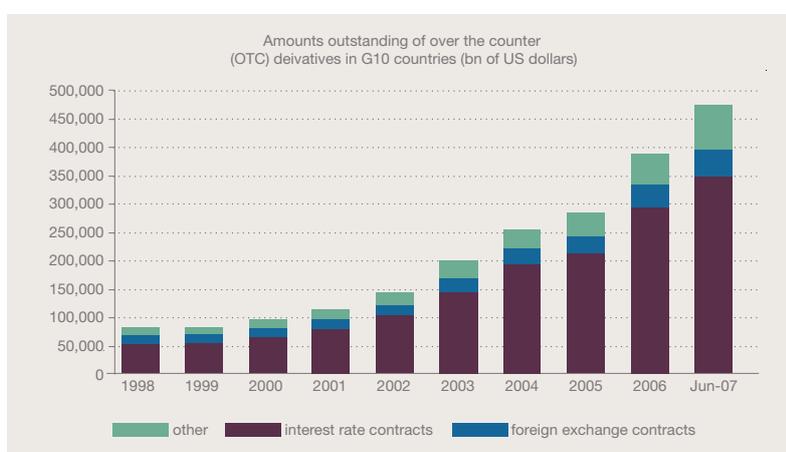
In the swap market, represented mostly by bank- and financial institution debtors, spreads in relation to government bond yields increased significantly; first by approximately 10 bps (from 25 to 35 bps) then, as time passed, spreads grew further, reaching levels of up to 50 bps in December 2007. Swap markets also signalled their view on future risk, with long maturities representing lower spreads than short maturities.

On 21 November 2007, the ECBC (European Covered Bond Council) recommended suspending the inter-bank market-making to avoid undue over-acceleration in the widening of spreads. The recommendation by the ECBC can be seen as an attempt by the market to deal with its problems on its own (as market participants are members of ECBC and its purpose is to represent and promote the interests of the covered bond market participants at international level). Market-makers decided to triple bid-offer spreads as the result of the problems encountered. Again the market seems to have reacted itself to rules concerning the bid-ask spread which were perceived as too rigid.

Gross bond issuance by euro area non-financial corporations, which started to decline in the second half of 2006, declined further after the US subprime mortgage turmoil. The most pronounced was the decline of issuance of B to BBB rated and high-yield bonds i.e. those that recorded the highest growth in spreads. All in all, it may be the case that with the year 2007 the period of aggressively narrow credit spreads came to a halt and investors became more cautious when pricing risks.



Source: Datastream



Source: BIS Quarterly Review, December 2007 ⁴

Derivatives Markets

The volume outstanding of derivative financial instruments increased considerably during the first six months of 2007. The rate of growth of derivatives traded on organised exchanges was higher than the rate of growth of the OTC ones. Indeed, investors probably shifted some trading onto organised exchanges because of the increased uncertainty in financial markets.

From December 2006 to June 2007, notional amounts of all types of OTC derivatives³ increased from \$386 trillion to \$474 trillion with a rate of growth equal to that recorded in the first semester of 2006 (23%). OTC derivatives are mainly interest rate contracts (73%), while foreign exchange contracts represented only 16% of total volume. However, the amounts

³ Credit default swaps are not considered in this part of the analysis.

⁴ The category "other" includes equity-linked contracts, commodity contracts and positions reported by non-regular reporting institutions.

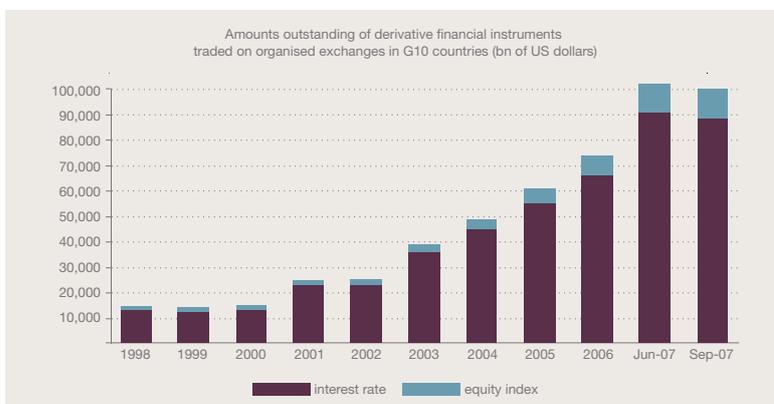
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outstanding of over-the-counter interest rate derivatives increased at a slower pace than the foreign exchange ones (19% against 21%). Lastly, in the first semester of 2007 equity-linked and commodity contracts represented together only 4% of the entire volume of OTC derivatives; their rates of growth were respectively 10 and 11%.

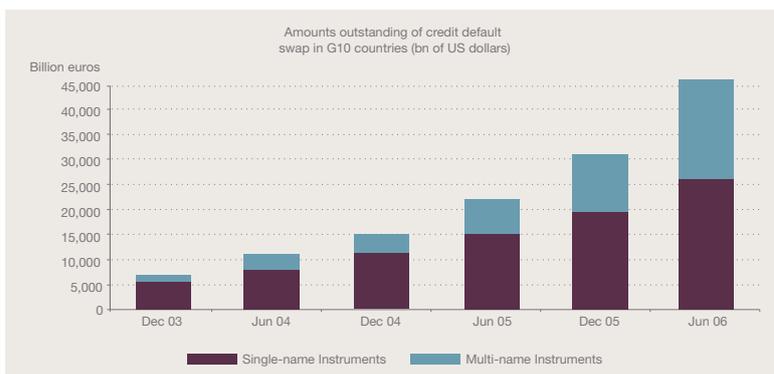
The volume outstanding of derivative financial instruments traded on organised exchanges reached \$84 trillion in September 2007 with a growth rate of around approximately equal to 35%.

Currency derivatives continued to represent less than 1% of the total amount outstanding, while interest rate derivatives corresponded to 88% of the entire volume. The growth of interest rate derivatives accelerated in 2007 (34%) with respect to 2006 (22%). In addition, the volume outstanding of futures and options on stock indices grew sharply by 44% to \$11 trillion. From June to September 2007, notional amounts of derivatives financial instruments slightly decreased by 2%, probably due to seasonal factors.

Credit default swaps grew at a brisk pace in the first semester of 2007; the rate of growth was approximately 50%.



Source: BIS Quarterly Review, December 2007⁵



Source: BIS Quarterly Review, December 2007

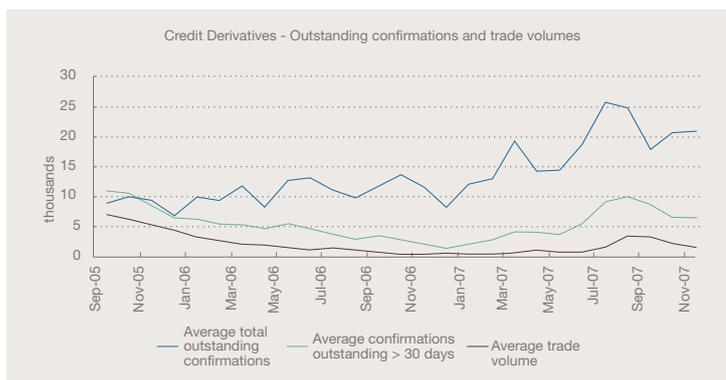
⁵ Currency derivatives are not reported because in all the years they represent less than 1% of the total notional amount.

Credit Derivatives Markets

Volatility in the credit default swaps market has increased markedly since July 2007. This is most clearly demonstrated by the US CDX and European iTraxx indices.



Source: Markit



Source: Markit

Credit derivative trade confirmation backlogs have been reduced while deal volume has grown rapidly (credit derivatives were up 80% on average in the 12 months to November 2007) and progress towards improving back-office operations continued.

However, despite the improvements that investment firms have made to processes and the increased automation of credit derivative trade confirmations, back-office operations were unable to manage the increases in volumes during periods of heightened market volatility during mid to late 2007. This resulted in a sharp increase in backlogs. Since then, firms have started to reduce their backlogs in spite of the historically high trade volumes. The industry continues to look at ways to

make the credit derivative trade confirmation process more efficient by focusing on increasing straight-through processing and improving trade capture.

Commodities Markets

Volatility in the commodity markets increased during the course of 2007, as supply pressures were pushing prices up while worsening sentiment on the global economy eased demand projections. Crude oil prices saw record increases in the second half of 2007, with the benchmark crude oil prices nearly touching the psychologically important \$100 per barrel level before a single trade pushed through the \$100 per barrel level in intra-day trading in early 2008. Supply disruptions in the North Sea and in the Gulf of Mexico added to concerns over falling inventories and geopolitical tensions in the major oil-producing regions, which kept the supply pressures elevated. Although global demand for energy from advanced economies is likely to fall if economic growth falls, demand from emerging economies is likely to support overall demand in 2008. The markets remain tight overall due to limited capacity to increase production of refining output and continuing geopolitical pressures in key oil-producing regions.

Base metals continued to see record growth in the first half of 2007 as demand for raw materials in China and low inventories supported prices, leading to a 20% increase in industrial metals prices between the start of the year and early May. However, increasing uncertainty over the global economic outlook and the sustainability of demand for industrial metals put downward pressure on prices following the financial market dislocation that began in the summer of 2007, leaving prices down 14% over the year. Precious metals, in particular gold, benefited from flight-to-quality inflows during the financial market dislocation and nominal gold prices hit several 28-year highs in the last months of 2007. Precious metals are likely to be supported by the weak dollar and continuing financial market turbulence in 2008.

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Corporate Financing (M&A, Private Equity)

Mergers & Acquisitions

The volume of mergers and acquisitions reached an all-time record in 2007, the total activity amounting to \$4.4 trillion (\$3.8 trillion in 2006), according to Dealogic. The year started strongly, but around the middle of the summer the trend reversed due to the subprime mortgage market crash, the subsequent credit crunch, the resulting decline in debt financing and its impact on M&A activity. In the first half of 2007, M&A deals reached \$2.7 trillion worldwide, while the figure for the second half of the year was 27% lower (in the US by 46%).



Source: Dealogic

Private equity firms or financial sponsors were a major driver of M&A activity. They were responsible for \$872 billion, representing 19.5% of overall announced value of M&A, representing a 9% increase over 2006. Due to the so-called 'credit crunch' the number of private equity mega-deals (over \$5 billion) decreased substantially during the year (from 32 until July to one in the last 5 months).

Top fifteen worldwide offers of 2007

Target (country, industry)	Acquirer (country)	Value (USD m)
Rio Tinto PLC (United Kingdom, Materials)	BHP Billiton Ltd (Australia)	192,752.8
ABN-AMRO Holding NV (Netherlands, Financials)	RFS Holdings BV (Netherlands)	99,364.8
Kraft Foods Inc (United States, Consumer Staples)	Shareholders (United States)	61,454.0
BCE INC (Canada, Telecommunications)	Investor Group (Canada)	46,835.8
TXU Corp (United States, Energy and Power)	Investor Group (United States)	44,372.4
Alcan Inc (Canada, Materials)	Rio Tinto PLC (United Kingdom)	43,922.7
Capitalia SpA (Italy, Financials)	Unicredito Italiano SpA (Italy)	29,528.1
First Data Corp (United States, High Technology)	Kohlberg Kravis Roberts & Co	27,031.7
Alltel Corp (United States, Telecommunications)	Atlantis Holdings LLC (United States)	26,901.5
Hilton Hotels Corp (United States, Media and Entertainment)	Blackstone Group LP (United States)	26,702.3
Endesa SA (Spain, Energy and Power)	Investor Group (Italy)	26,437.8
Tyco Healthcare Group Ltd (United States, Healthcare)	Shareholders (United States)	25,650.3
Eiffage (France, Industrials)	Sacyr Vallehermoso SA (Spain)	23,872.8
Archstone-Smith Trust (United States, Real Estate)	Investor Group (United States)	21,713.4
Altadis SA (Spain, Consumer Staples)	Imperial Tobacco Group PLC (United Kingdom)	21,489.4

Source: Thompson Financial

Europe increased its M&A activity by 26% to \$1.78 trillion in 2007, exceeding the activity of the US (\$1.57 trillion) according to Thomson Financial. While in 2004 40% of the deals by value originated in the US, Europe first took the lead over the US in 2006 and this tendency was more pronounced in 2007. Cross-border mergers and acquisitions also broke records in 2007, accounting for 47% of the total value worldwide, thanks to the global consolidation in Materials, Finance and Energy and Power sectors.



Source: Thompson Financial

As for the target industries concerned, similarly to 2006, the M&A activity of 2007 cannot be tied only to a single sector, as it was with Telecoms in 2000. In 2007 the leading sectors were finance, materials, energy and power and real estate.

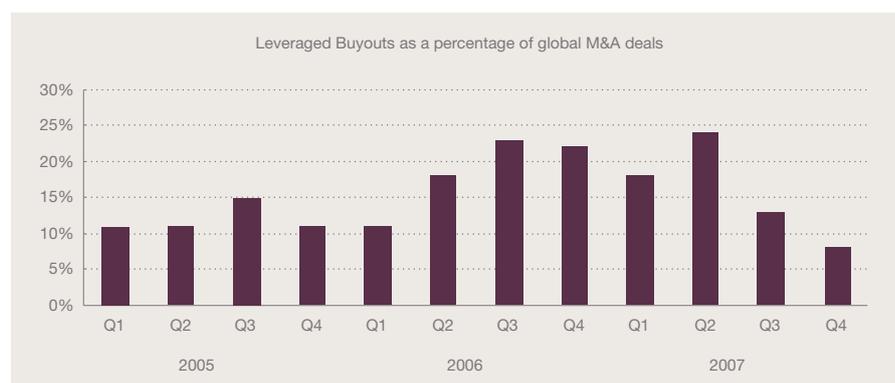
Private Equity

While over the past few years the market for private equity has been on the rise, in 2007 this growth came to an abrupt halt. Recent years were characterised by abundant liquidity, a search for yield and a favourable credit market with continuing low interest rates. Furthermore, the development of complex funding structures and the distribution of syndicated loans enabled a wider spreading of risks. As a result, not only has the activity in the LBO segment of the private equity market increased significantly, but innovation has also contributed to an increase in the size and the leverage of LBO deals as well.

The 2007 US subprime loan market crisis put an end to the easy access to debt financing by private equity. Firstly, credit was supplied at higher prices since banks were no longer able to syndicate private equity debt as easily. While in mid-2005 the corporate-bond yield was 4.4% and the trailing earnings yield on European equities was 6.8%, by mid-July 2007 they were 6.1% and 6.3% respectively⁶, making issuing debt to buy shares less attractive. Bridge finance – a construction where banks provide interim finance until longer term finance can be arranged – came to a halt as well. Before the crisis, banks were willing to provide bridge loans, enabling private equity firms to undertake large deals without having to club together with competitors to finance them. Terms also became less attractive. As a result of the favourable market conditions in the past few years, LBO funds were in a position to choose underwriting banks and influence terms and conditions of the financing of a deal. The total amount of ‘covenant-lite’ loans issued in the first two quarters of 2007 was \$105 billion, compared to \$32 billion from 1997 to 2006⁷. Since the crisis, however, the market for ‘covenant-lite’ loans has dried up.

The following graph illustrates the global fall in LBO activity. In the second quarter of

2007, buyouts as a percentage of M&A deals amounted to 24%. By the third quarter of 2007, this number had fallen to 13% and in the fourth quarter, only 8% of M&A operations consisted of LBO deals.



Source: Dealogic

Private equity funds continue to hold and raise large amounts of capital. The middle market has hardly experienced a slowdown. However, the top end of the market has suffered from the crisis. This may indicate that the period of record LBO deals has come to an end.

While LBO activity fell, criticism of private equity continued. In January 2008, in the Netherlands, the Enterprise Chamber of the Amsterdam Court of Appeal ordered an inquiry into the affairs of PCM, the Dutch newspaper conglomerate. Sufficient grounds were found to question PCM's strategy in relation to private equity fund Apax, with which it had been involved from 2004 to 2007. In the claimants' view, Apax left the company burdened with debt (long term debt increased from €24 million to €590 million) and in a worse financial position. While the outcomes of the inquiry will not affect Apax directly, a judicial conclusion of mismanagement may contribute to the public debate regarding the pros and the cons of the private equity activity.

In the short to medium term, private equity faces several issues. The first issue concerns the level of the corporate interest rate. Notwithstanding

⁶ Citigroup, via the Economist, July 28th 2007)

⁷ S&P, via the Economist, June 30th 2007

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the low level of policy rates in the Eurozone, and an even further reduction in the US, corporate interest rates have gone up as a result of the subprime crisis. Consequently, the costs of new loans and of existing loans at variable interest rates have increased. Private equity investments that rely for the main part of their return on leveraged contracts bear the risk of rising costs against income. This risk has been foreseen by many private equity firms, leading them to diversify the financing of their investments. For example, KKR and Blackstone have attracted a considerable amount of money by issuing their own mutual funds. This liquidity has not yet been invested and might serve as a buffer when required.

Another issue is the negative sentiment in equity markets. This reduces the exit possibilities of private equity companies by public offerings. As a result, private equity companies are expected to concentrate on the performance of the firms they hold in the portfolio, rather than transactions.

Finally, in the case of a US recession, the liquidity of the firms in the portfolio of private equity companies can come under pressure. Firms might become unable to generate enough cash flow to service the debt that was used to acquire them. Until now, however, defaults on corporate debt have remained low. Furthermore, deals are not as highly leveraged as they were in the 1980s, reducing the risk of bankruptcy. Moreover, the conditions under which deals are financed limit the ability of banks to force a firm into bankruptcy.

Asset Management

Though separating short-term from more structural and longer-term developments is a complex task, a number of factors support the view that the European asset management industry should remain on a robust growth path. Although the subprime crisis of the second semester of 2007 had some negative effects on the industry, several factors lead to a somewhat more positive

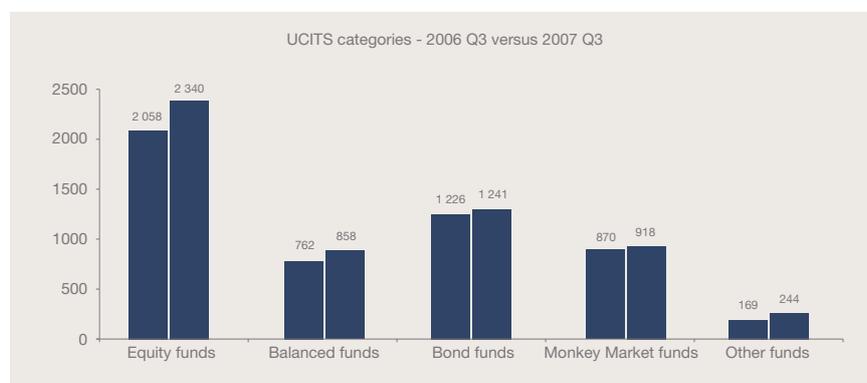
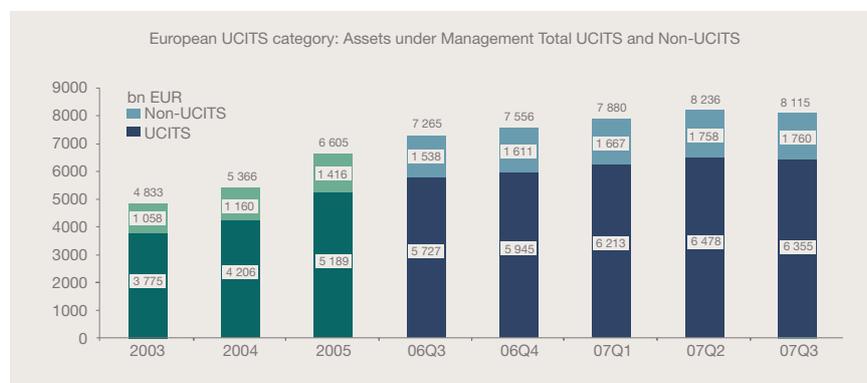
perspective. Firstly, figures recorded in the second semester followed growth by 9% in assets managed in the first (compared to the previous semester). Thus, figures for the first semester of 2007, which already took account of (increasingly) negative net investment flows in Equity funds, reflected, on the whole, both positive valuation effects and positive net fund collections, chiefly from Balanced and Money Market funds.

Thus, year-on-year (stripping the seasonal effects and despite significant redemptions in the third quarter of 2007), European investment funds' activity showed a certain degree of resilience at the end of September 2007, as total UCITS and non UCITS assets under management rose by 11.7% to €8,115bn, whereby non-UCITS assets actually outgrew those of UCITS (with respective growth rates of +14.4% and +11.0%). Hence, although underlying growth in Blue Chip indices remained globally limited (except in Germany), this trend was underpinned by 13.4% asset growth in

Equity and Balanced funds, and, despite third quarter outflows, by 5.5% growth in money market funds assets, reflecting the continuous rise in short term interest rates. Similarly, bond funds' assets remained practically unchanged (+1.2%) on the year.

In addition, the effects of the crisis did not adversely affect all market participants, as significant discrepancies among specific product performances were observed. German equity ETFs, emerging markets funds, or commodity funds, for example, posted positive performances and subsequent positive net fund collections even towards the end of 2007. From a geographic point of view, and since product mixes remain largely country-dependent, strong discrepancies were also noted as, for example, several smaller Eastern European markets still recorded positive investment flows in November 2007.

Finally, from a medium-term perspective, effects on the profitability of the asset manage-



Source: EFAMA



Source: McKinsey

ment industry that had, until 2006, continuously recovered from its 2002 trough (see graph), are complex to anticipate. As long as ongoing negative flows do not significantly erode the managed asset basis, a source of resilience may be found in the fact that profitability is largely asset-based. Conversely, various factors such as, against a background of lower confidence, possible downside effects on the pricing of fund products, may raise substantial risks.

More generally, the effects of the crisis, once it had hit the markets, were widespread on the asset management industry, as few significant managers avoided some level of loss. Knock-on effects of the crisis were felt in the first instance by products that had –generally by means of derivatives (CDS) and/or structured products (ABS) – a direct exposure to US subprime debt, such as Dynamic Money Market Products, but at a second stage by a wider range of products, as fears of contagion took their toll on interbank credit markets and, subsequently, on equity markets.

Interestingly, in the third quarter of 2007, more significant and widespread effects on the net collection of assets by mutual funds were registered in Europe than in the US, as EFAMA recorded €61bn in net outflows, a loss of about one third of total sales since the beginning of the year. More specifically, this drop was highest with regard to Bond funds (€46bn outflows) and both Equity and Money market funds (respectively €22bn and €20bn). Lipper FER1's Enhanced Money Market category (a category

that does not match with EFAMA's classification) accounted alone for €34bn of withdrawals in Q3, following widely published shortages of liquidity that affected some French funds during the summer. Although final figures for the last quarter of the year remain unpublished, indications given by monthly data show that the trend has been continued as, for example, record €26bn outflows were recorded in November (€45bn excluding the safest categories of Money Market funds), €25bn being attributable to Equity funds and €10bn to Bond funds.

From a geographical standpoint, some countries appeared at first more resilient than others, as UK- and Luxembourg-domiciled UCITS still showed positive net sales in the third quarter of the year. However, the latest monthly data, which takes into account the effects of the Northern Rock failure in the UK, seem to indicate that the sell-off was evident virtually across Europe (except for previously mentioned EECs).

Lastly, with regard to the types of investors concerned, institutional and corporate investors seem to have been most directly affected, as households' total holdings represent only a very small fraction of their total financial wealth. This was the case even in France, for example, the country in which money market funds are the most marketed in Europe, where this fraction represented only 1% at mid-2007. Conversely, French non-financial corporations held 37% of the fund category's total assets under management (€399bn) at the same date,

whereby institutional investors accounted for another 43% and other sectors ("households", "rest of the world" and "general government") for the remainder.

Against this background, market developments in 2007 shed light on a number of potential challenges to the industry. Some criticism was addressed to the fund management industry on the ground that some product categories did not perform as anticipated, as was for example the case with regard to strongly promoted fund types such as enhanced money market or absolute return funds. Fundamentally, the fact that underperforming types of fund tend to be replaced by new, complex –and therefore expensive– strategies ultimately raises questions on the readability of the product offer and the relation between a funds fee and to performance (risk-adjusted return). In competitive terms, and at times when banks' traditional saving products appear to have strongly benefited from the search for safety, issues arising with regard to innovative products may actually be particularly significant in areas where financial intermediaries promote products competing directly with UCITS (notably on the market of retail structured products such as certificates etc.). However, in the broader context of the integration of the European fund market, a number of structural, and often technical, issues remain largely unrelated to the market downturn (the opening of distribution networks, the standardisation of transfer agency and registrar services etc.), which also provide the asset management industry with opportunities for efficiency improvement.

From a regulatory perspective, market developments late in 2007 may highlight a number of issues raised by the European Commission in the context of the review process of the UCITS directive under way since 2005, such as the revision of the format and content of the UCITS simplified prospectus (with an increasing focus on Key Investor Information), the establishment of a regulatory framework more favourable to cross-border mergers of funds, or the investigation of competitive issues relating to UCITS "substitute" banking and insurance products.

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However, some broader issues are likely to persist over the longer-term. Addressing the question of product suitability to a client's needs would, for example, require consideration of behavioural patterns in which investment flows still largely reflect past fund performances, and thus reach far beyond the scope of the review of the UCITS directive.

Hedge funds

According to Hennessee Group LLC, hedge funds assets under management (AUM) reached a new record in 2007 with \$1.99 trillion (according to LipperTass: \$1.73 trillion). In comparison to equity indices, the performance of the hedge fund industry looked favourable, despite severe losses in August and November 2007 that could not be compensated by modest gains in December. Different hedge fund indices show performances between ~ 4% and 12% for 2007⁸. In comparison, the Dow Jones industrial average rose by 6.4%, the S&P 500 by 3.6%, the NASDAQ composite index by 9.8% and the EuroStoxx by 6.4%.

Currently, funds of hedge funds account for approximately 45% of AUM, followed by high net worth individuals with 33%, pension funds with 10%, corporations/institutions and endowments/foundations each with 5%⁹.

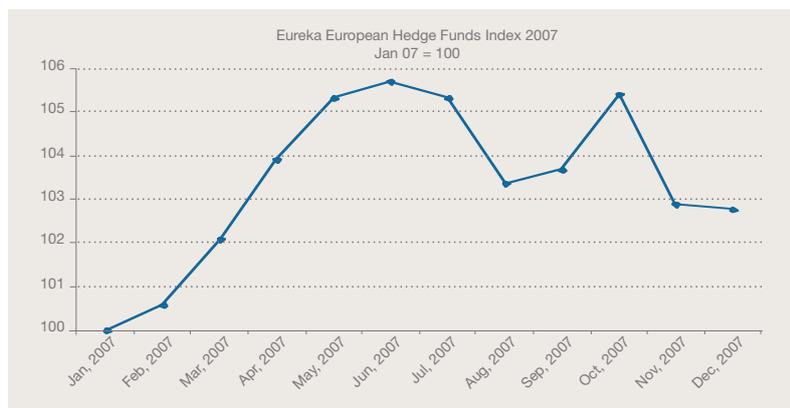
The Eureka European Hedge Fund Index continuously increased until June 2007. Thereafter it lost half of this increase due to the subprime-crisis, with a temporary recovery in October.

The US is by far the leading geographical source of hedge fund investments with approximately 63%, followed by Europe (essentially London)

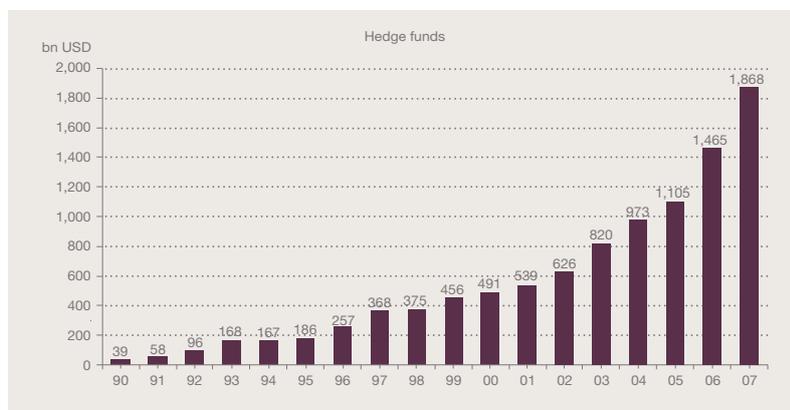
with 32% and Asia with 5%. However, the highest growth in the hedge fund industry is at present taking place in Europe and Asia, where hedge fund assets are increasing at approximately 40% a year, even though in both regions the assets under management in absolute terms are significantly less than in the US¹⁰.



