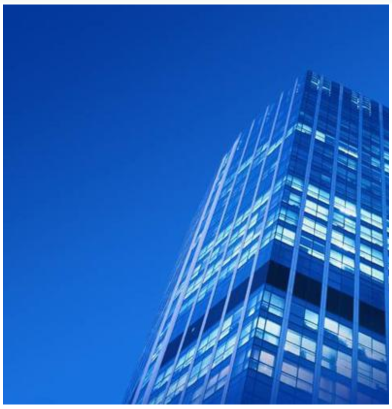
Deloitte.



Governance, Regulation & Compliance

Regulatory Radar

Regulatory Newsletter, Issue 34, April 2011

Newsletter on banking and financial regulation

In this issue

This month's Regulatory Radar includes, amongst others, the following interesting publications:

Financial Services Industry – general

- The EC's Green paper on Corporate Governance launching a consultation on possible ways forward to improve the corporate governance framework in Europe. The deadline for submitting contributions in response to the consultation is 22 July 2011;
- The FSB's report on the implementation of the G20 recommendations for strengthening financial stability;
- A number of position papers on collective redress.

Credit institutions and investment firms

- The benchmark to be used in the 2011 stress tests;
- The FSB's background note on "Shadow banking".

Investment products and asset management

- The BIS working paper on Market structures and systemic risks of exchange – traded funds;
- The ESMA Discussion paper on policy orientations on possible implementing measures under Article 3 of the Alternative Investment Fund Managers Directive and ESMA Guidelines on Global Exposure and Structured UCITS.

Insurance, reinsurance and pensions

- The EIOPA report on reporting requirements to supervisory authorities;
- The EIOPA report illustrating the work of Task Force on Variable Annuities (TF), set up by CEIOPS in March 2010 with the aim of establishing common EU guidelines for the supervision on insurers selling Variable Annuities (VAs).

Tax

- The letter of the Hungarian Presidency of the Council of the European Union and the European Commission to US Tax Authorities inviting them to engage in a dialogue on how to best achieve the objectives of the US Foreign Account Tax

compliance Act (FATCA);
- A number of position papers on the taxation of the financial sector.

We hope you enjoy the reading.

The Editorial Board.

Financial Services Industry

Normative documents

Official Journal of Belgium (BS/MB)

Shareholder' rights

On 18 April, the Law of 20 December 2010 on the exercise of certain rights of shareholders in listed companies was published in the Official Journal. The law transposes the ➲Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies. Notwithstanding its name, the law also has some implications for certain unlisted companies such as the possibility to introduce in the articles of association the option for shareholders to remotely participate in and vote at the general meeting and to ask questions during the general meeting. With regard to listed companies the law contains changes regarding the terms and manner of convening the general meeting, the content of the summon and formalities to be fulfilled to attend the general meeting. It also foresees in the right of one or several shareholder(s) who individually or collectively hold(s) at least 3% of the share capital to add topics to the general meeting agenda, as well as submit proposals regarding the agenda and in the mandatory registration of shares.

Pursuant to an amendment of the Law published on the same day, the Law will come into force on 1 January 2012. At this date, the companies' articles of association must be adapted to the new Act.

Official Journal of the European Union (OJ)

AML/CFT and sanctions

In April, the following documents related to AML/CTF and sanctions were published:

- ➲ Council Implementing Regulation (EU) No 419/2011 of 29 April 2011 implementing Regulation (EC) No 560/2005 imposing certain specific restrictive measures directed against certain persons and entities in view of the situation in Côte d'Ivoire in OJ L111 of 30 April
- ➲ Council Implementing Decision 2011/261/CFSP of 29 April 2011 implementing Decision 2010/656/CFSP renewing the restrictive measures

against Côte d'Ivoire in OJ L111 of 30 April

- Council Decision 2011/239/CFSP of 12 April 2011 amending Decision 2010/232/CFSP renewing restrictive measures against Burma/Myanmar (L101-15 April)
- Council Regulation (EU) No 359/2011 of 12 April 2011 concerning restrictive measures directed against certain persons, entities and bodies in view of the situation in Iran in OJ L100 of 14 April
- Council Implementing Regulation (EU) No 360/2011 of 12 April 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 L100 of 14 April
- Council Decision 2011/235/CFSP of 12 April 2011 concerning restrictive measures directed against certain persons and entities in view of the situation in Iran in OJ L100 of 14 April
- Council Implementing Decision 2011/236/CFSP of 12 April 2011 implementing Decision 2011/137/CFSP concerning restrictive measures in view of the situation in OJ L100 of 14 April
- Council Implementing Regulation (EU) No 348/2011 of 8 April 2011 implementing Regulation (EC) No 560/2005 imposing certain specific restrictive measures directed against certain persons and entities in view of the situation in Côte d'Ivoire in OJ L97 of 12 April
- Council Implementing Decision 2011/230/CFSP of 8 April 2011 implementing Decision 2010/656/CFSP renewing the restrictive measures against Côte d'Ivoire in OJ L97 of 12 April
- Council Decision 2011/221/CFSP of 6 April 2011 amending Decision 2010/656/CFSP renewing the restrictive measures against Côte d'Ivoire in OJ L93 of 7 April
- Council Regulation (EU) No 330/2011 of 6 April 2011 amending Regulation (EC) No 560/2005 imposing certain specific restrictive measures directed against certain persons and entities in view of the situation in Côte d'Ivoire in OJ L93 of 7 April
- Commission Implementing Regulation (EU) No 317/2011 of 31 March 2011 amending for the 147th 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 L86 of 1 April.

European Stability Mechanism

On 6 April, the ➲European Council Decision of 25 March 2011 amending Article 136 of the Treaty on the Functioning of the European Union with regard to a stability mechanism for Member States whose currency is the euro was published in OJ L91. The Decision amends article 136 of the Treaty on the Functioning of the European Union to provide a legal basis for the establishment of a permanent crisis mechanism to safeguard the financial stability of the euro area as a whole. The amended article 136 allows Member States whose currency is the euro to establish a stability mechanism to be activated if indispensable to safeguard the stability of the euro area as a whole. The granting of any required financial assistance under the mechanism will be made subject to strict conditionality.

Consultative or informative documents

CEA

Omnibus II

On 29 April, the CEA published a ➲position paper on the proposed ➲Omnibus II Directive, which amends several pieces of financial services legislation to reflect the powers given to the new EU financial services supervisory authorities. The paper outlines key concerns of the CEA in relation to the proposed timing for adoption of the Omnibus II Directive, transitional provisions and amendments to Solvency II Levels 1 and 2. With respect to the timing for adopting the Directive, the Federation expressed some concerns. The Directive must be formally adopted before the Commission can formally present the Level 2 implementing measures and Level 3 guidance for Solvency II. Prolonged political negotiations would therefore delay negotiations on Level 2 and Level 3, in turn reducing the amount of time available for insurers to implement changes before coming into force at 1 January 2013. The paper stressed, nevertheless, that the quality of legislative drafting should not be compromised. On the subject of transitional provisions or period, the CEA indicated that while it supports entry into force of Solvency II by 1 January 2013, it recognizes that in certain areas, transitional provisions are necessary to allow for a smooth transition from Solvency I to Solvency II. During the negotiations on Omnibus II, it will be important to maintain a clear distinction between a transitional period and an actual delay to the Solvency II project. During the drafting of Omnibus II, care should be taken to ensure that transitional provisions are applied only where necessary, and that they do not create additional ambiguity in the context of Solvency II implementation. According to the CEA, it is also essential that a harmonized approach is adopted towards transitional provisions. Diverging practices will prove problematic for cross border groups, in particular when subsidiaries in a group apply different rules according to each Member State. All countries should apply transitional provisions in a consistent way. In the paper, the Federation also expressed strong concerns that an internal model shall not be considered as approved if the supervisory authority fails to reach a decision within six months. It stated that in cases where the undertaking or group has fully cooperated with the supervisor or college and has provided sufficient information to ensure fulfillment of the use test, it should be possible for the undertaking to use their internal model for calculating the SCR until the supervisor reaches a decision.

