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Governance, Regulation & Compliance

Regulatory Radar

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Newsletter on banking and financial regulation

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Before the UK media turned all their attention to the royal wedding, the interim report of the Independent Commission on Banking released on April 11, triggered a lot of public interest, with the website crashing under the weight of unexpected traffic volumes.

One of the central discussion themes of the report, is whether retail banking activities should be fully separated or "just" ring fenced from wholesale and investment banking activities. The report states that merely having separability of operational systems may not be enough. The underlying idea is of course that the second sort of banking activities is much more likely to run into problems, given the higher level of risk taking, and the hope that by separating them to some extent, these activities will not contaminate the retail banking services that are so crucial for the economy should they run into trouble.

What exactly is meant by ring fencing (as being less severe than separation) and what would still be allowed in terms of financial (read: funding) links between retail activities and wholesale banking, is unclear. The report does argue for a higher capital ratio (10%) for the retail activity than what is contained in the current Basel III proposals. Together with the discussion on living wills, in which the UK is also leading the pack, all this fuels a significant countercurrent against the secular trend for ever higher operational and financial integration of financial institutions over the past two decades, driven by IT evolutions. This financial integration and operational efficiency was of course key in increasing the profitability of financial institutions.

It will clearly take some time for all of us to learn where the new equilibrium lies, between maximizing profitability and minimizing the expected losses of financial crises.

In March, interesting publications have been issued on topics such as the new supervisory architecture in Belgium, 2011 EU-wide stress tests, the Proposal for a Directive on Mortgage Credit, the use of gender in insurance pricing and the results of the QIS5.

The Editorial Board.

Financial Services Industry

Normative documents

Official Journal of the European Union

Remuneration

On 2 March, the Royal Decree of 22 February 2011 approving the CBFA Regulation of 8 February 2011 on the remuneration policy of financial institutions was published in the Official Journal. The regulation details the principles which must be taken into account when drafting and implementing remuneration policies and governs the disclosure of information regarding remuneration.

New supervisory architecture

On 9 March, the Royal Decree of 3 March 2011 implementing changes to the supervisory architecture for the financial sector was published in the Official Journal. The Royal Decree sets out the organization of the new supervisory architecture for the financial sector. It describes the supervisory competences of the two supervisors and mechanisms of consultation, advice, exchange of information and other forms of interaction between the two supervisors. Within the new framework, the prudential supervision of most financial institutions is in the hands of the National Bank of Belgium ("the Bank") while the supervision of the financial markets and of the "conduct of business" rules is the responsibility of the Financial Services and Markets Authority ("FSMA"). FSMA is also responsible for the micro-prudential supervision of portfolio management and investment advice companies, UCI management companies and UCI's, institutions for occupational pension, financial intermediaries and the financial education of investors and their protection against the illicit provision of financial products and services. The new supervisory architecture came into effect on 1 April.

Official Journal of the European Union (OJ)

AML/CFT

In March, the following documents related to AML/CTF have been published:

- Council Regulation (EU) No 204/2011 of 2 March 2011 concerning restrictive measures in view of the situation in Libya in OJ L58 of 3 March;
- Council Decision 2011/137/CFSP of 28 February 2011 concerning restrictive measures in view of the situation in Libya in OJ L58 of 3 March;

- Notice 2011/C 68/01 for the attention of the persons to which restrictive measures provided for in Council Decision 2011/137/CFSP and Council Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya apply in OJ C68 of 3 March;
- Notice 2011/C 68/02 for the attention of the persons to which restrictive measures provided for in Council Decision 2011/137/CFSP and Council Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya apply in OJ C68 of 3 March;
- Council Implementing Regulation (EU) No 233/2011 of 10 March 2011 implementing Article 16(2) of Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya in OJ L64 of 11 March;
- Council Implementing Decision 2011/156/CFSP of 10 March 2011 implementing Decision 2011/137/CFSP concerning restrictive measures in view of the situation in Libya in OJ L64 of 11 March;
- Notice 2011/C 77/05 for the attention of the persons and entities to which restrictive measures provided for in Council Decision 2011/137/CFSP and Council Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya apply in OJ C77 of 11 March;
- Commission Regulation (EU) No 260/2011 of 16 March 2011 amending for the 146th time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban in OJ L70 of 17 March;
- Notice 2011/C 83/12 for the attention of Doku Khamatovich Umarov who was added to the list referred to in Articles 2, 3 and 7 of Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban, by virtue of Commission Regulation (EU) No 260/2011 in OJ C83 of 17 March;
- Council Regulation (EU) No 269/2011 of 21 March 2011 amending Regulation (EU) No 1284/2009 imposing certain specific restrictive measures in respect of the Republic of Guinea in OJ L76 of 22 March;
- Council Regulation (EU) No 270/2011 of 21 March 2011 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Egypt in OJ L76 of 22 March;
- Council Implementing Regulation (EU) No 271/2011 of 21 March 2011 implementing Article 8a(1) of Regulation (EC) No 765/2006 concerning restrictive measures against President Lukashenko and certain officials of Belarus in OJ L76 of 22 March;
- Council Implementing Regulation (EU)

No 272/2011 of 21 March 2011 implementing Article 16(2) of Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya in OJ L76 of 22 March;

- Council Decision 2011/169/CFSP of 21 March 2011 amending Decision 2010/638/CFSP concerning restrictive measures against the Republic of Guinea in OJ L76 of 22 March;
- Council Decision 2011/171/CFSP of 21 March 2011 amending Decision 2010/573/CFSP concerning restrictive measures against the leadership of the Transnistrian region of the Republic of Moldova in OJ L76 of 22 March;
- Council Decision 2011/172/CFSP of 21 March 2011 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Egypt in OJ L76 of 22 March;
- Council Decision 2011/173/CFSP of 21 March 2011 concerning restrictive measures in view of the situation in Bosnia and Herzegovina in OJ L76 of 22 March;
- Council Implementing Decision 2011/174/CFSP of 21 March 2011 implementing Decision 2010/639/CFSP concerning restrictive measures against certain officials of Belarus in OJ L76 of 22 March;
- Council Implementing Decision 2011/175/CFSP of 21 March 2011 implementing Decision 2011/137/CFSP concerning restrictive measures in view of the situation in Libya in OJ L76 of 22 March;
- Notice 2011/C 90/02 for the attention of the persons to which restrictive measures provided for in Council Decision 2010/638/CFSP, as amended by Decision 2011/169/CFSP, and in Council Regulation (EU) No 1284/2009, as amended by Regulation (EU) No 269/2011, concerning restrictive measures against the Republic of Guinea apply in OJ C90 of 22 March;
- Notice 2011/C 90/03 for the attention of the persons to which restrictive measures provided for in Council Decision 2011/172/CFSP, and in Council Regulation (EU) No 270/2011, concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Egypt apply in OJ C90 of 22 March;
- Notice 2011/C 90/04 for the attention of the persons to which measures provided for in Council Decision 2010/639/CFSP and in Council Regulation (EC) No 765/2006 apply in OJ C90 of 22 March;
- Notice 2011/C 90/05 for the attention of the persons and entities to which measures provided for in Council Decision 2011/137/CFSP and in Council Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya apply in OJ C90 of 22 March;
- Council Implementing Regulation (EU) No 288/2011 of 23 March 2011 implementing Article 16(1) and (2) of Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya in OJ L78 of

24 March;

- ➲ Council Decision 2011/178/CFSP of 23 March 2011 amending Decision 2011/137/CFSP concerning restrictive measures in view of the situation in Libya in OJ L78 of 24 March;
- ➲ Council Regulation (EU) No 296/2011 of 25 March 2011 amending Regulation (EU) No 204/2011 concerning restrictive measures in view of the situation in Libya in OJ L80 of 26 March.

Banking, Finance and Insurance Commission (CBFA)

Prudential status of payment institutions

On 30 March, the CBFA published the Communication CBFA_2011_16 on the prudential status of payment institutions (in ➲Dutch and in ➲French) which details the prudential framework within which payment institutions must carry their activities. In the communication, the CBFA indicates that the prudential framework that is already in place for credit institutions will be applied analogously to payment institutions while, at the same time, taking into account the differences that exist between the two types of financial institutions. To this effect, the communication describes which circulars applicable to credit institutions are also applicable to payment institutions and how these circulars must applied by payment institutions.

Periodic reporting

On 17 March, the CBFA published the Communication CBFA_2011_11 on the layout for periodic reporting (in ➲Dutch and in ➲French). The communication provides guidance to investment firms, UCI management companies and their branches in relation to the accounting treatment of transactions in relation to the Protection Fund for Deposits and Financial Instruments and the Special Protection Fund for Deposits and life insurance.

AML/CFT

On 2 March, the CBFA published the Circular CBFA_2011_09 modifying circular CBFA_2010_09 of 6 April 2010 on the customer due diligence obligation, the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, and the prevention of the financing of the proliferation of weapons of mass destruction (in ➲Dutch and in ➲French). The Circular amends Circular CBFA_2011_09 to take into account the entry into force of the ➲Council Regulation (EU) No 961/2010 of 25 October 2010 on restrictive measures against Iran and repealing Regulation (EC) No 423/2007.

Consultative or informative documents

Banking, Finance and Insurance Commission (CBFA)

New supervisory architecture

On 24 March, the CBFA published the Communication CBFA_2011_15 on the new supervisory architecture for the financial sector (in ➲Dutch and in ➲French). The communication provides guidance regarding the new supervisory architecture for the Belgian financial sector that came into effect on 1 April. It contains an overview of the principles of the new supervisory architecture and competences of new Financial Services and Markets Authority ("FSMA").

Basel Committee on Banking Supervision (BCBS)

Foreign exchange settlement risk

In a ➲press release of 17 March, the BCBS together with the Committee on Payment and Settlement Systems (CPSS) announced the establishment a joint working group to revise the BCBS's ➲Supervisory guidance for managing settlement risk in foreign exchange transactions (2000), with the goal of ensuring that financial institutions adequately control their foreign exchange settlement exposures. The guidance issued by the BCBS in 2000 was before CLS Bank and other payment versus payment (PVP) settlement systems were operational and does not fully reflect advances in the market and key differences between trades that settle through sound PVP arrangements and those that settle bilaterally through correspondent banking relationships. The revised guidance will address these and other developments with respect to foreign exchange settlement risk management. The committees plan to issue revised guidance by the end of this year for public comment.

Center for European Policy Studies (CEPS)

European Stability Mechanism

On 10 March, CEPS published a policy brief, titled ➲"On the Tasks of the European Stability Mechanism". The Policy Brief aims to clarify the proper role of EU financial assistance to member states confronted with sovereign debt crises and to outline the tasks that the new European Stability Mechanism (ESM) should be able to perform in order to put in place an effective and credible crisis management system for both the eurozone and the European Union.

Council of the European Union

SEPA

On 16 March, the Council published the ➲presidency compromise on the Proposal for a Regulation of the European Parliament and of the Council establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) 924/2009.