Source: Bloomberg



Source: Bloomberg



Source: HFR

⁸ For example, the Hennessee Hedge Fund Index increased by 11.6%, while the HFR Global Hedge Fund index increased by 4.2% in 2007. In January 2008, the HFR Global Hedge Fund index dropped 2.1%. Some big hedge funds were down significantly at mid-January 2008 in lockstep to equity markets.

⁹ See McKinsey "The new power brokers: how oil, Asia, hedge funds and private equity are shaping global capital markets", October 2007.

¹⁰ See previous footnote.

Only a few hedge funds were significantly affected by the early turbulences of global financial markets between February and March 2007. Concerns about stresses in the hedge fund sector came up in the summer with respect to the subprime crisis against the background of widespread losses by individual funds in August and several collapses or closures of high profile hedge funds¹¹. The market turmoil due to the subprime crisis affected many asset classes simultaneously whose premiums from credit, liquidity and other risks account for a large part of hedge fund returns. Half a dozen large hedge funds suffered significant losses. In a few cases during the recent period of market turmoil, de-leveraging by hedge funds to meet margin calls appears to have resulted in distressed sales of assets or in the closure of smaller and midsize funds to withdrawals, in order to avoid distressed sales. In other cases, hedge funds appear to have been a stabilising influence, buying assets in falling markets¹². In this context it is worth mentioning that a few hedge funds have achieved returns of more than 100% since the beginning of the subprime turmoil.

The hedge funds failures over the summer revealed that some of them had concentrated and leveraged investments in securities backed by US subprime mortgages. The losses of hedge funds in August and November indicated that their models were more correlated than previously thought. This confirms the risk that hedge funds holding similar positions can

lead to an abrupt collective exit from crowded trades. Nevertheless, there was a broad-based rebound in hedge funds returns in September and October, by 2% in each month. This rebound largely compensated for the August setback. Moreover, by the end of September, aggregate year-to-date returns of the whole sector remained positive and in line with the median of historical returns. But hedge funds again recorded losses in the last quarter of 2007, especially in November.

At the end of June 2007, multi-strategy investing hedge funds (+11%) and event-driven investing hedge funds (+9%) showed the highest year-to-date return. As the only strategy type, dedicated short bias strategy investing hedge funds showed a negative return (-2%) in the first half of 2007. At the peak of the subprime crisis in August almost all strategies had negative returns; managed future strategy investing hedge funds showed the highest negative return (-4%).

In their search for returns, hedge funds have increasingly invested in illiquid assets. Hedge funds are major players of illiquid structured credit vehicles like collateralized debt obligations (CDOs) and collateralized loan obligations (CLOs). The share of their investments in illiquid and difficult to value securities had already risen before the crisis to as much as 20% of total AUM. On average, the

share of trading volume in 2007 accounted for approximately 42% for liquid high-yield credit derivatives, 35% for high-yield cash bonds, 25% for leveraged loans, 16% for structured fixed-income products and 11% for liquid investment-grade credit derivatives¹³.

The Financial Stability Forum (FSF) issued an update of its report on highly leveraged institutions in May 2007. The severity of market problems has highlighted the importance of ensuring sound counterparty risk management at regulated institutions and fostering the exchange of relevant information between hedge funds and their counterparties. In October 2007, the FSF took stock of progress on work to address recommendations. An international supervisory review group is working to enhance the risk management practices of core intermediaries. The FSF also welcomed private-sector initiatives launched in the UK and US to enhance best practice standards for hedge fund managers and investors in hedge funds¹⁴.

11 During the week of 6th August, several large hedge funds experienced unprecedented losses; however, unlike the Bear Stearns and Sowood funds, which had signalled significant setbacks in June and July respectively, these hedge funds were invested primarily in exchange-traded equities, not in subprime mortgages or credit-related instruments. It is noticeable that most of the hardest-hit funds were employing long/short equity market-neutral strategies sometimes called "statistical arbitrage" strategies that, by construction, were supposed to be immune to most market movements (i.e. had no beta exposure). See Khandani's and Lo's MIT working paper "What Happened to the Quants in August 2007", November 2007.

12 See for this and the following paragraphs ECB, Financial Stability Review, December 2007 and McKinsey "The new power brokers: how oil, Asia, hedge funds and private equity are shaping global capital markets", October 2007.

13 See Greenwich Associates "The 2007 Liquidity Crisis: European Fixed Income, Before and After", December 2007.

14 See FSF press release, October 2007.



‘The Lamfalussy process has introduced greater transparency. As part of this process, CESR has sought to actively engage all market participants in its contribution towards building Europe’s regulatory framework’.

02 MARKET PARTICIPANTS CONSULTATIVE PANEL

The Market Participants Consultative Panel held three meetings in 2007: on 22 March 2007 and 21 June 2007 in Paris and on 16 October in Estoril (Portugal), jointly with CESR Members. The following issues were discussed during these meetings.

Take-over bids

Following an introduction by Salvatore Bragantini, the members of the Panel had a policy discussion on the issues arising from the implementation of the Take-Over Bids Directive. This discussion was designed to help CESR in identifying whether the Committee should play a role in this area and, if so, in which regard.

In the introductory remarks Salvatore Bragantini recalled that the Take-Over Bids Directive consists of:

- 1 an equal price provision;
- 2 a part on derogations i.e. situations that may lead to exceptions to the bid;
- 3 a part on how to deal with anti-bid defensive measures that were put in effect as a precaution against a possible bid, and how the bid can “break through” such rules;
- 4 a part on post-bid defence i.e. rules imposing board neutrality after the bid.

He also noted that a reasonable and, most of all, realistic, way to start work on the Take-Over Bids Directive might be along the following lines:

- a neutrality rules must be applied without exceptions;
- b breakthrough rules, which are opposed by the whole of the EU, must be shelved. Insisting on them, while desirable, would be unrealistic. It must be added that such rules, as they are now written, would not cover all kinds of pre-bid defences;
- c reciprocity rules must be shelved, and no one should be allowed to stop a bid from getting to shareholders’ desks merely by claiming, whether on a sound legal basis or not, that the suitor is not applying the same rules.

Members of the Panel expressed disappointment over the situation arising from the transposition and implementation of the Take-Over Bids Directive, whereby too many options and derogations had created national obstacles to the efficient functioning of the markets for corporate control. Members therefore proposed to start addressing the potential revision of the Directive ahead of the foreseen deadline of 2011. Members also discussed the practical difficulties of the “one-share-one-vote” principle and its impact on the breakthrough rules; this topic was considered to be one of the most sensitive, where realistic progress would be difficult to achieve.

The US experience was also recalled as a possible model for Europe, whereby securities laws are harmonised at federal level and commercial laws are left to State jurisdictions.

Transparency and disclosure of hedge funds

Following a brief introduction by the Secretary General of CESR on the state of play of the discussions on hedge funds in Europe, the members of the Panel discussed the issue of transparency of hedge funds and possible ways to enhance their disclosure.

Generally speaking members found that too many objectives are currently discussed under the same heading of “hedge funds” and this makes it difficult to achieve solutions and good results.

The representatives of issuers in the Panel expressed concern about the shareholder hyper-activism of some hedge funds and, more generally, institutional investors (code of conduct elaborated by institutional investors to disclose the attitude in shareholders’ meetings should be applicable also to hedge funds). It was also noted that there is a lack of clarity about who are the ultimate beneficial owners and the decision makers; this is related to the transparency of transactions that allow separation of ownership and control, such as equity swaps and others.

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As regards transparency of positions of hedge funds in the market, the idea of gathering data on the positions was perceived as not realistic in terms of timing, and could potentially disrupt the smooth functioning of the markets.

As regards investor protection and particularly the participation of retail investors, it was suggested that this should happen via funds of hedge funds as is already the case in some European countries.

Andrea Corcoran updated members on the current developments in the US on hedge funds and the recent case of Amaranth.

Evaluation of the Lamfalussy process

Members of the Panel were also invited to discuss how CESR could best contribute to the evaluation of the Lamfalussy procedure that would take place in the second half of 2007. Members considered the procedure too complex and suggested that it should be simplified, in particular by giving a more direct role to CESR. Allocations of roles between different participants in the process should also be better clarified. The consultation process was praised but additional efforts should be made to take into account the consumer perspective. Finally, it was stressed that the collection of evidence and impact analysis should be more systematic before decisions are made.

Public oversight of auditors and the needs and costs of a public company's oversight board

Theodoros Philippou gave a presentation on the objectives, needs, cost/funding of public oversight of auditors in the context of the Statutory Audit Directive and with a view to the system in the US. The presentation served as a catalyst for a policy discussion among the Members of the Panel about possible ways forward in Europe in this area.

In his introductory remarks Theodoros Philippou emphasised that the objective of public oversight is to improve public confidence and the credibility of high quality financial reporting. The Statutory Audit Directive requires Member States (MS) to establish an effective system of public oversight of statutory auditors and audit firms but leaves to the discretion of MS the precise manner in which to establish this body, in line with transparency and fairness principles established by the Directive (for example, system of inspection by staff of a public oversight body or a system of delegated inspection by a professional body of 'peers').

In the context of cost of public oversight, Theodoros Philippou underlined that the Directive does not make a distinction between monitoring and monitored peer review, whereas the latter system can be significantly less costly. From a funding point of view, it was noted that few MS fund the system of oversight in total. In the majority of the MS the auditors and the audit firms fund the cost of public oversight.

Theodoros Philippou compared the EU system of public oversight being developed with the US system overseen by the Public Company Accounting Oversight Board (PCAOB). The PCAOB, which was created by the Sarbanes-Oxley Act 2002, sets its own budget and levies fees on US public companies. Based on the first years of its existence, it has been suggested that the standards introduced by the PCAOB have imposed substantial compliance costs on registered accounting firms and their public company clients. Additionally, the high cost of compliance disproportionately affects smaller public companies and will have long-term negative implications for the US economy. Given the fact that this system is still in its infancy, it was concluded by the MPCP that the EU should not converge to this US quality assurance system. In general, it was suggested that a combination of self-regulation and public oversight, i.e. a mechanism which combines the benefits of significant auditing expertise with the benefits of public confidence of independent non-practitioners, will deliver the best results.

In the following discussion, one member underlined the need to have outsiders on the board in case oversight is being conducted by a professional body of peers. Other members noted that the auditing industry is a strong oligopoly where public authorities must be able to influence the outcome if the first line of supervision is carried out by peers. The German system of oversight, organised under private law and under the umbrella of the BaFin, was presented as a balanced solution between self-regulation and public oversight.

Corporate Governance in the European context

Dr Rolf Breuer introduced the subject of Corporate Governance by explaining the reasons for the enhanced interest over recent years, namely (1) as an attempt to restore public confidence after various corporate incidents and (2) as a way to deal with present-day shareholder activism. With regard to the first reason, Dr Breuer holds the view that there is no reason for the EU Commission to deal with Corporate Governance. The present EU framework for corporate governance with a mixture of principles and rules avoids the US box-ticking approach. Current convergence between 1-tier and 2-tier corporate governance systems (with more emphasis on independent directors and a changing role of the supervisory board respectively) and enhanced transparency improve the present approach in the EU.

Dr Breuer noted that shareholder activism follows in most cases a similar model; a voting stake is being built up, discussion with management follows, views are made public, the voting stake is accumulated and supporters are solicited. According to Dr Breuer, there is nothing wrong with this pattern, but from a corporate governance point of view, management should not be taken by surprise, should be aware of corporate strengths and weaknesses and communicate these with its shareholders. In this context it would be advisable to improve the quality of shareholders' registers. Other types of shareholder activism, such as

abuse of stock lending, require enhanced awareness among lenders or, as is the case with acting in concert, are difficult to prove. It was concluded that some improvements in the area of corporate governance might be helpful, but members emphasised the risk of over-regulation and the need to create a European consensus on the matter.

In the discussion that followed, members broadly agreed with the presentation, but underlined the importance of 'knowing your shareholder' and the need to disclose the ownership of derivatives positions, in case these are used for voting. It was concluded that the collection of voting power around an Annual General Meeting is difficult to counteract. The creation of a double record date could possibly be helpful in this respect. Dr Breuer also suggested introducing a system of declaration of "non-concert" by certain shareholders. Finally, further guidance given about the independence of outside directors could also improve the system.

The future role of CESR in the context of the forthcoming evaluation of the Lamfalussy procedure

On the basis of an introduction by CESR Vice-Chair Carlos Tavares, the members of the Panel were invited to give their views on the way forward for CESR. One member noted that although the Lamfalussy concept is clearly a success – there is still too much detail at Levels 1 and 2 and issues are sometimes addressed too late in an on-going process. Other members noted that too many options for Member States in EU Directives will not assist harmonisation. The members of the Panel felt there was a clear need to have a balanced debate about the pros and cons of CESR's current legal status.

Members of the Panel also discussed the draft CESR Work Programme for 2008 as well as the crisis of financial markets and possible future mutual recognition with the US.

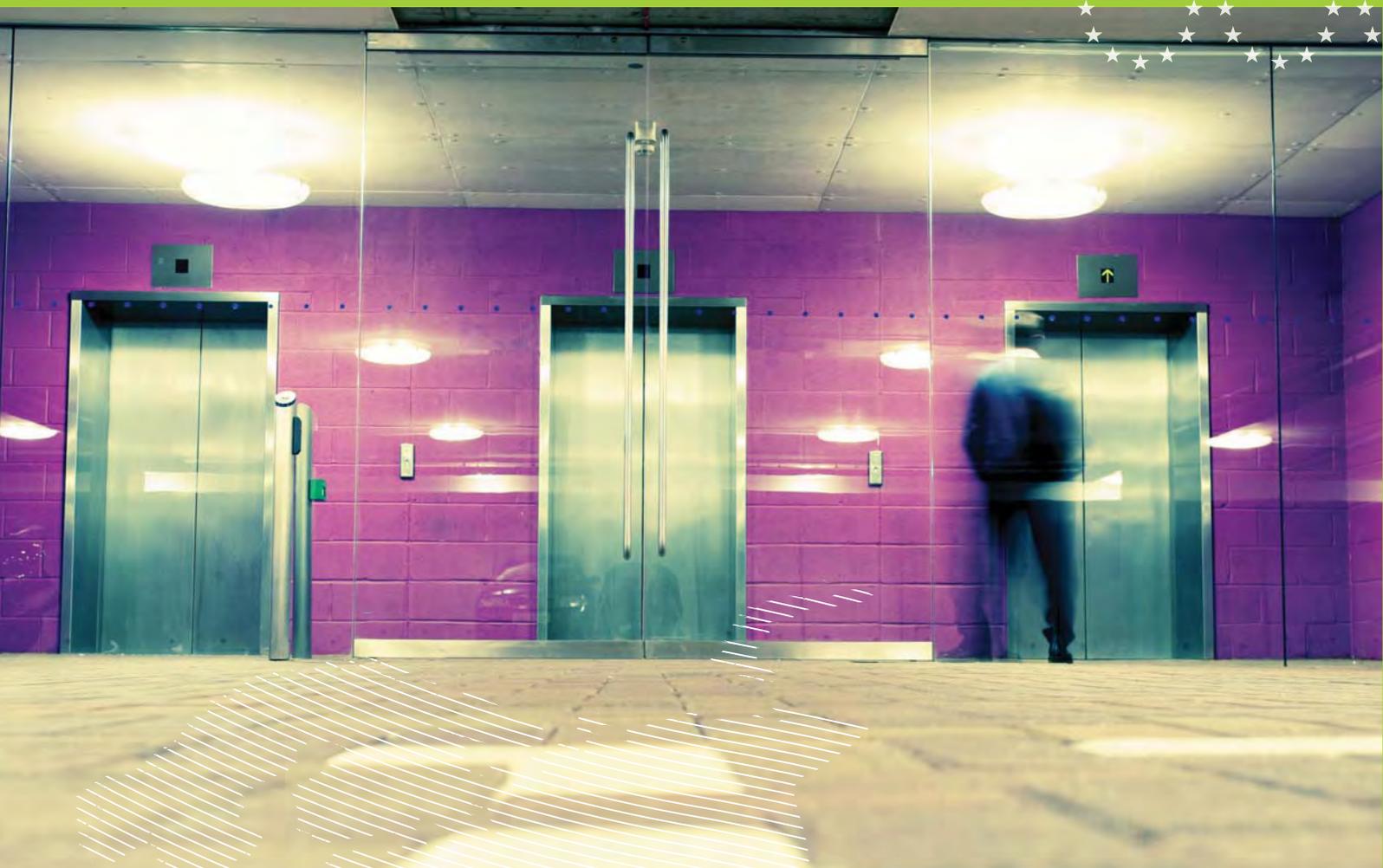
Partial renewal of the Panel

Members took note of the end of the current mandate of five members: Rolf E. Breuer, Theodoros Philippou, Rüdiger von Rosen, Zoltan Speder and Tom Healy (resignation). The following members were (re)appointed: Antonio Borges, Elena Kohutikova, Olivier Lefebvre, Franz S. Waas and Rüdiger von Rosen.

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

Next steps

The next meetings of the Market Participants Consultative Panel will be held in Paris in April, September and December 2008.



'Greater uniformity in the regulatory framework across Europe provides investors with the ability to make informed choices'

03 SUPERVISORY CONVERGENCE THROUGH POLICY WORK

3.1 Third progress report to the Financial Services Committee

Following the May 2006 ECOFIN conclusions and the FSC 2005 Francq report¹⁵, CESR delivered its third supervisory convergence report in June 2007. In the report CESR updated the FSC on its continued implementation of the ECOFIN conclusions of 2006. Despite good progress, CESR also reported on a continued need to address the obstacles to supervisory convergence set out below.

Legal basis and financing of EU projects

- a The lack of EU financing arrangements for the Transaction Reporting Exchange Mechanism (TREM) under MiFID made CESR's work very difficult and forced reliance on the use of financial reserves that could have been used to further develop important Level 3 convergence tools.
- b The legal basis for CESR to carry out EU IT projects such as TREM was insufficient.

Delegation under MiFID

- c MiFID does not explicitly address the issue of delegation and therefore does not give the necessary legal certainty for arrangements of delegation (of tasks and possibly responsibilities as well) between CESR Members within the EU legal framework. Obstacles in national laws might inhibit CESR's ability to meet the EU institutions' expectations in this area.

Cross-sector issues

- d There are disparities in the treatment of financial products aimed at the retail client across financial services sectors. These can only be addressed at Level 1 by legislative changes, although there is an expectation among EU institutions, industry organisations and at a national level, that differences in treatment could be addressed at Level 3.

Obstacles related to implementation of the Transparency Directive

- e The lack of any decision or direction regarding the advice CESR provided to the Commission in July 2006 about the officially appointed storage mechanisms for regulated information as required by the Transparency Directive, has hampered progress in this area. CESR still awaits a clear indication from the Commission and Member States on the way forward and on the leadership of this important project. The late transposition of the Transparency Directive is already delaying its proper implementation in Member States.

Supervisory powers under the Market Abuse Directive and the Prospectus Directive.

In addition to the supervisory convergence report in 2007, CESR also contributed to the discussion on supervisory convergence with a mapping exercise of the supervisory powers under the Market Abuse Directive and the Prospectus Directive.

¹⁵ FSC Report on financial supervision, prepared by an FSC Subgroup chaired by Thierry Francq, FSC 4159/06

Summary of key findings

The May 2006 ECOFIN Council conclusions recognised the need to achieve greater equivalence of powers among competent authorities. CESR conducted a mapping of the supervisory powers covering two directives and their relevant implementing measures applicable for more than two years: the Market Abuse Directive (MAD) and the Prospectus Directive. CESR found that, in general, Member States have seriously taken into account the need to achieve equivalence when granting to their competent authorities the minimum powers envisaged by the directives. **The general degree of equivalence was found to be high (on average, 93%), although significant divergences still remain on important points.** The overall picture was more satisfactory for the Prospectus Directive than for MAD. This might be explained by the fact that the Prospectus Directive is a maximum harmonisation directive. The Annexes to the mapping exercise identify the individual Member States where further convergence will contribute to better supervisory arrangements in the Union.

At a more detailed level, where divergence still exists (less than 85% of equivalence), it was noted that several supervisors lacked the possibility to **issue practical rules** to apply the directives properly; particularly with respect to lists of insiders and notification of management transactions under the MAD, or for the determination of equivalent information under the Prospectus Directive. As regards the **general powers to apply the directives**, the remaining areas of weakness covered the capacity to disclose supervisory information to the public under the Prospectus Directive (register of qualified investors, publication of prospectus approved over a period of 12 months, and the publication of Summaries of prospectuses) or under the MAD (disclosure of measures or sanctions to be imposed due to infringements). Authorities are generally well equipped in terms of **supervisory investigative and sanctioning powers**, but with a number of exceptions, such as the possibility to require telephone and data traffic records, request the freezing and/or sequestration of assets, request

temporary prohibition of professional activity or carry out on-site inspections of issuers. This understandably affected the relevant authorities' capacity to co-operate with their foreign counterparts.

It was recognised, however, that cross-border **supervisory co-operation powers have been significantly harmonised.** Nevertheless, some areas of improvement remained; in particular the capacity to open an investigation solely on the request of a foreign authority.

The mapping exercise was a valuable opportunity for CESR Members to compare supervisory practices and to benefit from the experiences of others. It helped also to identify areas of potentially divergent application that could be corrected by further supervisory convergence at Level 3. All this information has been sent to the relevant operational groups of CESR that are currently evaluating the practical functioning of these two directives.

Next Steps

CESR will continue its work to facilitate supervisory convergence and will report to the FSC with its annual supervisory convergence report in June 2008.

CESR will continue to map supervisory powers in relation to MiFID and the Transparency Directive.

3.2 Increasing active dialogue and assisting the cross-border retail investor

Since the end of 2005, CESR has been progressively changing its processes to ensure greater engagement with Retail Investor Associations (RIAs) in the development of CESR's technical advice. This is reflected in the way in which CESR has consulted retail investor associations very actively in the development of its advice on key investor disclosures for UCITS, designed

to replace the existing simplified prospectus, as well as on MiFID, in relation to CESR's guidance on inducements (outlined in more detail in Chapters 6.3 and 6.4 respectively).

In addition, CESR is now taking a further significant step forward vis a vis retail investors with the development of some very basic and practical information directed at retail investors investing in Europe, both in the form of information to be added to CESR's new website (expected to be launched by September 2008) and in a practical guide which will explain MiFID. To do this work, CESR will be increasing its very productive dialogue with the RIAs, in order to ensure that the information CESR develops, is as useful and practical as possible.

A two day Retail Investor Workshop

CESR organised a two-day Retail Investor Workshop on 12-13 February 2007 in Paris, chaired by Carlos Tavares, Vice-Chair of CESR. The decision to host the workshop on an annual basis reflects the Chairs' commitment to intensify the participation of retail investors in the work of CESR and to ensure CESR is better placed to hear and take into account the views of retail investors. 26 representatives from RIAs attended the meeting, with a large number of countries represented.

The two-day meeting was focused on the following issues:

- 1 MiFID, specifically the guidance CESR was developing on Inducements. In relation to this issue, retail investors were very pleased with the balance CESR had sought to strike between the interests of service providers and those of retail investors. Best Execution and Passporting were also discussed at length.
- 2 The work on replacing the simplified prospectus for UCITS with key investor disclosures.

- ③ The distribution and marketing of products, with particular emphasis on competing products and compatibility with MiFID of selling restrictions at the national level.

The meeting also provided CESR with an opportunity to illustrate how it had actively listened and responded to the issues raised at the previous meeting with RIAs, which had been held in Valencia in November 2005. In particular, concerns were raised in Valencia that regulators were not enforcing legislation vigorously enough. CESR-Pol¹⁶ took the opportunity to respond to these concerns with a very thorough presentation on enforcement approaches and the various systems developed by CESR-Pol to ensure supervisory co-operation on cross-border cases, and provided statistics on the number of cases enforced. RIAs welcomed the presentation but stressed that they would like CESR Members to consider making more information available on the number of cases investigated which did not lead to enforcement, along with those where enforcement was successful. The reasons why CESR Members have not provided more transparency at this stage were explained.

RIAs had clearly indicated that CESR did not have a role in undertaking investor education but noted that some retail investor-friendly information regarding compensations schemes, the regulatory landscape and common terms would be useful. The Consumer Taskforce (a group of investor representatives issued from CESR Members) presented the work it had carried out to develop content for a new Investor Corner page on the new CESR website which would respond to this request. RIAs will be asked to provide their views on a test version of this to ensure the content meets their needs effectively before the new website goes live.

The associations welcomed the tangible improvements made since Valencia and the more

active engagement that they had experienced with CESR. They encouraged CESR to continue on this path.

The increased efforts that CESR has put into encouraging greater involvement by RIAs in CESR's work is beginning to bear some fruit, as can be witnessed from the positive remarks made about CESR to the Inter-Institutional Monitoring Group (IIMG) on CESR's willingness to engage with RIAs. This is evidenced further by statistics which show a small but gradual upward trend in formal responses from RIAs to CESR consultations since 2005. For example, CESR received 12 responses (out of a total of 51) from RIAs to its consultation on the content of key investor disclosures for UCITS (the KID).

Next steps

An online portal will be launched for retail investors investing cross-border. The goal of this section in the website is to provide a useful source of information for retail investors based in one Member State (MS) wishing to invest in a different MS. CESR Members will be asked to translate the pages if they feel this information is useful.

The next steps of the Investment Management Expert Group on its work to develop key investor disclosures for UCITS are set out in section 6.3.

The MiFID Expert Group is preparing a guide of MiFID for retail investors, presenting how the Directive impacts investors at different stages of an investment. This guide will be published on CESR's website, and will be made available in a number of European languages, to facilitate its use by investors.

3.3 Developing supervisory convergence through movement of staff and joint training

CESR is working with the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)¹⁷ on the development of a common training platform for supervisors, covering cross-sectoral issues. Further details on this joint work are set out in section 7.1.

¹⁶ For more detail on the work of CESR-Pol, please see section 5.2.

¹⁷ CEBS, CEIOPS and CESR are known collectively as the 29 3L3 Committees.



'Assessing the day-to-day application of the law ensures a level playing field across Europe.'



04 SUPERVISORY CONVERGENCE THROUGH MONITORING AND SELF-ASSESSMENT

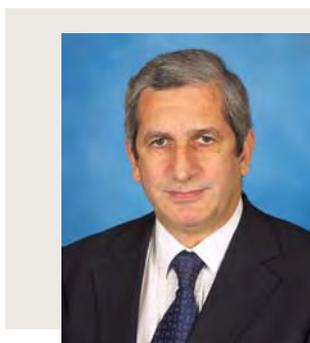
4.1 Review Panel

Mandate of the Review Panel

The “Stockholm Resolution” adopted by the European Council on 23 March 2001 stated: ‘The Committee of European Securities Regulators should also contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective co-operation between national supervisory authorities, carrying out peer reviews and promoting best practice.’ This statement was also reproduced in the Commission Decision that established CESR (2001/527, Recital 9).

To fulfil this important task, CESR established the Review Panel in March 2003. The Panel,

chaired initially by the former Vice-Chair of CESR, Kaarlo Jännäri, and as of February 2007 by Carlos Tavares, Vice-Chair of CESR, is a permanent group comprising representatives of each CESR Member. The Review Panel is mandated to undertake exercises such as peer reviews, surveys or mapping exercises regarding the implementation (day-to-day application) by all CESR Members of CESR standards, guidelines and recommendations (“CESR Standards”) into national rules and of EU legislation as well as selective reviews involving one or more CESR authorities, upon a specific mandate from CESR.



Chair's message

Carlos Tavares, Chairman of the CMVM, Portugal, and Vice-Chair of CESR

“The Review Panel is the core mechanism through which CESR exercises peer pressure. Over the last few years, it has conducted several important exercises and promoted actual supervisory convergence. During the last year, its crucial role was recognised on several occasions both by CESR Members and the EU institutions, especially in the framework of the Lamfalussy review. The Review Panel's importance was made evident in the ECOFIN conclusions, by asking the Level 3 committees to strengthen the national application of Level 3 guidelines, recommendations and standards. 2007 was a busy year for the Review Panel, and I am looking forward to our goals for 2008, which will involve a number of work streams stemming from the ECOFIN conclusions, the EU/US mutual recognition agenda and ongoing peer review and deregulation exercises. I will do my best to further strengthen and reinforce the Review Panel, in order to fulfil its role as a crucial tool for supervisory convergence.”