Collective redress

On the same day, the CEA also published ➲its response to the ➲European Commission's consultation "Towards a Coherent European Approach to Collective Redress". In the response, the Federation indicates that the need for an EU-wide collective redress scheme has not been demonstrated and that priority should be given to improving consumer awareness of existing alternative dispute resolution (ADR) schemes. It also recommended that the results of the Commission's ongoing consultation on ADR should be awaited before introducing any new procedure at EU level. A priority should be to improve consumer awareness of existing ADR systems. Furthermore the CEA stressed that adequate safeguards are necessary if the Commission nevertheless decides to introduce an EU collective redress system: consumers should be able to decide whether they wish to join a collective redress action through an opt-in system; the "loser pays" principle, where the losing party pays the costs of the proceedings, should be applied to avoid unmerited collective redress claims; and the organisations entitled to bring collective redress actions should be restricted to non-profit consumer organisations. Also the following features should in any case be excluded: punitive damages, recovery of unlawful profits beyond the compensation of the damage suffered, contingency fees and the creation of a fund financing future collective redress claims.

Center for European Policy Studies (CEPS)

EU's response to the financial crisis

On 20 April, CEPS published on a ➲policy brief, titled "The EU's Response to the Financial Crisis: A mid-term review". The paper first details the role and powers of the new European Supervisory Authorities (ESAs). This is followed by a review of the measures adopted or currently under discussion within the EU. These measures are then compared with the US Dodd-Frank Act. Furthermore the paper discusses the new eurozone stability mechanism (ESM) and the financial stability issues raised by the sovereign debt crisis. According to the paper both elements reinforced the determination to tackle short-selling and legislate hedge funds, and convinced policymakers of the need for strict supervision of rating agents. They highlighted the continuing fragility of the banking sector in the EU and the dependence of the financial system on the quality of the sovereign. The paper concludes that the combined effect of a new institutional structure and new and more direct rules is introducing a sea change into EU financial markets. It should bring the single financial market project back on track and allow European financial integration to move forward once again. The EU's response to the crisis has however been complicated by the sovereign crisis. The latter crisis strengthened the EU's resolve to tackle some issues, but complicated a solution for others. A permanent crisis mechanism improves the coherence between euro financial systems in the short term, but may render them more fragile in the long term, because of the collective action clauses and the preferred creditor status. The central role of the ESM for local financial systems will require close cooperation with the new ESFS. The new governance structure of European financial markets is thus becoming even more complex, with not only the ESAs and the ESRB, but also with the participation of the ESM.

Council of the European Union

Powers of ESMA and EIOPA

On 14 April, the Council of the European Union published the ➲Presidency Compromise on the Proposal for a Directive of the European Parliament and of the Council amending Directives 2003/71/EC and 2009/138/EC in respect of the powers of the European Insurance and Occupational Pensions Authority and the European Securities and Markets Authority.

Eurofinas

Collective redress

In April, Eurofinas published its ➲response to the ➲European Commission's consultation "Towards a Coherent European Approach to Collective Redress". In its response, the Association stated that while efficient means for resolving disputes and obtaining compensation promote consumer and business confidence in the market and improve market performance, the Commission has not shown that the measures that consumers and businesses currently have at their disposal are inadequate to deal with mass claims. Nor has it been shown that there is a need for collective redress mechanisms and that any introduction of such mechanisms would provide added value to the enforcement of EU law. Eurofinas therefore indicated that it opposes the introduction of new collective redress mechanisms at EU level. Nonbinding guidelines on the national systems in the Member States or an exchange of best practices, applicable to all sectors, could however be considered. Additionally, the Association stated that it would support extending the scope of the Directive on Injunctions to ensure that all consumer agreements are covered. Eurofinas also indicated that it sees the development of alternative dispute resolution (ADR) schemes as a viable alternative to judicial mass claims and strongly supports its introduction. However as the level of development of ADR schemes across Europe remains for the time being limited, it thinks it would be premature to envisage collective out-of-court settlements. The first priority should be to ensure that ADR schemes are provided for all sectors and cover the whole of the EU.

European Banking Federation (EBF)

Collective redress

On 29 April, the EBF published its ➲response to the ➲European Commission's consultation "Towards a Coherent European Approach to Collective Redress". In the response, the Federation welcomed the Commission decision to strive for a more consistent approach towards collective redress in its different forms and to ensure a consistent and homogenous approach between the different services departments and underlying workstreams. However, it indicated that it is not convinced that there is a need for an EU initiative in this area. European Member States have to provide for the verification of effective enforcement of the rights which derive from European Union legislation. They are responsible for shaping their national procedural law in such a way that consumers and other parties involved have effective legal measures to enforce their claims. The Federation did welcome the announcement of the Commission's intention to prevent class action along the lines of the US model. However, according to EBF, it remains unclear how the Commission plans to prevent the abuse of collective redress instruments.

European Central Bank (ECB)

Indicators and early warning signals for systemic risk

On 24 March, the ECB published a ➲working paper, titled "Systemic risk diagnostics: Coincident indicators and Early Warning Signals". The paper develops a framework to assess financial system risk. Using recent statistical techniques, it infers common factors underlying macro-financial and credit risk conditions from a large data set comprising the U.S., the E.U. area, and the respective rest of the world. The extracted risk factors are then combined into coincident risk measures and early warning indicators for financial distress.

Coincident risk measures are referred to as "thermometers". As an analogy, such indicators can be plugged into the financial system to read off its "heat". For example, the paper estimates a broad financial sector failure rate that takes into account a large cross section of banks and financial non-banks. This failure rate represents the share of currently active financial firms which, at current levels of stress, can be expected to fail over the next three months. It further estimates the probability of simultaneous failure of a large number of financial sector firms. The proposed early warning indicator for financial distress is based on current deviations of credit risk conditions from their underlying macro-financial fundamentals. In an empirical study of international credit and macro data, the paper found that credit risk conditions can significantly and persistently de-couple from fundamentals due to e.g. unobserved changes in credit supply and the ease of credit access. It demonstrates that such decoupling has preceded financial and macroeconomic distress in the past. As a result, such decoupling can serve as an early warning signal for financial stability policies.

European Commission

Corporate governance

On 5 April, the European commission published the ➲Green Paper, titled "The EU corporate governance framework", launching a ➲public consultation on possible ways forward to improve the corporate governance framework in Europe. The paper aims to launch a general debate on a number of issues such as the role of the board of directors, how to enhance shareholders' involvement on corporate governance issues and how to more effectively apply the “comply or explain” principle when a board decides to deviate from agreed corporate governance principles. With regard to the role of Board, the Commission puts the focus on diversity in Board members’ profiles and backgrounds. The Commission expects this gives the board a range of values, views and sets of competencies. It can lead to a wider pool of resources and expertise. Different leadership experiences, national or regional backgrounds or gender can provide effective means to tackle ‘group-think’ and generate new ideas. The Commission is also requesting comments with regard to the supervisory role of non-executive directors, board evaluation, board remuneration and the responsibilities of the board in respect to risk management. On the subject of shareholders' involvement, the Commission focuses on encouraging shareholders to take an active interest in the company in which they have invested. It states that major developments in capital markets in recent decades, as well as the agency relationship between institutional investors and their managers has contributed to increasing short-termism in capital markets in recent decades and may have hindered long-term investment. According to the Commission, more transparency about the performance of fiduciary duties by asset managers could shed more light on whether or not asset managers’ activities are beneficial for long-term institutional investors and long-term value creation on their behalf. In addition to the aforementioned, the Commission also identifies conflicts of interest and ineffective shareholder cooperation as obstacles to engagement by institutional investors. The Green Paper asks for comments on possible ways to overcome these obstacles. Finally, with regard to the “comply or explain” principle, the Commission indicates that corporate governance statements seem not to be monitored as they should be. In most Member States, responsibility for enforcing the obligation to publish is left to investors who often take little action. According to the Commission, “comply or explain” could work much better if monitoring bodies such as securities regulators, stock exchanges or other authorities were authorised to check whether the available information is sufficiently informative and comprehensive. This could be achieved by defining corporate governance statement as regulated information within the meaning of Article 2(1)(k) of Directive 2004/109/EC (the “Transparency Directive”) and thus make it subject to the powers of competent national authorities laid down in Article 24(4) of the Directive. The deadline for responses to the Green Paper is 22 July 2011.