Eurofinas

Consumer Rights

In a ➲press release of 24 March, Eurofinas welcomed the European Parliament's decision to ➲amend the European Commission's Proposal on the Consumer Rights Directive and the referral of the file back to the Internal Market and Consumer Protection Committee (IMCO) of the Parliament in view of further negotiations with the Council and the Commission. The Federation indicated that while it agrees with the objective of the Commission to remove inconsistencies and address the fragmentation of national laws regulating 'business-to-consumer' transactions, it supports the Council's opinion that financial services agreements should be excluded from Chapter II & III of the Directive on pre-contractual information and right of withdrawal. This is because the proposal of the Commission fails to address the specificities of financial services agreements, thereby threatening the viability of sound and well-accepted practices across Europe. Excluding financial services agreements would also avoid unnecessary overlaps with existing EU legislations as well as future contradictory transpositions at national level.

European Association of Co-operative Banks (EACB)

Common rules for Central Securities Depositories (CSDs) and securities settlement

On 1 March, the EACB published its ➲response to the ➲European Commission's consultation on central securities depositories (CSD's) and securities settlement.

European Association of Public Banks (EAPB)

Credit ratings

On 31 March, the EAPB published its ➲comments on ESMA's ➲consultation paper on the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Regulation 1060/2009. In its response, the Association stated that an endorsement would signify high informational requirements and will be difficult to obtain. The annexed impact assessment shows that the implementation of the regulation of credit ratings agencies leads to high costs particularly for the financial sector in the short-run. In the long-run it is expected to be of macro-economical use through an improved quality of ratings. Since other changes in prudential requirements, among others those of Basel III, lead to further costs for the financial sector, it would be reasonable to spread the costs over a longer period without affecting the desired aim of a higher quality of ratings. This can be achieved through a grandfather clause for existing investments. If an institution made an investment decision in the past based on a rating, this rating should be further on used for prudential purposes taking into consideration the changes over time. New business should consequently be based on the requirements of the new prudential framework. This procedure would have the positive effect that the costs of the regulation would only incur when the old portfolio is replaced and thus could be spread over time according to

trading activity. Otherwise institutions would be punished for an investment decision made in the past in good faith.

European Banking Federation (EBF)

Credit ratings

On 31 March, the EBF published its ➲comments on ESMA's ➲consultation paper on the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Regulation 1060/2009. In its response, the EBF indicated that it disagrees with ESMA"s legal analysis of the "endorsement" regime and in particular, the interpretation that this regime refers to rules that are established by law or the regulation of the third country. Rather, the Federation firmly believes that the reference to rating agencies" "conduct" leaves the responsibility for endorsement to the endorsing Credit Rating Agency (CRA). It stated that this interpretation has been explicitly confirmed by several Member States, as well as by the European Parliament's Economic and Monetary Affairs Committee in its own-initiative report on rating agencies, as voted on 16 March 2011. Furthermore, the EBF expressed its concern that ESMA's Impact Assessment seems to under-estimate the effects of its endorsement interpretation on banks" regulatory capital requirements and on the markets more widely. Most importantly, the assessment relies on too little data and not sufficiently substantiated assumptions to provide a representative picture.

In addition to the legal and political considerations, EBF stated that the European banking industry does therefore also not believe that ESMA"s interpretation of the endorsement process would have the aggregate economic advantages that ESMA appears to expect.

Common rules for Central Securities Depositories (CSDs) and securities settlement

On 1 March, the EBF published its ➲response to the ➲European Commission consultation on central securities depositories (CSD's) and securities settlement. In its response, the EBF welcomed the European Commission's intention to regulate the Central Securities Depositories (CSDs). Traditionally, every country had a CSD but with a significant increase in cross-border investment activities, the EBF believes that the future legislation under consideration by the European Commission should be instrumental in creating a harmonised EU framework for CSDs to operate in a safe and efficient manner. The Federation suggested to define a CSD as an institution which (1) provides and performs the core services of notary, central safekeeping and central settlement as well as directly connected low-risk ancillary services and (2) is an operator of a Securities Settlement System (SSS). The EBF indicated that European banks consider that a CSD, given its importance for the stability and efficiency of the market in trading securities, is a market infrastructure provider which is expected by user-banks to have a low-risk profile. Would a CSD perform high-risk ancillary services that could potentially bear credit or liquidity risk,

the Federation indicated the provision of these services should be clearly disconnected and segregated from the provision of core services and be subject to a separate (usually banking) license and to the related rules. This would (1) ensure there is a level-playing field between institutions that are able to provide similar services and (2) prevent that the high risks associated to these separate commercial activities will spill over into the core functions of a CSD. In relation to the scope of the scope of future legislation, the Federation recommended that provisions on the governance of CSDs should limit itself to ensure the core functions can be performed in a safe, sound and efficient manner. The future regime of authorization and supervision should also limit itself to the core services and to the low-risk ancillary services that are required to perform the core services. Finally, the EBF stated that agrees with the fact that harmonisation of certain aspects of securities settlement is needed. However it asked the Commission to avoid over-regulation as it could have counter-productive effects. A future legislation should limit itself to establish high level principles and refrain from elaborating specific and detailed rules which would not fit the market structure and would prevent post-trade processes to adapt to changing market circumstances in order to meet efficiency gains and improve safety in operations.

European Central Bank (ECB)

Assessing systemic risks and predicting systemic events

On 24 March, the ECB published a working paper, titled ➲"Macro-financial vulnerabilities and future financial stress: assessing systemic risks and predicting systemic events". The paper develops a framework for assessing systemic risks and for predicting (out-of-sample) systemic events, i.e. periods of extreme financial instability with potential real costs. It test the ability of a wide range of "stand alone" and composite indicators in predicting systemic events and evaluate them by taking into account policy makers' preferences between false alarms and missing signals. It found that taking into account jointly domestic and global macro-financial vulnerabilities greatly improves the performance of discrete choice.

European Fund and Asset Management Association (EFAMA)

Common rules for Central Securities Depositories (CSDs) and securities settlement

On 2 March, EFAMA published its ➲response to ➲European Commission's consultation on central securities depositories (CSD's) and securities settlement. In its response, the Association welcomed the Commission's objective to achieve an efficient, integrated and safe system for the clearing and settlement of securities transactions and to harmonize certain aspects of securities settlement in the EU. For the first Part of the Consultation, concerning the regulatory framework for CSDs, EFAMA focused on the questions related to the

scope and definitions, as well as on the access and interoperability of CSDs. On the subject of the scope and definitions, it voiced its support for the proposal of the Commission to provide a definition of CSD's following a functional approach, referring to the services that a CSD provides. The Association stated that very clear definition of CSDs is very important in order to avoid as much as possible legal uncertainties as to which entities fall within the scope of the Directive. If the definition is clear, it should not be necessary to set out long lists of exemptions for entities which the Commission does not want to encompass in the definition of CSDs (e.g. Transfer agents, registrars, account operators, etc…). In relation to access, EFAMA indicated that it supports the principle of the Commission following which a CSD should grant access to market participants on an open and non-discriminatory basis. All market participants should be given the possibility to access the CSD of their choice. This would enhance the competition between CSDs and may reduce the issuance, clearing and settlement costs borne by market participants. The Association also emphasizes the need for interoperability and access rights between the various CSD's. Furthermore, future legislation should aim at limiting outsourcing by CSD to certain tasks under specific conditions. In relation to the second Part of the Consultation, concerning the harmonization on certain aspects of securities settlement, EFAMA welcomed a harmonization of key post trading processes (e.g. settlement discipline and settlement cycles). Harmonization of securities processing would be beneficial in facilitating switching between investments which are settled under different systems and in standing settlement instructions (SSI).

European Securities and Markets Authority (ESMA)[1]

Credit ratings

On 18 March, ESMA published a ➲consultation paper on the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Regulation 1060/2009. The endorsement regime allows the use of ratings issued outside the EU under certain conditions. One of the conditions that an EU-registered (or seeking registration) credit rating agency (CRA) must comply with, in order to endorse ratings, is to verify and to demonstrate on an ongoing basis that the conduct of credit rating activities by the third-country credit rating agency resulting in the issuing of the credit rating to be endorsed fulfills requirements which are at least as stringent as the requirements set out in Articles 6 to 12 of the Credit Rating Regulation. The Consultation Paper asks for comments on ESMA's interpretation of Article 4.3 of the Regulation which requires that the law or the regulation of the third country contains rules that are "as stringent as" the one in the EU regulation and rules on authorization (or registration), and supervision to be in compliance with Article 4.3. The reasoning for this

[1]ESMA has replaced the Committee of European Securities Regulators (CESR), as of 1 January 2011.

interpretation is that third-country CRAs need to be subject to supervision and enforcement by the relevant authority of the third-country for endorsement to be effective. Therefore the competent authorities of the endorsing CRA should assess and monitor compliance of the CRA with requirements of the EU Regulation according to Article 4.3 (c) and not grant the authorization to endorse, at the moment of the decision on registration – or withdraw the authorization to endorse afterwards – in cases where the third-country CRA does not comply with requirements, according to the third country's regulatory framework, as stringent as those set out in Articles 6 to 12 of the Regulation. The Paper also asks market participants to provide comments on the impact assessment and Cost-Benefit of the aforementioned interpretation contained in its annex. The consultation period ended on 31 March. ESMA expects to publish the final guidelines on endorsement by 7 June of this year.

Common rules for Central Securities Depositories (CSDs) and securities settlement

On 15 March, ESMA published its ➲response to the ➲European Commission's consultation on central securities depositories (CSD's) and securities settlement. With regard to the scope of the regulatory framework for CSDs, ESMA stated that the rational for the exemption on government debt management offices and its implications should be specified. Furthermore, the Supervisor indicated its agreement with the Commission's approach of having a high level definition of settlement function. In this context ESMA recommended to align the definitions in the CSD legislation with internationally adopted ones and to consider a simpler definition of the settlement function, such as the exchange of securities against cash or free of payment with the aim of completing a transaction in securities. On the subject of access and interoperability to CSD's, ESMA welcomed the European Commission's position that limits on access should only be based upon risk grounds, following the main lines of CESR-ESCB Recommendation 14. The supervisor did however not agree with the European Commission's decision not to make changes to company law. It wondered whether that an effective removal of restrictions for issuers wanting to "export" a security to a non-national CSD and restrictions for CSDs wanting to "import" a security from a non-national issuer could occur without harmonizing certain aspects of company law, in particular if the barrier has a company law nature. Regarding prudential rules and other requirements for CSDs, ESMA stated that that there should be no obligation to lend or borrow securities on CSDs, nor very specific requirements upon system operators in the design of such systems. In relation to settlement discipline, it expressed its support for a high level definition of settlement fail. Although the concept of a settlement fail is commonly accepted, an exact definition of settlement fail does not exist. Adopting a common definition would provide clarity as regards the application of a settlement discipline regime and would facilitate

comparability between different CSDs. Settlement discipline should be applicable irrespective of the trading method. Regulated markets, MTFs, other organized trading facilities and OTC trading should be covered without discrimination. Finally, ESMA commented on the European Commission proposals regarding outsourcing of settlement functions to the Targat2-Securities settlement platform.

[1] ESMA has replaced the Committee of European Securities Regulators (CESR), as of 1 January 2011.

European Parliament

Credit Rating Agencies

In a ➲press release of 16 January, the European Parliament announced the adoption of the German Liberal MEPs Wolf Klinz's report on credit ratings agencies by the Economic and Monetary Affairs Committee (in ➲Dutch and in ➲French) as a draft resolution. The resolution supports measures and initiatives that would make market players (investors, banks, central banks) more engaged in risk analysis, which would reduce their over-reliance on ratings. It also demands agencies be exposed to civil liability in cases of gross negligence. Furthermore the resolution calls for the establishment of European Credit Rating Foundation.