04 SUPERVISORY CONVERGENCE THROUGH MONITORING AND SELF-ASSESSMENT

Introduction

During the course of 2007, the Review Panel focused its work on the mapping of the supervisory powers under the Market Abuse and the Prospectus Directives, the preparation and updating of institutional texts regarding the operation of the Review Panel (Protocol, methodology for self-assessments and peer reviews and methodology for mapping exercises) and on the review of the existing CESR Standards, Guidelines and Recommendations.

The recent work of the Review Panel includes a survey conducted at the request of the European Commission regarding implementation of the European Commission's recommendations on UCITS and a review of the CESR Standard Number 1 on financial information. Moreover, the Review Panel started a self-assessment and peer review exercise for the implementation of CESR Guidelines to simplify the notification procedure for UCITS; this exercise will be completed during the course of 2008.

Institutional texts regarding the operation of the Review Panel

A. Protocol of the Review Panel

On 1 April 2007 CESR published its protocol on the Review Panel. This Protocol sets out the principles of the Review Panel provided for in Article 4.3 of the CESR Charter and, more specifically, sets out the role of the Review Panel, the purpose of its work, its tools and working procedures as well as the commitments of CESR authorities actively to ensure that the Review Panel fulfils its role.

The Review Panel was established by CESR to monitor the consistent and timely implementation of supervisory provisions set out in Community Legislation and CESR measures, with a view to fostering a common and uniform day-to-day application of all the above and of enhancing supervisory convergence among CESR Members.

Methodology for Self-assessment and Peer Review Tool

On 26 June 2007, CESR published its updated methodology for the self-assessment and peer review tool, which aims to determine whether the objective of each supervisory provision assessed is sufficiently met in accordance with Article 2 of the Protocol. The aim is also to determine the overall assessment of each CESR Member regarding the whole exercise.

The Methodology does not aim to extend or change the scope or nature of supervisory provisions but, where relevant, to lead to their consistent implementation in each CESR authority's jurisdiction.

Methodology for the mapping exercises

The Review Panel has created a methodology for the mapping exercises. The Review Panel will use this methodology as an internal document when conducting mapping exercises.

Extent of equivalence of supervisory powers across Europe under the Market Abuse and Prospectus Directives

In mid-2006, CESR launched a mapping exercise, through its Review Panel, which assessed the supervisory powers that had been given to CESR Members following the entry into force of the Market Abuse and Prospectus Directives. The purpose of the study was to assess whether the competent authorities benefit from equivalent supervisory powers. 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 findings of these reports were submitted by CESR to the Financial Services Committee (FSC) on 16 May, which was requested by the Economic and Financial Affairs Council (ECOFIN), in its Conclusions of May 2006, to monitor the convergence of supervisory powers and ensure that they are at an adequate level. As a complement to this exercise, CESR published a report on the supervisory functioning of the Prospectus

Directive and Regulation (Ref. CESR/07-225) on 12 June, which had been prepared by the CESR Prospectus expert group and was also submitted as part of CESR's contribution to the Lamfalussy Review.

CESR's assessment not only mapped the powers themselves, but also examined how these powers are exercised in practice by the competent authorities (i.e. in their day-to-day application). CESR considers that the mapping of national supervisory practices will contribute to a better understanding between the EU supervisors and will ultimately enhance supervisory convergence as CESR Members will compare supervisory practices and try to benefit from each others' best experiences. It will also provide valuable insight as to where further work can be undertaken by CESR to develop common standards (for example, supplementing the Prospectus Q & A already available or developing a second set of guidelines on the Market Abuse Directive), and where this may face limits due to national implementation.

To summarise, the key findings include an assessment of:

- the general powers provided to CESR Members under the Market Abuse and Prospectus Directives;
- the ability to issue practical rules;
- co-operation powers;
- the assessment of supervisory practices.

The findings of CESR are set out in more detail in the following documents:

- A report submitted to the FSC (Ref. CESR/07-334): The report provides an overview of all the findings set out in the reports below.
- Two correspondence tables: one for the Market Abuse Directive (Ref. CESR/07-382) and one for the Prospectus Directive (Ref. CESR/07-385). These illustrate through a tick box approach what supervisory powers CESR Members hold and how they are exercised.

- Two full reports including executive summaries: one describing its Members' supervisory powers under the Market Abuse Directive and relevant implementing measures (Ref. CESR/07-380) and one describing its Members' supervisory powers under the Prospectus Directive and relevant implementing measures (Ref. CESR/07-383).

Review of existing CESR/FESCO Standards, Recommendations and Guidelines

During the second half of 2007, and in line with the better regulation agenda, the Review Panel conducted an extensive mapping of the existing CESR standards, guidelines and recommendations against the measures contained in the Financial Services Action Plan. The aim of this exercise was to ensure the alignment of CESR measures with existing legislation and market needs.

Self-assessment and peer review exercise of the application of CESR's Guidelines to simplify the notification procedure for UCITS

During the second half of 2007, the Review Panel conducted a self-assessment exercise of the application of CESR's guidelines to simplify the notification procedure of UCITS (Ref: CESR/06-120b).

Statistics of the meetings

The Review Panel met six times during the reporting period.

Next steps

It is anticipated that in 2008 the Review Panel will focus its activity on:

- Follow-up of the revision of the existing CESR standards, guidelines and recommendations;
- Conducting a peer review of the implementation of CESR Guidelines to simplify the notification procedure of UCITS;
- In light of the post-Ecofin conclusions and in the context of the mutual recognition initiative, conducting a mapping exercise on the supervisory and sanctioning powers and practices arising from the implementation of MIFID in the different Member States;
- Conducting a follow-up peer review on Standard No 1 on Financial Information;
- Conducting a peer review exercise on the application of CESR Standard No 2 on Financial Information- Coordination of enforcement activities (Ref. CESR/03-317c) and simultaneously updating the exercise conducted in 2006 on the implementation of Standard No.1 on Financial Information;
- As stated in the work programme, starting in the last quarter a mapping exercise on the subject of "Acting in concert" and another in relation to the Transparency Directive; and
- Updating the Review Panel IT tool.



'Our network provides the technical (policy) infrastructure which creates greater transparency and helps investors reach their desired destination safely.'



05 OPERATIONAL GROUPS

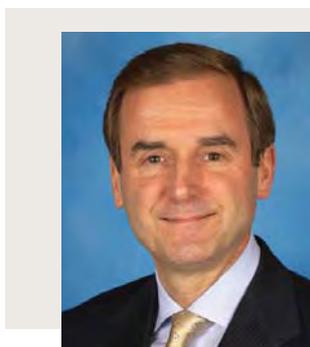
5.1 CESR-Fin

Mandate of CESR Fin

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

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

Until 31 December 2007 CESR-Fin was chaired by Paul Koster, Member of the Board of the Dutch AFM. From 1 January 2008, CESR-Fin has been chaired by Fernando Restoy, Executive Board Member of the Spanish CNMV and supported at the CESR secretariat by Javier Ruiz del Pozo, Director of Financial Information, Marion Bougel-Bomtemps, Senior Officer and Lotte Andersen, Officer.



Chair's message

Paul Koster, Board Member at the Netherlands Financial Market Authority (AFM) (Chair of CESR-Fin until December 2007)

“Since January 2005, International Accounting Standards (IAS/IFRS) have been adopted for all EU listed groups. CESR was closely involved in the process that led to the introduction of the standards in the EU, notably through its monitoring work on the development and adoption of the EU standards, or with the publication of additional recommendations accompanying the transition to IFRS. After the second year of IFRS accounts, CESR-Fin's main priority is to contribute to the consistent application of the standards. CESR-Fin has already taken the initiative to help with the development of robust and co-ordinated enforcement across the EU by establishing a framework for discussion and information-sharing among European enforcement agencies (European Enforcers' Co-ordination Sessions –EECS). In 2007, we increased the number of meetings of the EECS and we have also seen a growing use of the enforcement database created by CESR-Fin. I also think that the publication of the enforcement decisions included in the database produced further benefits for harmonisation. Issuers, auditors and non-EU enforcers can

now see which accounting treatments adopted by issuers are considered by EU enforcers as being within or outside the legal framework.

Discussion and analysis of enforcement decisions is the main CESR-Fin task, but the enforcers' sessions also enable us to identify issues which are not covered by the standards or which may be affected by conflicting interpretations. The referral of these issues to the International Accounting Standards Board (IASB) or International Financial Reporting Interpretations Committee (IFRIC), if needed, will further contribute to proper implementation of IFRS in the EU.

But our work to promote consistent application does not stop at the EU's borders. As this consistent application is a key condition for the lifting of the SEC's reconciliation requirement of IFRS accounts to US GAAP, we have established periodic exchanges of information with the SEC; these exchanges contribute to the achievement of that goal and help us to avoid conflicting regulatory decisions.”

During the course of the year, CESR-Fin devoted a large part of its attention and resources to the following projects:

- the development of the European Enforcers' Coordination Session (EECS), in particular the development of the database of enforcement decisions and the publication of extracts from this database;
- the review of the implementation and the enforcement of IFRS in the European Union;
- the CESR-SEC dialogue;
- the monitoring of the application by the CESR members of the transitional measures¹⁸ adopted by the European Commission on the use by third country issuers of internationally accepted accounting standards (GAAP); and
- the monitoring of the adoption by the European Commission of a Regulation¹⁹ establishing a definition of equivalence and a mechanism for determining equivalence of third country GAAP.

With respect to the latter, CESR produced in 2007 two sets of technical advice to the European Commission, and in December published a consultation paper on the equivalence of Chinese, Japanese and US GAAP.

In addition to these major initiatives, CESR-Fin continued to monitor the EU endorsement of standards/interpretations published by the IASB and IFRIC, as well as regulatory developments concerning auditors' work. In this respect, CESR-Fin has set up a permanent project group for the oversight of the standard-setting processes in the area of financial reporting and

is an observer in the following EU bodies: the Accounting Regulatory Committee (ARC), the Auditing Regulatory Committee (AuRC), the European Financial Reporting Advisory Group (EFRAG) and the EU Accounting Roundtable.

In addition, CESR monitored closely the work done by the European audit regulators represented in the European Group of Auditors' Oversight Bodies (EGAOB) as well as with the recently established International Forum of Independent Audit Regulators (IFIAR).

The European Enforcers' Coordination Session (EECS)

The core objective of CESR-Fin is to promote convergence on the application of IAS/IFRS in the European Union.

During the period covered by this report, the CESR database of enforcement decisions has been in continuous operation, regularly populated and visited by Members. As of December 2007, a total of 104 decisions had been entered in the database.

In parallel, the EECS, which includes CESR and non-CESR members who have competences in the enforcement of compliance with IFRS, held eight meetings devoted to discussion of the 29 decisions sent to the database, as well as 28 emerging practical and technical issues or cases that Members encounter or are made aware of in the process of the surveillance of financial information. The group also held a joint session with representatives of the IFRIC/IASB in July 2007.

As a further contribution to the promotion of market confidence and supervisory convergence in the European Union, CESR published 2 extracts of the EECS database:

- One extract in April 2007 including 16 decisions;
- One extract in December 2007 including 11 decisions.

Publication of enforcement decisions informs market participants about which accounting treatments, as adopted by issuers, EU National Enforcers consider as complying or not complying with the IFRS. This means that the treatment adopted by the issuer is considered as being within or outside the accepted range of possible treatments allowed by the standards. Such publication, along with the rationale behind these decisions, will contribute to a consistent application of IFRS in the European Union. Finally, it may also facilitate wider consensus on IFRS matters by fostering public discussion and exchange of views with other interested parties, namely issuers and auditors, on publicly disclosed enforcement decisions, which will help diminish the risk of divergent and unacceptable financial reporting treatments.

Decisions that deal with simple or obvious accounting matters, or oversight of IFRS requirements, will not normally be published, even if they involve material breaches leading to sanctions. Published decisions will generally include a description of the relevant accounting treatment or presentation, the decision taken by the National Enforcer and a summary of the

¹⁸ Commission Regulation (EC) 1787/2006 of 4 December amending Commission Regulation 809/2004 on prospectuses and Commission Decision 2006/891/EC of 4 December 2006 on the use by third country issuers of securities of information prepared under internationally accepted accounting standards (the Transparency Decision).

¹⁹ Commission Regulation (EC) 1569/2007 of 21 December 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.

Enforcer's underlying rationale. In response to concerns about confidentiality and privacy laws, which vary between EU jurisdictions, extracts will not usually include the name of the issuer or the enforcing authority, or any other details that would enable the issuer or its jurisdiction to be identified.

CESR anticipates publishing further extracts from the database on a regular basis.

CESR's review of the first experience with the enforcement of compliance with the IFRS standards

In November 2007, CESR-Fin published its review of the implementation and the enforcement of IFRS in the European Union (Ref. CESR/07-352).

The aim of the report was to provide a review of the activities of CESR Members and other related regulators (European or EEA enforcers), acting through CESR's Enforcement Coordination Sessions, in their capacities as enforcers of IFRS in the consolidated accounts of issuers admitted to trading in the EU, for accounting periods ending on or after 31 December 2005. It also provided a record of European Enforcers' experience with the enforcement of IFRS during the first year of their compulsory use in the consolidated accounts of EU-listed issuers. Finally, the report aimed to record EU enforcers' compliance at the time with CESR's Standards on Enforcement.

The main objectives of the report were:

- to give an overview of the status of the implementation of enforcement activities in relation to 2005 IFRS financial statements within individual Member States;
- to present findings and some tentative conclusions arising from these activities relating to IFRS and to the enforcement activities themselves; and
- to provide some more general observations about the implementation of IFRS and its impact on EU markets.

The key findings of the report are as follows:

- The results of CESR's survey suggest that 20 out of 27 Member States (MS) had introduced an enforcement mechanism by 2006 that met, at least in part, the requirements laid down by CESR standards on enforcement. In addition, 11 MS had introduced an enforcement mechanism that fully met the requirements laid down by CESR's Standards on Enforcement. It is also worth noting that these 11 countries represent around 60% of all issuers using IFRS admitted to trading in Europe at the time of publication. In an additional 9 MS, most of the CESR standards on enforcement were in place.
- At the date of publication of the report, a Competent Authority had been designated in accordance with the requirement of the Transparency Directive (Article 24.1), in 24 out of 27 MS. Where it has been so designated, the Competent Authority is

the CESR Member in all but 6 MS (Czech Republic, Denmark, Ireland, Germany, Iceland and UK) where accounting enforcement is carried out in co-operation with other authorities designated under national legislation.

- The number of issuers where a review of the 2005 financial statements was carried out varied from one country to another. On average, reviews were planned in 2006 of around 23% of all issuers admitted to trading in the EU who were users of IFRS, and over 85% of reviews planned were in fact completed. Those reviews planned but not completed were replaced by unplanned reviews of financial statements as part of the prospectus vetting procedures in the countries concerned.
- On the whole, EU Enforcers agree that the implementation of IFRS in the consolidated accounts of over 7,000 EU issuers has presented a very significant challenge to preparers, auditors and regulators, and one which through tremendous hard work from all participants has been achieved without major disruption to the markets or the reporting cycle. There has consequently been no evidence of a loss of market confidence during the transition period.
- In general, EU Enforcers also believe that the move to IFRS has improved the quality of financial reporting in their jurisdiction, mainly due to increased transparency of disclosures and greater comparability between issuers. Nevertheless, EU Enforcers did identify a number of areas in the 2005 financial statements where the level of compliance could be improved.
- This report also provides an update on CESR's programme of co-operation with the SEC. Generally, it is felt that progress is being made towards a common understanding of the events that trigger the exchange of information between CESR Members and the SEC, which should con-

tribute to more timely bilateral consultation taking place in the future. Finally, CESR is analysing possible ways of strengthening its co-operation with the enforcers of other third countries.

Equivalence of third country GAAP

The Prospectus Directive and Regulation (“the prospectus regime”)²⁰ and the Transparency Directive²¹ will require the European Commission (“EC or the Commission”) to establish by mid-2008 whether a given third country GAAP is equivalent to IFRS.

As a result of the prospectus regime, third country 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, have been required since 1 January 2007 to publish a prospectus including financial statements prepared on the basis of IFRS adopted pursuant to EC Regulation 1606/2002, or on the basis of a third country’s national accounting standards (“third country GAAP”) equivalent to those standards. From the period 1 January 2007 until 31 December 2008, appropriate transitional arrangements apply under Article 35 of the Commission Regulation on prospectuses.

Similarly, under the Transparency Directive, from January 2007 third country issuers whose securities are admitted to trading on an

EU-regulated market will also have to provide annual and half-yearly financial statements which should either be prepared in accordance with IFRS adopted pursuant to EC Regulation 1606/2002, or third country GAAP equivalent to those standards. Appropriate transitional arrangements also apply under Article 26 (3) of that Directive.

In December 2006 the EC adopted two measures²² allowing a two-year transitional period (until January 2009) during which third country issuers can prepare their annual financial statements and half-yearly financial statements in accordance with the accounting standards of Canada, Japan or the United States. The aim of these transitional provisions was to give more time to the standard-setters and regulators of those countries to continue with their convergence processes. As other countries are also in the process of converging their national GAAPs to IFRS over various periods of time, the Commission considered it appropriate to allow the same two-year transitional period to third country issuers preparing their annual and half-yearly financial statements in accordance with a GAAP that is converging to IFRS, provided certain conditions are met.

These measures envisage a different treatment of such issuers before and after January 2009:

- **Transitional period until January 2009:** During this phase, accounting

frameworks other than IFRS, Canadian, Japanese or US GAAP may be used subject to certain conditions²³. The decision to accept other accounting frameworks is the responsibility of the competent authority, although recitals in the two measures state that “*To ensure consistency within the Community, CESR should co-ordinate the competent authorities’ assessment as to whether those conditions are satisfied in respect of individual third country GAAPs*”.

- **After the transitional period,** a third country’s GAAP will be acceptable only if it has been determined equivalent to IFRS by the European Commission after having received CESR’s advice.

CESR-Fin work on the first phase: transitional period

In April 2007, CESR-Fin published guidance (Ref. CESR/07-022b) on how individual competent authorities might decide during the transitional period, on a consistent basis, which third country GAAPs satisfy the transitional requirements published by the Commission in December 2006. This guidance sets out a list of criteria that competent authorities should follow to determine whether third countries’ convergence programmes fulfil the conditions stipulated in the Commission’s Regulation on prospectuses and its Decision on Transparency.

20 Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC. Commission Regulation (EC) No 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and the Council as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements.

21 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

22 Commission Regulation 1787/2006 of 4 December amending Commission Regulation 809/2004 on prospectuses and Commission Decision 2006/891/EC of 4 December 2006 on the use by third country issuers of securities of information prepared under internationally accepted accounting standards (the Transparency Decision).

23 According to Article 35.5A (c) of the Prospectus Regulation (and the similar provision in the Transparency Decision) these conditions are:

The third country authority responsible for the national accounting standards in question has made a public commitment, before the start of the financial year in which the prospectus is filed, to converge those standards with IFRS;

That authority has established a work programme which demonstrates its intention to progress towards convergence before 31 December 2008; and

The issuer provides evidence that satisfies the competent authority that the conditions in (i) and (ii) are met.

CESR-Fin work on the second phase: equivalence of third country GAAP

On 22 February 2007, CESR received a request from the European Commission for technical advice on the equivalence of third country GAAP.

First set of advice: definition of equivalence

The Commission was expected to report to the European Securities Committee and the European Parliament before 1 April 2007 on the timetable envisaged by national accounting authorities of Canada, Japan and the United States for the convergence. To this end, the Commission requested CESR to provide an update on the convergence programmes towards IFRS in Canada, Japan and the US, a list of the GAAPs currently being used on EU markets and a definition of equivalence.

In March 2007, CESR provided a set of advice (Ref. CESR/07-138), including a factual description of the work timetable of the Canadian, Japanese and US standard-setters on the convergence between IFRS and the GAAPs of these countries and a definition of equivalence. Regarding the latter aspect, CESR indicated in the advice that *“third country GAAP would be equivalent to IFRS if investors should be able to make a similar decision irrespective of whether they are provided with financial statements based on IFRS or on such third country GAAP”*. CESR also indicated that a determination that third country GAAP are equivalent to IFRS should be based on the presumption that filters at country levels, audit assurance and enforcement on entity levels are sufficient for investors to rely on.

Second set of advice: mechanism for determining equivalence

The Commission is expected to decide on the equivalence of the GAAP of third countries, pursuant to a definition of equivalence (on which CESR advised in its aforementioned March 2007 advice) and a mechanism that it was due to establish before 1 January 2008.

To this end, the Commission asked CESR for further advice on a mechanism for determining the equivalence of a third country GAAP. CESR submitted its second set of advice to the European Commission (Ref. CESR/07-289) in June 2007. This advice was not an assessment of which GAAPs are equivalent, but a proposal for a mechanism to make that assessment.

On the basis of this second set of advice, the 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 out in article 2. The Regulation also sets out in article 4 the conditions for the acceptance of third country accounting standards for a limited period expiring no later than 31 December 2011.

Third set of advice: equivalence of Chinese, Japanese and US GAAP

On the basis of the aforementioned Regulation on the mechanism, the European Commission mandated CESR in August 2007 to advise on the equivalence of Chinese, Japanese and US GAAP. In December 2007, CESR published a consultation paper on the equivalence of these 3 GAAPs (Ref. CESR/07-761).

Rather than relying solely on an assessment of the individual standards, as was the case in its 2005 advice, CESR decided to adopt a more **holistic approach** on this occasion, mainly due to the important changes that have taken place since 2005 in the international accounting environment. The main reasons for this holistic or dynamic approach are as follows:

- The definition of equivalence in the Commission Regulation on the mechanism is clearly an outcome-based definition. This definition does not require GAAP to be “the same” to be equivalent.

- The accounting environments in Japan and the US have changed dramatically in the last two years, for example through: the issuance of a new MoU between the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB); the signature of the Tokyo agreement between the IASB and the Japanese Accounting Standard Board (ASBJ); and the SEC decision to accept financial statements prepared under IFRS without reconciliation to US GAAP for foreign issuers.
- An approach to equivalence based purely on comparing differences in accounting standards is not relevant as the actual significance of any differences identified can only be measured in the context of an issuer's individual financial statements.
- As the IASB, the ASBJ and the FASB will continue working together in future to develop mutually acceptable standards, any detailed assessment of the differences between US GAAP, Japanese GAAP and IFRS at any given moment would be soon out of date.
- The equivalence decision by the European Commission, as envisaged in the Directives and in the Commission Regulation on the mechanism, does not contain explicit provisions on a follow-up or *monitoring* system. This leads CESR to believe that the equivalence decision may be performed on a one-off basis. A decision on equivalence based solely on the analysis of individual standards without further monitoring runs the risk of soon being out of date, as new standards are issued by the IASB and/or the relevant standard-setter.

In the consultation paper, CESR recommends that the European Commission, by June 2008:

- consider US GAAP equivalent;
- consider Japanese GAAP equivalent unless there is no adequate evidence of the ASBJ achieving to timetable the objectives set out in the Tokyo Agreement; and
- postpone a final decision on Chinese GAAP until there is more information on the implementation of Chinese accounting standards, because CESR believes that evidence of adequate implementation is important in the context of an outcome-based definition of equivalence.

The consultation period will finish on 25 February 2008.

CESR's co-operation with the SEC and other third countries

In the context of the dialogue between CESR and the SEC, CESR-Fin devoted time in 2007 to the implementation of the work programme signed in August 2006 on the application by internationally active companies of US GAAP and IFRS.

In particular, the SEC and CESR agreed on a **standard protocol** covering exchanges of confidential information on dual-listed issuers. The SEC and a CESR-Fin delegation met in Washington on 25 October 2007. The meeting focused on discussing the publication of the SEC rules on the acceptance for foreign issuers of financial statements prepared under IFRS without reconciliation to US GAAP.

In November 2007, CESR-Fin held a session with the securities regulator of Israel (Israel Securities Authority, ISA). The discussion focused on the enforcement system in Israel as well as issues identified by the ISA on the application of IFRS by Israeli issuers.

Survey on the Direct Communication of Auditors with the Public on the Statutory Audit of the Annual or Consolidated Accounts of Listed Companies

On 11 June 2007, CESR published a report setting out the conclusions of a survey of its Members on the direct communication of auditors with the public on the statutory audit of annual or consolidated accounts of listed companies.

CESR surveyed its Members with two purposes. The first was fact-finding on direct communication of the auditor with the public in CESR Member States. The second was identifying the desirability of potential enhancement of direct auditor communication as perceived by CESR Members.

The main conclusion of the survey is that a majority of CESR Members agree that extra information (in general) from the auditor to the public on the statutory audit could contribute to the decision-making ability of the public, although confidentiality regulations restrict the extra information the auditor could provide. Auditor communication is a subject of public interest. However, in order to make more precise recommendations the subject should be analysed further.

Statistics of the meetings

CESR-Fin met four times in 2007.

The EECS met eight times in 2007 and held one joint meeting with representatives of IASB / IFRIC.

Next steps

On equivalence, CESR plans to submit its advice on the equivalence of Chinese, Japanese and US GAAP to the European Commission by the end of March 2008. CESR plans to continue its equivalency project on other third countries during the first months of 2008 (i.e. Canada, India and Korea).

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: the next publication is expected to take place in May 2008.

CESR-Fin will continue to monitor the EU endorsement of standards/interpretations published by the IASB and IFRIC, as well as regulatory developments concerning auditors' work.

Finally, CESR-Fin will continue its regular dialogue with the SEC and other third countries' authorities.

5.2 CESR-Pol

Mandate of CESR-Pol

CESR-Pol is a permanent operational group within CESR. It is made up of senior officials, from each CESR Member, who are responsible for the surveillance of securities activities and the exchange of information. CESR-Pol's purpose is to facilitate effective, efficient and proactive sharing of information, in order to enhance co-operation on, and the co-ordination of, surveillance and enforcement activities between CESR Members. CESR-Pol's key objective is to make information flow across borders between CESR Members as rapidly as it would internally and, by so doing, to enhance the transparency, the fairness and the integrity of European markets as a whole. The ability of CESR-Pol Members to co-operate in the field of enforcement was

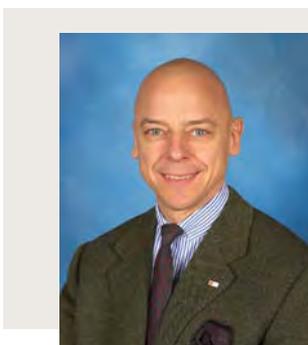
established by their signature of the CESR multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (MoU) in January 1999.

CESR-Pol is mandated to promote closer co-operation and to ensure the consistent and effective application of key EU Directives, particularly the Market Abuse Directive (MAD). To this end, it is also mandated by the CESR Chairs to conduct Level 3 work in the area of the MAD.

As a result of the MAD work, CESR-Pol became more operational. It established a permanent sub-group, the Surveillance & Intelligence Group (S&I Group), which provides experts in

the investigation and enforcement of market abuse with a forum for sharing their experiences on the basis of individual cases, and exchanging valuable information on methods and procedures used in day-to-day supervision. In addition, CESR-Pol has the capacity to create on an ad-hoc basis 'Urgent Issues Groups'. These groups allow the respective CESR-Pol Members to co-ordinate and jointly conduct investigations in urgent cases.

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



Chair's message

Kurt Pribil, Chief Executive Officer of the Austrian Financial Market Authority (FMA)

"Under the umbrella of CESR-Pol Members deal with a wide spectrum of issues. Subjects range from jointly tackling substantial market abuse cases to sharing experience and knowledge in the area of market surveillance and international co-operation to developing new guidance to the market on the operation of the Market Abuse Directive. I am grateful for the opportunity to chair CESR-Pol. During my third term I look forward to continuing this very important work, and to leading the group towards the more operational focus which seems to be a logical consequence of our Level 3 work.

Our work is aimed at developing fairer and more transparent markets where investors' confidence is justified, admittedly an ambitious goal in the current times where markets are heavily shaken by subprime and other crises.

However, this makes our work even more important. We try to achieve a common understanding among all CESR Members on relevant aspects of market surveillance and co-operation, and to establish convergent application of key European directives, in particular the Market Abuse Directive.