The publication of the Green paper was accompanied by a ➲Frequently Asked Questions providing background information.

European Securities and Markets Authority (ESMA)[1]

Credit ratings Agencies

On 18 April, ESMA published a ➲consultation paper on its technical advice to the Commission on Fees for Credit Rating Agency (CRA) Supervision. In the paper, the Supervisor sets out the possible options for the fee structure for CRA supervision and registration in the EU. For on-going supervisory fees, it is considering a single periodic fee based on the turnover of the CRA relative to other CRAs registered in the EU. For registration fees to be charged to applicant CRAs, ESMA indicated that it favors different bands of registration fees based on objective factors since a single flat fee would not be proportionate for all applicants. On the subject of the certification fees for non-EU CRAs, ESMA stated that it is in favor of a flat fee for processing an application for certification. The amount of the fee would correspond with the estimated cost of supervision of certified CRAs. With regard to the calculation Period and Collection of Fees, the Supervisor mentioned that it is considering if it is better to have one fee collection at the start of the year of two or more fee collections throughout the year. The second option has the advantage of permitting the CRAs to split their annual payment over two installments which may assist the financial management of the fee.

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

European Savings Banks Group (ESBG)

SEPA

On 29 April, the ESBG published ➲a position paper, titled "A compromise on interchange fees, no compromise on SEPA". In its ➲Proposal for a Regulation on SEPA migration, the European Commission bans interchange for normal direct debit transactions. Interchange is a fee which compensates the bank of the debtor for the costs it incurs when rendering the collection service to the creditor. Interchange fees are levied either for "normal" direct debit transactions (i.e. the collections presented by creditor banks to debtor banks), and/or for "R" transactions (i.e. collections which cannot be processed or debited to a debtor for a number of reasons). In the paper, the ESBG voices its opposition to the proposed ban of interchange for "normal" direct debit transactions. According to it, Commission's reasons for banning interchange are without ground. Although ESBG maintains its fundamental concern about ruling on interchange in a regulation, the Group recognizes that removing dispositions on interchange from the draft Regulation text during the co-decision process at European Parliament and Council will probably not be possible. Therefore, the ESBG as drafted a compromise approach to interchange in the Regulation that could still give direct debits a chance for success in SEPA. The ESBG proposes to complement the proposal of a multilateral interchange fee with the option for payers' payment service providers to claim a different yet still capped interchange fee, provided they are able to cost-justify such fee. Both arrangements could be reviewed 5 years after the end date for legacy direct debits, on the basis of an analysis of the acceptance of SEPA direct debits, including if relevant an objective evaluation of the reasons for limited acceptance.

Financial Stability Board (FSB)

Standards on international cooperation and information exchange

On 29 April, the FSB published a ➲report on the progress of its ➲initiative to encourage the adherence of all countries and jurisdictions to regulatory and supervisory standards on international cooperation and information exchange in the areas of banking supervision, insurance supervision and securities regulation (i.e. the BCBS Core Principles for Effective Banking Supervision, the IAIS Insurance Core Principles, and the IOSCO Objectives and Principles of Securities Regulation). In the report, the Board indicated that a large number of jurisdictions that were evaluated demonstrated sufficiently strong adherence to aforementioned regulatory and supervisory standards. Jurisdictions evaluated that did not yet demonstrate sufficiently strong adherence were invited to engage in a confidential dialogue in order to further evaluate their adherence and, if necessary, identify ways to improve adherence. Furthermore, some of these jurisdictions are in the process of implementing reforms. The Board did however find that a very small number of jurisdictions have not to date cooperated satisfactorily with the FSB's process for promoting adherence to regulatory and supervisory standards on international cooperation and information exchange. To recognize the progress that most jurisdictions have made toward addressing weaknesses in international cooperation and information exchange, and incentivize improvements by those jurisdictions not cooperating fully, the FSB will ahead of the November 2011 G20 Leaders Summit publish the names of all jurisdictions evaluated under the current initiative. The public list will identify non-cooperative jurisdictions.

G20 Recommendations

On 10 April, the FSB published ➲a report on Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability. The report provides an overview of work underway to implement the G20 recommendations for strengthening financial stability. It focuses on international policy development and implementation that has taken place since the G20 Finance Ministers and Governors meeting in February 2011 and describes the progress that has been made with regard to:

- the implementation of reforms to bank capital and liquidity standards (Basel III);
- the regulation of systemically important financial institutions (SIFIs), in particular how systemic importance of financial institutions at a global level

can be assessed, SIFI loss absorbency requirements, recovery and resolution regimes for SIFI’s and how SIFI’s can be effectively supervised;
- the regulation of shadow banking;
- the development of macro-prudential frameworks and tools;
- the convergence on strengthened accounting standards;
- strengthening adherence to international supervisory and regulatory standards.

In a ➲press release of 1 April, the FSB announced the publication of the ➲national responses from its members to an FSB survey designed to monitor the implementation of the G20’s recommendations for strengthening financial stability. The survey was conducted by the FSB Implementation Monitoring Network in September 2010 and the responses were summarized in the ➲FSB progress report on implementation, that was submitted to the G20 Seoul Summit in November 2010.

Financial Services and Markets Authorities (FSMA)[2]

Shareholder’ rights

On 27 April, the FSMA published the communication FSMA_2011_01 on the Law of 20 December 2010 on the exercise of certain rights of shareholders in listed companies (in ➲Dutch and in ➲French). The communication provides listed companies with a practical overview of the changes brought about by the aforementioned law.

[2] As of 1 April 2011, the new “Twin Peaks” supervisory architecture has come into force in Belgium. The new architecture replaces the Banking, Finance and Insurance Commission (CBFA) with two new regulators, the National Bank of Belgium (NBB) and the newly created Financial Services and Markets Authority (FSMA). Within the new framework FSMA is responsible for the supervision of the financial markets and the “conduct of business” rules, the micro-prudential supervision of portfolio management and investment advice companies, UCI management companies and UCI’s, institutions for occupational pension, financial intermediaries, the financial education of investors and their protection against the illicit provision of financial products and services.

World Savings Banks Institute (WSBI)

AML/CFT and Financial Inclusion

On 27 April, the WSBI published its ➲comments on the FATF draft guidance paper on AML/CFT and financial inclusion. In its comments, the Institute welcomed the initiative taken by the FATF to develop a Guidance paper on AML/CFT in a financial inclusion context. It supports the development of well balanced and proportionate frameworks, which reconcile the goals of encouraging the provision of formal financial services to the largest part of the population, including to the low-income categories, and designing efficient. Within this context, the WSBI welcomed the FATF’s willingness to encourage and facilitate agent banking. It did however empathize that it will be important that the CDD applicable regime is implemented in a proportionate manner, with a view to prevent putting some undue restrictions to the ongoing development of agent networks and avoid creating a new barrier to financial inclusion. With regard to the scope of the guidance paper, the WSBI stated that it should be limited to payment and account management services. While financial inclusion generally understood as spanning account management and payments, savings, borrowing, and insurance products, relaxing identification obligations as suggested will seriously challenge the feasibility of access to several these products, for example savings products generally require a proper identification of the beneficiary. On the subject of providers of payment and account management services, the Institute noted that when assessing providers one should look at the function being exerted and not the type of institution. According to the WSBI, a fundamental requirement is however that on one side there is adequate supervision and regulation of this function and the entities which deliver the related services, on the other side that a level playing field be guaranteed between entities according to the risk profile of the service(s) they deliver. Furthermore, it indicated that not all payment and/or account products should require the application of all FATF rules in a narrow acceptance. Products should be exempted from the application of a number of obligations according to several risk-based variables. Within the context of this approach, the customer should always be "identifiable" – even when not identified on the basis of a formal document issued by a formal entity. Finally, the WSBI stated that proper monitoring and reporting by supervisors and regulators is essential. However this activity can lead to substantial costs for service providers. The working principle should therefore be that there is an inverse relationship between the level of formal document-based KYC that can be performed by service providers and the level of reporting required and monitoring performed by supervisors and regulators.