European Savings Banks Group (ESBG)

Credit ratings

On 31 March, the ESBG published its ➲comments on ESMA's ➲consultation paper on the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Regulation 1060/2009. In its response, the Association expressed its support for the framework established by the ESMA through guidelines on the application of the endorsement regime set out in the Credit Rating Regulation (CRR). Regarding the question as to whether the Regulation establishes two different tests depending on which method is followed ('at least as stringent as' vs. 'equivalent to') for the two mechanisms by which ratings issued outside the EU can be used for regulatory purposes, ESBG indicated that it agrees with the approach proposed by the ESMA. It also stated that it supports the understanding of the ESMA that an equivalence decision from the European Commission recognizing the legal and supervisory framework of the third country as equivalent to the requirements of the Regulation would certainly facilitate the obligation of the endorsing EU CRA to demonstrate that the third-country CRA fulfils requirements that are at least as stringent as those set out in Articles 6 to 12 of the Regulation. Although ESBG agrees with the overall framework proposed by the ESMA's draft guidelines, it stressed that in order to avoid the expected burdensome short-term costs for market participants, especially for smaller and medium sized financial institutions, that a further transition period of minimum on year must be introduced, during which these institutions are allowed to

use third country ratings without those ratings being subject to the restrictions imposed by the new framework. To conclude the Association stressed that market participants will only benefit from the regime of high quality endorsed ratings proposed by the ESMA if appropriate cooperation and coordination exists between supervisors at the international level, and not just within the EU. Furthermore it should be ensured that there is an improvement in transparency and the quality of information to which market participants, particularly investors, have access.

Financial Stability Board (FSB)

G20 recommendations

On 3 March, the FSB published a ➲joint FSB-BIS-IMF report, titled "Macro-prudential policy tools and frameworks - Update to G20 Finance Ministers and Central Bank Governors". The report summarizes the work underway internationally and nationally to develop effective macro-prudential policies and frameworks to implement the G20 recommendations. These efforts include regulatory reforms and the design of policy tools to strengthen the resilience of the financial system, as well as efforts at the national and regional level to develop fully-fledged - policy frameworks. The report concludes that major steps have already been taken. However further work is needed to address the remaining challenges in successfully implementing macro-prudential policies and institutional frameworks, including:

- Design and collection of better information and data to support systemic risk identification and modeling;
- Design of techniques to identify and measure systemic risk that utilize this information and help inform the design of policies;
- Design of an effective macro-prudential toolkit of powers and instruments, including the criteria for the choice and calibration of the instruments and methods to assess their effectiveness, as well as the respective merits of rules versus discretion; and
- Design of appropriate governance arrangements for the exercise of the macro-prudential policy powers.

International Capital Market Association (ICMA)

Credit rating

On 31 March, the ICMA published its ➲comments on ESMA's ➲consultation paper on the Guidelines on the application of the endorsement regime under Article 4 (3) of the Credit Rating Regulation 1060/2009. In its response, the Association stated that it considers that it is quite possible for self-imposed requirements to be as stringent as those imposed by legislation or regulators; and that Article 4.3(b) of the Regulation clearly states that it is the "conduct" of credit rating activity by the CRA that must fulfill requirements that are at least as

stringent as those in Articles 6 to 12. As such the ICMA does not concur with the view proposed by ESMA that the third country regulation has to contain enforceable rules that are "as stringent as" the one in the EU regulation. The ICMA highlights that the only requirements in Article 4 that relate to the third country regulatory environment itself are Articles 4.3(f), (g), and (h) (which collectively apply from 7 June 2011). These merely require that the CRA in question be subject to third country authorization or registration, and supervision (4.3(f)); without that third country interfering with the content of credit ratings and methodologies (4.3(g)); and that appropriate cooperation arrangements be in place between the competent authority of the home Member State of the endorsing CRA and the relevant competent authority of the CRA established in a third country (4.3(h)).

Common rules for Central Securities Depositories (CSDs) and securities settlement

On 1 March, the European Repo Council ("ERC") of the ICMA published its ➲response to the ➲European Commission's consultation on central securities depositories (CSD's) and securities settlement. The response is limited to the repo oriented aspects of the European Commission's Consultation.

International Organization of Securities Commissions (IOSCO)

Principles for financial market infrastructures

On 10 March, IOSCO together with the Committee on Payment and Settlement Systems (CPSS) published a ➲consultative report, titled "Principles for financial market infrastructures". The report contains proposals for new and more demanding international standards for payment, clearing and settlement systems. When finalized, the new principles will replace the three existing sets of CPSS and CPSS-IOSCO standards, the Core principles for systemically important payment systems (2001); the Recommendations for securities settlement systems (2001); and the Recommendations for central counterparties (2004). The CPSS and IOSCO believe that a single set of principles will provide greater consistency in the oversight and regulation of financial market infrastructures (FMIs) worldwide. Compared with the current standards, the new principles introduce more demanding requirements in many important areas including: the financial resources and risk management procedures an FMI uses to cope with the default of participants, the mitigation of operational risk; and the links and other interdependencies between FMIs through which operational and financial risks can spread. There are also principles covering issues that are not fully addressed by the existing standards. These include new principles on segregation and portability, tiered participation and general business risk. Comments on the principles should be sent by 29 July 2011. The final report will be published in early 2012.

Official Journal of the European Union (OJ)

Deposit guarantee schemes and investor-compensation schemes

The ➲Opinion 2011/C 99/01 of the European Central Bank of 16 February 2011 on a proposal for a directive of the European Parliament and of the Council on deposit guarantee schemes (recast) and on a proposal for a directive amending Directive 97/9/EC of the European Parliament and of the Council on (CON/2011/12) has been published in OJ C99 of 31 March. The proposed recast directive will require all credit institutions to become members of deposit guarantee schemes (DGS) offering deposit guarantees under harmonized conditions and to be funded, in principle, by individual *ex ante* contributions of DGS members. The ECB indicated that such harmonized arrangements are necessary to ensure a level playing field in the context of the Union's single market for financial services. At the same time, the ECB acknowledged the long-standing successful functioning in some Member States of mutual and voluntary schemes, which achieve deposit protection through arrangements other than pre-defined deposit guarantees. The ECB understands that the proposed recast directive is not intended to limit the continuing capacity of the mutual and voluntary schemes to offer protection to their member institutions in a manner characteristic to such schemes, which would be provided in parallel to the deposit guarantees that clients of such member institutions will be offered in accordance with the proposed recast directive. With regard to the repayment period, the ECB welcomed the principle of further reducing the repayment periods for guaranteed deposits. On the subject of financing, the ECB stated that it welcomes the introduction of an explicit target level of ex ante funding, which considerably enhances financial stability and the level playing field by shifting the burden of DGS financing to the member credit institutions, i.e. to entities controlling the risks that DGSs insure. As regards to calculating individual contributions of DGS members, the ECB welcomed in principle the proposed model of partial risk-based contributions, with provisions ensuring comparability of various asset classes. Finally, the ECB stated it supports the provision of the proposed recast directive under which credit institutions ceasing to be a member of a scheme and joining another scheme will have their contributions for the last six months reimbursed or transferred to the new scheme. In relation to supervision, the ECB welcomed the fact that the supervision of DGSs by Member States will be enhanced by stress tests and that these will be subject to peer reviews executed by the EBA and the European Forum of Deposit Insurers.

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Credit institutions and investment firms

Normative documents

Banking, Finance and Insurance Commission (CBFA)

Guarantee fund contributions

On 17 March, the CBFA published the Communication CBFA_2011_12 on layout A (in ➲Dutch and in ➲French) which provides guidance to credit institution in relation to the accounting treatment of transactions in relation to the Protection Fund for Deposits and Financial Instruments and the Special Protection Fund for Deposits and life insurance.

Capital Requirements

On 11 March, the CBFA published the Circular CBFA_2011_10 on the prudential expectations with regard to stress testing (in ➲Dutch and in ➲French). The Circular complements the Circular PPB-2007-15-CPB-CPA on the prudential expectations with regard to Internal Capital Adequacy Assessment Process (ICAAP) as well as Title XII of the Own Funds Regulation. It details what the CBFA expects of financial institutions in terms of stress testing under Pillar 2 (Supervisory Review and Evaluation Process). The circular largely reiterates the CEBS guidelines for stress testing.

Consultative or informative documents

European Association of Co-operative Banks (EACB)

Capital Requirements

In a press release 14 March, the EACB expressed its concerns for the Basel 3 measures. According to the Association, the Liquidity Coverage Ratio (LCR) and the Net Stable Funding Ratio (NSFR) can have a much stronger effect on the EU economy where bank intermediation plays a much stronger role than in the USA. There is a risk of overregulation with negative effects for the whole economy. It would be paradoxical to force the Co-operative Banks, for regulatory reasons, to reduce our capacity to finance small and medium enterprises and at the same time to call for developing social entrepreneurship in Europe. Therefore, the transition period for their implementation has to be used to carefully assess their impact and improve the concept. Moreover, it has to be ensured that the specific mechanisms and liquidity management processes of co-operative banks, making them less vulnerable to market turbulences, and being at the core of their financial solidity, are not undermined.

EU Crisis Management Framework

On 10 March, the EACB published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, the EACB stated that it supports the 7 general principles set out in this context in the ➲Communication on a new EU framework for crisis management in the financial sector: 1) put prevention first, 2) provide for credible resolution tools, 3) enable fast and decisive action, 4) reduce moral hazard, 5) contribute to a smooth resolution of cross-border groups, 6) ensure legal certainty and 7) limit the distortions of competition. However, there are still uncertainties as regards the possibilities for an EU framework on crisis management. Furthermore, the Association indicated that if put into practice, the proposal contained in the consultation paper will lead to far-reaching changes to the way in which banks operate on a day to day basis. Some of the suggested preventative powers and early intervention measures would be very intrusive considering that they would apply to banks which still have 'a going concern' status. According to EACB, the crisis management should also be seen in the context of the other prudential measures on the way such as Basel III/CRD IV, the enhanced supervision via the new ESA's and other regulatory measures to prevent a future crisis. Moreover, at a global level there is a need to maintain a level playing field. The possible future EU framework should not put European banks and/or their subsidiaries operating on a global level at a disadvantage in comparison with their non-EU counterparts. Finally, while the European Commission has mentioned and taken account of certain specificities of the cooperative banking model, the EACB indicated that there are a number of other specific co-operative features that have to be taken into consideration. Co-operative banks are to promote members' interest by providing services to them. They have to be profitable, but they do not have the aim to generate maximum profit. Co-operative banks serve their members on a long-term and intergenerational basis. As co-operative banks do not prioritize the maximization of profits, they do not attract large investors, but individuals who invest a limited amount of money. Moreover, co-operative banks are democratically controlled by their members, and typically each member has one vote regardless of the amount of capital he holds.