In my view it is pivotal to combine forces effectively when we conduct investigations and to exchange information across borders to prevent and enforce infringements of securities regulation. It is clear to us that this can only be achieved by close collaboration of all securities regulators. To this end, it is our strong endeavour to improve international co-operation and, in particular, to assist those regulators which can only provide information by overcoming legal barriers."

One of CESR-Pol's key priorities in 2007 has been to achieve greater convergence in the application of the Market Abuse Directive (MAD) at Level 3 of the Lamfalussy process, and to foster greater co-operation in fighting market abuse.

Public guidance on the Market Abuse Directive:

After the first two years of experience under the new market abuse regime, CESR-Pol was of the view that this was the right moment to provide further guidance to market participants on common understandings developed among supervisors, with a view to achieving a convergent application of the legal requirements of the MAD on a day-to-day basis.

CESR-Pol's MAD Level 3 drafting group published a second set of guidance on the operation of the Market Abuse Directive (Ref. CESR/06-562b) on 12 July 2007. The draft guidance had been revised to take account of comments made during a public consultation exercise. Where relevant, CESR took into account the advice it had itself provided to the European Commission in framing the implementing measures for the Directive. The European Commission was also consulted in development of the guidance and its comments taken into account. A Feedback Statement on the consultation exercise (Ref. CESR/07-402) was also published.

In this guidance, CESR developed a common understanding among its Members regarding the treatment of the following aspects of the Directive and associated issues concerning market abuse:

What constitutes inside information?

The guidance in this context gives: further clarification on 'information of a precise nature'; further guidance on making information public; amplifies what is meant by the concept 'information likely to have a significant price effect'; and provides a non-exhaustive list of indicative types of event or information which may constitute inside information.



When is it legitimate to delay the disclosure of inside information?

The guidance provides illustrative examples of the two circumstances where the Directive generally recognises a potential legitimate delay of disclosure of insider information (for example 'negotiations in course' and 'decisions taken which need the approval of another body'). Depending on the circumstances of the specific case in question, a delay can be legitimate where there are confidentiality constraints relating to competitive situations; or product development or selling of major holdings in another issuer that could be jeopardised by disclosure.

When does information relating to a client's pending orders constitute inside information?

This section of the guidance covers what can be defined as a client's pending order and includes factors to be used in an assessment of when inside information would be involved; in particular it provides further specification of the terms 'price sensitivity' and 'precise nature'.

Insider lists in multiple jurisdictions

To reduce the burdens on issuers that are subject to the jurisdiction of more than one EEA Member State with respect to insider list requirements, CESR recommends that the relevant competent authorities recognise insider lists prepared according to the requirements of the Member State where the issuer in question has its registered office, thus leading to a mutual recognition system.

Further Issues for Work in the Area of the Market Abuse Directive

Work programme

In the consultation process of the second set of guidance on the Operation of the Market Abuse Directive (Ref. CESR/06-562b), it became clear that the work undertaken so far would not be the final word; in fact, market participants were calling for even more guidance from CESR. On 26 July 2007 CESR published its work programme for further work in the area of the MAD (Ref. CESR/07-416). The work programme encompasses issues where CESR identifies a need for further consideration, so further guidance may be provided to CESR Members and/or to the market, to the extent possible.

The work programme reflects CESR's continuing efforts to prepare the ground for convergent application of the market abuse regime. This will be done by ensuring that a common approach to the operation of the Directive takes place among supervisors throughout the EU.

Many of the issues included in the work programme were flagged by market participants during the Call for Evidence, which CESR launched in 2006 following two years of experience of the new market abuse regime in Europe (Ref. CESR/06-078). Further subjects were raised during the consultation on the second set of guidance but were outside the scope of the proposed guidance, while others were identified in the mapping exercise of the implementation of the MAD that was conducted by CESR's Review Panel.

Issues identified for further work include:

- Assistance to the European Commission in developing the list of administrative measures and sanctions applicable under the MAD.
- Harmonisation of the requirements for insiders' lists.
- Suspicious transaction reporting.
- Stabilisation regime.
- The two-fold notion of inside information.
- Mapping exercise of the existing thresholds in Member States and other practices of CESR Members concerning directors' dealings.
- Development of guidance on the definition of inside information with regard to commodity derivatives (to the extent possible).

As indicated in these areas, CESR will seek to develop guidelines for CESR Members and/or the markets; where appropriate, CESR will consider whether in any cases it is appropriate to propose that the European Commission examine an issue in its forthcoming review of the operations of the Directive. If a decision is made that CESR should issue specific guidance to the market, this will be developed following CESR's standard consultation process. At the end of 2007, the assistance to the European Commission regarding the list of administrative measures and sanctions under the MAD was finalised and substantial progress had been made on work on a third set of guidance.

Advice to the Commission on the list of sanctions

CESR-Pol prepared CESR's response to the request of the European Commission to assist in setting up a list of administrative measures and sanctions according to MAD, an exercise aimed at enhancing transparency. In November 2007, CESR published the "Report on Administrative Measures and Sanctions as well as Criminal Sanctions available in Member States under the MAD" (Ref. CESR/07-693). The work was presented to the ESC in December 2007 and was well received. An Executive Summary including four annexes (Ref. CESR/08-099) was provided to the market shortly afterwards;

the summary briefly illustrates the content of the extensive list, thus allowing a quick and comprehensive overview of the measures available in the Member States to enforce infringements of MAD provisions. This work was considered a voluntary contribution that did not fall within the deadline of the request of the European Commission.

Background

In 2005, CESR-Pol conducted a mapping exercise on powers and sanctions in the area of market abuse. It was found that there was a broad range of sanctions within Europe e.g. administrative fines, imprisonment, withdrawal of licenses, disgorgement of profits, settlements etc, and that this was likely to remain the case even after the full implementation of the MAD in all Member States, since the sanctioning systems lay at the national discretion of Member States. CESR highlighted this in a letter to the European Commission and recommended that such a list be drawn up for purposes of transparency.

3rd set of guidance on the operation of MAD

As outlined in the CESR work programme, CESR-Pol's MAD Drafting Group carries out work to develop additional assistance to the market on specific requirements of the MAD. On "insiders' lists" and "suspicious transaction reporting", surveys have been conducted among CESR-Pol Members to obtain a full picture of legal requirements and practical approaches which will provide a basis for appropriate guidance.

In the context of stabilisation activities, the question has arisen as to the appropriate mechanism to achieve "adequate public disclosure" of stabilisation activities and buy-back programmes according to the Implementing Regulation 2273/2003/EC.

Article 2 No. 5 of the Regulation defines an "adequate public disclosure" by reference to Articles 102 and 103 of Directive 2001/34/EC on the Admission of Securities to Official Stock Exchange Listing. These articles mainly

set out publication in widely distributed newspapers with simultaneous information to the competent authorities. However, these Articles were deleted as a result of Article 32 of the Transparency Directive (TD), 2004/109/EC, and references made to the repealed provisions shall be construed as being made to the provisions of the TD. To this end, it seems there is a lack of clarity on the legally required method for providing the market with the necessary information. CESR-Pol will request clarification from the European Commission. In a first statement the Commission expressed its view that the principle of the law would require the use of an Officially Appointed Mechanism according to the TD.

Members agreed to proceed with the consultation process for the third set of guidance on the operation of MAD in two steps. Draft guidance on insiders' lists and suspicious transaction reporting will be issued for public consultation in summer 2008; draft guidance on the other topics will follow at a later date. Ultimately, all issues will be integrated in the third set of guidance.

Database for market abuse enforcement cases

In June 2006 CESR-Pol started a project to establish a database for market abuse enforcement cases. This project is intended to fulfil the mandate to undertake Level 3 work on the MAD and to develop a common understanding among CESR Members of what constitutes market abuse.

The database will allow the central recording of enforcement decisions made/sanctions imposed by CESR Members (and possibly non-CESR members) in respect of breaches of the MAD with a view to assisting regulators in applying the provisions of MAD in a consistent and co-ordinated manner. The decision to record the case in the database will be taken by the CESR Member who conducted the investigation. For reasons of confidentiality, only CESR Members and specifically nominated staff of the CESR Secretariat will be granted access to the database.

The project is achieving good progress. On 9 January 2008, the French data protection authority, the Commission nationale de l'informatique et des libertés (CNIL), submitted its acknowledgment of notification receipt which is in effect the "green light" for CESR to proceed with the operation of this database.

Operational Co-operation

The members of CESR-Pol co-operate closely with a view to achieving efficient and successful investigations and enforcement of market abuse cases. Intelligence and expertise is shared through in-depth discussions of concrete cases and investigatory methods, always with the aim of achieving a convergent approach.

Surveillance & Intelligence Group

The work of the sub-group of CESR-Pol, the Surveillance & Intelligence Group (S&I group) successfully contributes to the operational approach of CESR-Pol and the aim of achieving a convergent application of the MAD. The S&I

group was established to foster simultaneous and comprehensive intelligence-sharing and discussion of practical issues arising from day-to-day supervision of firms and markets.

The report of the Chair of the S&I group, Regina Schierhorn (BaFin), on the current work of the group is a standing item on the agenda of CESR-Pol's meetings. In 2007, the S&I group conducted several surveys among its members to get a better picture of the legal and practical situation in the jurisdictions involved. Meetings of the S&I group also provide the opportunity for a comprehensive and informative exchange of views and experiences about current cases.

Urgent Issues Groups

As part of the work at Level 3 of MAD designed to achieve a more operational focus, CESR-Pol established the framework for 44 Urgent Issues Groups (UIGs) to be formed. Thus CESR-Pol has the capacity to create on an ad-hoc basis UIGs, allowing the respective CESR-Pol Members who are concerned by alleged unlawful cross-border activities to co-ordinate and jointly conduct

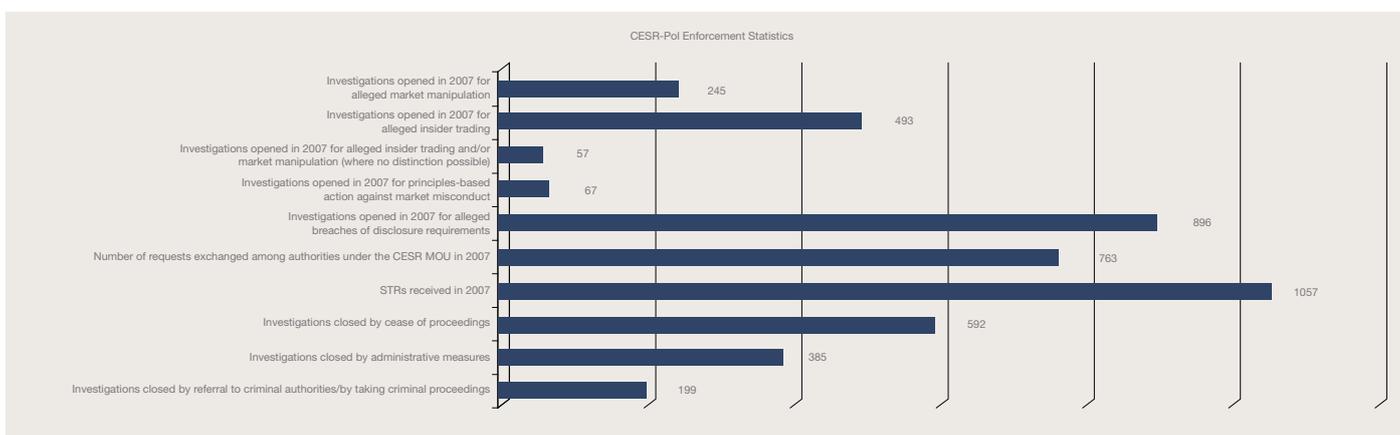
investigations in urgent cases. So far, five ad hoc UIGs have been established, and they have been working very efficiently and successfully.

Co-ordination with other supervisory institutions

CESR-Pol Members inform each other of their experiences - positive as well as negative - when requesting assistance from other regulators (within the European Economic Area or worldwide), and try to achieve joint solutions. To this end, CESR-Pol maintains bilateral contacts with other institutions that tackle co-operation issues, such as the International Organisation of Securities Commissions (IOSCO), as well as with regulators that are not members of CESR.

Dialogue with Switzerland

A delegation of the Swiss Federal Banking Commission (SFBC) attended a session of the



CESR-Pol meeting in London in March 2007. The SFBC gave a presentation on its powers concerning enforcement against unauthorised financial institutions and the exchange of information with foreign securities supervisors.

In October 2007 the annual high-level meeting between CESR and the Swiss regulator to exchange views on issues of common concern took place in Berne. CESR acknowledged the Swiss' efforts to enhance their international co-operation but it was emphasised that the client's right to appeal against the decision of the SFBC to forward information about that client to a foreign regulator still gave rise to concerns. The Swiss representatives emphasised their willingness to co-operate to the greatest possible extent.

Dialogue with the Crown Dependencies

In order to enhance dialogue and co-operation, representatives of the Crown Dependencies were invited to the CESR-Pol meeting in September 2007 in Madrid. Representatives of the Jersey Financial Services Commission, the Guernsey Financial Services Commission and the Financial Services Commission of the Isle of Man attended the meeting, which represented the third joint session with these entities in the history of CESR-Pol, and outlined the current situation within their territories as regards powers and ability to co-operate. All representatives emphasised their strong willingness to co-operate closely with CESR Members to the extent possible and asked for increased use of more informal communication in the context of requests for assistance.

Statistics of the meetings

CESR-Pol and its subgroup, the Surveillance & Intelligence group, each convened three times during 2007, as well as working on a virtual basis. The Urgent Issues Groups and Drafting Groups on MAD and the Database met separately.

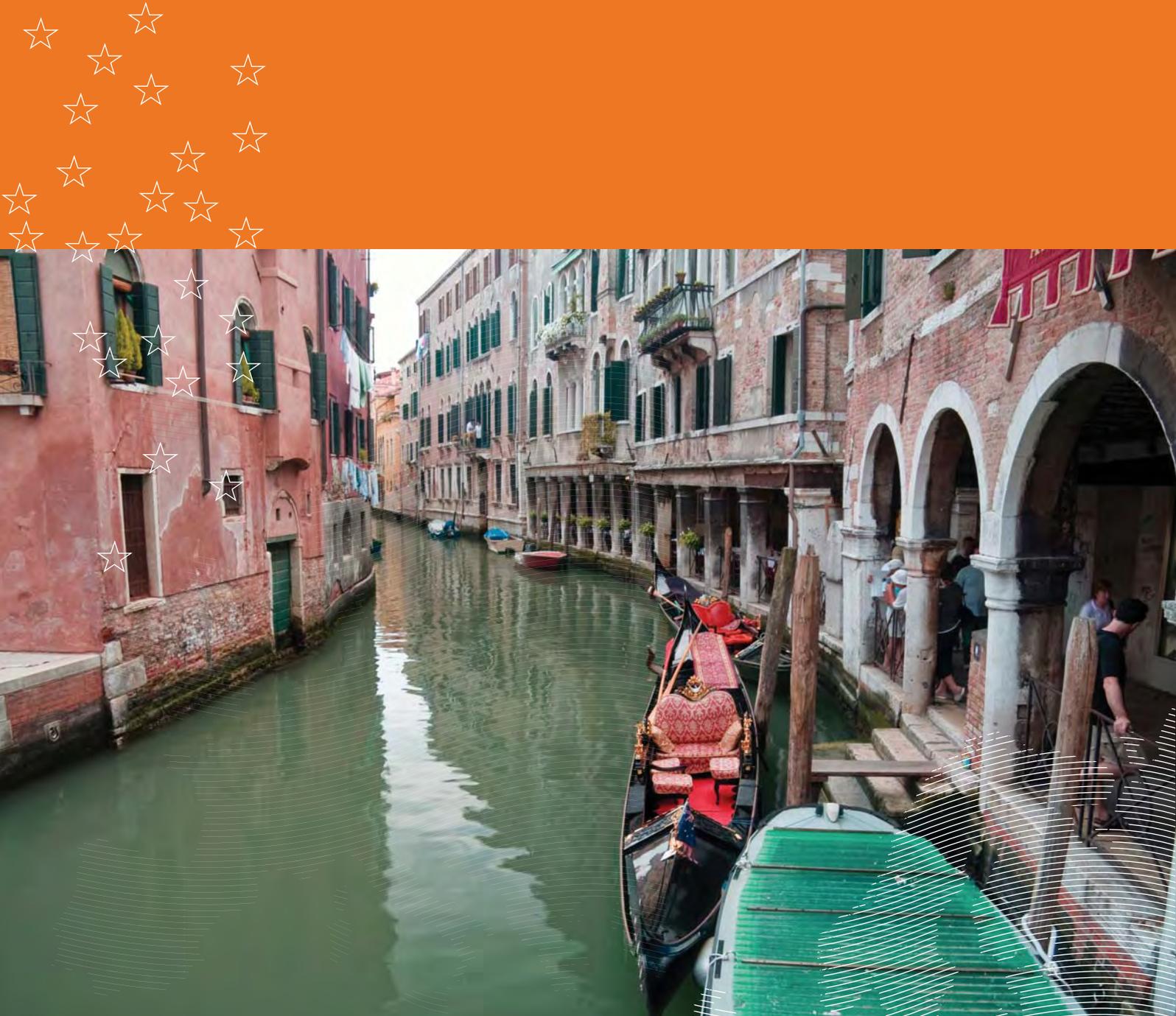
Next steps

CESR-Pol will seek to develop a common understanding among its Members regarding treatment of various aspects of the MAD and associated issues related to market abuse, as it has identified further market-facing work that may merit further guidance in order to achieve harmonised application of the Directive. The aim will be to establish, if possible, further guidance for CESR Members and/or the market which will add value to the provisions of the Level 1 and 2 Directives/Regulation and accompanying recitals.

CESR-Pol will also provide technical assistance to the European Commission, when specifically mandated, on the functioning of the market abuse legal framework. The technical advice

of CESR will be used in preparation of the Commission's report on the operation of the MAD, which is due at the end of 2008.

Furthermore, CESR-Pol will continue its efforts to tackle enforcement cases in the area of market abuse with cross-border relevance. It will also continue its dialogue and collaboration on non-cooperative jurisdictions with other bodies that are affected by similar co-operation difficulties in order to exchange views and experiences. It will also take steps on a bilateral and multilateral basis in relation to non-cooperative jurisdictions with the aim of fostering common understanding of the need to co-operate closely and to improve the situation in such jurisdictions.



'As markets and trade evolve, the need for greater co-operation amongst supervisors increases to ensure new distribution channels can function effectively'.

06 EXPERT GROUPS

6.1 CESR-Tech

Mandate of CESR-Tech

CESR established CESR-Tech in May 2006 in order to strengthen its information technology governance structure. The Expert group enables CESR to work on IT projects that CESR undertakes in conjunction with its Members. CESR-Tech is chaired by Ari Voipio, Senior Advisor at Rahoitustarkastus, Finland and supported by a member of the secretariat, Nicolas Vasse, IT Director, who acts as rapporteur. CESR-Tech was established to deal with any form of pan-EU IT project stemming from EU legislation (either current, or future) and any other area where CESR Members consider it necessary or useful to work together on IT issues. CESR-Tech is composed of senior rep-

resentatives of CESR Members who have experience, knowledge and expertise in IT project management, financial markets, and supervisory related issues.

The main tasks of CESR-Tech are:

- Allocation and use of IT budget on a 'project by project' basis;
- Operational issues related to the management and running of IT projects;
- Technical issues that arise during the course of specific projects;
- Setting up of an operational working method necessary to achieve its objectives.



Chair's message

Ari Voipio, Senior Advisor
at Rahoitustarkastus, Finland

“CESR and its Members face new challenges as the operators of new Europe-wide IT systems. The first CESR-Tech project was a success. The TREM system went live on 1 November 2007. The success of the project demonstrated that CESR was able to assume a new operational role in the area of IT. This new role has been and still is a learning process for CESR. We have implemented a new governance structure to share responsibilities and new ways to cooperate. As the chairman of CESR-Tech, I am proud of our achievements and look confidently towards future projects which seem to be as challenging as the first. I wish to thank as well my predecessor, Hector Sants, for these achievements. We have not only built a system to exchange transaction reports, but a real network for information sharing. I am certain it will bring benefits to CESR Members in the coming years.”

The TREM project

The first task of CESR-Tech was to conduct a major pan-European IT project: Transaction Reporting Exchange Mechanism, TREM. The aim of the TREM project was to implement a system to interchange transaction reports between CESR Members in accordance with Article 25 of MiFID. The project started in June 2006 and MiFID set a fixed deadline of 1 November 2007 for the system to be up and running.

The main tasks of the project team were to specify the content of the reports to be exchanged between competent authorities, to set up a file server to exchange data and to define the technical arrangements to be implemented by CESR Members. In April 2007, all CESR Members committed themselves to a common interface specification document on how to connect to the system.

Meanwhile, a central file server, called the HUB, was set up and tested by the 29 Members. All CESR Members demonstrated their ability to exchange files in June 2007.

In July 2007, the testing phase of TREM was launched. To ensure the quality and homogeneity of the 29 systems, the testing phase contained three kinds of stages:

- a unit test stage where CESR Members used samples to test files against the HUB;
- group test stages, which consisted of testing the interchange in small groups of authorities;
- two acceptance tests, conducted in October, to test the system with all Members during a simulated regular trading day.

Training seminars

One of the keys to the success of the TREM project was the organisation of a number of training seminars for CESR Members. The first seminar was an executive briefing held in November 2006 in Paris. The purpose was to

inform CESR Members of the practical steps they needed to take in order to connect their national transaction reporting systems to TREM. A second seminar was organised in February 2007 in Paris to discuss practical issues related to the implementation. The last seminar, in June, focused on the testing of the system. It was kindly hosted by the CNVM (Comisia Nationala a Valorilor Mobiliare) in Bucharest. The seminars were very well received with more than 60 participants in each.

Consultations and coding standards

CESR-Tech ran in December 2006 a consultation on coding standards (Ref. CESR/06-648b) for the exchange between CESR Members. It was felt useful to consult the industry on this aspect of the system since the choices for TREM were bound to influence the choices to be made in national transaction reporting.

The discussions with industry representatives confirmed the concept proposed but raised two practical issues with the intended arrangements. CESR-Tech started to work with a number of industry representatives led by the Federation of European Securities Exchanges (FESE) to identify solutions to these issues. In October 2007, CESR published new arrangements for transaction reporting (Ref. CESR/07-627b):

- The market operators for the non-securities derivatives regulated markets committed themselves to reporting trading on their markets to the local regulator. They assumed the role of an alternative reporting channel. In this context securities derivatives were defined as derivatives that have shares, bonds or similar securities directly or indirectly as underlying. Other derivatives are non-securities derivatives.
- An alternative method was introduced for the identification of securities derivatives on some derivatives markets. The new identification is based on a number

of fields rather than a single identifier. In order to facilitate communication they are commonly called the Alternative Instrument Identifier (AII).

CESR will review these arrangements in three years' time or earlier where appropriate e.g. because of changes in MiFID or its implementing measures.

The first three months of TREM

During the course of November, December and January, the TREM system has been shown to work reliably. CESR Members have exchanged on average 50 million transaction reports per month and are expecting to exchange approximately one billion transaction reports annually, once the exchange reaches its full volume. In parallel, CESR-Tech has launched a TREM User Network for CESR Members. The network assesses the quality of data exchanged among regulators and works on ways to improve it.

Next steps

The next steps will be to carry out in 2008 two new projects to enhance reliability, coverage and accuracy of the TREM system:

- the implementation of an application to exchange instruments' reference data on all instruments admitted to trading on regulated markets. This will enable the regulators to define precisely the relevant authority for all instruments; and
- the adaptation of TREM to exchange transaction reports using the Alternative Instrument Identifier.

Statistics of the meetings

CESR-Tech met ten times during the reporting period.

6.2 ECONET

Mandate of the ECONET

ECONET was established in June 2006 in order to facilitate the ability of CESR to meet an increasing number of reporting commitments to European bodies that require the input of financial economists, and to evaluate and, as appropriate, develop CESR's approach to the use of Impact Analysis. This group is chaired by Alexis Pilavios, Chairman of the Hellenic Capital Markets Commission, and assisted by a member of the secretariat, Alexandra Berketi, Senior Officer.

The objectives of ECONET are to:

- enhance CESR's ability to undertake economic analysis of market trends and key risks in the securities markets that are, or may become, of particular significance for its Members;
- review existing impact analysis methodologies regarding financial regulation and supervision, evaluate the feasibility of

developing such a methodology for use in CESR's work, and develop practical impact assessment principles and methods for use on a case by case basis by CESR.



Chair's message

Alexis Pilavios, Chairman of
Capital Markets Commission, Greece

"2007 was a very active and fruitful year for ECONET, which I have the pleasure to Chair. Firstly, ECONET aligned the 3L3 Committees with the European Commission's commitment to a better regulation agenda that includes Impact Assessments. During the year, ECONET drafted, tested, consulted upon and finalised the common 3L3 approach to Impact Assessment (IA). The 3L3 IA Guidelines are now fully operational, ensuring that anticipated side effects of any new policy initiatives will be properly addressed, assessed and taken into account.

Secondly, ECONET continued to carry out work to facilitate the ability of CESR to meet its increasing number of reporting requirements to EU institutions. More specifically, ECONET provided several updates to the European Financial Committee that dealt with market developments and risks in the securities markets; it submitted reports that analyse the risks involved in the hedge fund industry and it delivered a discussion paper, which analysed issues arising from structural developments as a result of mergers and acquisitions of markets and infrastructures.

Furthermore, during 2007 ECONET drafted and published a fact book on the market structure and on the type and nature of the financial supervision within CESR which analyses, albeit at a fixed point in time, the market structure of the 29 CESR Members and ascertains in a comprehensive way the regulatory structure of the membership as well as the types of supervisor.

In addition, in collaboration with World Bank's administered program "Convergence", ECONET provided training on the application of Impact Assessment methodology to officials of central banks and governmental authorities of ten South Eastern European countries.

Finally, ECONET IA experts were heavily involved in the Impact Assessment training organised by the 3L3 Committees in October 2007, and in December 2007 they gave a 2-day internal seminar for those of their colleagues with less experience in IA application in order to enhance CESR's pool of IA Experts."

Reporting to the April 2007 FST/EFC

In March 2007 ECONET submitted to the April 2007 Financial Stability Table of the European Financial Committee the following documents (Ref. CESR/07-151):

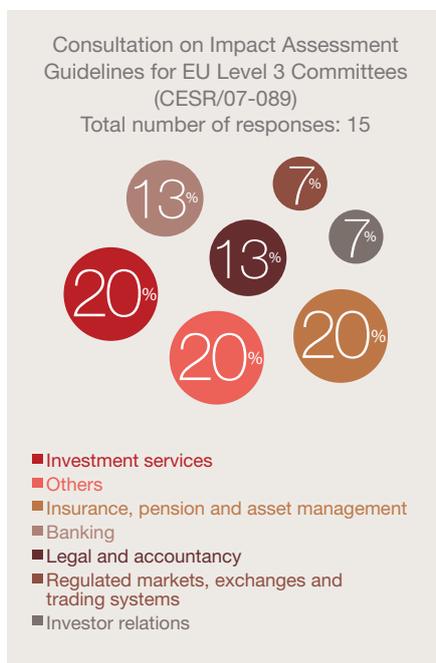
- “An update on major trends, developments and risks in EU Securities markets”, which analysed in particular the trends and risks in the EU equity markets, the credit derivative markets, the private equity and the hedge funds industry; and
- “A review on hedge funds classification systems according to their investment strategies”, which showed some significant degree of heterogeneity in current classification practices covered by data providers.

Impact Assessment (IA) Guidelines – Consultation & Pilot study

In April 2007, the 3L3 Chairs approved the IA Guidelines as a 3L3 draft document subject to a three-month consultation with the industry and also to testing the IA approach via pilot studies conducted separately by each Committee.

a Finalisation of IA Guidelines based on consultation results

The consultation period of the IA Guidelines ran from May to August 2007 and over a dozen responses were received (Ref. CESR/07-089). These came from a variety of industry associations including representatives of the banking, securities, insurance and pensions industries. Securities dealers and exchanges were particularly well represented. The comments received from market participants during the consultation were very encouraging. All respondents welcomed the 3L3 Committees’ initiative to draft a set of IA Guidelines for use by financial regulators.