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Consultative or informative documents

Basel Committee on Banking Supervision (BCBS)

Capital Requirements

On 6 April, the BCBS published ➲the speech its Secretary-General, Stefan Walter, had given at a Conference on Basel III organized by the Financial Stability Institute. In his speech, the Secretary-General recalled the motivation behind the Basel III reforms and why these reforms are central to promoting financial stability. According to the Secretary-General, there is a wide body of evidence that the most severe economic crises are associated with banking sector distress. Banks are highly leveraged institutions and are at the centre of the credit intermediation process. A destabilized banking system affects the provision of credit and liquidity to the broader economy and ultimately leads to lost economic output. The objective of the Basel III reforms is to reduce the probability and severity of future crises. This will involve some costs arising from stronger regulatory capital and liquidity requirements and more intense and intrusive supervision. But the BCBS analysis and that of many others have found the benefits to society well exceed the costs to individual institutions. The Secretary-General then briefly outlined the key reforms that comprise Basel III. Finally, he focused on what still needs to be done to ensure longer-term stability. In particular, he discussed the need for global and consistent implementation of the Basel III reform package, the ongoing work to address the risks of systemic banking institutions and the need to tackle shadow banking which was a key mechanism through which the crisis was propagated.

Council of European Union

Credit transfers and direct debits in euro

On 11 April, the Council of the European Union published the ➲Opinion of the European Central Bank on a ➲proposal for a Regulation establishing technical requirements for credit transfers and direct debits in euro. In the opinion, the Bank welcomed the European Commission’s proposal to impose end-dates for migration to the Single Euro Payments Area (SEPA) credit transfers and SEPA direct debits by means of a Union regulation as the ECB and the Eurosystem have repeatedly drawn attention to the need for ambitious but realistic end-dates to be set for migration to SEPA credit transfer and SEPA direct debit, in order to reap the full benefits of SEPA. In addition, the ECB proposed some amendments to clarify the text of the Regulation.

European Banking Authority (EBA)[3]

Revision of common reporting framework

On 28 April, the EBA published a ➲revision of its framework on Common Reporting (COREP). The changes to the COREP templates take account of the CRD III amendments (Directive 2010/76/EU) of the European Parliament and of the Council of 24 November 2010. They stem from: 1) the reviewed frameworks for securitisations (including re-securitisations) in the banking and the trading book, 2) the revised provisions with regard to market risk, including new correlation trading provisions or reviewed provisions for internal models (e.g. stressed VaR) and 3) the extension of settlement/delivery risks requirements to the non-trading book. The changes will be applicable as of 31 December 2011.

The EBA also reported that is currently working on the development of uniform reporting standards in accordance with Art. 74(2) of Directive 2006/48/EC relating to the taking up and pursuit of the business of credit institutions. In order to ensure uniform conditions of application of this Directive, EBA stated that it shall develop draft implementing technical standards to introduce, within the Union, uniform formats (with associated instructions), frequencies and dates of reporting before 1 January 2012. Related draft implementing technical standards will be subject to public consultation in due course.

2011 EU-wide stress test

On 8 April, the EBA ➲announced the benchmark of Core Tier 1 (CT1) against which to assess banks in the 2011 EU-wide stress test. The CT1 benchmark will be set at 5% of risk weighted assets. This CT1 definition will be used solely for the purpose of the EU-wide stress test and refers to specific criteria which will be applied consistently across all countries participating in the exercise. This definition is based on existing EU legislation in the Capital Requirements Directive (CRD). It takes the existing EU definition of Tier 1 net of deductions of participations in financial institutions and it strips out hybrid instruments including existing preference shares. It recognizes existing government support measures, which will be identified separately in the results. Only commercial instruments of the highest quality are included in this CT1 definition – ordinary shares or similar instruments in line with the principles detailed in ➲CEBS/EBA guidelines on core capital. To ensure full transparency, the stress test will include full disclosure of all capital elements included in CT1 and their evolution since December 2010, under both the baseline and the adverse scenarios. The 5% CT1 benchmark is not a legal minimum requirement. However, the EBA expects any bank failing to meet the benchmark, or showing specific weaknesses in the stress test, to agree with the relevant supervisory authority the appropriate remedial measures and execute them in due time. The EBA expects these measures to be disclosed separately. The announcement of the benchmark was accompanied by the publication of a ➲Q&A document.

The EBA has also released four supporting documents to assist in the understanding of the definition of capital:

- ➲ The first one is the sample of banks involved in the EU-wide stress exercise.
- ➲ The second is a technical template which outlines the criteria used in defining Core Tier 1 for the EBA's 2011 EU-wide stress test. It maps the criteria against the existing COREP framework for ease of reference. The disclosure of capital will be made at this level of granularity in the stress test results.
- ➲ The third is a draft of the publication template which will be used for disclosing the high level outcome of the stress test in 2012.
- ➲ The fourth is a template which outlines the way in which mitigating measures will be disclosed.

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

European Banking Industry Committee (EBIC)

Bank Recovery and Resolution

On 18 April, EBIC published its ➲response to the European Commission's ➲consultation on technical details of a possible European crisis management framework. In its response, the Committee expressed its support for the Commission's work on an EU framework for bank recovery and resolution which sets out to minimize the systemic and fiscal consequences of bank failures. It did however highlight that resolution frameworks need to be introduced globally to ensure a level playing field. Additionally, the Committee emphasized that in order to prevent excessive burdens for smaller and less complex, proportionality should be a guiding principle for the use of the different tools and powers of supervisors and resolution authorities. Concerning the designation and allocation of the resolution authority, EBIC stated that this should be left to national discretion. The new framework should not require the establishment of (new) separate resolution authorities, and allocation of responsibility within the existing national supervisor should be a possibility. On the subject of the triggers for preventative, early intervention and resolution actions, EBIC noted that the Commission must ensure that such triggers are clearly defined and provide transparency and legal certainty. In addition, triggers need to be clearly distinguished from each other, as preventive and early intervention actions address the 'going-concern phase', whereas resolution actions apply only as a matter of last resort and at the point of non-viability (gone-concern scenario) of a bank. As concerns the possible measures to be taken at the various stages, the Committee highlighted that the tools chosen should be proportionate to the impact of the breach of the relevant requirements and should be compatible with the overall business model of the bank. It stated that it has concerns regarding some measures such as imposing a 'special manager', the bail-in tool and preventative supervisory intervention in groups or group structures. Finally, as regards the resolution fund, EBIC emphasized the need to keep in mind the cumulative impact and burden of this and other (existing or proposed) measures on the banking industry. The Committee stated its objection to introducing or maintaining additional national bank levies in parallel to contributions to resolution funds. It also indicated that it is important to ensure that, if established, the resolution funds function according to common principles and stressed that there should be an appropriate and clearly defined basis for the calculation of contributions. The use of these funds needs to be clearly defined and limited to resolution exclusively (liquidation or orderly wind-down).

Financial Stability Board (FSB)

Shadow banking

On 12 April, the FSB published a ➲background note of its

Shadow Banking Task Force, titled "Shadow Banking: Scoping the issues". "Shadow banking" can broadly be described as "credit intermediation involving entities and activities outside the regular banking system". While intermediating credit through non-bank channels can have certain advantages, the recent financial crisis has shown that the shadow banking can also be a source of systemic risk both directly and through its interconnectedness with the regular banking system. It can also create opportunities for arbitrage that might undermine stricter bank regulation and lead to a build-up of additional leverage and risks in the system. The note sets out the Task Force's current thinking with regard to definition of "shadow banking", potential approaches for monitoring the shadow banking system and regulatory measures to address the systemic risk and regulatory arbitrage concerns posed by the shadow banking. With regard to the definition of "shadow banking", the Task Force stated that authorities should first cast the net wide, looking at all non-bank credit intermediation to ensure that data gathering and surveillance cover all the activities within which shadow banking-related risks might arise. They should then narrow the focus, concentrating on the subset of non-bank credit intermediation where maturity/liquidity transformation and/or flawed credit risk transfer and/or leverage create important risks. Concerning potential approaches for monitoring the shadow banking system, it was indicated that shadow banking is currently being monitored and mapped via a combination of quantitative and qualitative information from both a macro and micro perspective. The Task Force has however identified a number of significant limitations in both the macro and micro perspectives. As such recommendations will be developed for improving the monitoring framework from both of the two perspectives. On the subject of possible regulatory measures for the shadow banking system, the Task Force stated that differentiation in the regulatory response may be required to account for differences in business model, risk characteristics and contribution to systemic risk. In addition, regulatory responses need to be forward-looking and flexible, so they should not focus solely on the recent crisis but also address issues and problems that may arise as financial markets adapt and evolve for example as institutions adjust in response to the changes in incentives provided by the Basel III framework. Based on the work of the task force and feedback from stakeholders, the FSB will consider initial recommendations at its July Plenary meeting and submit recommendations to the G20 in autumn. Comments on the background note could be submitted until 16 May.