European Association of Public Banks (EAPB)

EU Crisis Management Framework

On 10 March, the EAPB published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. With regard to the scope of the proposed framework, the Association stated that promotional banks should not be covered by an initiative on crisis management as the measures described in the consultation paper do not fit the special organization of the banks and are inadequate for them. On the subject of supervision, detection and prevention, the EAPB stated that the banking institutes

should be in charge of drawing up and organizing the stress scenarios, since they know best how to assess the risk that could endanger their economic progress. Supervisory authorities should only develop the commonly used framework with the parameters in question for further orientation of the institutions and to ensure common quality standards. The stress test results should be interpreted against a quality background and not automatically linked with additional capital requirements. There should also be no automatic disclosure of test results. In general, recovery plans can help to prepare credit institutions for crisis situations, but such a plan should be proportional regarding the level of detail. Furthermore, an intra-group financial support agreement must be optional but not a compulsory requirement that feeds into recovery planning of a credit institution. In relation to early intervention, the EAPB stated that the proposed trigger of the European Commission regarding Art. 136(1) CRD with the extension to include circumstances of a 'likely breach' as too vague in legal terms. It also strictly rejects the introduction of automatic triggers. Additionally, the appointment of a special manager should be a supervisory tool that is used as a last resort, in extraordinary, legally defined circumstances only and with a clearly limited time horizon. Finally, on the subject of financing of the framework, the association stated that an EU framework for national resolution funds should stipulate common standards for the scope of contributors, the use of the funds, the calculation of the contributions as well as their treatment in the balance sheet and fiscal treatment. The Commission could also consider defining minimum contributions or maximum caps.

European Banking Authority (EBA)[2]

Test scenarios and methodology for EU-wide stress test

On 18 March, the EBA published ➲documents explaining the macro-economic scenarios and methodology for its 2011 EU-wide stress test, which will be applied on a wide sample of European banks covering over 60% of total EU banking assets. The stress test will use a set of baseline and adverse macro-economic scenarios developed by the EU Commission and the ESRB/ECB respectively, in conjunction with the EBA and national supervisors. The adverse scenario is more severe than the 2010 CEBS' exercise in terms of deviation from the baseline forecast and probability that it materializes. For the purposes of the trading book stress test as well as to address the sovereign risk component of the exercise, a set of stressed market parameters will be directly applied on the trading book positions. The exercise also uses a number of stringent assumptions aimed at ensuring overall consistency of the exercise as well as common definitions based on the common EU regulatory and reporting frameworks. The capital threshold will be focused on a definition of core tier 1 capital which is more restrictive than the tier 1 threshold used last year. The test will be carried out on the basis of the consolidated

[2] EBA has replaced the Committee of European Banking Supervisors (CEBS), as of 1 January 2011.

year-end 2010 figures (both for banking and trading book) and the scenarios will be applied over a period of two years – 2011 and 2012. The stress is being run between March and June 2011.

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[2] EBA has replaced the Committee of European Banking Supervisors (CEBS), as of 1 January 2011.

European Banking Federation (EBF)

Operational risk

On 24 March, the EBF published its ➲comments the ➲CEBS consultation paper on Guidelines on AMA changes. In its response, the EBF welcomed the willingness of CEBS (EBA from 1 January 2011) to gather the views of the industry with regard to the introduction of guidelines on the Advanced Measurement Approach (AMA) changes. The Federation indicated that the categorization scheme proposed by CEBS shall encourage common understanding of the circumstances that should give way to an application with the competent authority. It would be useful if explicit recognition could be given to the case of takeovers. The EBF also insisted on reinforcing the important role played by the internal validation function of the bank. In this vein, it is broadly understood that the requirement for an independent review of the AMA change policy could be adequately fulfilled by the internal validation of the bank. Explicit recognition of this possibility would be clarifying. Regarding the time for the submission of the required documentation, both for significant changes and major changes, the Federation indicated that six months prior to the planned implementation should be adequate for the delivery of all related documentation, with the exception of the independent review. The report of the internal validation (or external upon the choice of the institution) would be timelier three months in advance of the implementation date. This way the competent authority could start reviewing the changes put forward by the institution and receive the complementary independent review report at a later stage.

Counterparty credit risk

On 9 March, the EBF published its response to the European Commission's ➲Consultation on possible measures to strengthen bank capital requirements for counterparty credit risk. The consultation deals with capitalization of banks exposures to central counterparties and the treatment of incurred credit valuation adjustments. In regards to the capitalisation of bank exposures to central counterparties and the Basel Committee proposal to establish a 2% risk weight to trade exposures to a "qualifying CCP", the EBF raised a concern that relates to the regulatory treatment suggested by the Committee to incentivise the use of CCPs by banks: Taking into account the fact that the capital framework currently contemplates no capital charges for such exposures, the recommended approach in fact reduces the existing capital relief available for central clearing and creates burdens that may outweigh

supervisory benefits that might result from the capital charge. Furthermore, the Federation indicated that the lack of clarity regarding the interaction of the proposals relating to capitalisation of bank exposures to CCPs and the large exposures regime is of concern. It stated its support for the exemption of banks' exposures to CCPs from any large exposure limits. Failure to adopt such an approach would undermine the incentive to move OTC derivatives to CCPs and consequently hinder the efforts to reduce systemic risk. On the subject of credit valuation adjustments (CVA), the EFB stated that there is a there is general discrepancy with the recognition of incurred CVA by reducing the exposure amount. The alternative treatment being considered in the consultation, i.e. the recognition of incurred CVA via provisions/increase of available capital seems to have broader acceptance in the European banking community, according to the Federation. Differences in practices of computation of CVAs should also be considered. For instance, in the US, it is common to calculate the CVAs based upon market implied default probabilities and recovery rates (marked to market based CVAs, using CDS spreads). In contrast, in Europe, many banks calculate the CVA based upon historical probability of default of the counterparties in their portfolios, reflecting a banking book approach (rating-based CVAs). As such the Federation indicated that rating-based CVAs should be used as not only less volatile than marked to market based CVAs, but they also reflect better the business model of the vast majority of European banks.

EU Crisis Management Framework

On 3 March, the EBF published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, the Federation expressed its support for proposals put forward in terms of planning and prevention, enhanced supervision, Recovery and Resolution Plans, and resolution colleges. The EBF did, however, express concern about the way some early intervention is planned, such as the changes in the business structure and special management proposals, which should take place only when all recovery measures have failed. The trigger mechanism should be as transparent, objective and predicable as possible. Triggers need to be scaled and sequential to differentiate different points in the crisis management continuum i.e. planning and prevention, early intervention and resolution using a mix of hard and soft triggers for early intervention. The Federation also requested the Commission to make an impact assessment taking into account all the other supervisory reforms including Deposit Guarantee Schemes Directive (DGS) and Capital Requirement Directive. If Deposit Guarantee Schemes are able to finance resolutions, there is no need to create a resolution fund, according to the EBF. Should a fund be needed, the Federation indicated that it supports harmonized requirements for resolution funds to ensure a level playing field, e.g. alternative funding requirements, calculation of contributions and provisions to avoid double taxation. Furthermore, the EBF indicated that debt-write

down (bail-in) mechanisms must be further analyzed and a thorough impact analysis must be done before it is introduced. If introduced it should be a last recourse action once other tools have failed and only in situations which are transparent and leave the holders of the „bailed-in“ instruments in no worse a position than had the bank become insolvent and liquidated in an orderly fashion. In addition, the cost of a bank failure should be borne by shareholders and holders of other loss absorbing instruments. Creditors should suffer losses only in exceptional circumstances.
Shareholders should bear losses before junior creditors and this in turn before senior creditors.

European Banking Industry Committee (EBIC)

Capital Requirements

On 29 March, the EBIC published a position paper, titled ➲"Views on the transposition of Basel III into the European Union through the review of the Capital Requirements Directive (CRD)". In the paper, the Committee indicated that, in general, it supports Basel III, which addresses several weaknesses observed during the crisis. However, due account needs to be taken of the important specificities of the European banking sector, such as the variety of business models operating under different legal forms; the fact that the European corporate sector is predominantly financed through bank lending and mortgage lending predominantly kept on balance sheets rather than in SPVs; and, finally, the absence of government-sponsored and government-guaranteed institutions, to which banks in some other jurisdictions are in a position to sell their mortgages to alleviate their capital and liquidity requirements. In addition, the EBIC stated that it has to be kept in mind that Basel III was developed for internationally active banks. Yet its EU transposition will be applied to all EU credit institutions, i.e. large and small, international and regional, and retail and universal banking models with different ownership and organisational structures. To the Committee, it is also essential that Basel III should be implemented globally, and that EU regulators should remain mindful of developments in other jurisdictions when deciding on the transposition details at EU level, so as to preserve the competitiveness of Europe's banking sector, abroad but also at home, where a level playing field between European banks must be an overriding priority. Furthermore, the EBIC expressed its concerns regarding the format of the legislative package. If the Commission is indeed determined to cover important parts of the Basel III transposition in the form of a Regulation, directly applicable to all EU credit institutions, EBIC urges for great caution. Here it is essential that all relevant national specificities are sufficiently taken into account. Finally, EBIC stressed that the European Commission should not re-open issues which have already been agreed upon in the CRD and its two previous reviews (CRD II&III), particularly in relation to complex and sensitive areas. The Commission should also take the cumulative impact of all the various legislative measures currently on the table (the review of the

Deposit Guarantee Schemes Directive, initiatives for an EU crisis management and resolution framework and so on) into account alongside the review of the CRD.

Eurofinas

Interest rate restrictions

On 25 March, Eurofinas published its ➲response to ➲European Commission's consultation on the Study on interest rate restrictions. In its response, the Federation indicated that a sound and constructive discussion at European level on interest rate restrictions can only take place if it is first recognized that different types of pricing control mechanisms for credit agreements coexist across Europe, that their underlying rationales differ and the impact of these mechanisms varies depending on the type of restrictions in place, the structure and maturity of the market and/or the type of active providers. Eurofinas also highlighted the fact that the absence of statutory rate ceilings does not imply the nonexistence of limits or controls whatsoever on credit interest rates and the existence of statutory rate restrictions does not impact per se the validity of extortionate credit agreements. Because of this the Federation recommended to analyze interest rate restrictions in the wider context of consumer protection at European and national levels, addressing unfair commercial practices, unfair contract terms, information and pricing transparency. Furthermore, Eurofinas stated that it firmly believes that any statutory intervention in the field of interest rate restrictions will undoubtedly have substantial impacts on market characteristics and business structures. Interest rate restrictions will reduce credit access, in particular for low-income borrowers, will have a negative impact on the level of competition existing in the market where such restrictions apply and will lead to a decline in the volumes of consumer credit granted. Additionally, it indicated that the average consumer would not be granted cheaper credit in the presence of interest rate restrictions. Market data and existing literature show that following the imposition of a rate ceiling, lenders do not lower the price of credit but rather refuse more applications from high risk borrowers. Finally, Eurofinas stated that the European-level problems are yet to be identified and that the business case for an EU intervention is therefore still to be made. It indicated that elements such as over-indebtedness, illegal lending markets and market exclusion require further analysis and warned against a potential intervention that could lead to profound structural and technical changes of the consumer lending business.