The issues which were particularly prominent in the majority of consultation responses concerned the governance and quality control, and the timing of stakeholder involvement. Regarding governance and quality control issues, the case was made by market participants for the conduct of IA to be placed in the hands of independent experts, to be subject to independent scrutiny and challenged by a panel of IA experts and/or senior decision-makers. It was also suggested that an explanation should be given in situations where the results of an IA exercise have been ignored by policy-makers.

ECONET recognised the importance of having effective governance and quality control arrangements in place in order to ensure that IA exercises make a genuine contribution to the policy-making process. Therefore, the revised Guidelines clarified that the soundness and independence of IA exercises will be safeguarded by (a) the involvement of IA experts from within the L3 Committees but who are independent of the Committees’ relevant policy-making expert groups, (b) the various panels of stakeholder groups that assist the L3 Committees, and

which are always invited to comment during the policy-making process, and (c) the process of public consultation. Finally, the revised Guidelines propose to 3L3 Committees to justify a policy decision that deviates markedly from the findings of an IA exercise.

Regarding the timing of stakeholder involvement, market participants highlighted the importance of involving industry and other stakeholders throughout the impact assessment process and giving due weight to the importance of informal consultation with stakeholders.

ECONET recognised the importance of involving stakeholders in the IA process both formally and informally. The Guidelines have been revised accordingly.

b Finalisation of IA Guidelines based on feedback received by policy-makers conducting CESR’s pilot study

In January 2007, CESR committed to test the effectiveness of the IA Guidelines in the process of its review of the Simplified Prospectus for UCITS. The CESR pilot began in spring 2007 with the formation of the Key Investor Information (KII) working group, charged with considering how to address the shortcomings of the Simplified Prospectus identified by the European Commission as part of its review of the UCITS Directive. A consultation paper that included the IA was published in October 2007 (Ref. CESR/07-669).

According to written feedback received from the KII Expert Group, the policy-makers involved followed the steps in the IA Guidelines without difficulty and confirmed that the Guidelines were particularly helpful in providing them with a checklist of steps and questions that ensured that they did not inadvertently ignore material issues. In addition, the flexibility of the Guidelines was appreciated, given timing and resource constraints. Finally, the advice and guidance provided by the nominated ECONET IA experts, as envisaged in the IA Guidelines, was considered very helpful.

Factbook on Market Structure and on the Type and Nature of the Financial Supervision within CESR

At the January 2007 CESR Plenary, it was proposed that CESR should, as part of its June 2007 Lamfalussy Review, create a factbook on CESR Members' market structures. The compilation of this factbook was assigned to ECONET.

ECONET reviewed and collated the responses received by the CESR membership. The objective of the review was to be factual and informative. It aimed to present in a concise way certain aspects of the market structure of the 29 CESR Members and to ascertain the regulatory structure of the membership as well as the type of supervisor that they are. The review was published on CESR's website in autumn 2007 (Ref. CESR/07-306).

Reporting to September 2007 FST/EFC

In August 2007, ECONET submitted to the September 2007 Financial Stability Table of the European Financial Committee the following documents (Ref. CESR/07-516):

- "An update on major trends, developments and risks in the securities markets during the 1st half of 2007", which analysed in particular the trends and risks in the EU equity markets, the bond markets, the private equity and the hedge funds industry and
- "A report on the structural developments in the securities markets" which discussed a number of aspects that arise from the structural developments that have occurred in the securities markets as a result of mergers and acquisitions of markets and infrastructures.

ECONET's Training Provision to Members

In December 2007, ECONET organised a two-day IA seminar for its members in order to enhance its IA Experts' knowledge and facilitate the future work of the IA Experts in CESR's (and possibly the other L3 Committees) policy-making groups.

ECONET IA experts were also heavily involved in the 3L3 IA training organised by BaFin in October.

Promotion of the 3L3 Impact Assessment Guidelines

ECONET promoted the IA Guidelines in South Eastern European (SEE) countries in co-operation with the World Bank's "Convergence" program, the aim of which is to contribute to financial sector modernisation in the countries concerned.

Three major events took place during 2007; one in Ljubljana (Slovenia) in September 2007 with the participation of officials of central banks and governmental authorities from 10 SEE countries; one in Sofia (Bulgaria) in mid-November 2007 and one in Tirana (Albania) at the end of January 2008. ECONET presented the 3L3 IA Guidelines at the aforementioned events and the World Bank representatives are now using the 3L3 IA framework to conduct their IA work in these countries.

ECONET'S overview of major economic trends and risks in 2007

ECONET has given its views on the major economic trends and risks that affected the markets in 2007 in Chapter 1 of this annual report.

Statistics of the meetings

ECONET met five times during 2007 and held one conference call. ECONET's subgroup on IA met four times in 2007.

Next steps

Reporting to European financial institutions

Over the course of 2008, ECONET is expected to submit three reports to the Financial Stability Table (FST) of the European Financial Committee on topics mandated by the FST. These reports will mainly deal with current market developments and risks in the securities markets with a particular emphasis on the US subprime loans' market crisis. The reports are expected to be delivered in February, March and August 2008 respectively.

In addition, ECONET is expected to provide feedback and comments to two discussion papers of the Financial Services Committee (FSC) that deal with the recent developments in financial markets and with the European non-regulated debt markets respectively. Both responses are expected to be delivered in February 2008.

Work on Impact Assessment

ECONET will work on finalising and publishing the IA guidelines and the associated feedback statement.

ECONET will advise CESR's and CEBS' Joint Task Force on Commodities on the application of the 3L3 IA methodology in the policy-making work they do for the Commission.

Impact Assessment Training

ECONET will provide, upon request, IA training to members of Expert Groups and to members of the CESR Secretariat involved in coordination of such Groups.

6.3 Investment Management

Mandate of the Investment Management Expert Group

The work is carried forward by an Expert Group chaired by Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione Nazionale per le Società e la Borsa (CONSOB). The Group is assisted by Patrice Debono, Senior Officer, and Richard Stobo, Officer, at the CESR secretariat.

The mandate (Ref. CESR/04-160) and work programme for the Group was approved by

CESR in June 2004. Drawing heavily on the responses from a consultation on “The role of CESR in the regulation and supervision of UCITS and asset management in the EU”, and the needs expressed by market stakeholders, it was decided that the short-term priority of the group would be to focus on ensuring that the single market on investment funds is fully functional.



Chair's message

Lamberto Cardia,
Chairman of the CONSOB, Italy

“This year the Expert Group has continued its work to improve the functioning of the current UCITS Directive, while focusing increasingly on assisting the Commission in its work to revise the Directive.

The Group brought to an end its work on eligible assets of UCITS through publication of two sets of Level 3 Guidelines: the first on eligible assets of UCITS, the second on the classification of hedge fund indices as financial indices. These were both important pieces of work designed to bring further clarity and consistency to the application of the Commission's Level 2 implementing Directive.

In response to the Commission's request for assistance, the Group has worked intensively to prepare a set of recommendations on the content and form of key investor information disclosures for UCITS. Increasing investor confidence amongst EU citizens is a high priority

for CESR. Enabling retail investors to distinguish the key information that they should consider when buying a UCITS will ensure they are better placed to make informed decisions. The Group has greatly appreciated the willingness of retail investor associations and market participants across the EU to invest time in providing very useful feedback as we have developed our proposals. The next phase of wider market testing, funded by the European Commission, should produce very worthwhile results and we look forward to working closely with the Commission on the outcomes of that exercise.

The group has also been working increasingly at fostering mutual understanding of supervisory practices and convergence in the day-to-day application of rules, which both the Commission and CESR believe are crucial issues with a view to building a fully integrated European market for UCITS.”

CESR Members adopt common supervisory approaches for the new regime of eligible assets for UCITS

On 19 March 2007 CESR published its final Level 3 guidelines on eligible assets of UCITS (Ref. CESR/07-044). The publication of CESR's Guidelines coincided with the adoption by the Commission of a Level 2 implementing Directive (Directive 2007/16/EC, the "Eligible Assets Directive" or EAD). These measures will help remove uncertainty as to whether UCITS can properly invest in categories of financial instruments, including transferable securities, money market instruments, derivative instruments and financial indices.

The Level 3 CESR Guidelines are part of CESR's advice to the European Commission adopted in January 2006 (Ref. CESR/06-005, together with a feedback statement, Ref. CESR/06-013) regarding the clarification of definitions concerning eligible assets for investments of UCITS. The advice was submitted to two rounds of consultation. CESR did not consider it necessary to consult again on the Level 3 Guidelines as the changes made were not substantial and were necessary in order to align the Guidelines with the EAD.

The CESR Guidelines are meant to foster supervisory convergence in the day-to-day application by national authorities of the criteria set out in the EAD and to ensure their consistent implementation.

CESR undertakes further work on eligibility of hedge fund indices for UCITS

When publishing its advice to the European Commission on clarification of the definition concerning eligible assets for investments by UCITS, CESR concluded that it needed to consider further whether or not hedge fund indices could be considered eligible investments for UCITS. This was in light of the fact that the impact of such instruments

raised questions about the risk profile of the UCITS, and the ability of retail investors to assess this impact.

CESR adopts common supervisory approaches concerning the classification of hedge fund indices as financial indices for the purposes of the UCITS Directive

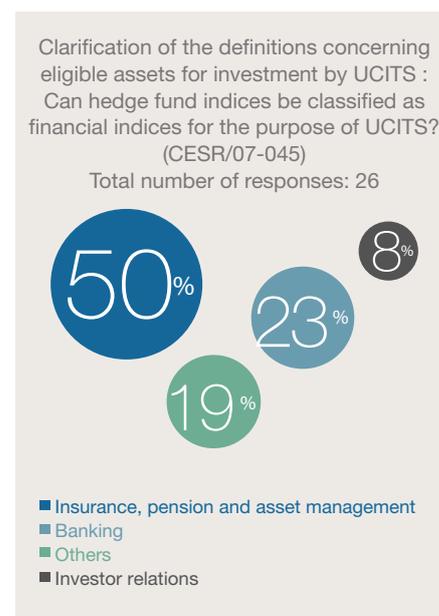
On 17 July 2007 CESR published its final Level 3 Guidelines on the classification of hedge fund indices as financial indices (Ref. CESR/07-434), with a feedback statement (Ref. CESR/07-433). The advice involves the adoption of common supervisory approaches concerning the classification of hedge fund indices as financial indices for the purpose of the UCITS Directive.

The classification of hedge fund indices was tackled by CESR in two preliminary public consultations on the Guidelines concerning eligible assets for investment by UCITS, but due to the complexity of the topic and the relatively new nature of such indices, CESR decided that further, in-depth consultation was needed to reach a conclusion.

In order to obtain additional input to the debate on eligible assets under the UCITS Directive in relation to the inclusion of hedge fund indices, CESR published two papers: an issues paper – "Can hedge fund indices be classified as financial indices for the purpose of UCITS?" (Ref. CESR/06-530, October 2006), and a consultation paper – "Clarification of the definitions concerning eligible assets for investment by UCITS: can hedge fund indices be classified as financial indices for the purpose of UCITS?" (Ref. CESR/07-045, February 2007). An open hearing was also held in Paris in April 2007.

CESR considers that in order to fall under the classification of a "financial index" as referred to by the UCITS Directive, hedge fund indices must comply with the criteria applicable to common financial indices provided by Article

9 of the EAD as regards the degree of diversification, the market to which they refer and the way they are published, but also have to fulfil additional requirements as regards methodology and information disclosure. The selection has to be made on the basis of pre-determined rules and objective criteria, it must not be influenced by any payments made to the provider, and the methodology must ban any "backfilling" practice (namely any retrospective changes to previously published index values). Furthermore, the Guidelines set out additional checks to be completed by UCITS which consider gaining exposure to hedge fund indices, as regards the comprehensiveness of the methodology, the availability of information and the treatment of index components.



CESR makes progress in response to Commission request for assistance on key investor disclosures for UCITS

The UCITS Directive (85/611/EEC) requires the use of the simplified prospectus (SP) for the purpose of informing clients before they invest in a UCITS. The current content and format of the SP is considered not to have achieved its initial objectives, since these documents are

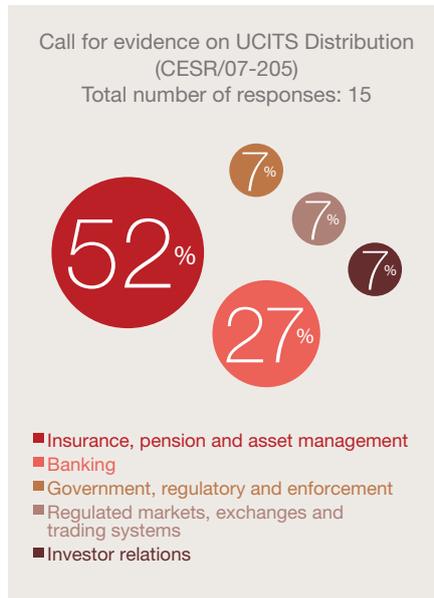
often overly long and technical, and difficult for the average investor to understand and use.

On 11 April 2007, CESR received from the Commission a letter requesting CESR's assistance on the detailed content and form of key investor disclosures for UCITS. The letter clarifies the purpose and objective of the request, the focus of the work to be undertaken by CESR, the proposed organisation of the work and the timetable. CESR invited all interested parties to submit their views regarding the request for assistance received from the Commission, via the following calls for evidence: Call for evidence on UCITS distribution (Ref. CESR/07-205); a further Call for evidence on Key investor disclosures for UCITS (Ref. CESR/07-241); and a Questionnaire on simplified prospectus for retail investors (Ref. CESR/07-214). All three documents were published on 13 April 2007.

In light of responses to the call for evidence, CESR prepared a consultation paper (CP) on its draft advice to the Commission on Key Investor Information (KII) disclosures (Ref. CESR/07-669).

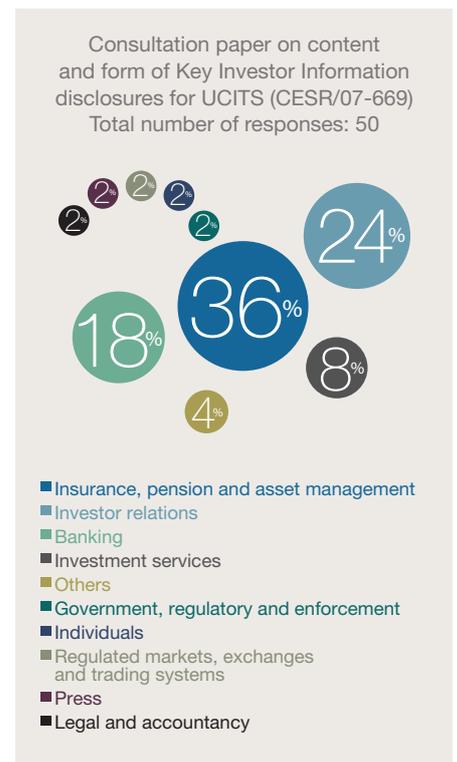
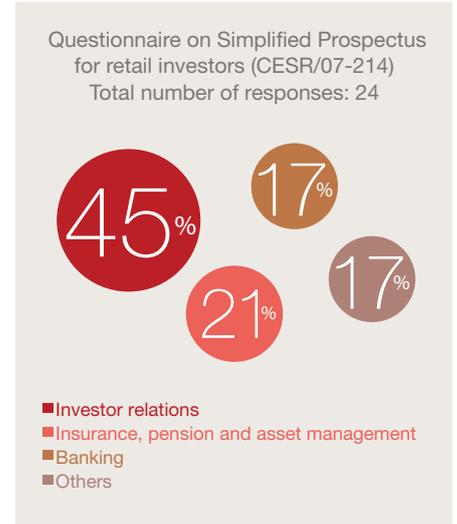
The CP set out CESR's proposals in five key areas: the format and content of the KII; objective and strategy of the fund; risk/reward disclosure; past performance and charges. Some of the key proposals set out in the consultation paper included:

- KII should take the form of a two page document format (i.e. two sides of A4) that includes a standardised core content (list of permitted content in a fixed order and hierarchy). Certain modifications are required when KII is provided for funds of funds, umbrella funds or funds with multiple share classes.
- Information about the fund's investment objectives and strategy should be presented jointly.
- Two high-level approaches regarding the relationship between risk and reward:



1. one which is based on a purely narrative description of risks, and

2. one which uses a synthetic indicator to evaluate the level of risk and potential reward that investment in the fund would represent. The draft consultation paper proposed a set of criteria which might be used to identify or develop a common methodology at European level, to be built either by regulators or by industry participants. The issue was to be further discussed within the Expert Group following the outcome of the consultation.



- The fund's past performance should be included in the KII; a set of presentation and calculation guidelines was proposed.
- Two options for presentation of fund charges:
 1. the first would be an improved version of the existing simplified prospectus disclosure;

2. the other would give the same information plus a single “summary” figure.

The consultation ran until 17 December 2007 and CESR received 51 responses. There was broad support among stakeholders for the general approach taken by CESR, although conflicting views were expressed in relation to risk/reward disclosure in particular. An Open Hearing was also held at the CESR premises on 23 November 2007 at which attendees debated a wide range of issues covered in the CP. Taking into account responses to the consultation, views expressed at the Open Hearing and wider discussions with relevant stakeholders, CESR will finalise its advice to the Commission ahead of a market testing exercise to be carried out during 2008.

CESR has also identified a number of areas arising from its advice on which further technical work is required, in particular on aspects of risk/reward disclosure, past performance and charges.

Statistics of the meetings

During the period covered by this report, the Investment Management Expert Group met five times; the Operational Task Force met seven times; and the Key Investor Information Sub-group met on six occasions.

Next Steps

The CESR Investment Management Expert Group and its sub-groups will focus on the following in the year ahead:

- Providing assistance to the Commission on the proposed changes to the Level 1 Directive, in particular by delivering a set of advice on key investor information (KII) disclosures for UCITS. CESR will continue to work closely with the Commission during the market testing phase of the KII work.
- Promoting supervisory co-operation and mutual understanding via the Group's Operational Task Force, on the basis of surveys on effective supervision and risk measurement systems, but also through practical discussions relating to the day-to-day application of rules, in particular in the areas of eligible assets and innovative products.
- Carrying out further work on the interaction between MiFID and UCITS, in parallel with the Commission's work.

6.4 MiFID

Mandate of the MiFID Level 3 Expert Group

The MiFID Level 3 Expert Group undertakes work to deliver supervisory convergence in the day-to-day application of the legislation (i.e. Level 3). This group is chaired by Jean-Paul Servais, Chairman of the Managing Committee of the Belgian CBFA. The rapporteur for this group at the CESR secretariat is Carlo Comporti (formerly Director of Markets and Intermediaries).

There are two working sub-groups reporting to the MiFID Level 3 Expert Group:

- the 'Intermediaries Sub-group' is chaired by María José Gómez Yubero, Director for Investors at the Comisión Nacional del Mercado de Valores (CNMV), Spain's

securities supervisor. The rapporteur of the 'Intermediaries Sub-group' is Diego Escanero, Senior Officer at the CESR secretariat;

- the 'Markets Sub-group', chaired by Hans Wolters, Head of Policy at the Autoriteit Financiële Markten, The Netherlands' securities supervisor. The rapporteur of the 'Markets Sub-group' is Eija Holttinen, Senior Officer at the CESR secretariat.

CESR has also formed a MiFID Consultative Working Group which draws together technical experts from the markets and industry practitioners with expertise in the various sectors

covered by MiFID to provide advice on the technical practicalities of the guidance developed under the work programme. A list of its members is available on the CESR website.

Finally, a number of MiFID Implementation fora were organised in 2007 to enable the exchange of information between Members on the practical implementation of MiFID across Europe.



Chair's message

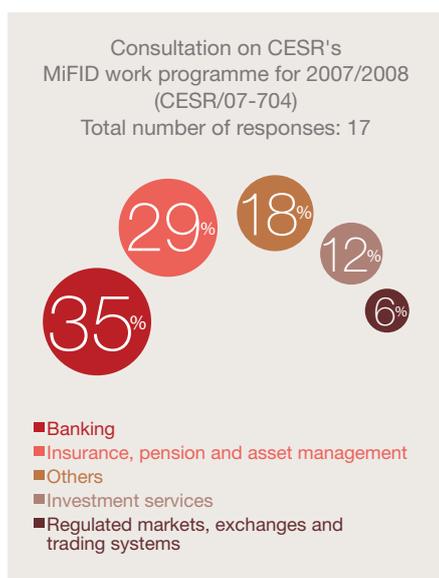
Jean Paul Servais, Chair of the CESR MiFID Level 3 Expert Group and Chairman of the Belgian CBFA

"The arrival of the MiFID implementation deadline in November made 2007 a significant year for all involved – industry, investors and regulators alike. The MiFID Expert Group has worked hard to ensure the smooth implementation of the new regime, putting in place a comprehensive set of practical measures to support this goal, including extensive work on the passport and the development of a framework for more effective supervision of branches. As MiFID beds in, we will continue to work together to share our supervisory experiences and foster co-operation, and I am confident that we can build on our successful work to date to provide market participants with greater certainty and confidence."

During the period January 2007 – January 2008, the MiFID Level 3 Expert Group focused its efforts on fulfilling the work programme adopted in October 2006 (Ref. CESR/07-550b). The work programme, which was established on the basis of the priorities proposed by market participants themselves, identified the areas where CESR would seek to encourage supervisory convergence among Member States, so as to provide market participants with greater certainty when adopting pan-European measures to meet the requirements set out in the new legislation.

This work led to the publication of several guidelines and protocols designed to consolidate supervisory convergence in the run-up to the MiFID implementation deadline of 1 November 2007. Key developments are detailed below. Furthermore CESR organised several sessions (Implementation fora) to coordinate the work of national competent authorities in the first phase of transposition and implementation of the new rules. Following these meetings CESR published a list of national options and discretion exercised at national level.

In October 2007, building on the successful completion of this work, CESR published a draft follow-up MiFID Level 3 work programme for the period through to December 2008 (Ref. CESR/07-704).



This sets the direction for the work of the MiFID Level 3 Expert Group over the coming months, and includes:

- 1 mandates issued by the European Commission;
- 2 establishment of a CESR MiFID Q&A;
- 3 thematic work;
- 4 supervisory work;
- 5 on-going technical work for the application of the Level 2 regulation on Markets;
- 6 co-operation with other committees of regulators.

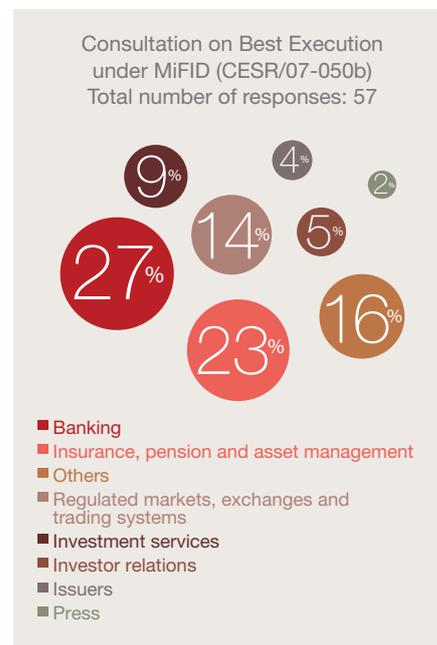
Intermediaries

Best Execution

CESR published a Question and Answer (Q&A) document on best execution (Ref. CESR/07-320), with a feedback statement (Ref. CESR/07-321) on 29 May 2007; this followed publication of a consultation paper on 2 February 2007 (Ref. CESR 07-050b). The Q&A aimed at fostering supervisory convergence and consistent implementation in the day-to-day application of the MiFID Level 1 and the MiFID Level 2 Directive requirements on best execution. MiFID's best execution requirements establish a new overarching standard that requires firms to implement a process that will enable them to obtain the best possible result for their clients' orders on a consistent basis.

This process-driven approach aims to promote two of CESR's most important objectives, namely market efficiency and investor confidence, by ensuring that investment firms will take all reasonable steps to execute their orders for the best possible result, by choosing the execution venue that appears most likely to do so.

The best execution Q&A sets out to achieve a common supervisory approach in relation to the best execution requirements. It covers in a practical manner the content of the execution arrangements, the content and degree of differentiation of the best execution policy, the possibility of using single execution venues,

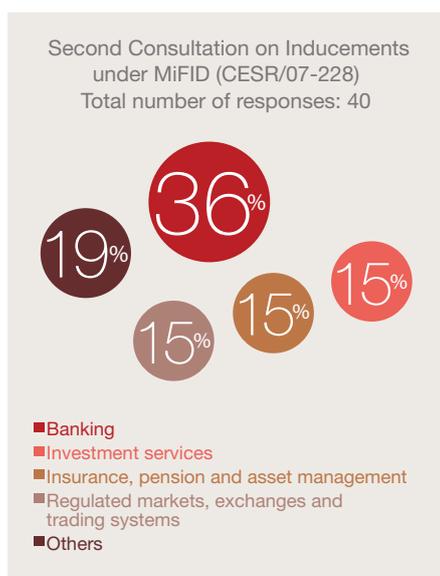


the assessment of the relative importance of the best execution factors, the notion of total consideration and fees and commissions, disclosure of information, consent, and the requirements of monitoring and review.

Inducements

CESR's Recommendations on Inducements (Ref. CESR/07-228b), published on 29 May 2007, were aimed at fostering supervisory convergence and consistent implementation in the day-to-day application of Article 26 of the MiFID Level 2 Directive. Article 26 sets out requirements in relation to the receipt or payment by an investment firm of a fee, commission or non-monetary benefit that could place the firm in a situation where it would not be acting in compliance with the principle in MiFID Article 19(1) that the firm act honestly, fairly and professionally in accordance with the best interest of its clients. The content of these Recommendations, which included a series of illustrative examples designed to help assess practical situations, reflects comments received from industry and consumer groups during the course of

two consultations (Ref. CESR/06-687 and Ref. CESR/07-228). CESR adjusted some of its views in response to significant issues raised by stakeholders both as a result of the two public consultations on inducements and the two open hearings held on 2 February 2007 and 24 April 2007.



Passporting and the Protocol on Notifications

CESR's recommendations on passporting (Ref. CESR/07-337), a feedback statement (Ref. CESR/07-318) and a protocol on notifications (Ref. CESR/07-317)²⁴, were published on 29 May 2007. The recommendations on passporting were meant to foster supervisory convergence and consistent application of the passporting provisions under MiFID. Passporting of intermediaries was identified as one of the key priorities in CESR's MiFID Level 3 work programme. The passporting recommendations set out a number of practical proposals with the aim of promoting a common supervisory approach to Article 31 and Article 32 of the MiFID in order to guarantee efficient and consistent supervision of firms' cross-border activities. The protocol on notifications provides a framework for co-operation between Competent Authorities with regard to the passport notification process for investment firms and market operators operating an MTF in the EEA under Article 31 and Article 32 of MiFID.

List of Minimum Records under Article 51(3) of the MiFID Implementing Directive

CESR's Recommendations (Ref. CESR/06-552c) and a Feedback Statement (Ref. CESR/07-085) on the List of Minimum Records under Article 51(3) of the MiFID Implementing Directive, were published on 9 February 2007.

The recommendations set out the content of the list of minimum records that competent authorities need to draw up in accordance with Article 51(3) of the MiFID Level 2 Implementing Directive (Ref. CESR/06-552c) and that investment firms have to keep.



Commodities

In March 2007, the European Commission made a request to CESR for initial assistance on commodities and exotic derivatives and related business. The first phase of CESR's response consisted of a fact-finding exercise on the regulation and operation of commodity and exotic derivatives in Member States. As part of this, CESR developed a questionnaire that asked Members to state their views on the key issues identified as well as explaining the rationale for the approach taken. The second phase of work entailed a closer focus on the areas where interpretation exists, particularly as regards the practical application of MiFID exemptions under Articles 2(1) (i) and (k) and Article 38. CESR published the report of its findings from the second phase of work on 22 October 2007 (Ref. CESR/07-673).

²⁴ A revised version of which was published in October 2007 (Ref. CESR/07-317b).

In December 2007, the European Commission issued a further Call for Technical Advice on commodities to CESR and CEBS (Ref. CESR/08-064). Delivery of this work is envisaged for Q3 2008.

Table of national discretions

As part of its efforts to encourage supervisory convergence, CESR published a summary of the different approaches taken by Member States in respect of the options and discretions embedded in the MiFID Level 1 & 2 texts (Ref. CESR/07-703). This overview is intended to assist market participants and those affected by cross-border implementation by providing greater transparency.