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Investment products and asset management

Consultative or informative documents

Bank for International Settlements (BIS)

Exchange-traded funds (ETFs)

On 13 April, the BIS published a ➲working paper, titled "Market structures and systemic risks of exchange-traded funds". The paper examines recent market developments in ETFs and their potential implications for financial market stability as growth of ETF assets under management gathers pace. It is organized as follows. First, the plain vanilla structures and their legal framework are presented and put in the context of how the ETF industry has evolved over the last several years. Second, the synthetic structures and, subsequently, the more exotic structures are discussed, and some parallels to the structured finance market developments in the last decade are drawn. Next, the underlying motivation for index replication using synthetic structures is examined from the perspective of financial intermediaries. Finally, the key channels through which risks to financial stability might materialize are explored.

Council of European Union

Investor Compensation Scheme

On 6 April, the Council of the European Union published a ➲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 Parliament

Investor Compensation Scheme

In a ➲press release of 13 April, the European Parliament announced the adoption by the Economic and Monetary Affairs Committee of an amended 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. In proposed changes to the current EU rules on investor compensation schemes, the European Commission had set a minimum guaranteed compensation level of €50,000. The committee text doubles this to €100,000. And whereas the Commission allowed ten years for compensation schemes to reach their required funding level, the committee text grants only five. On the other hand, whereas the Commission proposal required a target fund level of 0.5% of the assets held by a scheme's participating investment firms, the committee text requires only 0.3%. The committee also broke new ground by widening the permissible grounds for claiming compensation to include cases where it is proven in a court that an investment firm provided "bad advice". The MEPs also added a risk-weighting mechanism, whereby investment firms taking the biggest risks would have to pay the biggest contributions into the compensation scheme to which they belong, and empowered schemes to oblige their members to pay in their contributions. Furthermore the Committee parted company with the Commission even at the general level, by opting for details of the schemes' structures and capacities to be designed at EU level rather than by each Member States, so as to reduce fragmentation of the schemes and make them more effective. In addition, the Committee text aims to enhance transparency in three ways. First, it imposes new reporting requirements on Member States, so as to provide the Commission and the EU markets watchdog with more information on their national schemes and the nature of the risks being covered. Second, it requires investment firms to inform investors through their web sites about compensation coverage and how to apply for compensation. And third, it requires investment firms to state clearly the cost to each investor of the firms' participation in a compensation scheme. Finally, the MEPs decided to exclude undertakings for collective investment in transferable securities (UCITS) from the scope of the proposal, as they deem them sufficiently well-covered by other legislation.

European Securities and Markets Authority (ESMA)[4]

MiFID

On 18 April, ESMA published ➲an update to its MiFID Q&A in the area of investor protection and intermediaries in response to a question in relation to the scope of the MiFID definition of investment advice or investment research. The Supervisor was asked whether "advice" or "research recommendations" regarding the underlying products (e.g. oil, gold, indices, currencies, etc.) of the financial instruments falls within fall under the MiFID definition of investment advice or investment research. With regard to "advice", ESMA indicated that when a firm offers the possibility to deal in financial instruments which have other products (commodities, financial indices, currencies, etc) as underlying, it would be artificial and contrary to the overarching obligation of the firm to act honestly, fairly, and professionally to make a distinction between advice regarding the underlying products of a financial instrument and that financial instrument. In this situation, the underlying product of a financial instrument and that financial instrument should be regarded as a whole and any personal recommendation, for example, about the underlying product should be regarded as investment advice within the meaning of MiFID. On the subject of the investment research, ESMA stated that research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several products other than financial instruments or the issuers of those products is, in most circumstances, outside of the definition of investment research under MiFID, and therefore not subject to the MiFID requirements relating to investment research. Where it might fall within the definition is if, in the light of the context and substance of the research, it implicitly suggests an investment strategy in relation to derivatives. Where research covering the underlying product of a derivative is not investment research as defined in the MiFID Implementing Directive then it could still be information to a client.

Alternative Investment Fund Mangers

On 15 April, ESMA published a ➲discussion paper on possible implementing measures under Article 3 of the Alternative Investment Fund Managers Directive (AIFMD). The paper sets out ESMA's proposed approach, including alternative options where relevant, for developing these measures. In particular, the paper asks for stakeholders' views on:

- how to identify the portfolios of Alternative Investment Funds (AIFs) under management by a particular fund manager and the calculation of the total value of assets under management;
- how leverage influences the assets under management;
- how to determine the value of the assets under management by an AIF for a given calendar year;
- how to treat potential cases of cross-holding among the AIFs managed by a fund manager;
- how to treat AIFMs whose total assets under management occasionally exceed and/or fall below the relevant threshold;
- what the registration requirements for entities falling below the threshold should be;
- how the obligation to register with national competent authorities should be implemented and establishing what the suitable mechanisms for gathering information might look like; and
- what the procedures should be for small managers to 'opt-in' to the AIFMD.

Responses to the discussion paper will help ESMA in narrowing down its policy approach. Based on the responses to this discussion paper, ESMA will develop a formal proposal for possible implementing measures of the AIFMD in the summer of 2011. Comments to the paper could be submitted until 16 May.

Global exposure and structured UCITS

On 14 April, ESMA published its ➲final report on the guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS. The report contains the policy approach agreed by ESMA, the cost-benefit analysis, the feedback from the public consultation and the draft guidelines in English to be addressed to competent authorities and UCITS management companies. The draft guidelines supplement ➲CESR's guidelines on Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS published in July 2010 (hereinafter "General Guidelines") and implement, for certain types of structured UCITS, an optional regime for the calculation of the global exposure using the commitment approach. This approach entails that each scenario, to which investors can be exposed at any one time, must comply at all times with the 100% global exposure limit using the General Guidelines. Furthermore, UCITS making use of the approach are subject additional disclosure obligations. They must ensure that the prospectus contains full disclosure regarding the investment policy, underlying exposure and payoff formulas in clear language which can be easily understood by the retail investor and includes a prominent risk warning informing investors who redeem their investment prior to maturity that they do not benefit from the predefined payoff and may suffer significant losses. The scope of above mentioned alternative approach is defined by ESMA via a list of all the criteria with which structured UCITS should comply in order to be able to benefit from this specific approach. Finally, ESMA indicated that structured UCITS authorized before 1 July 2011 and which satisfy certain of the criteria in Box 1 of the draft Guidelines do not need to comply with Boxes 1 to 25 of the General Guidelines. This is due to the fact that the criteria in Box 1 were not in place when these UCITS where launched and if the UCITS portfolio were adjusted to comply with the new guidelines, this would affect the pre-defined payoff to investors at maturity. This would not be in the best interests of investors as they invested in the UCITS on the basis of the pre-defined payoff.

The final version of the guidelines (which will be unchanged) will be translated into all the European Union languages and will be available at a later stage on the ESMA website. The guidelines will take effect when this translation process is completed and will accompany the Level 2 implementing measures of the UCITS Directive that take effect on 1 July 2011.