Mortgage credit

In a ➲press release of 31 March, Eurofinas responded to the ➲European Commission's proposal for a Directive on credit agreements relating to residential property. In its response, the Federation welcomed the fact that the scope of the proposal is restricted to residential property loans for consumers. This will avoid overlaps with the Consumer Credit Directive. Eurofinas also acknowledged

the European Commission's objective to create an Internal Market for mortgage credit. It did however doubt that the proposal, as is, will help foster it. In addition, Eurofinas' Director commented that the discussions in Parliament and Council must focus on the key elements of the Directive. The objective must be to provide consumers and lending institutions with a clear and proportionate framework. The Commission's proposal should not be used as an opportunity to open up wider, unrelated and often populist debates. The financial crisis did not originate from the provision of mortgage credit in Europe. The Federation did indicate that the Commission's proposal provides a good starting point to further discuss the issues at stake at European level. However, a number of modifications and/or clarifications are required on the assessment of applicant borrowers' creditworthiness, early repayment and advertising requirements. On the subject of the assessment of creditworthiness, Eurofinas takes the view that the obligation to deny credit based only on the negative outcome of a narrow creditworthiness assessment could exclude different categories of borrowers such as, for example, a 25 year old professional who might have a limited income but a long-term earning capacity. With regard to early repayment, it believes that in the event of early repayment of credit, lending institutions should be entitled to fair and objectively justified compensation. However, the proposal for the Directive only mentions that Member States may provide creditors for such compensation which creates legal uncertainty for lending institutions. Finally the Federation empathized that advertising requirements must be aimed at ensuring clarity of the offer and be adaptable to all marketing medium.

European Commission

Mortgage credit

On 31 March, the European Commission published a ➲Proposal for a Directive on credit agreements relating to residential property. With the proposal, the Commission aims to create a responsible, efficient, healthy and competitive pan-European market that works to the benefit of consumers and to promote customer mobility, cross-border activity of creditors and intermediaries, and create a level playing field for all actors involved. The proposed Directive will:

- introduce certain requirements for the advertising of mortgage credit;
- ensure that all institutions involved in the origination and distribution of mortgage credit to consumers are adequately regulated and supervised;
- establish principles for the authorization and registration of credit intermediaries and for the establishment of a passport regime for those intermediaries;
- ensure that lenders benefit from provisions enabling them to access information in credit databases on a non-discriminatory basis;
- introduce certain information and assessment

obligations for lenders and credit intermediaries;
- introduce the obligation for borrowers to provide the necessary information to enable an assessment of their ability to repay;
- introduce an entitlement for borrowers to repay their credit before the expiry of the credit agreement, subject to certain conditions to be determined by Member States
- introduce a harmonised annual percentage rate of charge.

The ➲publication of the proposal was accompanied by an Impact Assessment, an overview of national measures and practices to avoid foreclosure procedures for residential mortgage loans, a Frequency Asked Questions and a press release.

On 31 March, the Commission also published the ➲final report of a Study on the costs and benefits of different policy options for mortgage credit. The study examines the costs and benefits of different policy options in relation to following elements: pre-contractual information, annual Percentage Rate of Charge (APRC), responsible lending and early repayment.

European Credit Research Institute (ECRI)

Deposit guarantee schemes

On 29 March, the ECRI published a policy brief, titled ➲ "Options for reforming deposit protection schemes in the EU". The policy brief reviews current policy discussions on deposit insurance in the EU. It looks at the role of deposit insurance as part of the (European) financial safety net and examines the Commission's recent proposal to amend the EU Directive on deposit guarantee schemes (DGS). The three options for a European DGS are assessed, i.e. (1) Single entity replacing the existing DGS, (2) A DGS that is complementary to existing DGS that would support the existing DGS if needed ("28th regime") and (3) European system of DGS (i.e. a network of schemes in the Member States that provide each other mutual assistance if needed, e.g. by borrowing from each other). The paper concludes that the only efficient, reliable and sustainable solution is full harmonization, meaning the creation of a single European deposit insurance scheme. The network structure always leaves regulatory gaps, as does a 28th regime.

European Federation of Building Societies (EFBS)

Mortgage credit

In a press release of 31 March, the EFBS published its ➲comments on the ➲European Commission's proposal for a Directive on credit agreements relating to residential property. The federation stated that the proposal for a Directive for the regulation of mortgage credit in Europe, is counterproductive for the internal market. Instead of increasing product diversity for the consumer, the

European Commission's concepts make it more difficult to compare cross-border financial offers. The rules for calculating the annual percentage rate of charge (APRC) are the best example of this. Under the proposal for the Directive, the calculation will in future include the costs of collateral submission, such as the costs of registering the mortgage. However, these costs vary widely in the EU Member States. As such the requirement will distort the cross-border comparison of lending terms, according to EFBS. In addition the provisions on early repayment are likely to increase the price of fixed-interest loans in some countries. This is because the costs of the risk associated with early repayment have to be passed on to consumers.

European Mortgage Federation (EMF)

Mortgage credit

In a ➲press release, the EMF commented on the ➲European Commission's proposal for a Directive on credit agreements relating to residential property. According to the EMF, the Industry still remains to be convinced that there is a business case for such an initiative. She indicated that the EMF has reservations about whether the regulation of consumer protection in the field of mortgage credit will ensure a more efficient functioning of the Single Market, as appears to be the Commission's intention. For consumers, mortgage markets are purely domestic – they do not shop around on a cross-border basis. Therefore, any cross-border mortgage lending is supply-driven, i.e. it is lenders who cross borders to offer their products. She also stated that the Commission's Impact Assessment does not make a convincing case that regulation will bring about any change to this. If the Commission's aim is a more integrated mortgage market, then its focus should be on removing obstacles to lenders lending across borders, obstacles which have been clearly identified in the course of this reflection process. According to the EMF, the Industry has serious concerns about a number of the provisions proposed, such as the legal obligation to deny credit in the event of a negative creditworthiness assessment and to justify this decision to the consumer. The EMF stated that such provisions will lead to an unbalanced shift of liability to the lender and to even more legal uncertainty and litigation, which in turn will result in a restriction of access to credit for an increased range of prospective borrowers

European Savings Banks Group (ESBG)

Counterparty credit risk

On 10 March, the ESBG published its ➲response to the European Commission's ➲Consultation on possible measures to strengthen bank capital requirements for counterparty credit risk. In its response, the ESBG expressed its agreement with the idea that banks should maintain sufficient capital for exposures to central counterparties (CCPs), and appreciates the efforts of the European Union to improve derivative regulation and

create more central counterparty clearing, as decided at the G-20 level. However, the Association drew attention to the fact that in September 2010, the European Commission tabled its proposal for a Regulation on OTC derivatives, central counterparties and trade repositories (EMIR), which purports to ensure that by the end of 2012, all standardized derivatives contracts will be centrally cleared. In ESBG's view, this initiative of the Commission already fulfils the objectives to a considerable extent, and therefore the current consultative document's proposals should avoid presenting additional and unnecessary burdens. Furthermore the ESBG expressed doubts as to whether decisions or determinations which are made by the CCP itself should indirectly be incentivized by banking regulation, as banks may ultimately only have a very limited influence on CCP's decisions regarding their own capital and organization. Rather, sufficient capital adequacy of CCPs should be achieved through direct qualitative and quantitative capital requirements and the prudential supervision of CCPs. Finally, in ESBG's view there is a clear need for introducing grandfathering provisions for the proposed requirements. This is particular important considering the parallel development of the EMIR regulations and the inter-connections with the CCP regulations and requirements. For example, if a "qualifying" CCP under the current CRD regulations would not be recognized as a qualifying CCP under the CRD IV requirements, trade exposures, collateral "exposures" and default fund contributions to such a CCP must be grandfathered under the new regulations.

Capital requirements

On 4 March, the ESBG published a ➲position paper, titled "Transposing Basel III into the EU: Core messages of Europe's savings and regionally oriented retail banks". In the paper, the ESBG indicated that it generally supports Basel III. However there is a general caveat, namely the one-size-fits-all-approach, that may stop Basel III from reaching its goal and can even prove destabilising. This is especially the case if the application greatly exceeds the original scope of the regime. As a result, differences in transposition in the jurisdictions concerned are necessary. Consequently, for a transposition of Basel III in the EU, it is vital to recognize the relevant EU specificities and to adapt a legislative proposal to EU realities.

On this basis ESBG listed its most important concerns as regards the suitability of some parts of Basel III for the European retail banking sector. The Association also stressed the importance to avoid collateral damages to an important part of the EU financial system, which hitherto has been stable, sound and responsible. The ESBG further reiterated that Basel III should be implemented globally, and that EU regulators should remain attentive to developments in other jurisdictions when deciding on the transposition details at EU level. Of similar importance for the success of Basel III in increasing financial stability is that regulators consistently and coherently reduce the scope for shadowbanking activities to which risk taking may otherwise migrate. Equally, EU

regulators should be highly conscious that, unlike other important markets, the EU real economy is predominantly bank financed, and that firms' access to capital markets not only varies greatly across the EU, but also between enterprises of different sizes. It is in the common interest, that transposition of Basel III does not change the relationship between EU banks and their customers for the worse. With regard to the format of the legislative package, the ESBG stated that a Directive is the only appropriate format as only this way national specificities can be taken into account.

EU Crisis Management Framework

On 4 March, the ESBG published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, the ESBG highlighted the following points and concerns. The Association stated that it shares the Commission's view that the resolution of failing banks needs to be a credible option even for systemically important banks. However it is necessary to have realistic expectations with regard to the currently proposed framework: while it is very promising in addressing a crisis in a particular institution, much greater uncertainty prevails on how it will perform – or even be applied – under the conditions of another system wide crisis. In addition, the ESBG argued that the value added by these new rules will be much greater for larger, complex and interconnected institutions, while for smaller regional institutions with a straight-forward business model, the associated burden and costs to the individual bank will easily prevail over any benefit the framework may have. As such the importance of conscientiously adhering to the principle of proportionality cannot be overstated, according to the ESBG. In relation to existing institutional protection scheme, the Association stated that it should be made clear in the legislation that such schemes pose a valid alternative to the present framework, with adequate implications on the related requirements for and burden of the individual institutions concerned. While, in general ESBG welcomed the approach chosen, and in particular the importance given to early intervention and preventative measures, it stated that some of the concrete tools and powers are disproportionately intrusive, while the respective trigger events are not sufficiently clear. Furthermore, while resolution and restructuring especially of systemically important credit institutions are promising approaches towards safeguarding financial stability, creditors (and also owners – whether shareholders or others) should not be worse off due to a resolution or restructuring process than they would be in the case of a regular liquidation. Restructuring should also not distort competition. Finally, the ESBG stated that financing a resolution fund should not amplify the burden on institution. Contributing to a European or national resolution fund, while at the same time being subject to a bank levy or 'financial activities tax' is unacceptable.