Supervision of Branches

On 22 October 2007, CESR published a protocol for the supervision of branches under MiFID (Ref. CESR/07-672). The protocol marked a major advance in fostering greater co-operation between CESR Members in the exercise of their core supervisory functions over entities with cross-border activities. The protocol sets out a framework for co-operation between competent authorities under two different models: (i) joint supervision conducted through common oversight programmes, and (ii) requests for assistance based on efficient allocation of supervisory tasks.

This new framework is designed to achieve effective and transparent supervision of branches of investment firms and credit institutions that provide investment services, making it easier for firms to do business across Europe and fostering competition.

Continuity of the passport (late implementation)

On 22 October 2007, CESR published a statement to give reassurance regarding the continuity of the current passports of investment firms based in the limited number of countries

that were late in transposing MiFID. This statement is contained within the revised version of the CESR recommendations on the passport under MiFID, originally published in May 2007 (Ref. CESR/07-337b). The guiding principle of the statement was to provide business continuity and minimise the potential disruption to business that might have been caused by late transposition of MiFID. Indeed, transposition after 1 November 2007 in some Member States could potentially have raised questions about the ability of firms to keep their current passports under the Investment Services Directive. The practical arrangements adopted by CESR clearly state that the passports of investment firms originating from late-implementing States continue to be valid for any branches established in other Member States and for services they provide abroad without establishment. It is also understood that firms that wish to exercise their rights under MiFID in late-implementing States are allowed to do so.

Markets

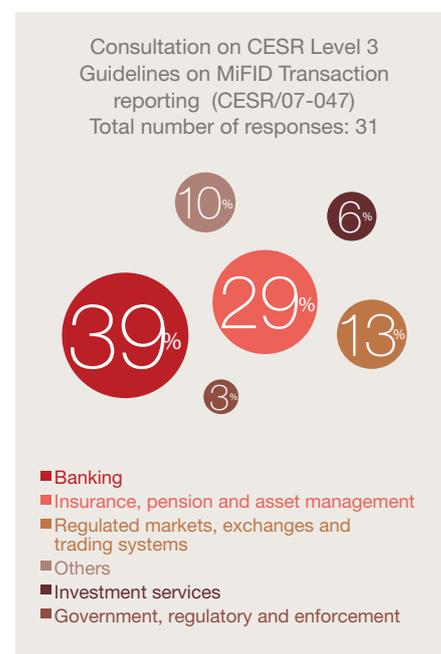
Publication and Consolidation of Market Data

CESR's guidelines and recommendations on Publication and Consolidation of Market Data (Ref. CESR/07-043) are meant to facilitate the understanding of certain requirements of the MiFID and its Implementing Regulation on publication and consolidation of market information. These guidelines and recommendations were accompanied by a feedback statement (Ref. CESR/07-086) on the Publication and Consolidation of Market Data, which was published on 9 February 2007. These measures are intended to facilitate a consistent implementation of the provisions concerned, without imposing further obligations on investment firms, MTFs or regulated markets.

Transaction Reporting

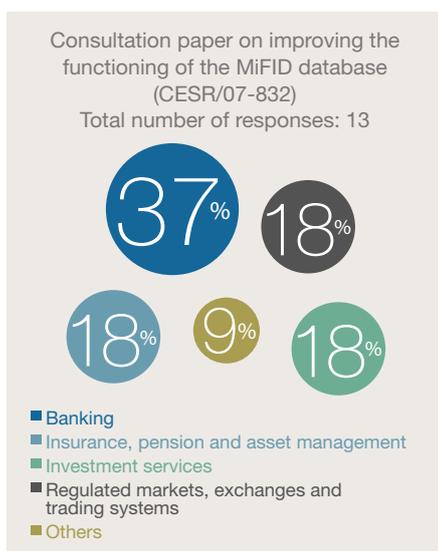
CESR Level 3 Guidelines on Transaction Reporting (Ref. CESR/07-301) and a Feedback Statement (Ref. CESR/07-319) were published on 29 May 2007. The transaction reporting regime estab-

lished by MiFID is key for CESR Members in monitoring the activities of investment firms and ensuring that they act honestly, fairly and professionally, and in a manner which promotes the integrity of the market. The reports can be made either by the investment firm itself; a third party acting on its behalf; by a trade matching or reporting system approved by the competent authority; or by the regulated market or MTF through whose systems the transaction was completed. CESR Members shall further exchange the reports between themselves through the Transaction Reporting Exchange Mechanism (TREM). This system for exchanging the data between CESR Members was implemented by CESR on 1 November 2007. The process involved a consultation paper which was published on 2 February 2007 (Ref. CESR/07-047), and an open hearing which was held on 1 March 2007. For more detail on the creation and operation of TREM, see section 6.1.



Publication of the results of MiFID market transparency calculations

The results of the MiFID market transparency calculations (Ref. CESR/07-450) were first published on 3 July 2007 and were subject to a first update in October 2007. The MiFID Implementing Regulation (No 1287/2006, of 10 August 2006) requires the relevant competent authorities to calculate and publish a set of information regarding all shares which are admitted to trading on a regulated market. CESR collects this information and publishes it in the form of a database. The information included in the database allows market participants to recognise liquid shares (which trigger the obligations for systematic internalisers according to Article 27) and to determine the block sizes for waivers from pre-trade transparency requirements and delayed post-trade publication. Since the beginning of November, the database has been continuously updated by CESR Members. The first annual update, including a recalculation of the data for all shares admitted to trading on regulated markets, and the addition of new functions following a consultation with market participants (Ref. CESR/07-832), will be made on 3 March 2008.



The information can be accessed through CESR's website on the following address <http://mifidatabase.cesr.eu>.

Non-Equities Transparency

On 17 November 2006, CESR published its response to the Commission's request for initial assistance on non-equities markets transparency (Ref. CESR/06-599). On 9 August 2007, CESR published its technical advice to the Commission on the potential extension of the market transparency obligations to financial instruments other than shares (Ref. CESR/07-284b). This work is conducted under Article 65 of MiFID under which the Commission is asked to report to the European Parliament and to the Council on the possible extension of the scope of the provisions of the Directive concerning pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares.

In terms of non-equities transparency, CESR concluded that it had not identified a clear market failure in relation to market transparency which would warrant mandatory transparency for bonds. However, some re-distribution of the existing transparency information could be useful to help retail participants. CESR also recognised that there were market-led initiatives planned in this direction. CESR proposed that the progress of these initiatives should be followed and their effect evaluated before considering any possible regulatory action. CESR's response was prepared in close co-operation with different markets participants including a call for evidence – non-equities markets transparency, which was issued on 6 February 2007 (Ref. CESR/07-108). A consultation paper – Non-Equity Transparency, was published on 10 May 2007, (Ref. CESR/07-284), and a Feedback Statement – Technical Advice on Non-equities transparency, was published on 9 August 2007 (Ref. CESR/07-538).

Statistics of the meetings

During the period covered by this report, the MiFID Level 3 Expert Group met 5 times; the Intermediaries Sub-group met 10 times; and the Markets Sub-group met on 7 occasions.



Next Steps

CESR has developed a Consumer Guide to MiFID, which is due to be published in March 2008. The guide is written in plain language and provides an easy-to-follow summary of the main consumer protections available under MiFID. Members will be free to translate the guide into their national languages.

As discussed above, in October 2007 CESR published its draft MiFID Level 3 work programme for the period through to December 2008 (Ref. CESR/07-704), setting the direction for the work of the MiFID Level 3 Expert Group over the coming year.

6.5 Post-trading

Mandate of the Post Trading Expert Group

The Post-Trading Expert Group (PTEG), consisting of experts from CESR Members, was created on the basis of a decision by the CESR Chairs in May 2007, in light of the number of on-going developments in the area of post-trading relevant to CESR and its Members.

The activities of the PTEG are focused on: (1) contributing on behalf of CESR as a member of the Monitoring Group in the context of the Code of Conduct, (2) closely monitoring on

behalf of CESR the developments of the T2S project as an observer in the Advisory Group and (3) acting as a platform for the exchange of information and expertise among CESR Members,

The Post-Trading Expert Group is chaired by Istvan Farkas, Chairman of the Hungarian FSA, and supported at the CESR Secretariat by Wim Moeliker, Senior Officer. The European Commission participates at the meetings of the group as an observer.



Chair's message

Istvan Farkas, Chair of the CESR Post-Trading Expert Group and Chairman of the Hungarian FSA

“The second half of 2007 showed an increasing activity by both industry and public authorities for various post trading initiatives going on. The provisions of MiFID facilitating access to infrastructure providers that entered into force on the first of November proved to enhance competition in the area of post-trading in the EU. For the PTEG, the main issues under discussion were the definition of a role for securities regulators and CESR in monitoring compliance by signatories of part III of the Code of Conduct in the areas of unbundling and accounting separation and to prepare and to share views among members on the ESCB-project of TARGET 2 for Securities.”

After the adoption of the Code of Conduct by the infrastructure providers in November 2006, 2007 was used by the signatories of this self-regulatory initiative to initiate a phased implementation with regard to price transparency (1 January 2007), access and interoperability (1 July 2007) and unbundling of services and accounting separation (1 January 2008) respectively. To monitor implementation of the Code, the Commission set up the Monitoring Group of the Code of Conduct on Clearing and Settlement, composed of public authorities in this area, including CESR, and chaired by the Commission.

In view of MiFID provisions on access to providers of post-trading infrastructure entering into force in November 2007, the implementation of part II of the Code on access and interoperability and a growing number of cross-border requests for access to infrastructure providers in the EU, the PTEG started a process to map existing arrangements for access and interoperability in the various jurisdictions.

Additionally, in preparation for CESR's contribution to the Monitoring Group, the PTEG defined the national regulators' limited scope of intervention in the monitoring process with regard to unbundling of services and accounting separation.

CESR supported and contributed to the initiative taken by the European Commission to implement the methodology, developed by a consultancy firm, to monitor the evolution of prices, costs and volumes across the post-trading value chain in a number of financial centres to improve the basis for future policy-making in this area.

In a separate stream of work, CESR continued its participation in 2007 in CESAME, the clearing and settlement advisory and monitoring group for the Commission, with a focus on the removal of the Giovannini barriers in the area of post-trading.

In the context of TARGET 2 Securities, the ESCB project to create a single EU mechanism for the settlement of euro-denominated securities settled in central bank money, the focus of the PTEG was aimed at the possible consequences of a future transfer of the settlement function from central securities depositories in each of the jurisdictions to this central mechanism, should the project be implemented. CESR holds an observer seat in the Advisory Group of the T2S project.

At the time of establishing the PTEG, it was decided that working on the CESR/ESCB Standards was not within the scope of its mandate, given the outstanding request to EU Institutions for political guidance on the way forward. The European Commission indicated previously that the adoption of Standards would add value to other initiatives in the post-trading area. In the ECOFIN meeting of early October 2007, the Financial Services Committee was invited to deepen its work on the scope, legal basis and contents of the Standards and to propose ways forward on this subject to be submitted to the Council in early spring 2008. Should political agreement be achieved by the EU Institutions in 2008, CESR (in co-operation with the ESCB) will act accordingly.

Next steps

CESR awaits the outcome of the discussion in EU Institutions on how to go forward with the efforts taken by CESR and the ESCB in recent years to improve the safety, soundness and efficiency and to create a level playing field for post-trading arrangements operated in the EU area.

Statistics of the meetings

The Post-Trading Expert group held five meetings in the reporting period.

6.6 Prospectus

Mandate of the Prospectus Contact Group

To ratify the work conducted during 2005 by CESR prospectus experts, the Committee set up on 19 January 2006 a Prospectus Contact Group and issued the mandate this group would follow. The Prospectus Directive and the Commission's Regulation on prospectuses became effective on 1 July 2005. Regulators and market participants are facing many application and operational issues arising from the implementation of this new legal framework. This is compounded by the fact

that the Prospectus Directive is a maximum harmonisation Directive and that the scope for interaction between competent authorities has increased because of the passport. It is therefore essential to have convergent application among the competent authorities. CESR considers that, in order to achieve such convergence, it is necessary to hold practical and operational meetings of prospectus contact experts to discuss specific implementation and application issues and, to

the extent possible, agree common solutions. The Prospectus Contact Group was therefore set up to fulfil this objective. The Prospectus Contact Group is chaired by Gérard Rameix, Secretary General of the AMF, France, and supported at the CESR secretariat by Javier Ruiz del Pozo, Director of Financial Information, and Raquel García Alcubilla, Senior Officer. The European Commission also participates at the meetings of the group as an observer.



Chair's message

Gérard Rameix, Secretary
General of the AMF, France

"CESR has been very active in the area of Prospectuses over the last five years by providing advice to the European Commission on the implementing measures of the Prospectus Directive and producing Level 3 recommendations for the consistent application of the Prospectus legislation.

After completion of these tasks, there has been a strong call from market participants for the establishment within CESR of a method of exchanging views on implementation problems and ideas, and the development and sharing of daily operational and supervisory best practices between Members.

To cater for these demands, CESR has continued its work through the Prospectus Contact Group that has focused the efforts of competent authorities on ensuring supervisory convergence in the application of the new legal framework on Prospectuses that became effective on 1 July 2005. This group has focused on the simplification of procedural aspects for the correct functioning of the passport, but has also made an important effort

to reach and publish common approaches on the practical aspects put forward by market participants and regulators.

The positive response from market participants to the Q&A on prospectus that we have published and the demands for a continuous update of this guide, highlights the relevance of CESR's work on effectively reducing divergent practices in Member States and fostering a proper and consistent implementation of the European legislation on Prospectus.

To add up to this work, the Prospectus Contact Group undertook the challenging task of producing this year a report on the evaluation of the practical functioning of the Prospectus Directive and Regulation. In this report, we identified obstacles and divergent practices that pose a risk for the proper functioning of the single market and, where needed, proposed solutions. We have taken the issues identified in this report as the basis of the Prospectus Contact Group work and have been actively working towards harmonised solutions to those issues through our Q&A document".

Background

CESR has been very active in the area of prospectuses over the last five years, providing the European Commission (Commission) with technical advice on the implementing measures of the Prospectus Directive. CESR completed this initial work in 2003 and continued its activity in this area during 2004 in order to ensure the consistent application of the Prospectus legislation. To this end, the CESR expert group prepared a set of recommendations (Ref. CESR/05-054b) which gave guidance on how to produce a prospectus. In addition, in 2005 CESR delivered its advice to the Commission on how to deal with those circumstances where the historical financial information to be included in the prospectus might not sufficiently reflect the issuer's whole business throughout the required period ("complex financial histories"). In a parallel manner, CESR Members have been co-ordinating procedures to assist a seamless operation of the passport and to deliver supervisory convergence. These have contributed to the smooth functioning of the passport since 1 July 2005.

Publication of Q&A on prospectuses

The Prospectus Directive and the Commission's Regulation on prospectuses became effective on 1 July 2005. During the course of 2005 and 2006, regulators and market participants have responded to practical application and operational issues arising from the implementation of this Community framework into national law. The need for a 'common approach' is compounded by the fact that the Prospectus Directive is a maximum harmonisation Directive and that the scope for interaction between competent authorities has increased because of the passport that it provides for issuers. It is, therefore, essential for CESR Members to achieve convergence in their approaches.

To this end, prospectus experts from CESR Members have been holding practical

and operational meetings to discuss specific implementation and application issues and, to the extent necessary, agree on common solutions.

The work of this group materialised in July 2006, when CESR published a guide for market participants (Ref. CESR/06-296d). During 2007 three updates of the Prospectus Q&A were made in February, September and December (Ref. CESR/07-852). Taking these updates into account, the number of questions included in the document was 56. Some of the questions discuss several issues, whereas others provide a more in-depth analysis of complex issues.

This Q&A guide that CESR Members have developed establishes a convergent response from all EU securities supervisors to commonly asked questions on the day-to-day application of the EU legislation regarding the preparation of prospectuses. It focuses on responses to queries that are likely to have an EU-wide impact on market participants or end users, and therefore on the smooth functioning of the Single Market. Some of the agreements aim at facilitating the correct functioning of cross-border offers (for example, information from the issuers to host competent authorities or passport of the supplements). The remainder are responses to questions on the application of the legislation that have been arising frequently in most Member States (for example, supplements, incorporation by reference, free offers or interpretation on the historical financial information to include in the prospectus).

CESR does not intend to issue new standards, guidelines or recommendations on prospectuses. Rather, the purpose of this publication is to provide quick answers to the questions market participants channel to the relevant CESR Members and/or to the CESR secretariat. The common approaches reached are not set in stone. The Group operates in a way that will enable it to react efficiently if any aspects of the published 'common positions' need to be modified or adapted for greater clarity.

The European Commission Services have provided very useful input on some of the questions discussed in the paper. However,

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

Report on the evaluation of the practical functioning of the Prospectus Directive and Regulation

In addition to this effort to achieve and publish common approaches, the Prospectus Contact Group prepared a report on the supervisory functioning of the Prospectus Directive and Regulation (Ref. CESR/07-225) that was published on 13 June 2007. The objective of this report was to assess whether the new prospectus regime is achieving its objectives of protecting investors and lowering the cost of capital, and, in particular, whether it is contributing to the development of the single market for securities. The findings of the report will also contribute to the evaluation of the Lamfalussy process. In addition to the input provided by market participants, the report also included some statistical data provided by CESR Members on the number of prospectuses passported and on the transfer of the approval of prospectuses.

In general, most market participants seem to be satisfied with the new European legislation. They consider the Prospectus Directive and Regulation to be a step in the right direction in achieving a single market. Among the positive aspects of the new legislative framework, and despite the existence of a few obstacles in its practical functioning, respondents highlighted the value of the passport mechanism as a useful tool in the development of a single market. Nevertheless, they have also identified certain provisions in the Prospectus Directive and Regulation that are causing some practical difficulties and asked CESR to advise the European Commission to work on the necessary amendments.

In particular, respondents identified a number of areas where divergent practices of the different competent authorities posed some difficulties, for example, in relation to the use of certain

definitions (i.e. that of a public offer, transferable securities and qualified investors), or the use of exemptions which determine whether the obligation to produce a prospectus exists. All the issues identified by market participants are set out in section IV of the report.

As a result, market participants strongly commended CESR's Q&A on prospectuses as a means of reducing the divergent practices in Member States and strongly encouraged CESR to keep working on the development of common practices at EU level.

The findings of the report were developed following a public call for evidence in November 2006 and an open hearing which was held in January 2007.

Overview of language requirements for the scrutiny of Prospectus and requirements regarding the translation of the Summary Prospectus in CESR Members

In order to ease the functioning of the passport of prospectuses and to provide clarity for market participants in relation to the use of languages in the different competent authorities, CESR compiled the relevant information in each Member State and published in December a table (Ref. CESR/07-520) with the following information:

- Languages that each CESR member accepts when acting as home competent authority for the purpose of the scrutiny of the prospectus.
- Requirements in relation to the translation of the summary, clarifying the language(s) acceptable in each CESR Member for the translation of the summary when requested.

The information in the table will be updated, when necessary, on the basis of new information provided by CESR Members.

European Commission's request for assistance on employee share schemes

Commissioner McCreevy sent a letter to CESR in September 2007 requesting that CESR carry out work at level 3 to try to agree a short-form disclosure regime for offers to employees in those cases where a prospectus is required.

In December, CESR published a public statement (Ref. CESR/07-825) informing market participants that CESR had started its work on Employee Share Scheme Prospectuses and encouraging interested parties to send their views by 31 January 2008.

Taking into account the feedback provided by market participants, the Prospectus group has been working on this request and the outcome of the work will probably be published through an update of the Q&A document.

Mandate from the European Commission to CESR for collection of data on prospectuses approved and passported

The European Commission welcomed the statistical data included in CESR's Report on the supervisory functioning of the Prospectus Directive and Regulation (Ref. CESR/07-225) in relation to the number of prospectuses approved and passported. Thus, it proposed that CESR formalise this exercise in view of the forthcoming review of the Prospectus Directive, due by the end of 2008, and sent in July a mandate to CESR for collection of data on prospectuses approved and passported.

The Prospectus Contact Group has been working to collect this data (with a quarterly disclosure) for the period July 2006 to June 2007, and a table of the information provided by the Members will be prepared and submitted to the Commission. CESR is considering the possibility of publishing this information on its website.

Statistics of the meetings

The Prospectus Contact Group met four times during 2007.

Next steps

The CESR Prospectus Contact Group will continue to meet regularly to provide future updates of the Q&A, giving priority to those areas identified in CESR's report on the operation of the Prospectus Directive (Ref. CESR/07-225) where market participants requested CESR to ensure consistent application by its Members. 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. CESR will seek the Commission's endorsement before publishing its proposals to address this issue.

In addition, the Prospectus Contact Group intends to continue collecting statistical data on a regular basis on prospectuses approved and passported.

6.7 Credit Rating Agencies - Code of conduct

Mandate of the Credit Rating Agencies Task Force

The European Commission published on 27 July 2004 a call to CESR for technical advice on possible measures concerning credit rating agencies (CRAs); CESR submitted its advice in March 2005 (Ref. CESR/05-139b).

On 17 May 2006, CESR received a letter from the European Commission formally requesting CESR to report by the end of 2006 on credit rating agencies' compliance with the IOSCO Code. In January 2007, CESR published the requested report (Ref. CESR/06-545).

In May 2007, CESR received a letter from the European Commission asking CESR to monitor the voluntary compliance with the IOSCO code and to prepare its second report.

In September 2007, the Commission expanded its request to CESR to include an investigation whether the recent developments within structured finance would cause CESR to change its view on whether to regulate CRAs.

The work in this area is being carried forward by a task force on which nine Member States are represented. The task force is led by Ingrid Bonde, Director General of Finansinspektionen, Sweden, and supported at the CESR secretariat by Raquel García Alcubilla, Senior Officer, and Javier Ruiz del Pozo, Director of Financial Information. In addition, representatives from the Commission and from the Committee of European Banking Supervisors (CEBS) take part in the task force as observers.



Chair's message

Ingrid Bonde, Director General of Finansinspektionen, Sweden

"The voluntary framework of co-operation between CESR, IOSCO and Credit Rating Agencies has been a way to move forward in an environment where there is an absence of regulation. However, following the turmoil in the US subprime market this summer, CESR has analysed in depth the role that the CRAs play in the structured finance market. Following this analysis, CESR will need to conclude in this year's report to the European Commission whether the self-regulatory approach recommended in 2005 is still satisfactory or whether, given the new circumstances, it would be more appropriate to advise the European Commission on the need to move towards some kind of regulation in this area. In line with the usual CESR procedures, CESR will analyse in detail interested parties' views before reaching any conclusion. At this stage, CESR wishes to state that the CRAs' concerted initiatives put forward so far are not sufficient and that the rating industry response needs to be supported by further prompt and firm actions"

Background

On 30 March 2005, at the request of the European Commission, CESR delivered its advice (Ref. CESR/05-139b) regarding the potential options to regulate Credit Rating Agencies (CRAs). In its advice, CESR proposed not to regulate the Credit Rating Agencies industry at an EU level for the time being, and instead proposed that a pragmatic approach should be adopted to keep under review how CRAs would implement the standards set out in the IOSCO Code of Conduct²⁵. CESR therefore developed this strategy on the basis of voluntary participation from CRAs. Moody's, Standard and Poors', Fitch Ratings and Dominion Bond Rating Service Limited are the CRAs that have currently chosen to adhere to the voluntary framework.

In summary, this framework includes three elements: (i) an annual letter from each CRA to be sent to CESR, and made public, outlining how it has complied with the IOSCO Code and indicating any deviations from the Code; (ii) an annual meeting between CESR and the CRAs to discuss any issues related to implementation of the IOSCO Code; and (iii) CRAs would provide an explanation to the national CESR Member where any substantial incident occurs with a particular issuer in its market.

In January 2006, the European Commission published a Communication setting out its approach to Credit Rating Agencies. In line with the advice provided by CESR, the Commission concluded that at that point in time no new legislative proposals were needed. The European Commission considered that the existing financial services directives, combined with self-regulation by the CRAs on the basis of the IOSCO Code, would provide an answer to all the major issues of concern in relation to CRAs. However, the communication concluded that there was a need for the Commission to monitor the global development of the rating business and for CESR to monitor compliance-

25 <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD180.pdf>

with the IOSCO Code and to report back to the Commission on an annual basis.

On 17 May 2006, CESR received a letter from the European Commission formally requesting it to report by the end of 2006 on Credit Rating Agencies' compliance with the IOSCO Code. In its formal letter the Commission asked CESR not only to carry out the theoretical work of comparing codes, but also to assess the level of day-to-day application of the IOSCO Code in practice.

CESR's first report on the compliance of the CRAs with the IOSCO Code

In January 2007, after meeting with the CRAs in June 2006, receiving written responses from them and analysing the responses received from market participants to CESR's open survey in July 2006, CESR published its first report to the European Commission on the compliance of the CRAs with the IOSCO Code (Ref. CESR/06-545).

This was the culmination of a year's work under the voluntary framework of co-operation between CESR and the CRAs outlined on CESR's website (Ref. CESR/05-751). The report provides a clear analysis of the codes of the four CRAs that have chosen to adhere to the voluntary framework in relation to the OSCO Code.

CESR's conclusions are explained in the last section of the report. CESR considers that the CRAs' codes comply to a large extent with the IOSCO Code. There are, however, some areas or provisions where the CRAs' codes do not comply. Some of these are of minor importance, because the CRAs achieve the desired outcome that the IOSCO Code aims at, without formally having provisions in their codes that mirror the IOSCO Code (these minor deviations can be found in the analysis provided in section II).

There are, however, some areas highlighted in the last section of the report and mostly in line with those pointed out by market participants, where the deviations are of greater importance. Some of them are common to all four CRAs, and some of them are specific to individual CRAs. In particular, the area where all the CRAs seem to have difficulties in complying with the IOSCO Code relates to the separation between the rating service and the ancillary services provided by the CRAs and the disclosure of unsolicited ratings.

Questionnaire regarding the rating of structured finance instruments

On 7 May 2007, CESR received a letter from the European Commission acknowledging the usefulness of CESR's 2006 report on CRAs' compliance with the IOSCO Code and formally requesting that CESR prepare a second report by the end of 2007.

As part of the preparation for CESR's second report to the European Commission, CESR sent a letter to the four CRAs that have chosen to adhere to the voluntary framework requesting that they provide information on the changes introduced in their codes since the publication of CESR's first annual report. In their responses to CESR, the CRAs reported that for the time being no changes had been made in their internal codes. However, some CRAs explained that they intended to revisit their codes in the following months taking into account not only CESR's December 2006 report, but also the new SEC NRSRO rules²⁶ and the outcome of IOSCO's consultation report on CRAs²⁷ (which discusses potential areas for clarification of the IOSCO code).

In light of this, the European Commission agreed to CESR's suggestion to set 30 April 2008 (instead of 31 December 2007) as a new deadline for the preparation of CESR's

second annual report on CRAs, in order to allow CESR to assess the changes in the CRAs' codes when they took place.

In the meantime, CESR worked on other relevant sections of the report, and in particular on the analysis of the rating process for structured finance instruments (e.g. quality of the rating process, conflicts of interests) as specifically requested by the European Commission in its letter to CESR.

To this effect, CESR published a questionnaire in June 2007 regarding the rating of structured finance instruments (Ref. CESR/07-394). The purpose of the questionnaire was to enable CESR to gather information from interested parties on the functioning of this specific segment of the rating business. To facilitate the participation in this consultation, CESR divided the questionnaire into two sections; the first part addressed to the credit rating agencies and the second to all market participants.



²⁶ <http://www.sec.gov/divisions/marketreg/ratingagency.htm>

²⁷ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD263.pdf>

New request from the European Commission on the role of CRAs in structured finance

In September 2007, the Commission expanded its request to CESR to include an investigation whether the recent developments within structured finance would cause CESR to change its view on whether to regulate CRAs.

In particular, the Commission asked CESR to gather additional data in this year's report and provide its views about the following areas of the rating process regarding structured finance instruments:

- Transparency of CRAs' rating methodologies;
- Human resources allocated to rating and monitoring;
- Periodic monitoring of the ratings and timeliness of rating actions;
- Potential conflicts of interest (i.e. remuneration structures of CRAs).

As planned and envisaged in CESR's existing work plan, the CESR Task Force held separate hearings on 4 and 5 October with the four CRAs. During these sessions, the CRAs provided CESR with updated information on their codes of conduct, discussed the Commission's new request and expressed their views on the subprime crisis, particularly on how they intended to address any possible shortcomings in this market.