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

Federation of European Securities Exchanges (FESE)

MiFID Review

On 8 April, the FESE published ➲a letter it had sent to Commissioner for Internal Market and Services Michel Barnier regarding the ongoing MiFID review. In the letter, the Federation expresses its concern that the current EU efforts to close the regulatory loopholes in the EU trading environment will not bear fruit without a significant reorientation in the policy options under consideration. According to the FESE, Europe has become a marketplace where some of the world's largest investment banks are running exchange-like platforms for their own private (wholesale and retail) clients, without providing these clients and the wider investor community with any of the protections of a MiFID-regulated trading environment. This has happened because regulatory flexibilities originally designed for very limited kinds of wholesale trading ('OTC') are being used for wide segments of the equity trading business. To close this loophole, the Federation stated that these platforms should be considered as a trading venue according to MiFID – with the Review providing the necessary clarifications to ensure that all supervisors interpret MiFID in the same way. The current framework is perfectly suitable to capture all trading types in equities but needs to be implemented forcefully and consistently throughout Europe. Furthermore it indicated that the proposed a new trading venue type, i.e. "Organised Trading Facility (OTF)", will not fix the problem, and will actually make it worse because of the following reasons: 1) A new category will create a significant scope for regulatory arbitrage, worsening the current situation, 2) There are currently no transparency requirements in the OTF proposals and 3) The real issue is regulating appropriately dark trading and OTC markets. Except for well defined cases meriting OTC flexibilities, the entire core MiFID protections (transparency, fair access, equal treatment, predictable execution, and market surveillance) should apply to equity trading. OTC should no longer be a default category into which it is easy to opt. To conclude, the FESE empathized that the new MiFID must ensure that all share trading happens with the rules designed to protect the EU markets. Otherwise Europe is in danger of turning into a network of badly regulated private markets.

Post-trade transparency

In a ➲press release of 7 April, the FESE announced that the European Securities Exchanges together with the London Stock Exchange, Bloomberg and Thomson Reuters agreed to adopt common trade reporting standards to improve post trade transparency in the European equity markets. The standards will enable trade data resulting from executions on Regulated Markets and MTFs to be easily consolidated with OTC trade reports. They ensure a pan-European view of the fragmented trading landscape enabling market users to accurately interpret post trade data for the first time since MiFID's introduction. The trade reporting standards are complementary to the efforts being undertaken by the data vendors to ensure consistent output across multiple data consolidators. Finally, It is intended that the standards be open for all market users.

Financial Stability Board (FSB)

OTC Derivatives Market Reforms

On 15 April, the FSB published a progress ➲report on implementation of OTC derivatives market reforms. The report summarizes progress made toward implementation of the G20 commitments concerning standardisation, central clearing, exchange or electronic platform trading, and reporting of OTC derivatives transactions to trade repositories. In particular, it looks at progress against the 21 recommendations set out in the ➲FSB's October 2010 report for implementing reforms in an internationally consistent and non-discriminatory implementation to meet the G20 commitments. The FSB indicated that while a great deal of work has been undertaken at national, regional, and international levels towards implementation of OTC derivatives market reforms, a number of jurisdictions have not yet taken threshold decisions regarding the shape of the regulatory framework for their respective markets. In this regard, the Board noted its concern regarding many jurisdictions' likelihood of meeting the G-20 end-2012 deadline and expressed its belief that in order for this target to be achieved, jurisdictions need to take substantial, concrete steps towards implementation immediately. Furthermore, it stated that it is concerned about the substantial variation across jurisdictions in the pace of implementation and differences in approaches that are emerging, in particular regarding central clearing and reporting of transaction data to trade repositories. Such differences, according to the Board, could weaken the effectiveness of reforms in these markets, create potential opportunities for regulatory arbitrage, or subject market participants and infrastructures to conflicting regulatory requirements. The FSB indicated that it will continue to monitor developments through its OTC Derivatives Working Group as implementation progresses, and identify any further emerging inconsistencies that should be addressed. It will publish a further progress report by October 2011 that should provide greater insight as to whether progress is on track, including greater detail on implementation by asset class (covering interest rate, credit, equity, commodity and foreign exchange).

Exchange-traded funds (ETFs)

On 12 April, the FSB published a ➲note on Potential financial stability issues arising from recent trends in exchange-traded funds (ETFs). The note highlights recent developments in the ETF market and aims at improving understanding of the possible emerging issues for financial stability, and encouraging the financial industry, early in the product cycle, to adapt risk management practices, disclosure and transparency to the pace of innovation in this market. On the subject of developments in the ETF Market, the FSB indicated that since its creation in the early nineties, the ETF market has exponentially grown in size, complexity and diversity. Currently there are two main structures for ETFs. Physical ETFs are "plain-vanilla" products that replicate the index by simply reconstituting the basket of physical securities underlying the index (e.g. the basket of S&P 500 stocks) with appropriate weights. Synthetic ETFs obtain the desired return through entering into an asset swap, i.e. an OTC derivative, with a counterparty, instead of replicating the index physically. While ETFs bring a number of benefits to investors and market participants, including cost efficiency, diversification and easier access to specific asset classes or risk exposures, they also generate new types of risks, according to the FSB. ETFs have branched out to other asset classes (fixed-income, credit, emerging markets, commodities) where liquidity is typically thinner and transparency lower. The increased popularity of "synthetic" ETFs (which use derivatives) as well as the more intensive recourse to securities lending by ETF providers of plain-vanilla ETFs raises new challenges in terms of counterparty and collateral risks. In addition, the expectation of on-demand liquidity may create the conditions for acute redemption pressures on certain types of ETFs in situations of market stress, which could in turn affect the liquidity of the large asset managers and banks active in this market. In view of the new challenges raised by recent trends on ETF markets, the Board recommended that ETF providers and investors should review the risk management strategies of ETFs, especially in areas such as counterparty risk and collateral management, as well as assessing their exposure to market and funding liquidity risks. Furthermore, ETF providers should consider enhancing the level of transparency they offer to investors on the entire range of ETF products. Finally, the FSB indicated that work is underway nationally and internationally to assess whether recent innovations and the related increase in complexity in some segments of the ETF market add to financial system risks and whether regulatory actions are needed to address potential shortcomings in the management of counterparty, collateral and liquidity risks, and in market transparency.

International Organization of Securities Commissions (IOSCO)

Commodity Futures Markets

On 15 April, IOSCO published a ➲report titled "Task Force on Commodity Futures Markets – Report to the Financial Stability Board". The report sets out the IOSCO Task Force on Commodity Futures Markets' current work on the supervision of commodity derivative markets, market transparency, and the ongoing monitoring of developments in OTC financial oil markets. It was prepared in response to the G20's request for an update to be provided to the Financial Stability Board on IOSCO's workstreams in support of the G20's aim of improving the regulation and supervision of exchange-traded, OTC derivative and physical commodity markets. In the report, the Task Force indicated that its first workstream is to update and review existing guidance on contract design and market surveillance for commodity contracts set out in the ➲1997 Tokyo Communiqué on Supervision of Commodity Futures Markets which sets out a number of criteria including: Accountability; Economic Utility; Correlation with Cash Market; Settlement and Delivery Reliability; Responsiveness; and Transparency. The Communiqué also included important Guidance on Components of Market Surveillance and Information Sharing. For its second workstream, the Organization is engaging with representatives from the International Energy Forum (IEF), International Energy Agency (IEA), and the Organisation of Petroleum Exporting Countries (OPEC) to assess the impact of oil price reporting agencies on overall market functioning and on financial markets in particular, in line with previous recommendations made on the need for improved physical market transparency. Finally, with the aim of improving oversight, understanding and transparency of OTC financial oil derivative markets, the Task Force stated that it is working with the ISDA Commodities Steering Committee (COSC) on creating a trade repository for these products by Q1 2012, as an initial step which will branch out into other commodities at a later date. This repository is intended to record, as a starting point, all oil financial derivative trade types in a centralised database and to provide a trade report structure in line with regulatory requirements. With regard to future work, the Task Force indicated the need to broaden its mandate to other commodities, including agricultural and soft commodities, that have a similar bearing on economic activity.