Febelfin

EU Crisis Management Framework

On 9 March, Febelfin published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, Febelfin indicated that it overall concurs with the European Banking Federation's (EBF) position paper on this subject (see above). Therefore, it has not developed a special position for the overall crisis management consultation. However, on two points, Febelfin members want to put forward a specific Belgian view: namely (1) financing of the resolution framework and (2) debt write down as an additional resolution tool. In relation to the financing of the resolution framework, the Federation stated that the contribution to a possible resolution fund is to be seen in function of the following considerations. Firstly Febelfin noted that the financing aspects of a crisis management framework are to be added to a number of other issues where important financial efforts are asked from the financial sector. The possibility for the financial sector to absorb these measures without unduly burdening economic recovery should in our view be taken into account when calibrating these measures. Secondly, the overall financial burden for the financial sector should not only be seen in a European context but rather on a global basis to stay competitive also on a global scale. A further problem in developing European principles for the financing of a crisis management framework is the diverse initiatives of local member states which have been taken already. Nonetheless, the Federation strongly urged European and national authorities to level the playing field for European banks in financial efforts to be made to implement the new regulatory model. Also, taking into account the diversity of measures which are developed locally, institutions should pay only once. Febelfin also addressed a number of specific points of attention such as the fact that a resolution fund must not be seen as a tool, but just as a way to finance resolution tools. On the subject of debt write down as a resolution tool, Febelfin stated that prior to the use of debt write down as a resolution tool, some preliminary measures seem essential to first improve bank liquidity such as the temporary suspension of payments or delivery obligations. In addition the Federation indicated that it cannot make a choice between the two alternative methods for debt write down as put forward in the consultation document. Both methods have pros and cons. While the comprehensive approach largely looks at the issue from an economical angle, the targeted approach tackles the debt write down issue from a legalistic angle. To conclude, Febelfin stated that, in determining the final features of a possible bail in framework, it believes that further investigation is necessary. In any case, a balance is to be found between the cost of funding a bank and the possibility to use debt write down as a resolution tool.

Financial Stability Board (FSB)

Residential mortgage underwriting and origination

practices

On 18 March, the FSB published a ➲peer review report on residential mortgage underwriting and origination practices in FSB member jurisdictions. The report provides an overview of existing practices and oversight – including recent crisis-induced reforms – in relation to underwriting practices for residential mortgage origination and draws internationally applicable lessons. The FSB concluded that nearly all mortgage lenders across its membership are regulated either by prudential supervisors or consumer protection authorities and in some cases by both. As a result, industry practices are moving in the right direction. However, most FSB member jurisdictions do not yet have adequate public disclosure or monitoring of information concerning the overall health of their mortgage market, including evolving mortgage underwriting practices and market trends. In the report, the board made the following recommendations to further promote sound residential mortgage underwriting practices and financial stability:

- National supervisors should develop a framework for sound residential mortgage underwriting standards and practices that is as explicit and specific as possible.
- Financial authorities should regularly review their standards on residential mortgage underwriting and adjust them as appropriate to address the build-up of risks in the housing market or to help counteract a lending boom that poses significant risks to financial stability.
- Policymakers should broaden the regulatory perimeter to ensure all residential mortgage lending activity is supervised and/or regulated to safeguard both borrowers and investors and to promote financial stability.
- Regulators and supervisors should ensure that mortgage insurers, where active, are appropriately regulated and robustly capitalized in order to avoid regulatory arbitrage.
- Authorities should collect and disclose enough detailed data to allow a comprehensive view of residential mortgage lending activities.

Risk disclosure practices in respect of exposures to structured credit product

On 18 March, the FSB published a ➲thematic peer review report of risk disclosure practices by financial institutions in FSB member jurisdictions in respect of exposures to structured credit products. This report reviews both financial institutions' public disclosures of these risk exposures as well as the actions undertaken by FSB member jurisdictions and the private sector participants to enhance disclosure practices. The review found that FSB member jurisdictions have successfully prompted financial institutions to improve their disclosure of exposures to structured credit products. More generally, standard setting bodies have improved their disclosure requirements for financial institutions in these areas in the wake of the financial crisis. Although firms' compliance with the FSF's recommended risk disclosures

has generally been good, the quality of public risk disclosures varies across institutions and jurisdictions and there remains room for improvement. According to the FSB, there is room to improve disclosures on: 1) the descriptions of the use and objectives of special purpose entities (SPEs) used for securitization; 2) off-balance sheet exposures of SPEs; 3) exposures both before and after hedging; and 4) the level of detail and granularity of the sensitivity analysis of securitization exposures measured at fair value. Also the level of external audit assurance provided on risk disclosures typically varies depending on whether the disclosures are made in financial statements, Pillar 3 reports regarding securitization, or management analyses in financial reports or websites, and practice varies on how that level of assurance is disclosed. The FSB recommended that the International Auditing and Assurance Standards Board review whether further guidance is needed in this area. The Board also recommended that banks improve their Pillar 3 disclosure practices, including by better aligning the publication of their Pillar 3 disclosures with the publication date of financial reports. Finally, the FSB urged follow-through on recommendation that the financial industry, investors, and auditors work together to provide risk disclosures that are most relevant as market conditions evolve, by developing principles and identifying leading disclosure practices.

International Capital Market Association (ICMA)

EU Crisis Management Framework

On 3 March, the ICMA published its ➲response to European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, the Association focused on the concept of a bail-in regime applicable to senior unsecured creditors. In this regard, it stated that there are some significant overriding challenges which will need to be overcome in the final design of any such senior unsecured debt bail-in regime. Concretely, the ICMA considered that whilst investors appreciate the capital risks of investing further down the bank capital structure, they invest in senior bank debt principally to match their liability structure; not to add risk. If bail-in extends to senior unsecured bank debt it will either: Restrict investment criteria; and/or make other asset classes more attractive on a relative value basis; and/or justify a significant premium over current senior unsecured levels. Furthermore banks will face increased competition for retail deposits and make increased use of various forms of secured funding and/or securitisation. This will encumber (typically higher quality) assets, to the detriment of other creditors – including depositors. Such increased competition for retail deposits is likely to drive up rates for depositors (so decreasing bank interest margins), but will also induce increased deposit shifting (i.e. funding becomes less stable). According to the ICMA, the risk of runs also likely to increase, as senior unsecured creditors are incentivized to ensure that they exit their debt investment ahead of

any triggering of a senior unsecured bail-in. The aforementioned issues are incongruous with the Basel proposed NSFR (Net Stable Funding Ratio) and LCR (Liquidity Coverage Ratio). They will also lead to higher bank lending costs; and/or reduced bank lending. For these reasons, the ICMA stated that it would be best to restrict explicit loss absorption features to capital instruments and not to extend them to senior unsecured debt.

On the same day, the European Repo Council ("ERC") of the ICMA also published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In this response, the ERC focused on the aspects that bear most directly on repo's, in particular the matters relating to the temporary suspension of rights. It viewed the imposition of a temporary suspension of close out netting as undesirable. Once a termination event occurs, a party should be able to manage its credit and market risk in relation to its positions with the relevant failing counterparty, based on its assessment of market conditions and the situation of the counterparty. It must be able to take action to mitigate market risk by closing out such positions, without delay. If there is, nevertheless, to be any form of suspension of rights it is essential that this should be both clearly defined and as limited as possible in terms of time frame. In addition the ERC indicated that it is pleased to note the safeguards proposed within this consultation paper which aim to prevent resolution authorities from „cherry picking" rights and liabilities under protected market arrangements, including title transfer financial collateral arrangements, set off arrangements, netting arrangements and structured finance arrangements. To conclude, the Council noted that the arrangements under consideration in the consultation proposals need to be carefully developed to take account of repo (and other types of financing) trades, in addition to underlying cash securities trades. The ERC considered that whilst it is right to seek the orderly resolution of a failing institution, this must be balanced with the market need for prompt close out so as to mitigate the risk of adverse market movement during the period of suspension. The imposition of rigid or ill defined constraints could serve to impede established market practice for the efficient (repo) financing of securities positions.

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Investment products and asset management

Consultative or informative documents

Council of European Union

Short selling and credit default swaps

On 25 March, the Council published a ➲revised

presidency compromise on the proposal for a Regulation of the European Parliament and of the Council on short selling and certain aspects of credit default swaps.

Derivative transactions, central counterparties and trade repositories

On 17 March, the Council published the ➲presidency compromise on the Proposal for a Regulation of the European Parliament and of the Council on derivative transactions, central counterparties and trade repositories.

Investor-compensation schemes

On 15 March, the Council published the ➲presidency compromise on the Proposal for a Directive of the European Parliament and of the Council amending Directive 97/9/EC of the European Parliament and of the Council on investor-compensation schemes.

European Fund and Asset Management Association (EFAMA)

Best practices for fund processing

In its ➲press release of 24 March, EFAMA announced the publication of ➲new recommendations to increase efficiency in the processing of fund orders.
The report consolidates the recommendations that were published in 2005 and updated in 2008, and extends the recommendations in two key areas:

- Transfers: Transfers of units between two accounts recorded in the legal register of fund holders are generally instructed using physical documents and faxes. As such, they require manual intervention, which makes them resource intensive and exposes them to the risk of human error. Moreover, their processing is usually not time-critical, leading to delays that can have a knock-on impact on a custodian's ability to service their client effectively. The report makes concrete recommendations to improve communication between the actors involved, shorten processing timelines, thereby reducing the risk of human error.
- Corporate actions: The report discusses various aspects in relation to events that arise from or have an impact upon holdings of units in an investment fund. The recommendations aim at improving communication with the wider market in order that underlying investors and their services agents are able to receive and process the information in a timely fashion.

European Parliament

Short selling and credit default swaps.

In a ➲press release of 7 March, the European Parliament announced the adoption by the Economic and Monetary Affairs Committee of the draft EU regulation on short selling and credit default swaps. The regulation foresees

in a ban on certain trades in sovereign bonds, and requires that traders settle their uncovered positions by the end of each trading day. The MEPs also inserted a requirement that short sale transactions be reported less often, but beefed up the rules to ensure that fines are dissuasive. The regulation is expected to be in force by 2012.

Derivatives trading

On a ➲press release of 1 March, the European Parliament announced that work on EU legislation to regulate derivatives trading began officially in the Economic Affairs Committee on Monday, with the presentation of a ➲draft report by Werner Langen. Mr Langen said the new rules should govern only privately-traded derivatives (rather than all kinds, as some Member States wish). His draft also advocates limited exemptions, and scrapping proposed "co-operation" arrangements between clearing houses.

European Savings Banks Group (ESBG)

OTC derivatives, central counterparties and trade repositories

On 9 March, the ESBG published its ➲comments on European Commission's ➲proposal for a Regulation on OTC derivatives, central counterparties and trade repositories. In its comments, the ESBG welcomed the Commission proposal, as it aims at reducing risks in derivatives markets and increasing the stability of the financial system in general and in the OTC derivatives market in particular. However, looking at the detailed proposals by the Commission, the Association did express a number of remarks and concerns. With regard to the clearing obligation for all eligible OTC derivative contracts, the ESBG stated that the scope of the application of the obligation should be restricted. Small credit institutions, whose derivative business is insignificant, should be exempted from the obligation to clear through a central counterparty. On the subject of eligibility for the clearing obligation, the Association stated that the Regulation will set incentives for using standardized derivatives, as these are most likely to qualify as eligible derivatives. Non-standardized derivatives will be more rarely used and will become more expensive (through increased capital requirements). This impact should be evaluated in the future, having in mind that standardization can limit investors' choices. Furthermore, the ESBG stated that the principle of non-discrimination should be emphasized more. In this sense, it should be clarified that access to a CCP shall be given in any case and not be linked to the size of the institution. It was also indicated that the reporting obligations should avoid double reporting and that the exact process of the reporting needs to be explained in more detail. In addition, the ESBG stated that the proposed set-up of the authorization process by the competent authorities of the Member State where it is established and the role of colleges and ESMA is not the optimal solution, but rather could lead to complex

structures with numerous members in the colleges and limited powers for ESMA. ESBG therefore suggested reflecting on strengthening ESMA's role in the authorization and supervision of CCPs. Finally, with respect to margin requirements, it should be specified that they capture the risk characteristics of the products cleared based on the Value at Risk (VaR) model.