In November 2007, as a follow-up to the meetings held with rating agencies at the beginning of October and in order to obtain the necessary data to fulfil the European Commission's new request, CESR sent a letter to the CRAs asking for additional information (Ref. CESR/07-781). CESR published on its website the list of questions and the answers provided by the CRAs (except those expressly requested by the CRAs to be kept confidential) (Ref. CESR/07-831).

Consultation Paper on the Role of CRAs In Structured Finance²⁸

The main areas that CESR is considering for inclusion in its forthcoming consultation paper are the following:

- Transparency of rating processes and methodologies: In particular, the consultation will focus on the ease of investor access to information on key limitations and assumptions in complex structured finance methodologies.
- Monitoring of rating performance: CESR will seek market views on the need for regular public disclosure of structured finance rating performance and the need for CRAs to maintain sufficient resources and organisational flexibility to act promptly in reviewing structured finance ratings.
- CRA staff resourcing: CESR will also ask market participants' views on whether CRAs were adequately resourced for the volume and complexity of structured finance ratings they were producing and whether there needs to be more transparency from the CRAs over their resourcing and levels of staff experience.
- Conflicts of interest: The key focus of CESR's analysis is whether the nature of CRA interaction with issuers during the structured finance ratings process presents additional, un- or poorly managed conflicts of interest leading to reduced rating integrity; whether the CRAs' activities constitute advisory activity in this area; and whether greater disclosure is required on the fees CRAs earn from structured finance activity.
- Regulatory options: CESR will seek market views on the benefits and costs, as identified by CESR, associated with the current self-regulatory regime and a

possible formal regulatory regime; and market views on whether the current regime should be maintained or a regulatory regime for CRAs established.

Next steps

CESR will publish in February 2008 its consultation paper on the role of CRAs in structured finance, and seek market participants' views by the end of March 2008 on the main issues arising from the activity of the CRAs in the structured finance market. CESR will also organise an open hearing for interested market participants (rating agencies excluded) on 26 March and will analyse the responses to the consultation paper before submitting its final advice to the European Commission by mid-May. In doing so, CESR will co-operate closely with fellow regulators, especially IOSCO and the SEC.

In addition to the analysis of the role of the CRAs in the structured finance market and CESR's views on the regulatory options for the ratings industry (which are the matters covered by the consultation paper), the advice to the European Commission will also include CESR's final and detailed findings about the CRAs' current application of the IOSCO Code to their own codes of conduct.

Statistics of the meetings

The Credit Rating Agencies task force met three times during the reporting period.

²⁸ Now published as Ref. CESR/08-036.

6.8 Takeover bids network

Mandate of the Takeover bids network

The Committee approved on May 2007 the establishment of a network between competent authorities on takeover bids set up by CESR with a view to exchanging views and experiences in the implementation of the Takeover Bid Directive.

The Takeover network is chaired by Eddy Wymeersch, Chair of CESR, and supported at the CESR secretariat by Raquel Garcia Alcubilla, Senior Officer, and Javier Ruiz del Pozo, Director of Financial Information. The European Commission also participates at the meetings of the network as an observer.

Meetings to discuss experiences on the application of the Directive 2004/25 on Takeover bids

On 15 March 2007, CESR organised a first meeting with representatives from the EU authorities on takeover bids (whether CESR Members or not) to discuss experiences on the application of Directive 2004/25 on Takeover bids (TOD).

The participants at the meeting considered that a network between competent authorities on takeover bids set up by CESR with a view to discussing experiences would be the right forum to foster co-operation between them, especially in the context of cross-border transactions. To this end, it was agreed that the CESR secretariat would produce a list with the contact details of the participants in the network, to be circulated to the members for internal use, and that ad hoc meetings of the network would be convened when the members provide sufficient issues for discussion (based on previous experience, it is expected that meetings will be held in Paris approximately once per quarter).



Eddy Wymeersch, Chair of the Takeover bids and Corporate Governance networks, and Chair of CESR

During this first meeting, the participants exchanged views on a number of substantive issues such as the equitable price, persons acting in concert, squeeze-out and sell-out provisions, the speak up or shut up principle and cross-border co-operation between competent authorities.

On 4 July 2007, a second meeting of the Takeover bids network was organised at the CESR premises to discuss further substantive issues, such as indirect control, empty voting techniques, and partial offers.

On 23 January 2008, the third meeting of the network took place. During this meeting, in addition to discussing substantive questions put forward by the members of the network, presentations of case analysis of relevant takeovers in the EU were made.

Statistics of the meetings

The group met three times during the reporting period.

Next steps

The Takeover bid network will continue meeting regularly when the members provide sufficient issues for discussion.

6.9 Corporate Governance

On 20 June 2007 a first meeting of corporate governance experts from CESR members and other authorities competent for the supervision of corporate governance issues took place. During this meeting, participants described the powers and practices of their authorities regarding corporate governance and the state of play of the transposition of the Corporate Governance Directive (2006/46/EC) in the different Member States. Moreover, they discussed the disclosure obligation with emphasis on the principle of comply or explain and the supervision of institutional investors. Finally, participants discussed the possible future work of CESR in the area of corporate governance, and agreed that it would be very useful to create a network of CESR experts on corporate governance that could exchange information and share their views on general issues or particular cases of corporate governance. CESR Chairs, in their meeting of 15-16 October 2007, agreed the creation of the corporate governance network. The scope of the network is limited to the area of securities law. The exchange of information would take place mainly electronically but also via meetings, and the participation in this network should be open to representatives of authorities or bodies other than the securities supervisors that are responsible for corporate governance supervision in some Member States.

Next steps

A meeting of the network will be convened as and when the members provide sufficient issues for discussion.

6.10 Transparency

Mandate of the Transparency Group

On 15 October 2007, CESR set up a Transparency Group of experts and issued the mandate this group would follow. The tasks of the group are:

To publish comparative information on implementation in all member states. One key concern raised by market participants is the lack of centralised and accurate information about how the Transparency 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 said they need to be able to access this information about implementation.

To reach common approaches on the practical questions asked by market participants and regulators on the level 1 and level 2 directives and on the Commission's Recommendation on storage. The publication of agreed common solutions reached by CESR Members in respect of the questions arising from the application of the Community legislation would enhance the proper functioning of the financial markets.

To facilitate the establishment of an EU network of national storage mechanisms. The Commission's Recommendation on storage requests CESR to play this role. CESR

would facilitate and provide support to Member States in executing the provisions of article 22.1 (b) of the Transparency Directive, the Commission's Recommendation on storage and the guidelines provided by CESR's advice on storage (Ref. CESR/06-292).

The Transparency Group is chaired by Uldis Cerps, former Chairman of the Latvian Financial and Capital Market Commission, and supported at the CESR secretariat by Anita Farkas, Senior Officer, and Javier Ruiz del Pozo, Director of Financial Information. From January 2008, Ville Kajala has replaced Anita Farkas as rapporteur of the group. The European Commission also participates at the meetings of the group as an observer.



Chair's message

Uldis Cerps, former Chairman of the Latvian Financial and Capital Market Commission

"One key concern raised by market participants is the lack of centralised and accurate information about how the Transparency Directive has been implemented across the EU. The difficulty in knowing the different requirements in the Member States arises partly because an issuer's home Member State is able to impose more stringent requirements than those provided for under the Directive. Also, Member States have discretion to choose between different options allowed by the Directive. Market participants would like to be able to access this information about implementation.

I think the mapping exercise our group is going to carry out, with the aim of publishing factual, comparative information about implementation in the Member States will be of great interest for the market and also for the regulators. In addition to this work stream, our members intend to discuss regularly the practical questions asked by interested parties and supervisors on the Transparency Directive and its implementing measures. I am sure these discussions, and the publication of their outcomes, will also be a valuable contribution to CESR's goal of fostering supervisory convergence within the EU."

Legal framework for transparency

The EU legal framework regarding transparency in relation to issuers having securities admitted to trading on a regulated market (essentially periodic financial information, information about major holdings and the way such information is disseminated and stored) is included in two legal measures:

- Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC (hereafter TD or Directive).
- Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC (hereafter Level 2 Directive). This Level 2 Directive supplements the TD with regard to half-yearly

reports, major holdings, pan-European dissemination of regulated information and equivalence of third country regulations in respect of some elements of the Directive.

In addition, the European Commission's Recommendation on storage (2007/657/EC) aims at facilitating the implementation of the TD as regards the storage of regulated information (the minimum quality standards to be respected by the national storage mechanisms and the conditions for the functioning of a pan-European network of such national storage mechanisms).

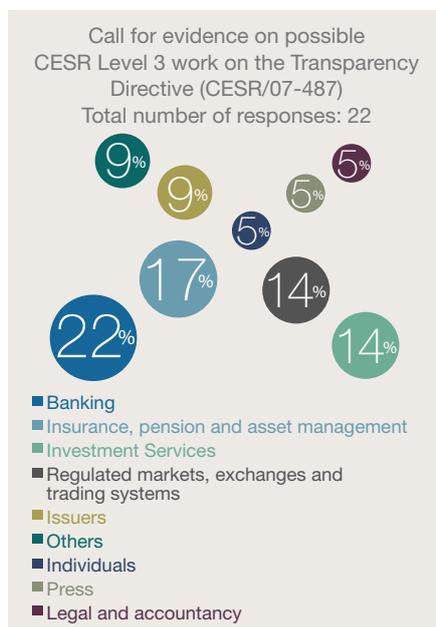
Member States were due to transpose the TD into their national laws by 20 January 2007 and the Level 2 Directive by 8 March 2008 (12 months after its date of adoption).

Now that most Member States have implemented the Directive and national practices are developing, market participants and competent authorities are raising questions about whether some provisions of the TD are being applied in a consistent manner in the different jurisdictions. An obvious consequence of its minimum harmonisation nature is that national legislation might vary regarding some aspects of the Directive. Furthermore, Member States also have to choose between different options provided in the legal EU text. While these different approaches are obviously legitimate as resulting from the choices made by EU legislators, issuers and market participants in general would expect that the minimum areas that the TD does harmonise are applied by the different competent authorities in a consistent way.

Call for evidence on the CESR Level 3 work on the Transparency Directive

On 13 July 2007, CESR issued a call for evidence (Ref. CESR/07-487) on the possible CESR Level 3 work on the Transparency Directive.

Following the outcome of its call for evidence, CESR decided to start working on the provisions of the EU transparency framework that might



give rise to different practices in the Member States that are not a result of different legitimate national discretions, but rather a result of inconsistent application of the Directive by CESR Members.

Several respondents to the call for evidence argued that any assessment on the concrete functioning of the TD seemed premature, and that CESR should not undertake any Level 3 work at this stage. However, most respondents have identified practical problems that would require action by CESR in order to promote a consistent application of the Directive.

In general, this latter group of market participants would like CESR to do the following:

- Publication of information about transposition of the TD.
- Publication of CESR common approaches on certain areas of the TD in order to promote a consistent application of the new regime.

CESR's reaction to the consultation

As noted in the Chairman's message above, and in order to respond to market demands,

CESR decided to set up a group that has started working on a mapping exercise. In parallel, the group has also started its discussions about practical questions asked by market participants and regulators on the Level 1 and 2 directives, with the aim of reaching common approaches where possible and/or exchanging views about the different practices.

EU electronic network of the officially appointed national mechanisms (OAMs) for the storage of regulated information

Following the Commission's Recommendation on storage (2007/657/EC) that requests CESR to facilitate the creation of such a network, the Transparency group discussed the different options and agreed on a proposal to be put to the CESR Chairs.

Statistics of the meetings

The group met twice in 2007.

Next steps

CESR will publish a feedback statement setting out its views on the points raised by the respondents to its July 2007 call for evidence. In this document, CESR will also announce its proposals regarding the setting up of the EU network of OAMs. CESR would set up the EU network of national storage mechanisms using the CESR MIFID database on shares admitted to trading on EU regulated markets, which is already running via the CESR website.

In addition, the group will be gathering information from its members in order to complete the mapping exercise regarding the implementation of the Transparency Directive and the way it is applied in practice. CESR intends to publish the results of this mapping during 2008.

Finally, the Transparency Group will continue discussing the issues previously put forward by the competent authorities and also those raised by respondents to the CESR call for evidence.



'A work of art captures imaginations, helping desires to be expressed and fulfilled. Our role as supervisors is to help the picture hang and speak for itself. The market place will provide the right gallery.'

07 CROSS-SECTORAL CONVERGENCE

7.1 Joint work with other Level 3 Committees

Supervisory convergence across sectors

The objectives of the co-operation between the three Level 3 Committees, namely the Committee of European Banking Supervisors (CEBS), the Committee of European Securities Regulators (CESR) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) are set out in the Joint Protocol signed by the three Committees on 24 November 2005, and include (i) sharing information in order to ensure compatible sector approaches are developed; (ii) exchanging experiences which can facilitate supervisors' ability to cooperate; (iii) producing joint work and reports to relevant EU Institutions and Committees; (iv) reducing supervisory burdens and streamlining processes; and (v) ensuring the basic functioning of the three Committees develops along parallel lines.

In accordance with the Joint Protocol, the three Level 3 Committees have published their joint 3L3 Work Programmes and Annual Reports in the previous two years.

In light of the need for convergence to take place across sectors wherever possible and appropriate, and given the increasing importance of market integration and cross-sector business activities within the EU, the objective of the Work Programme is to make supervisory co-operation transparent across financial

sectors and to enhance the consistency between the sectors so that work done in one financial sector is coherent with the work developed in the others.

The Committees have established liaison contacts for the daily work/contacts that take place between the Committees, as well as specific contact persons for each of the different work streams set out in the 3L3 Work Programme. The Secretariats and Chairs of the Committees meet on a regular basis. During the course of 2007 there were three 3L3 Secretariats and three 3L3 Chairs meetings.

3L3 Medium Term Task Force

Following an initiative from the 3L3 Chairs in autumn 2006, a 3L3 'Strategic Policy Task Force' was set up. It is comprised of 13 high level members/ supervisors who came from all three Committees and who met once in June 2007 in Paris. As a result a medium term 3L3 strategy was proposed for all three Committees, which the Committees launched as a 3L3 Medium Term Work Plan Consultation Paper on 22 November 2007. This draft Medium Term Work Programme proposed six key areas for the next three years: Home/host issues and delegation, competing products, credit rating agencies, internal governance and financial conglomerates and valuation

of illiquid instruments. The consultation with the market resulted in contributions from 13 respondents, and will be used to produce future 3L3 Work Programmes.

The work done under the 3L3 Work Programme 2007 can be divided into joint work, consistency projects, reports to EU institutions and information exchange.

Joint work

Financial conglomerates

The work on financial conglomerates is led by CEBS and CEIOPS, with CESR participating as an observer. Preparations were started by the Committees in late 2005 to form an Interim Working Committee on Financial Conglomerates (IWCFC), which came into being in early 2006. The decision to set up this Committee involved the EU supervisors in banking and insurance in the three Level 3 Committees, the European Commission and the finance ministries in the European Financial Conglomerates Committee (EFCC). The EFCC needs expert input on financial conglomerates issues to feed into its discussions, for example when reviewing the Financial Conglomerates Directive (FCD). The European Commission confirmed in a letter to the IWCFC in November 2006 its expectations of the IWCFC in addressing the unique challenges

posed by conglomerates. The Committee's work focuses on the consistent implementation of the FCD, looking at the convergence of national supervisory practices on issues such as the assessment of capital requirements, equivalence of third country supervision, and tackling issues related to identification, intra-group transactions, co-operation and co-ordination requirements.

The IWCFC met on three occasions in 2007. Most of the Committee's work in 2007 has led to analysing and exchange of information arising from the way the FCD has been implemented in the different Member States. In addition the Committee has been working on two Calls for Advice from the European Commission and the EFCC. These cover an investigation into the eligibility of capital in the different sectors, and a joint exercise with CEBS on the arrangements for supervision in the USA and Switzerland.

In September 2007, the IWCFC submitted its annual report on macro-prudential developments to the Financial Stability Table on Financial conditions and Financial Stability in European Financial Conglomerates. In November 2007, the IWCFC sent its list of identified conglomerates to the European Commission²⁹. By defining the list of identified conglomerates the Committee also worked on the use of the waiver provided by Article 3.3 of the FCD across the EEA.

The IWCFC has a full Work Programme for 2008. In addition to its work on the Calls for Advice on Capital and Equivalence described above, the Committee will continue its work on the current practices in applying the concept of Relevant Competent Authorities, and producing practical guidance for supervisors regarding the supervision of risk concentration and intra-group transactions. Also, the Committee will continue to work on co-operation arrangements between authorities involved in the supervision of each financial conglomerate. Finally, the IWCFC has been asked to assist the European Commission

in its review of the FCD on a number of issues that relate to the language, scope and internal control requirements of the Directive. Throughout 2008, IWCFC will continue its dialogue with the industry, such as via presentations and case studies at its plenary meeting.

Integrity

CEBS, on behalf of all three Level 3 committees, sits as an observer on The Committee for Prevention of Money Laundering and Terrorist Financing (CPMLTF). The CPMLTF expects the three Level 3 Committees to conduct work on convergence in supervisory practices for risk-based approaches to customer due diligence (CDD). The joint 3L3 Anti Money Laundering Task Force (AMLTF) was established in November 2006, when its mandate was agreed by CEBS, CESR and CEIOPS. The AMLTF is assisting CEBS, CESR and CEIOPS in providing a supervisory contribution to the implementation of Directive 2005/60/EC (the Third Anti-Money Laundering Directive). It also provides a forum for networking and the exchange of experiences between supervisory authorities. In conducting this work the AMLTF is, in accordance with its mandate, concentrating on practical supervisory work on risk-based approaches to CDD and the know-your-customer principle (KYC), and their impact on internal organisation and controls of intermediaries. More specifically, the AMLTF has in 2007:

- conducted a stock-take on the responsibilities of EEA financial supervisors in the prevention of money laundering and terrorist financing (AML/CFT), including a description of the supervisory measures and resources available;
- initiated the development of surveys of practical issues facing supervisors in the area of CDD/KYC;
- provided expert input to the contributions that the CPMLTF will request from CEBS, CESR and CEIOPS; and

- initiated development of a common understanding in relation to the information on the payer of accompanying fund transfers to payment service providers of payees, arising out of the EU Regulation 1781/2006, so as to propose some practical solutions in processing such messages, such as timeframes for seeking missing information, holding funds, reporting and internal controls.

Consistency projects to reduce supervisory burdens and streamlining processes

Supervisory Co-operation

The Secretariats of the three Committees finalised in 2007 a report on the sharing of information methods and supervisory co-operation practices across the sectors. The Committees thereby closed this item from the 2006 work programme. The report could be used internally in the home/host and delegation work stream that will be set up in 2008.

The 3L3 Medium Term Work Programme includes work on home/host issues.

Reporting requirements

The Committees finalised the report on reporting requirements from the 2006 work programme. The report was based on responses to a questionnaire from eight conglomerates in the EU with the objective of identifying possible inconsistencies between sectors in the application of reporting requirements in the EU. The responses have been analysed in the report, which has been approved by the Committees. It is noted that the respondents' main concern is not an overlap on a cross-sector basis. The conclusions from the report are published below at the end of this 3L3 section.

²⁹ http://ec.europa.eu/internal_market/financial-conglomerates/docs/200711_conglomerates_en.pdf

3L3 Annex – Conclusions from the 3L3 report on reporting requirements

The report was based on answers to a questionnaire addressed to eight conglomerates. The goal of the present exercise has been to find out, first, whether there are reporting requirements which are inconsistent and/or duplicative, and secondly, whether this poses a problem that the Level 3 Committees should address.

The main conclusions are the following:

- Market participants do not perceive that there are material cross-sectoral inconsistencies and overlaps in the reporting requirements arising from sectoral EU-regulations. A number of reasons were given to support this, among them: the existence of a single financial regulator (two respondents), the great difference between banking and insurance reporting that do not lead to significant overlaps (one respondent) and the lack of a centralised reporting unit, which implies that the company was not able to precise any inconsistencies or overlaps (on respondent).
- Nevertheless, some entities have raised concerns about the differences in the treatment of banking activity in the insurance financial statements, and vice versa (two respondents).
- Some market participants perceive not cross-sectoral, but rather cross-border inconsistencies: although this was not covered by the survey, several institutions express the view that the implementation of EU-regulations increases the reporting burden on a cross-border level due to overlaps and inconsistencies (five respondents).

- Market participants also indicate that the application of different accounting standards is one of the sources of potential inconsistencies (three respondents).
- Specific concerns were voiced in the insurance sector with regard to the reporting requirements arising from the Insurance Groups and Financial Conglomerates Directives in the area of intra-group transactions and adjusted solvency margin (two respondents).
- Other concerns were raised about the reporting requirements for statistical purposes stemming from ECB requirements; respondents were flagging its lack of usefulness (one respondent) or inconsistencies with financial reporting requirements (one respondent).

Internal governance

During the course of 2007, the 3L3 Committees continued examining the internal governance rules that exist within the three sectors. The analysis is being debated by the members of the three Committees, both regarding the similarities and the differences in sector requirements and guidelines. In addition, a stock-take was done on the differences that exist in the texts and the definitions of the internal governance requirements stemming from the CRD and MIFID.

Internal governance is included in the 3L3 Medium Term Work Programme and it is anticipated that during the second half of 2008, the three Committees will establish a joint 3L3 Task Force. The work of that task force will initiate a preliminary analysis of options for simplifying a cross-sector internal governance framework, building on a stock-take done on the differences that exist in the texts and the definitions of the internal governance requirements stemming from the CRD and MIFID.

Competing/Substitute products

The Committees have increased their co-operation on the issue of competing/substitute products i.e. products which have essentially the same characteristics for clients/investors, but are issued by institutions regulated in different sectors. There can be 'conduct of business' concerns as well as different burdens in case of a lack of level playing field regarding the requirements e.g. to provide information to clients. The Committees have undertaken a cross-sector survey among supervisors on the approach to substitute products at a domestic level, and on the issues supervisors should consider at an EU level. Given that the European Commission has undertaken work in this area, the Committees consider that further work from the Committees should first await the outcome of the Commission. The item is included in the 3L3 Medium Term Work programme.

Cross-border consolidation

During the course of 2007, the 3L3 Committees agreed to set up a new joint Task Force, the Cross Border Mergers and Acquisitions Task Force, to produce guidelines to assist supervisors in the implementation of the new Cross border consolidation Directive 2007/44/EC, which came into force in September 2007, including producing common guidelines for assessing "fit and proper". The item is included in the 3L3 Medium Term Work programme.

Reports to the European Institutions

Financial market trends and cross-sector risks

As set out in other sections of this report the three Committees have contributed to the work of the Economic and Financial Committee's Financial Stability Table (EFC/FST) for the meetings this Committee held in April and September.

For the April 2007 EFC/FST meeting, the three Committees presented a common letter as input to the Lamfalussy review, and as a response to the second Inter-institutional Monitoring Group report. For the September 2007 EFC/FST the three Committees provided the FST with a report on uncooperative jurisdictions ("OFC"). The report included references to uncooperative jurisdictions identified by the Committees and databases set up by the Committees, which will be annually updated.

In addition to the above, the IWCFC together with the BSC, also provided the EFC/FST with a report on financial conditions and financial stability in European financial conglomerates.

Information exchange

In addition to the items covered under the first three sections of the 3L3 Work Programme, the Committees have exchanged information on all issues set out under this section of the Work Programme, which is resulting in benefits such as identical or similar developments in areas such as peer review, impact assessment and mediation, and on the cross-sector changes to directives on acquisitions.

Commodities

In December 2007, CEBS and CESR received a joint Call for Advice on commodity and exotic derivatives and related business. On the basis of the technical advice already provided to the European Commission by the two committees, as well as the findings of the Call for Evidence issued by the Commission in December 2006, CEBS and CESR are mandated to conduct a market and regulatory failure analysis and to provide advice on whether the MiFID and CAD treatment of firms providing investment services relating to commodity derivatives and exotic derivatives continues to support the intended aims of market and prudential regulation, as well as their views on various options and combinations of options relating to the exemptions set out in MiFID and CAD.

The publication of the consultation paper is envisaged for May 2008. A public hearing for all interested parties will be organised in July 2008.

Supervisory Culture / 3L3 Training

Movement of staff and joint training

The three Level 3 Committees are working together on the development of a common training platform for supervisors, covering cross-sectoral issues. The work to develop proposals on the creation of a 3L3 Training Platform is carried out by the Steering Committee which brings together senior representatives from each of the 3L3 Committees' Members, and is chaired by Michel Prada (Chairman of the French AMF). A working group of similar composition has also been set up to carry out the preparatory work.

This initiative forms part of the Committees' work to improve supervisory convergence. The members of the 3L3 Committees have agreed that increased use of staff exchange and joint training would be useful in developing a common supervisory culture, and increasing regulatory and supervisory harmonisation/ convergence in Europe.

The ECOFIN conclusions of 4 December 2007 stated that the European Council welcomed "... the Level 3 Committees' efforts towards the development of tools with a view to overcoming or minimising differences in supervisory culture (joint training programmes and secondment schemes)" and underlined the importance placed on training as a means to deliver convergence.

The work undertaken by the 3L3 Steering Committee to develop proposals on how a 3L3 Training Platform could be organised, represents an important step forward in responding to this key request. As such, given the emphasis on the need for training to deliver convergence amongst supervisors, training will be limited at this stage to members of the three Committees.

During 2007 two test seminars were run by the 3L3 Training Steering Committee to gain a better understanding of how to organise a 3L3 training seminar successfully. These test seminars provided an opportunity to establish

the demand amongst the 3L3 Committees' Members and to gain practical information on the costs that this might involve, were the 3L3 Training Platform to be developed. The first test seminar, on Impact Assessment, took place from 17-19 October 2007 in Eltville, Germany; it was organised jointly by the BaFin and the Bundesbank, with the technical assistance of CESR's expert group ECONET. A second seminar, on Operational Risk, took place on 5-6 November 2007 at CEBS' premises in London; it was organised by the UK FSA on behalf of the 3L3 platform. The feedback from attendees on both seminars was very positive and both courses, which catered for 35-40 supervisors from across Europe, reflected a strong demand for this type of initiative.

Next Steps

A report will be prepared by the 3L3 Training Steering Committee, to be approved by the Committees' Chairs. This report will propose how the Training Platform could function and establish potential governance structures, the budget that would be needed and administrative practicalities which should be considered. Priorities for courses will be established as part of a 1-3 year forward plan.

During 2008, the 3L3 Platform will continue to offer further courses for its members, on an interim basis, and with the organisational support offered by some members of the 3L3 Committees.

Two further test seminars are scheduled to take place during the first half of 2008: one on Risk Models on 14-15 May, preceded in April by a further seminar on Credit Risk Transfer Modelling and risk management. It is likely that a further 3L3 training seminar will take place on the Financial Conglomerates Directive in the fourth quarter of 2008. In addition, in light of the success of the first seminar, it is likely that a re-run of the course on implementing the 3L3 Impact Assessment Guidelines will be organised during the course of this year.

The Three Level 3 Committees: comments on Impact Assessment (IA) Guidelines

On 24 May 2007 CESR, CEBS and CEIOPS launched their joint consultation paper on draft Impact Assessment Guidelines to be used by the EU Level 3 Committees (Ref. CESR/07-089). The consultation period ran until 24 August 2007. The guidelines are designed to provide the Committees' Expert Groups with a practical tool to assist them when using Impact Assessment (IA) as part of their policy analysis and in the course of formulating recommendations.

The three Level 3 Committees' commitment to developing an IA methodology for their own use reflects agreement reached by the European Institutions in December 2003 to implement the principles of better regulation in their legislative practices. In addition, the White Paper on Financial Services published at the beginning of 2006 (in Annex 2 COM (2005)629 of 05/12/2005), mentions explicitly that IA will accompany any new Commission proposal. As such, the adoption by the three Level 3 Committees of their own IA Guidelines keeps the 3L3 Committees in line with approved EU practice.

Key features of the IA methodology

The proposed IA methodology set out in the Guidelines is consistent with the European Commission's own IA guidelines. This means that it involves identifying problems relating to institutional objectives, identifying possible solutions (including leaving it to the market to solve), analysing their potential impacts, consulting with stakeholders on preferred policy options and considering their feedback.

The 3L3 guidelines draw an important distinction between 'Screening IAs' (implemented at the first stages of policy development) and 'Full IAs' (used only when a screening IA is deemed insufficient for assessing the problem and identifying and evaluating policy options). This has been done in order to ensure that a proportionate and flexible approach to IA is adopted,

which takes into account the distinct working practices of the 3L3 Committees.