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Insurance, reinsurance and pensions

Consultative or informative documents

CEA

Solvency II

On 12 April, the CEA published the following position papers setting out industry proposals in relation to the Solvency II implementing measures:

- In the industry proposal on own funds - hybrids, the insurance industry details its reasoning as to why the ranking provisions of Solvency II compliant hybrids should only apply to new to be issued Solvency II style hybrid instruments (Tier 1-3), and should not also apply vis-à-vis grandfathered hybrids.
- In a second position paper, the industry sets out its proposal on the approval of ancillary own funds ("AOF"). Such funds can only be used with supervisory approval. To ensure a thorough as well as efficient approval process that works despite potentially very tight deadlines, the industry proposes the establishment of a pre-approval process. During the pre-approval process, the supervisory authority would assess the pre-application against all criteria (including the financial soundness of the Guarantor) and, if possible, grant pre-approval as outlined above subject to the condition precedent that the Guarantor's financial soundness can be proven by the Applicant at the time of the final application. Already in the pre-approval, the supervisory authority should specify the conditions as regards the Guarantor's financial soundness subject to which the final approval will be granted. When deemed necessary by the Applicant, it will file the "final" application based on the pre-approval and provide the information relevant for the assessment of the Final Condition (the Guarantor's financial soundness) as specified in the pre-approval. If the Guarantor's financial soundness is deemed sufficient by the supervisory authority (as assessed against the previously defined Final Condition), it will grant the "final" approval.
- The third position paper details a proposal from the insurance industry for grandfathering requesting transitions that build explicitly on the

hybrid treatment under Solvency I rather than initiate an interim period. Under the proposed approach, and for a transition period of 15 years: hybrids that qualify for the Solvency I 50% bucket would be eligible in Tier 1 and hybrids that qualify for the Solvency I 25% bucket would be eligible in Tier 2. The proposal avoids the immediate reduction of the perceived quality for European insurers' capital that were able to issue perpetual hybrids. When Solvency II will be implemented, stakeholders will look closely into the capital quality and insurers who issued a significant amount of perpetual hybrid would be put at a disadvantage from decisions that were fully aligned with the spirit of Solvency I.

On the same day, the CEA also published ➲a position paper, titled "Issues with and solutions for QIS5 Currency Risk treatment. In the paper, the Federation indicates that the QIS5 approach for calculating the currency risk capital charge resulted in unduly conservative capital requirements for currency risk and penalised entities and subsidiaries covering their local SCRs in their local currencies. This also impacts on solo entities holding excess capital in foreign currency in order to protect against potential balance sheet stresses. According to the CEA, the requirement to calculate the charge based on the net value of assets (i.e. assets - (best estimate + risk margin)) produces illogical results which discourage good risk management in firms. It notes that that for groups, this is not in line with a going-concern view, which would require them to ensure their solo entities to cover their SCR in their own currency. To solve these issues, the Federation proposes calculating the group currency risk capital charge by applying the currency risk shock to the sum of the local surpluses net of the SCR (pre-currency risk). For solo entities, where no currency-specific SCR is available, a consistent approach could be achieved by weighting the currency risk capital charge by the proportion of assets and liabilities held in foreign currencies. To accommodate this proposal, the CEA recommends the number of changes to the current level 2 text.

On 4 April, the CEA published a ➲letter it has sent to Commissioner for Internal Market and Services Michel Barnier in which it urged the Commissioner to ensure that the excessively conservative and prescriptive elements that remain in the draft implementing measures of Solvency II are urgently addressed. The letter details the areas in which changes are sought to the measures being proposed by EIOPA. These include a more balanced calibration of certain requirements, the tackling of pro-cyclicality and volatility in the Solvency II framework and the need to address unnecessary complexity. Among the requests set out in the letter is the industry's call for an economic treatment of the value of insurers' in-force portfolio, with its value treated entirely as Tier 1 capital. In the letter, it is also argued that Solvency II will have failed to achieve its underlying principles if these problems are not addressed. Such a failure would hamper insurers' ability to offer policyholders appropriate long-term protection at a fair price, in the shape of pension or long-term care products and penalise the diversified growth of insurance companies, at odds with the EU Single Market Strategy. It would also introduce a complex, inconsistent and volatile prudential framework that would neither guarantee financial stability nor policyholders' protection and shorten insurers' investment time horizon. The CEA indicated that it has proposed a number of solutions, the combined application of which would address the issues identified as affecting the ability of insurers to continue to offer long-term savings and pension products. These proposals aim to introduce an appropriate extrapolation of the risk-free rate curve used for the discounting of technical provisions, ensure that a formulaic approach is used for the application of the illiquidity premium which should not depend on a subjective assessment by EIOPA to determine a period of "stress" and address the issues related to the design and calibration of capital requirements and their potential pro-cyclical effects which are amplified for long term products. The Federation also stated that it is currently analysing different proposals for ways to address issues related to asset/liability valuation mismatches, which affect products with long-term guarantees. On non-life insurance, the CEA has put forward a series of solutions related to the current structure for catastrophe risk, which produces a capital level that does not appropriately reflect the underlying risk of each type of man-made or natural catastrophe.

European Banking Federation (EBF)

Insurance Mediation

On 19 April, the EBF published its ➲response to the European Commission's ➲consultation on the Review of the Insurance Mediation Directive. In the response, the Federation stated the new Insurance Mediation Directive (IMD) should contain two regimes appear, one for the sale of general insurance products and one for insurance PRIPs. Whilst more consistent and coherent horizontal approach to the regulation of product disclosure and sales practices appears necessary, the EBF takes the view that the existing differences between general insurance products and for PRIPs should be taken into account. The Federation also indicated its support for the introduction of MiFID-inspired conduct of business and conflicts of interest rules for the sale of insurance PRIPs. With reference to general insurance products the current IMD regime already ensures satisfactory regulation of the activity of insurance mediation, particularly with regard to advice, transparency of remuneration and conflicts of interest rules. Furthermore, the EBF stated that, in order to improve the internal market and protect consumers, legislation should not, within its given scope, leave room for further rules at national level. In this context and with reference to consumer protection, it supports the full targeted harmonisation approach. With regard to general provision, the EBF expressed its support for measures aiming at an increased transparency regarding the application of provisions imposed in the interest of general good. On the subject of the scope of the Directive, the Federation indicated that the status quo under Article 12(4) IMD for reinsurance intermediaries and the intermediation of contracts of large risks must be maintained and "direct sales" by insurance undertakings should be included within the scope of IMD2. Furthermore the EBF stated that it is in favor of the general aim of ensuring a common basic principle of knowledge and ability, irrespective of the method of distribution. It takes the view that the current IMD regime appears satisfactory as it already establishes professional requirements for appropriate knowledge and ability for a 'reasonable proportion' of the persons responsible for mediation or directly involved in insurance/reinsurance mediation and, as far as banks are concerned, thanks to the professional training and practical experience of selling insurance and other financial products, employees directly involved in insurance mediation are usually very highly qualified. The introduction of additional formal professional requirements (e.g. additional special qualifications) for all the employees of a bank entrusted with the sale of insurance would, according to Federation, seriously restrict the scope of the bank's insurance mediation activities for formal reasons alone despite the existing high standard of qualification. To conclude, the EBF stated that it does not share the Commission's view to introduce additional conflicts of interest rules, such as the MiFID Level 1 because these rules are difficult to adapt to the insurance intermediation business where natural persons operate. It supports the current IMD regulatory approach which provides for a mandatory disclosure of information in certain situations where conflicts of interest could negatively influence the independence of an intermediary and may undermine its duty to act in the best interests of his customer.