European Securities and Markets Authority (ESMA)[3]

Prospectus Directive

On 23 March, ESMA published a ➲revised version of the CESR's recommendations for the consistent implementation of the European Commission's Regulation nr. 809/2004 on Prospectuses. These level 3 recommendations aim to help issuers and their advisers decide which information they should disclose in the prospectus and as such facilitate consistency across Europe in the way the disclosure requirements are complied with. The new version includes updated recommendation for the preparation of prospectuses by mineral companies and three new annexes related to mineral mining. It should be noted that the revised recommendations have not been adopted as recommendations under Article 16 of the ESMA Regulation and therefore the 'comply or explain' mechanism established under that Article does not apply. The publication of the recommendation was accompanied by the publication of the feedback statement

On the same day ESMA also published a ➲statement explaining the Framework for third country prospectuses under Article 20 of the Prospectus Directive. The Framework provides for a way in which a third country issuer that has drawn up a prospectus in accordance with a third country's legislation can meet the requirements of the Prospectus Directive. It allows a third country prospectus to have a 'wrap' added to it so that the resulting document meets the requirements of the Prospectus Directive. The annex to the statement sets out a categorization of disclosure requirements under the Prospectus Directive. This will be used by ESMA to assess what disclosure will need to be included in the wraps for prospectuses from specific third countries. ESMA's presumption is that all items should be addressed on a literal basis. However, in forming a view on what should be included in a wrap ESMA recognizes that there are alternative ways in which disclosure can be made and that this can be compatible with the requirements under the Prospectus Directive. However, ESMA recognizes that this approach will not be possible for all items and has therefore categorized such items as Category A. For these items it is required that the substantive disclosure appears in the form set out in the Prospectus Regulation's annexes.

When a successful application is made for an

[3]ESMA has replaced the Committee of European Securities Regulators (CESR), as of 1 January 2011.

arrangement under the above-mentioned framework, ESMA will publish a statement on the information that will be required in a wrap to prospectuses from that third country. The first such a ➲statement was published on 23 March in relation to Israeli laws and regulations on prospectuses and Israeli issuers.

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[3] ESMA has replaced the Committee of European Securities Regulators (CESR), as of 1 January 2011.

International Capital Market Association (ICMA)

European repo market

On 25 March, the European Repo Council ("ERC") of the ICMA published ➲an update to ➲its white paper on the operation of the European repo market, the role of short-selling, the problem of settlement failures and the need for reform of the market infrastructure. Among other things, the white paper highlighted concerns among market users about the persistence of barriers to interconnectivity between the ICSDs and the domestic CSDs in Greece, Italy and Spain. These barriers have undermined the efficiency of cross-border transfers of securities, fragmented the European financial markets and exacerbated the impact of the recent crisis. The update mentioned above sets out subsequent responses by the Greek authorities and the Italian CSDs, and summarizes progress since July 2010 towards the elimination of the identified barriers to interconnectivity.

MiFID review

On 10 March, the ICMA published the ➲letter that it and a number of other trade associations wrote to European Commissioner for Internal Market and Services Michel Barnier. In the letter the associations express their support for the principle that regulatory intervention in a market should tend to support a widening of choice for investors – whether financial investors or corporate firms seeking to hedge risk – rather than the reverse. They believe that preserving investors' freedom to choose where to execute trades is entirely compatible with the goals of ensuring transparency, strong risk management and operational efficiency. The requirements that apply to Organised Trading Facilities (OTFs) should be sufficiently tailored to meet the specificities of different markets and venues. This would support investor choice, whilst delivering on regulatory objectives.

International Organization of Securities Commissions (IOSCO)

Safeguarding of Client Assets

On 11 March, IOSCO published a ➲report on the result of a survey of Regimes for the Protection, Distribution and/or Transfer of Client Assets. The report describes differences in the treatment of Client Assets in various Regimes, based on two issues: (1) distinctions between (i) Securities for which a client has fully paid, and which

are free from further pledges and encumbrances (Fully-Paid Securities), and (ii) Securities purchased, in part, with money a customer has borrowed from the Investment Firm (sometimes referred to as "margin securities") and (2) distinctions between Client Assets securing debts of a client to the Investment Firm and Client Assets serving as a performance bond against the possibility of potential future debts of the client to the investment firm. It also details the protections that the Regimes afford to Client Assets, both before and after the bankruptcy of an Investment Firm.

Principles on Suspensions of Redemptions in Collective Investment Schemes

On 8 March, IOSCO published a ➲consultation report on Principles on Suspensions of Redemptions in Collective Investment Schemes. The report analyses how different jurisdictions' regulatory regimes address the suspension of redemptions by open-ended collective investment schemes (CIS) and proposes principles which provide general standards for how regulatory regimes should approach and oversee suspension of redemptions. The principles generally cover all types of open-ended CIS which offer a continuous redemption right, and apply irrespective of whether they are offered to institutional or retail investors. They are addressed to those entities responsible for the overall operation of the CIS and in particular its compliance with the legal/regulatory framework in the respective jurisdiction and thus for the implementation of the principles. The delegation of activities may not be used to circumvent the principles and there should be compliance with the principles, whether activities are performed directly or through a third party. The principles deal with the management of liquidity risk, criteria/Reasons for the suspension of redemptions, the decision to suspend and the obligations of responsible entity during the suspension period. The consultation period is open for comments until 30 May 2011.

Implementation of securitization recommendations

On 4 March, IOSCO published the ➲results of a survey on the implementation of its September 2009 ➲recommendations with respect to securitisation and credit default swap markets. The report shows that all jurisdictions surveyed by the Task Force had at least one, if not multiple initiatives in progress to implement the recommendations on: disclosure; the retention of economic interest (skin in the game); investor suitability, and international coordination and regulatory cooperation. Most measures are expected to be implemented in 2010 and 2011. The major themes which emerged from the Task Force's review were that the skin in the game concept is endorsed by most jurisdictions at this time. Furthermore, the majority of member jurisdictions are expected to implement the requirement for originator/sponsors to retain long term economic exposure to the securitization. Also in many instances, current laws, regulations or market practices for offering documents often covered elements of disclosure and third

party service providers. Most jurisdictions are either enhancing or considering enhancements for these areas. In relation to investor suitability, most jurisdictions are refining the definition of a sophisticated or wholesale investor. Depending on the jurisdiction, a greater burden will be put on the issuer/seller (to determine investor suitability) or on the investor (responsibility to buy products they understand). Based on the survey responses and subsequent discussions, IOSCO's technical committee made two further recommendations:

1. IOSCO recommends regulators encourage improvements in disclosure standards for private or wholesale offerings of securitised products; and
2. IOSCO recommends regulators engage in international cooperation toward convergence of national regulations, where desirable, and review progress regularly.

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Insurance, reinsurance and pensions

Normative documents

Banking, Finance and Insurance Commission (CBFA)

Guarantee fund contributions

On 25 March, the CBFA published the Communication CBFA_2011_14 to insurance and reinsurance companies on the accounting treatment of transactions concerning the Special Protection Fund for Deposits and Life Insurance (in ➲Dutch and in ➲French). The communication details how the amounts that insurance and reinsurance companies contribute to the Special Protection Fund for Deposits and Life Insurance must be treated in their books.

On the same day, the CBFA also published the Circular CBFA_2011_13 to insurance and reinsurance companies on the annual indexation of the absolute minimum amounts of the guarantee fund (in ➲Dutch and in ➲French). The circular describes the methodology for annual indexation of the absolute minimum amounts of the guarantee fund and its application.

Consultative or informative documents

Assuralia

The use of gender in insurance pricing

In a press release of 1 March, Assuralia commented on the decision of the European Court of Justice in the ➲Case C-236/05 in which the Court ruled that basing insurance premiums on an individual's gender counts as discriminatory behavior. Insurers will no longer be

allowed to take gender into account when deciding the price of annuities, life and health insurance, as of 21 December 2012. According to Assuralia, the aforementioned ruling will lead to increased premiums for both men and women. Furthermore the Association empathized that insurers base the height of insurance premiums on the objective risk factors to ensure that each insured person pays the right price for his/her risk. A principle, which according to Assuralia, is fully in line with Belgian anti-discrimination legislation. Finally, the Association expressed its concern that increased premiums, as a consequence of the ruling, will create situation where certain consumers will no longer be able to afford life insurance.

Banking, Finance and Insurance Commission (CBFA)

Solvency II

On 30 March, the CBFA published the ➲fifth quantitative impact study (QIS5) results for Belgium. The purpose of QIS5 was to gain insight into the impact of the proposed methodology on the financial position of insurance undertakings as per end 2009, and to test the standard formula calculation of solvency capital requirements. The exercise also aimed at identifying any remaining methodological and practical difficulties in applying the standard formula, such that areas for further refinement or simplification can be proposed. The results of QIS5 point out that for the sample of participants the solvency capital requirement (SCR) under the standard formula would increase substantially by 68% compared to Solvency I. The overall QIS5 results also reveal that available own funds would increase by 32% compared to the current statutory balance sheets. On aggregate this implies that the SCR would be covered for 179% by eligible own funds, whereas the current solvency ratio for the sample of firms is 230%. The minimum capital requirement, which acts as the ultimate solvency control point, would be covered for 271% by eligible own funds. Overall however, the excess of own funds above the SCR would increase by 2%, meaning that the financial soundness would have slightly improved at that point in time. As can be expected, there are important differences in QIS5 results across participating undertakings, depending on the risk profile of investments, types of insurance business written, size of the undertaking, use of proxies and simplifications in the standard formula as well as diverging interpretations in some areas of the QIS5 technical specifications. Finally, the QIS5 exercise showed that there are areas where further work is needed, such as the concept of contract boundaries, catastrophe risk and non-life calibration, simplifications and the importance of finding appropriate transitional measures. The accompanying statistical data is available ➲here.

Recognition of auditors

On 18 March, the CBFA published the opinion of the Insurance Commission on the draft regulation amending

the CBFA regulation of 21 February 2006 on the recognition of auditors and audit firms (in ➲Dutch and in ➲French). Since the enactment of the Law of 26 April 2010 on miscellaneous provisions regarding supplementary health insurance, mutual insurance companies are required to appoint an external auditor who is recognized by the CBFA. Article 72 of the Law foresees in a transitory regime that allows external auditors to complete their mandate and be reappointed once. Based on requests from external auditors, the CBFA decided to add an additional transitory regime via an amendment of CBFA regulation of 21 February 2006 on the recognition of auditors and audit firms. This regime would allow auditors without CBFA recognition to become the external auditor of a new mutual insurance company if this company has taken over the activities of another mutual insurance company. However, according to the Insurance Commission there is no legal basis for this amendment. The Law of 26 April 2010 only foresees in a transitory regime for the external auditor of existing mutual insurance companies. For this reason Commission stated that the CBFA must first clarify the legal basis for its envisaged amendment before it can give its final opinion about the draft regulation.