Scope

The expectation is that IA will apply to the work of the 3L3 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 proposed IA methodology does not represent a complete break with existing 3L3 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 proposed IA guidelines, the Committees will be putting these procedures on a more structured footing.

Testing via pilot studies

Before finalising the IA guidelines, the three Committees conducted three 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 methodology described in the guidelines in its work to deliver advice to the European Commission in the frame of the broad Solvency II project.

Next steps

The IA guidelines will be approved by the three Level 3 Committees during the first quarter of 2008.

3L3 Medium Term Work Plan and the 3L3 Priorities going forward

Joint 3L3 priorities

The 3L3 Committees identified and consulted in November 2007 in their 3L3 Medium Term Work Plan 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: (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 co-ordinated 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. While work has commenced on all these areas, for some with preliminary deliverables in 2008, the full visible results on all topics are not envisaged until 2010.

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

Furthermore, the three Committees will continue their co-operation in following the recent market turmoil, and coordinating their supervisory efforts, where appropriate.

7.2 EU / US Dialogue

Meeting with US SEC Chair Christopher Cox

CESR Chair Eddy Wymeersch and CESR Vice Chair Carlos Tavares met on 27 April 2007 with US Securities and Exchange Commission (SEC) Chair Christopher Cox as part of the ongoing CESR-SEC dialogue.

The discussion aimed at identifying the key issues that should be addressed in the ongoing dialogue in the future, and included:

- The progress to date that has been made in relation to the joint work plan that was agreed between the two organisations in August 2006 in order to facilitate the CESR-SEC dialogue.
- Current positive developments in relation to accounting standards and the possible elimination by the SEC of the reconciliation requirement, as well as the current CESR work that is being done on assessing the equivalence of US GAAP.

- The imminent agreement on the framework protocols covering the confidential exchange of information regarding dual-listed issuers to be executed between the SEC and each individual CESR member, in order to further enable close co-operation between the staff of CESR members and the staff of the SEC on the application of US GAAP and IFRS in the European Union and the United States.
- The mutual recognition of securities regulatory regimes.

CESR was in contact with the SEC during summer 2007 in order to follow their work on mutual recognition.

The Chair of CESR-Fin met with the SEC on the issue of IFRS/US GAAP in early October. The meeting formed part of the ongoing exchange of information within the current work plan in relation to the issue of IFRS.

CESR representatives also visited the SEC in December in order to discuss the issue of credit rating agencies (CRAs) in a technical meeting with the relevant CRA experts.

Meeting with SEC Commissioner Kathleen Casey

Eddy Wymeersch and Carlos Tavares met with the SEC Commissioner Kathleen Casey on 11 January 2008 to discuss current issues of common concern. The agenda covered the developments on the issue of mutual recognition as well as supervisory convergence

and the current work plan. There was a significant amount of consensus on the different items discussed.

Although no conclusion was reached on the issue of mutual recognition, the meeting led to a better understanding of the possible features of the process, its timing and the contents of a more detailed proposal.

Eddy Wymeersch and Kathleen Casey noted that mutual recognition represents a priority for their respective organisations. From the US perspective, the SEC envisaged that it would take the form of a comparability assessment between the US and other jurisdictions; but that the process would not necessarily be the same for the EU as

compared to other non-US jurisdictions. In these discussions the SEC stated that the process would be initiated by an entity expressing a desire to its local regulator to be mutually recognised. From CESR's perspective, the need was also stressed for a more general approach. A number of issues were mentioned that raised particular sensitivity, including competition and enforcement; it was also stressed that the correct balance should be struck between flexibility and detail. It was envisaged that, in the EU context, the Commission and CESR would take the lead on certain aspects of the assessment, but there might remain some room for bilateral discussions between the SEC and national regulators.

The meeting also discussed the issue of supervisory convergence, and it was agreed that some work could possibly be done.

Finally, the meeting covered the items of Credit Rating Agencies, IFRS and XBRL.

Next Steps

CESR and the SEC will keep in close contact in 2008, both in relation to the current work plan and the possible developments on mutual recognition. In the meantime, the Review Panel will start an exercise on supervisory powers and practices under MiFID, in order to prepare the process of practical implementation as soon as it is defined.

7.3 Other Third Country Contacts

Representatives of CESR-Fin visited Beijing in November 2007, with a view to gathering information needed for the work on equivalence of accounting standards. As mentioned earlier in this Report, CESR-Fin held a session in November 2007 with the securities regulator of Israel (Israel Securities Authority, ISA). The session was devoted to a discussion on the enforcement system in Israel as well as issues identified by the ISA on the application of IFRS by Israeli issuers.

As part of the general information exchange, the CESR Chair met with the Chair of the Swiss Banking Supervisory Authority. In addition CESR had contacts with Liechtenstein, Switzerland and the Crown dependencies in the form of its CESR-Pol group (for more detail on this, please see section 5.2 above).



‘Underlying the whole scheme of civilisation is the confidence men have in each other, confidence in their integrity, confidence in their honesty, confidence in their future’
Bourke Cochran (1854 -1923)

08 ACCOUNTABILITY AND REPORTING TO THE EU BODIES

8.1 European Commission

Meeting with EU Commissioner Charlie McCreevy

CESR Chair Eddy Wymeersch, Vice-Chair Carlos Tavares and former Chair Arthur Docters van Leeuwen met Commissioner Charlie McCreevy on 8 May 2007 as part of the regular meetings to report activities and discuss forthcoming matters of interest.

The exchange of views concentrated on the following issues:

- the evaluation and the future of the Lamfalussy approach; the CESR delegation informed the Commissioner of the launch of internal strategic thinking within CESR in the “Beyond 2007” Task Force, chaired by Michel Prada, and the intention of CESR to contribute with ideas on the way forward in the second part of the year;
- EU/US: there was general satisfaction after the recent announcements by the US SEC regarding IFRS recognition and mutual recognition of regulatory and supervisory regimes; and
- MiFID: CESR updated the Commissioner on the progress achieved in delivering common supervisory approaches vis a vis market participants, so as to facilitate a smooth transition to the new environment created by MiFID. The Commissioner was also informed of progress made in establishing national transaction reporting systems and TREM.

On 11 September 2007, CESR Chair Eddy Wymeersch and CESR Member, Ingrid Bonde (Finansinspektionen, Sweden, and Chair of CESR’s Credit Rating Agencies working group), met with Commissioner McCreevy and members of his cabinet and staff to discuss the issue of credit rating agencies.

8.2 European Parliament

As part of the regular updates that CESR gives, on 5 June 2007 the CESR Chair, Eddy Wymeersch, gave an update on CESR’s activities to the Economic and Monetary Affairs Committee (ECON) of the European Parliament.

Eddy Wymeersch expressed his intention to build on and continue the good relationship that his predecessor, Arthur Docters van Leeuwen, had always enjoyed with the Chair of ECON, its members and the European Parliament in general, before giving an update on the current work in relation to supervisory convergence. He emphasised that CESR has during its five years of existence achieved a great deal and that, during this time, it has been able to mark its place on the European map, to the extent that it has now become recognised both within and outside of Europe, in particular in the US.

He gave a number of examples of CESR’s achievements:

- the extensive breadth of its activities in many different fields within the securities sector, covering the full spectrum of the FSAP;
- the contribution that CESR has made in making the regulatory process in Europe significantly more transparent and visible; and
- actively pursuing the better regulation agenda in line with EU institutional policy.

Eddy Wymeersch further explained that CESR has now entered into a new phase where the emphasis is the Level 3 work by means of Standards, Recommendations and Guidelines, and by facilitating supervisory convergence across the EU in the day-to-day application by CESR Members of the new legal and regulatory framework. He explained that CESR has already put many of the Thierry Francq recommendations³⁰ into place, (Review Panel, mediation, operational databases for IFRS and Market abuse to facilitate CESR Members’ work in these areas).

Following the initial address, Eddy Wymeersch took several questions from the ECON members.

ECON arranged a hearing on 14 January 2008 regarding the role of credit ratings in structured finance instruments. The hearing was chaired by Pervenche Berès. CESR was represented by its Chair. Representatives from Moody’s, Standard & Poor’s, VdP (German association of Pfandbrief issuers), the Bank of England and the Chairman of the CGFS working group also participated.

³⁰ In light of FSC Report on financial supervision, prepared by an FSC Subgroup chaired by Thierry Francq, FSC 4159/06

8.3 Financial Services Committee (FSC)

In the course of 2007, CESR Vice-Chair Carlos Tavares took part in seven Financial Services Committee (FSC) meetings on behalf of CESR. Due to the review of the Lamfalussy structure, the discussions in the FSC were during the year of special significance to CESR in that they prepared the discussions on institutional matters, such as the long-term supervisory report, which eventually led to the Lamfalussy conclusions of ECOFIN on 4 December 2007.

During the year CESR also participated on a number of occasions in the FSC sub-group on Long Term supervisory Issues, as part of the work to prepare the report on Long-Term Supervisory Issues (as endorsed by FSC in early 2008). In the second half of 2007, the FSC also worked on issues arising from the international financial crisis. CESR contributed to the 10 December meeting with a report on the recent developments in the securities markets of CESR Members.

In addition, the FSC discussed the dialogue of the European Union with Third Countries. The relationship with the US was identified as a priority and, in particular, the possible mutual recognition of regulatory regimes. The Vice-Chair of CESR presented the possible role of CESR in this process.

8.4 Financial Stability Table of the Economic and Financial Committee (EFC/FST)

Meeting of 4 April 2007

Following discussion on the macro-economic and financial sectors conditions (to which CESR contributed with the work prepared by ECONET), the FST/EFC had a long discussion on the potential regulation of hedge funds (see also the section below on ECOFIN conclusions). There was agreement that CEBS, the European Central Bank and the Level 3 Committees should continue to monitor risks related to hedge funds and that the Commission and CESR should pursue further work to better understand the type and portfolio strategy/composition of hedge funds.

As regards the Lamfalussy review, the EFC/FST suggested that a first preliminary discussion should take place at the May ECOFIN where Johnny Åkerholm, the Chair of the IIMG, presented his report. The work of the EFC/FST in the second part of the year would be to prepare a key political discussion at the December ECOFIN. The Chair of the ECOFIN in the second half of 2007, Fernando Teixeira Dos Santos, indicated that the Lamfalussy Review would be a high priority for the Portuguese Presidency.

Meeting of September 2007

The Financial Stability Table of the Economic and Financial Committee (FST/EFC) met on 5 and 25 September 2007.

The EFC on these occasions discussed extensively the impact of the “subprime” crisis on EU financial markets and, as a result of that debate and building on the contributions from the Level 3 Committees (including CESR), sent to the ECOFIN a note on Financial Stability in the EU (Key issues on risks) that was discussed at the informal ECOFIN in Oporto on 15 September.

During its session on 25 September, the EFC also agreed on draft Council conclusions prepared by the FSC on Clearing and Settlement. These conclusions suggested further examination by the FSC for a way forward regarding the CESR-ESCB standards.

ECOFIN on 9 October 2007 adopted the above-mentioned conclusions on a way forward with regard to the CESR-ESCB standards, and also invited the securities and the insurance sectors to work on an extension of the Memorandum of Understanding or Crisis management, building upon the existing MoU from 2005.

The EFC/FST also met in an extra session on 22-23 November 2007 for discussions on the Lamfalussy review.

ECOFIN 4 December 2007

At the 4 December meeting, Ministers of Finance reached a number of Council Conclusions on the Review of the Lamfalussy process. The conclusions were addressed to the Member States, the Commission, the EFC, the FSC and the Level 3 committees.

The Conclusions were also summarised in a roadmap which was added to the conclusions.

Roadmap

Attached to the Conclusions is a roadmap outlining a number of tasks to be completed by Member States, the Commission, EFC, FSC and the Level 3 Committees in 2008.

- The Commission by April 2008 to prepare an assessment on how to clarify the role of the Level 3 committees and to consider all options to strengthen the working of these committees, with a view to the FSC and EFC examining these issues at an informal ECOFIN in April 2008.
- The FSC and EFC to examine the inclusion in the mandates of national supervisors of the objective of EU supervisory co-operation and convergence, and report to the informal ECOFIN in April 2008.
- Member States by April 2008, with the contribution of the Level 3 Committees as appropriate, to adopt common formats, where appropriate, to disclose national transposition and implementation of EU legislation. The Level 3 Committees by mid-2008 to transmit to the Commission, European Parliament and Council draft work programmes and thereafter start reporting annually on progress.
- The Level 3 Committees by mid-2008 to explore the possibilities to strengthen the national application of guidelines, recommendations and standards of Level 3 Committees, without changing their legally non-binding nature.
- The Level 3 Committees by mid-2008 to introduce in their charters the possibility to apply qualified majority voting, coupled with a comply or explain procedure.
- The Level 3 Committees by mid-2008 to study the possibilities to introduce a common set of operational guidelines for the operation of colleges of supervisors and monitor the coherence of the practices of the different colleges of supervisors.
- The Level 3 Committees and the Commission by mid-2008 to suggest a timetable for the introduction of EU-wide reporting formats for single data requirements and reporting dates.
- The Commission by the end of 2008, in co-operation with the Level 3 committees, to conduct a cross-sector stocktake of the coherence, equivalence and actual use of sanctioning powers among Member States and variance of sanctioning regimes.
- The Commission by end-2008, in co-operation with the Level 3 committees, to consider financial support under the EU budget for development of tools to help build a common supervisory culture by the Level 3 Committees.
- The Commission by the end of 2008 to consider financial support under the EU budget for specific EU-wide projects that are requested from the Level 3 Committees.
- The Commission and the level 3 Committees by end-2008 to review financial services directives to include provisions to enable the use of the voluntary delegation of tasks and analyse the options for voluntary delegation of supervisory competences.
- The Commission to carry out by mid-2009 cross-sector consistency checks, where still necessary to foster coherence of terminology and effect across all EU financial services law.
- The Council underlines the importance of economic impact assessments to be applied to all parts of the Lamfalussy process, taking into account the effect of the measures considered on supervisory convergence mechanisms.
- The Council invites Member States to keep under review the options and discretions implemented in their national legislation, limit their use (wherever possible) and report to the Commission on these findings, and invites the Institutions to introduce a “review clause” in future EU legislation on all options and discretions included in the respective acts. When this review clause comes into effect after a specified time, the necessity and the use of the options and discretions should be reviewed, and where necessary, abolished where there is no demonstrated need.
- The Council undertakes to limit the use of national options and discretions and “gold plating” to the minimum extent necessary, given the specificities of national markets and invites the European Parliament to join in these efforts.

09 CESR ANNUAL REPORT ANNEXES

9.1 CESR's draft work programme for 2008

The Ecofin Council of 4 December 2007, in one of its conclusions on the evaluation of the Lamfalussy procedure, invited CESR, as well as the other Level 3 Committees, by the middle of 2008 for the first time to transmit to the Commission, the European Parliament and the Council draft work programmes; and thereafter start reporting annually on progress achieved.

CESR intended to comply with this request and submitted, jointly with the other Level 3 Committees, the draft Work Programme for 2008.

The CESR work programme for 2008 is divided in two parts: new key projects that represent the two main priorities for the Committee for 2008 and the on-going work of Groups that are designed to enhance supervisory convergence.

As regards the key new priorities, the two new emerging projects should be considered:

- Cooperation with the US Authorities (namely the SEC) to facilitate the process of mutual recognition of exchanges and broker/dealers;
- Follow up of the conclusions of the Ecofin Council of 4 December and its roadmap.

As regards the on-going work the key priorities for 2008 are:

- evaluation of the functioning of Credit Rating Agencies;
- implementation of MiFID;
- strengthening the supervisory convergence as regards supervisory practices relating to mutual funds, market abuse investigations and enforcement of financial information;
- strengthening the peer pressure within the Review Panel.

Part I: key new priorities for 2008

A.1. THE TRANSATLANTIC DIALOGUE

- Defining the elements and reviewing the practices needed in the preparation of mutual recognition decision by US regulators and EU regulators.
- Develop a system of mutual recognition for Exchanges and intermediaries.
- Establish a joint EU/US Market Participants Panel to assist the work of mutual recognition.
- Equivalence of GAAP (see CESR-Fin).
- CFTC – development of a common derivatives risk disclosure statement, and development of an internet-based information portal that would make available on CESR Members and CFTC web-sites links to publicly available registration status information.

A.2. ECOFIN CONCLUSIONS OF 4 DECEMBER 2007

- Possible revision of working methods (decision, charter, ...).
- Possible EU financing for specific projects.

Part II: On-going work in 2008

B.1. PROSPECTUS

- On-going update of Q/A on CESR's website.
- Collaboration with the European Commission in its review of the directive and its implementing measures.
- Collection from members of statistical data on prospectuses approved and passports (quarterly disclosure).
- Common positions in the extranet: database of common (or not common) positions.
- Level 3 work on employees share schemes.

- Interaction with CESR-Fin on equivalence of third countries GAAP.
- Possible Level 3 work on complex financial histories.
- Interaction with CESR-Fin subgroup on financial information in prospectuses.
- Follow up of IAASB project group on an auditing standard in the area of prospectus.
- Delegation of powers: follow up of the data on transfer of prospectuses.
- Possible Level 2 measures on documentation for take-over bids and link with the prospectus directive.

B.2. CESR-Fin

- On going discussion of enforcement decisions through the EECs and regular publication of extracts on the CESR website.
- Equivalence: preparation of advice on equivalence and transitional arrangements for individual countries (US, Japan, China and others).
- On-going dialogue with the SEC to implement the CESR/SEC work programme on IFRS. Preparation of a framework for co-operation with other third countries.
- Monitoring of IFRS development and endorsement.
- Cooperation with the Level 3 work of other CESR groups on accounting and auditing matters (Prospectus and Transparency).
- Contribution to the Level 2 committee on accounting (ARC).
- Monitoring of ISA development and endorsement.
- Contribution to the Level 2 committee on auditing (AuRC), based upon views developed in CESR-Fin.
- Ongoing reports to the EC roundtable of cases where there are difficulties to adopt a decision (i.e. due to lack of standards or contradiction between them).

B.3. TAKE OVER BIDS

- Discussion of issues of application of the Directive.

B.4. CORPORATE GOVERNANCE

- Exchange of information and fact finding exercises on aspects of corporate governance related to the securities markets.

B.5. CREDIT RATING AGENCIES

- Annual report to the European Commission on the compliance with the IOSCO Code.
- Additional work on the role of CRAs in structured finance.
- Liaison with IOSCO on the review of the IOSCO code of conduct.
- Liaison with CEBS and CEIOPS.
- Analysis of new US legislation and monitoring of development in the US.
- Follow up of ESME work on CRAs.

B.6. TRANSPARENCY

- Mapping exercise about the implementation of the directives in Member States.
- Initiate level 3 works on the practical application of the Transparency directives.
- Facilitate the creation of the EU network of national storage mechanisms.

B.7. MiFID

- Input to Commission's reports on:
 - commodities
 - tied agents
 - telephone orders
 - market transparency (data consolidation, Art. 27, delay tables, best execution quality data, definition of 'transaction', criteria for liquid shares)
- Development of a CESR Q&A tool on MiFID.
- Passport functioning (Home/Host).
- Organising on-going sessions of supervisors on operational issues.
- Developing common approaches on major issues (Best execution, conflicts of interest, softing, complex financial instruments ...).
- Publication of data (liquid shares, blocs, list of internalisers, etc).
- Communication to retail investors.
- Transaction reporting.
- Preparation of Training seminars.
- Cooperation with Energy regulators on energy markets.
- Support to Transatlantic dialogue.

B.8. CLEARING AND SETTLEMENT

- T2S.
- Market Participants Code of Conduct.
- Depending on clarifications from EU Institutions, work on the Standards might be reinitiated, jointly with the ESCB.

B.9. INVESTMENT MANAGEMENT

- Mandate from the Commission on simplified Prospectus/ Key Investor Information.
- Follow-up of the revision process of the UCITS Directive (White paper).
- Co-operation work in view of fostering mutual understanding and improving convergence of regulatory practices (OTF).
- Interaction between MiFID and UCITS Directives.
- On-going assessment of the impact of the recent subprime crisis on the European fund industry.
- Developments on Conduct of business rules.
- Contribution to the work undertaken by the European Commission on private placement.
- Work of the European Commission on non-harmonised funds (funds of hedge funds, private equity, real estate funds).
Work on European real estate funds completed by the Expert group (industry stakeholders) set up by the European Commission.
- Follow-up and possible contribution to the 3L3 work on substitute products.
- Possible contribution to the work undertaken by the European Commission on retail financial services.
- Evaluation of the implementation of the notification guidelines.

B.10. CESR-TECH

- Transaction reporting exchange mechanism (TREM):
 - First sub-project on reference data logistic – long term solution;
 - Second sub-project on Alternative Instrument Identifier;
 - TREM maintenance organisation;
 - TREM training.
- IT security review of the CESR IT systems.

B.11. CESR-Pol

- Joint investigations through urgent issues groups.
- Surveillance and intelligence work.
- MAD Level 3 guidance for supervisors and for the market (contacts with ESME and several associations).
- Enforcement aspects of MiFID in support of MiFID L3 Expert Group.
- Database on enforcement cases.
- Exchange of views and experiences in the area of co-operation and enforcement.
- Contacts with IOSCO.

B.12. MEDIATION

- Mediation cases.
- Reporting to EU institutions.

B.13. REVIEW PANEL

- Mutual recognition (EU/US).
- Concept of “acting in concert”.
- Review of CESR Standard no. 2 and update of review on Standard and update of review on Standard no 1.

B.14. ECONET

- Finalisation of the impact assessment methodology.
- Improve intelligence gathering of data at EU level.
- Economic assessment to be included in the Annual report.
- Bi-annual contribution to the EFC (March/September).

B.15. 3L3

- Consistency work:
 - Supervisory cooperation (Home/Host);
 - Reporting requirements: follow up of questionnaire;
 - Internal governance: develop a consistent Level 3 approach;
 - Competing products.
- Cross representation:
 - Money laundering (CEBS leading).
- Joint work:
 - Conglomerates;
 - Mergers and acquisitions (establishment of a joint task force).
- Joint reports to EU institutions:
 - Cross-sector risks to EFC: mainly conglomerates;
 - Non cooperative jurisdictions (OFC).

B.16. LEGAL WORK

- Legal support to Expert Groups.
- Monitoring of legal initiatives related to CESR work: revision of UCITS Directive, etc...
- Legal aspects of the functioning of CESR in particular:
 - Data protection
 - Procurement
 - Charter/Protocol
 - Principles for Expert Groups
 - Institutional issues

B.17. REPORTING TO INSTITUTIONS

- Annual and half-yearly report to Commission, ECOFIN and European Parliament.
- Supervisory convergence report to the FSC.
- Economic trends of financial markets to EFC/FST twice a year.
- Yearly hearing in EU Parliament.

B.18. COMMON SUPERVISORY CULTURE

- Development of 3L3 Training platform:

- Creation of a website and database; to show courses offered;
- Sectoral training in CESR - For example, on elements of MIFID/Accounting.
- Development of exchange of staff between CESR members:
 - Questionnaire to assess implementation of toolkit recommendations. Development of communications material for Members Staff Newsletters.

B.19. ENGAGING RETAIL INVESTORS MORE EFFECTIVELY AND INVESTOR EDUCATION

- Organization of half-yearly sessions with consumer representatives.
- Involvement of consumer representatives in simplified Prospectus for UCITS.
- Development of a guide on MIFID and what it means for retail investors.

B.20. COMMUNICATIONS (EXTERNAL)

- Promoting more effectively CESR's efforts to develop convergence.
- Redesign and re-organisation of CESR's website:
 - Update of MIFID database and implementation of Transparency Directive Obligations;
 - The public website and databases;
 - The Extranet;
- Update of Review Panel database.
- CESR conference on supervisory issues (to be selected) relevant for securities markets.
- Handling of press enquiries.
- Press releases.
- Advice on publication and development of new tools.
- Management of speaking invitations / articles in publications.

B.21. RELATIONS WITH THIRD COUNTRIES

- Transatlantic dialogue (SEC and CFTC)
- Swiss/Liechtenstein
- Consultative group of Non EEA countries (Turkey, Croatia, Serbia, Montenegro)
- China

B.22. INTERNAL FUNCTIONING

As a consequence of expansion of the secretariat, and pending the human resources audit on the possible changes requested to ensure conformity to the French labour laws, the following might be requested:

- Establish by-laws for the personnel.
- Elaborate a number of organisational procedures to ensure better coordination and efficient functioning.

9.2 2007 Audited Annual Financial Statement

Statutory auditors' report and the accompanying financial statements of CESR (Profit & Loss, Balance Sheet and Cash Flow Statement)

PROFIT AND LOSS (Revenues and Expenses)		
As at December 31st, 2007 (In Euros)	31/12/2007	31/12/2006
REVENUES		
Contributions from Members	4 009 995	2 450 001
Profit on marketable securities	86 410	60 507
Other	3 850	2 779
Total revenues	4 100 256	2 513 287
EXPENSES		
Salaries and employee benefits	1 780 921	1 382 796
External staff	239 982	308 299
Rental	564 580	457 052
Traveling	223 088	185 307
Office supplies	31 250	17 662
Organization and follow up of meetings	59 909	38 399
Transportations & Communications	0	0
Telecommunications	42 766	39 532
TREM project	251 316	0
Printing	21 646	20 500
Computer & IT development	75 855	13 718
Professional fees	98 403	63 071
Depreciation of fixed assets excluding computer	42 688	35 268
Miscellaneous	12 806	4 690
Total expenses	3 445 210	2 566 293
<i>Excess of revenues over expenses</i>	<i>655 046</i>	<i>-53 007</i>

EVOLUTION OF MEMBERS' FUNDS		
As at December 31st, 2007 (In Euros)	31/12/2007	31/12/2006
ASSETS		
Balance, beginning of period	1 226 183	1 279 190
Excess of revenues over expenses	665 046	-53 007
Balance, end of period	1 881 229	1 226 183

WORKING CAPITAL		
As at December 31st, 2007 (In Euros)	31/12/2007	31/12/2006
ASSETS		
Accounts receivable	17 710	-1 754
Prepaid expenses	5 629	4 620
Accounts payable and accrued liabilities	-201 336	-10 773
Deferred revenues	200 000	76 097
(Increases) decreases in working capital	22 003	68 90

BALANCE SHEET (Financial position)

	As at December 31st, 2007 (In Euros)	31/12/2007	31/12/2006
ASSETS			
Current assets			
	Cash	100 652	452 261
	Marketable securities	1 894 217	1 176 261
	Prepaid expenses	123 149	117 520
	Accounts receivable	22 866	5 156
		2 140 884	1 751 198
	Fixed assets gross amount	733 779	448 761
	Fixed assets depreciation	-296 392	-226 230
	Total assets	2 578 271	1 973 730
LIABILITIES			
Current liabilities			
	Accounts payable and accrued liabilities	642 563	441 227
	Deferred revenues	0	200 000
	Bank overdraft	642 563	641 227
	Contingency provision	54 480	106 320
L	Total liabilities	697 043	747 547
MEMBERS' FUNDS			
	Invested in fixed assets	0	0
MF	Unrestricted	655 046	1 226 183
	Total members' funds	655 046	1 226 183
L+MF	Total	1 352 088	1 973 730

CASH FLOWS

	As at December 31st, 2007 (In Euros)	31/12/2007	31/12/2006
OPERATING ACTIVITIES			
	Excess of revenues over expenses	655 046	-53 007
Non-cash items			
	Depreciation of fixed assets	70 162	43 364
	Reduction in value of fixed assets	0	0
	Contingency provision	-51 840	-51 840
	(In)/Decrease in working capital items	-22 003	-68 190
NCG	Net cash generated	651 364	-129 672
INVESTING ACTIVITIES			
	Capital expenditures	285 018	59 274
	Disposal of fixed assets	0	0
NCU	Net cash used	285 018	59 274
	Increase in cash and cash equivalents	366 346	-188 947
	Cash and cash equivalents, beginning of period	1 628 522	1 817 469
NCG-NCU	Cash and cash equivalents, end of period	1 994 868	1 628 522
CASH AND CASH EQUIVALENTS			
	Cash	100 652	452 261
	Term deposits	1 894 217	1 176 261
		1 994 868	1 628 522

9.3 CESR's secretariat as at 1 May 2008



9.4 List of Members



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