CEA

Solvency II

On 28 March, the CEA published a ➲position paper on catastrophe risk within the context of the QIS5 exercise. According to the Federation, non-life Catastrophe risk sub modules as laid down in QIS5 have proved to be a major challenge for the industry. In both design and calibration, the sub modules have raised a number of concerns among industry participants.
As such the position paper aims to highlight the main drawbacks of the approaches proposed in QIS5, and suggests concrete proposals to address these drawbacks. The Scenario-based and Factor-based approaches are addressed separately for Natural Catastrophes perils and Man Made events, where possible. Independent of concrete proposals for the two methods, the CEA also proposes that an Undertaking Specific Parameter (USP) solution should be developed for the Catastrophe risk sub module.

In a ➲press release of 14 March, the CEA called for a number of essential corrections to the implementing measures that will provide the technical detail of the new Solvency II regulatory regime. According to the Federation, these corrections are necessary to maintain the health and competitiveness of Europe’s insurers. For example the sensitivity of the Solvency II framework to market volatility must be addressed. The complexity of certain calculations and requirements must also be tackled to ensure that Solvency II is workable for all and particularly for smaller companies. In addition, further work needs to be done to rework the calibrations in the non-life and catastrophe risk modules, which currently result in excessively high capital requirements that are not in line with the levels outlined in the Framework

Directive. Furthermore, the CEA expressed its concern about the treatment of long-term business and guarantees. A solution must be found that allows insurers to continue offering long-term savings and pension products, thus avoiding any unintended negative social and macro-economic impacts. Firstly, any volatility that is not indicative of market conditions should be avoided by ensuring that there is an appropriate extrapolation of the risk-free curve. Secondly, care should be taken that capital requirements are not in excess of the 1 in 200 shock level agreed in the Framework Directive. Last but not least, it is crucial that undertakings have the required certainty in the application of the illiquidity premium for their pricing and investment strategy so that they can continue to offer pension-type products.

The use of gender in insurance pricing

In a ➲press release of 1 March, the CEA stated that it regrets the European Court of Justice decision in the ➲Case C-236/05 that the provision enabling EU insurers to use actuarial and statistical factors based on sex in their risk assessment is invalid from 21 December 2012. It indicated that the decision of the judges does not to recognize that gender is a legitimate factor in insurance pricing and that insurance pricing based on a fair risk assessment process could be bad news for insurance customers. While, according to the CEA, insurers will ensure that their products remain as competitively priced as possible, some insurers will now face significant additional costs in reassessing data, transforming premiums and changing terms and conditions and marketing materials for certain products. As such increased premiums are to be expected for some groups, such as young women drivers, in markets where gender was previously used in motor insurance pricing. Furthermore, any increase in the cost and decrease in the choice of pension products could have a social impact on levels of retirement saving at a time when state pension schemes are already under financial pressure.

More information on the use of gender in insurance pricing can be found in the ➲CEA policy on the subject published on 1 March.

European Commission

Solvency II

In a ➲press release of 14 March, the European Commission welcomed the publication of the ➲result of the Fifth Quantitative Impact Study (QIS5) by European Insurance and Occupational Pensions Authority (EIOPA). According to the Commission, the results show that fine tuning of the planned implementing measures is still needed in relation to the requirements for technical provisions, own funds and the design and calibration of the Solvency Capital Requirement standard formula. It indicated that it will analyze whether changes are needed to address certain concerns relating to market volatility. Furthermore, the Commission stated that when finalizing the implementing measures, it will work closely with the

Member States, EIOPA and the industry to make these refinements, based on the information collected in QIS5. In the press release the Commission also mentioned that the study showed that the system is too complex particularly for SMEs. In light of this, the Commission vowed that it will work on a number of measures to reduce the complexity of the calculation of the quantitative requirements and also to introduce additional simplifications to the standard calculations. In addition, targeted transitional measures may be needed in certain specific cases to ensure that there is a smooth transition to the new regime. To conclude, the Commission stated that it will continue its technical work on the implementing measures, taking into account the results of QIS 5 during the course of the second quarter of 2011 and intends to publish its proposal for the Solvency II level 2 implementing measures by the end of the year.

European Fund and Asset Management Association (EFAMA)

Review of the Insurance Mediation Directive (IMD)

On 2 March, the EFAMA published its ➲response to European Commission's ➲consultation on the Review of the Insurance Mediation Directive. In its response, the Association expressed its support for the PRIPs initiative by the European Commission and welcomed the application of its proposals to all PRIPs, including insurance products. It also welcomed the review of the Insurance Mediation Directive (IMD) to ensure a consistent approach to the regulation of retail financial product distribution in the Union. However, EFAMA reiterated its deep concerns that the Commission decision to use separate legislative instruments to implement the PRIPs initiative might lead to a lack of harmonized implementation for sales rules. It therefore encouraged a close coordination of the work of the different Units in charge of PRIPs, MiFID Review and IMD Review to ensure that the implementation of the PRIPs initiative is coherent and harmonized not only at the principle level, but also in its details (Level 2). In particular, the Association indicated that the IMD should be made Lamfalussy conform and many details included in Level 2 (as is the case for MiFID), otherwise the risk of divergent implementation would be too great. Furthermore, ESAs (ESMA, EIOPA and EBA) must also ensure the same coherence and harmonized implementation in their technical standards and Level 3 work.

European Insurance and Occupational Pensions Authority (EIOPA)[4]

Europe-Wide Insurance Stress Test

In a ➲press release of 23 March, EIOPA announced of the second Europe-wide stress test for the insurance sector. The stress test is conducted in cooperation with the respective national supervisory authorities and will be

[4] EIOPA has replaced the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), as of 1 January 2011.

carried out between now and the end of May, based on 2010 financial results. EIOPA expects to publish the aggregated results of this exercise in July 2011. The stress test intends to replicate macro-economic scenarios and aims to identify and quantify the impact of three different stress scenarios: baseline, adverse and inflation scenario. The baseline scenario is defined as severe stress whereas the adverse scenario includes an even more severe market deterioration in the main macroeconomic variables. The inflation scenario assumes an increase in inflation, which forces central banks to rapidly increase interest rates. To run this exercise, EIOPA considered the macroeconomic assumptions that were applied to the banking stress test, in particular the assumptions underlying the macroeconomic adverse scenario provided by the European Central Bank. EIOPA further enhanced the definitions of those stress scenarios to address the actual market environment of the insurance industry.

Solvency II

On 14 March, EIOPA published the ➲results of the fifth Quantitative Impact Study (QIS5).
Overall, QIS5 showed that the financial position of the European insurance and reinsurance sector assessed against the Solvency Capital Requirements (SCR) of the Solvency II directive remains sound. The exercise also allowed EOIPA to identify areas where further guidance seems necessary or where the feasibility and complexity of the proposals should be addressed in order to ensure proper implementation by all undertakings, in particular small and medium undertakings. QIS5 also revealed other important areas, which were not tested in this quantitative exercise but require further attention of the industry in preparing for Solvency II. These areas are governance, risk management and reporting requirements. EIOPA stated that the main lesson learned from QIS5 is that a prudent framework has to be based upon sound capital requirements, with particular attention to the quality of capital. The Supervisor concluded that transitional measures are needed, particularly to ensure a smooth transition from Solvency I to Solvency II that would not disrupt ongoing business and would ensure continuous competitiveness of insurance companies. The transitional measures should be limited and not be extended excessively due to a potential adverse effect on competition and the incentive for the insurance sector to implement Solvency II requirements, nor should they be of too short a duration as to limit their effectiveness.

[4] EIOPA has replaced the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), as of 1 January 2011.

Organisation for Economic Co-operation and Development (OECD)

Good practices for mitigating and financing catastrophic risks

On 1 March, the OECD published its ➲"Good practices for mitigating and financing catastrophic risks". These practices provide governments and relevant public and private institutions with an integrated, action-oriented framework for the identification of disaster risks, promotion of risk awareness, enhancement of prevention and loss mitigation strategies, and design of compensation arrangement.

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Tax

Normative documents

Official Journal of the European Union (OJ)

Implementing regulation on the common VAT system

On 15 March, the Council adopted a ➲regulation laying down the rules for the implementation of the VAT directive. This regulation contains detailed rules in respect of certain concepts of the VAT legislation, particularly in respect of the changed place of taxation rules for services implemented in 2010 (the "VAT Package"). Amongst others, it sets criteria for allocating services purchased by an entity with branches in multiple countries to the correct jurisdiction, ensuring that VAT is paid in the country where services are purchased and used. This is a situation that concerns many internationally active financial institutions. The regulation does not have to be transposed into national legislation, but applies directly, as of 1 July 2011.

Consultative or informative documents

European Commission

Tax Forum on Financial Sector Taxation

On 28 and 29 March, the European Commission hosted an annual conference that brought together policy makers, experts, stakeholders and the general public from all over the world to discuss the 'Taxation of the Financial Sector'. The conference focused on whether increased or new taxes on the financial sector, such as Financial Transactions Tax (FTT), Financial Activities Tax '(FAT) or even a broader application of VAT, could help with correcting risk related behaviour and with the significant efforts for fiscal consolidation required in many Member States. Slide presentations are available ➲here.

CCCTB: EU Commission launches draft directive

On 16 March, the European Commission published a ➲draft directive on a common consolidated corporate tax base (CCCTB). The aim of this proposal is to significantly reduce the administrative burden, compliance costs and legal uncertainties that businesses in the EU currently

face in having to comply with up to 27 different national systems for determining their taxable profits. The proposed Common Consolidated Corporate Tax Base (CCCTB), would mean that companies would benefit from a "one-stop-shop" system for filing their tax returns and would be able to consolidate all the profits and losses they incur across the EU, to calculate the tax base (and it seems this tax base would be broader than most existing EU Member State tax bases), and file one corporate tax return for the EU.

The idea is then that the tax base would be shared by the different relevant Member States according to methods set out in the draft directive and each Member State would apply its own tax rate to its share. The tax authorities of the "principal" Member State would be in charge of processing and following-up on the return. For this proposal to become law, it would need to be agreed by all the EU Member States (– or perhaps be adopted via "enhanced cooperation" between at least 9 Member States. Based on some recent press articles, France and Germany seem to back this project and Ireland has clearly opposed it.

European Parliament

Introduction of a tax on financial transactions

On 8 and 10 March, the European Parliament adopted two ➲resolutions on the possibility to introduce a financial transaction tax (FTT). The Parliament called the Commission and the Council to produce a feasibility study on several options for an EU FTT and also to take legislative proposals in that respect. In order to avoid evasion of the tax, the parliament insisted on the importance of determining which transactions would be subject to that FTT, who will pay the tax and to determine clear rules on the exemptions and thresholds. It also stressed the importance to assess the impact of the FTT to other taxes such as the proposed tax on bank assets or the VAT exemption of the financial sector.

European Court of Justice (ECJ)

VAT treatment of underwriting guarantee services

In the Case (C-540/09) of 10 March 2011 the European Court of Justice ruled that underwriting guarantee services, in which a credit institution provided a guarantee to a company for the underwriting of shares issued by that company, falls within the scope of the exemption for transactions in shares (art. 135 (1)d of the VAT Directive).

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