European Insurance and Occupational Pensions Authority (EIOPA)[5]

Reporting requirements to supervisory authorities

On 20 April, EIOPA published a ➲report on reporting requirements to supervisory authorities. The report aims to analyze in detail the difference in reporting requirements for Institutions for Occupational Retirement Provision (IORPs) that exist amongst Member States, and the link, if any, between reporting requirements and supervisory regime. It focuses on ongoing reporting requirements. Reporting requirements e.g. during the licensing process are not covered. The data for the report was collected via a survey. In its conclusions, EIOPA noted that the reporting requirements differ widely between Member States. While some Member States receive a lot of information in a very frequent way, other Member States receive information mainly on request. Primary legislation is the predominant form for the implementation of the reporting requirements, as well as for the implementation of frequency. Different reporting requirements for different IORPs were reported by almost half of the respondents. Furthermore, EIOPA found that the reporting requirements for IORPs are affected by reporting requirements for other financial undertakings, namely insurance undertakings, in almost half of the Member States. The main reasons for the supervisory authority to collect data that were mentioned by the respondents are to perform its supervisory functions, to generate statistics and reports, to fulfill its legal objectives, to supervise the funding level of IORPs/schemes, to ensure financial stability of the pensions market and to identify special risks. With regard to the processing of the reported information, EIOPA found that almost all countries analyze data manually as well as electronically. Finally, the Supervisor reported that there seems to be a weak link between the reporting requirements approach and the predominant form of pension schemes that are operated in a Member State. Member States that have defined benefit and mainly defined benefit IORPs tend to use a mix of annual and quarterly data reporting. Member States that have mainly defined contribution IORPs tend to use a mix of annual, monthly and on request data collection. Member States that have only defined contribution IORPs tend to use quarterly and monthly data collection. A similar link seems to also exist between the number of IORPs and IORPs per employee respectively and the reporting requirements approach. The frequency in which information has to be sent seems to be higher for countries with fewer IORPs than for countries with thousands of IORPs.

Variable Annuities

On 5 April, EIOPA published a ➲Report on Variable Annuities. The report illustrates the work of Task Force on Variable Annuities (TF), set up by CEIOPS in March 2010 with the aim of establishing common EU guidelines for the supervision on insurers selling Variable Annuities (VA's). The Task Force was mandated to draft those guidelines having in mind two main areas of interest, i.e. i) technical and actuarial issues and ii) governance and colleges of supervisors. On technical and actuarial issues, the TF aims at defining common principles and methods for the assessment of the efficiency of the hedging techniques used for the guarantees provided and the calculation of technical provisions and capital requirements under Solvency I and under Solvency II either for the standard formula or internal models. On governance and colleges, the TF aims to define common principles and best practices regarding governance including internal controls. Guidelines must also include recommendations that can be put immediately in place but that will also be relevant for the upcoming Solvency II supervisory regime: therefore, the TF investigated on desirable supervisory treatment of VAs in a Solvency I as well as in a Solvency II context in the view of opportunity of a smooth transition from Solvency I to Solvency II.

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

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Tax

Consultative or informative documents

CEA

Taxation of the financial sector

On 20 April, the CEA published its ➲response to ➲European Commission's consultation on the taxation of the financial sector. In the response, the Federation indicated that it is of the utmost importance for any initiative in this field to appropriately distinguish between different types of financial institutions and activities, their role in the function. In this respect, the debate on taxation of the financial sector should, according to the CEA recognise that the insurance business model and risk profile are fundamentally different from banks. No core insurance activity has ever triggered a systemic financial crisis and the insurance industry only received a small portion of government funds compared to banks. Therefore, the CEA argues, it would be inappropriate to penalize the financial sector as a whole for risks arising mainly from the banking sector. Furthermore, the Federation stated that it is convinced that efficient supervision and appropriate regulation are the best way to tackle the issue of financial stability. This will already be assured by the Solvency II regulatory regime that will come into force at the end of 2012. The CEA also contradicted that the insurance sector is under-taxed compared to other sectors in the economy. Insurance companies are already subject to the national insurance premiums taxes, whereas a comparable tax does not exist in the banking sector. Insurance companies are also subject to non-deductible VAT on their activities. Given the above, the CEA opposes any additional taxation of the insurance sector whether it is in the form of a Financial Transactions Tax (FTT) or Financial Activities Tax (FAT).

Foreign Account Tax Compliance Act (FATCA)

In a ➲press release of 7 April, the CEA welcomed the joint letter sent by the European Commission and the Hungarian Presidency on 6 April to the US tax authorities inviting them to engage in a dialogue on how to best achieve the objectives of the Act introducing FATCA, although it disagrees with the Commission and the Presidency that an extension of the EU Savings Taxation Directive could be the answer. The CEA indicated that the insurance industry does not support the inclusion of life insurance products in the scope of the Directive and extending the Directive would not solve the reporting burden, since the requested data is currently not collected by the insurance industry.

VAT treatment of insurance services

On 11 April, the CEA published ➲its comments on the ➲latest EU Presidency compromise text for the Council Directive on the VAT treatment of insurance and financial services. With regard to the definition of insurance, the Federation stated that it has long advocated that a reference to "risk pooling" in the legal definition of insurance is not necessary and it therefore welcomed the decision of the Presidency to remove it. The CEA also indicated its support for the reintroduction of the explicit exemption of the management of (re)insurance contracts into the Directive. This is necessary to secure legal certainty for insurance companies and preserve a level playing field between insurance and other financial services. The CEA particularly supports the exemption of claims handling in the context of the management of (re)insurance contracts. It is also pleased that the proposed exclusion for "standardised services provided by call centres" has been deleted, because the nature of the service should be the key to determining the VAT liability, not the medium by which the service is provided. Finally, the CEA welcomed the criteria proposed by the Presidency to qualify an insurance service for the outsourcing exemption. It believes that the combination of the insurance outsourcing exemption criteria in the Directive and the non-exhaustive list of typically exempt services in the Council Regulation laying down implementing measures for Directive 2006/112/EC (the "VAT Directive") cover the important functions/activities of an insurance contract.

Council of the European Union

Foreign Account Tax Compliance Act (FATCA)

On 6 April, the Council of the European Union published the ➲letter the Hungarian Presidency of the Council of the European Union and the European Commission send to US Tax Authorities inviting them to engage in a dialogue on how to best achieve the objectives of the US Foreign Account Tax compliance Act (FATCA). FACTA could impose a significant compliance burden on EU financial institutions (including banks, investment funds and insurance companies). In light of the information exchange tools that already exist between tax administrations, and given the ongoing discussions on extending the scope of the Savings Tax Directive, which is a priority for the Hungarian Presidency and the Commission, the Hungarian Presidency and the Commission invited the US authorities to consider exploiting possible synergies to achieve their common goals in a cost-effective and business-friendly way.

European Association of Co-operative Banks (EACB)

Taxation of the financial sector

On 19 April, the EACB published ➲its response to the ➲European Commission's consultation on the taxation of the financial sector. In the response, the EACB indicated that its members of the EACB do not support any initiative concerning additional taxes on the EU financial sector at the current stage. It would be myopic and unsustainable to introduce additional initiatives that would further increase the complexity of existing regulatory requirements and therewith increase the burden of compliance for financial institutions. The Association also expressed its strong disagreement with the Commission's argument that the financial sector is under-taxed compared to others sectors of the economy. In this respect, it stressed that the VAT exemption for financial services does not mean that the financial service sector is under-taxed, given that input taxes cannot be deducted. However, whether it is decided to introduce a new taxation, it will be of essential importance, according to the EACB, that a detailed impact assessment is conducted in order to assess the direct and indirect implications of a potential initiative as well as to take the cumulative effects with the wide range of other regulatory initiatives into account. European measures should aim to consolidate existing fiscal regulations in the Member States rather than adding an additional tax-layer to the already very complex regulatory framework. Thus, any European measure – if decided to be introduced – should replace comparable measures at national level. Finally, the Association empathized that, at a global level there is a need to maintain a level playing field. The possible future taxes should not put European banks and/or their subsidiaries operating on a global level at a disadvantage in comparison with their non-EU counterparts.

European Association of Public Banks (EAPB)

Taxation of the financial sector

On 19 April, the EAPB published ➲its response to the ➲European Commission's consultation on the taxation of the financial sector. In the response, the Association indicated its opposition to additional taxation of the financial sector or services via a Financial Activities Tax (FAT) and/or Financial Transaction Tax (FTT). According to it, the fact that certain financial services are exempted from indirect taxation (value added taxation, VAT) does not mean that the financial sector is under-taxed. The VAT exemption of financial services leads to an irrecoverable VAT and therefore a cost burden for financial institutions which puts upon them a disadvantage in comparison with market participants from other sectors. As such the VAT exemption of financial services does not justify the introduction of a FAT. Additionally, a FAT would lead to an additional burden apart from income/profit taxation and value added taxation which would be in contrary to the principle of equal taxation. With regard to the Financial Transaction Tax (FTT), the Association stated that it cannot be effective per se because it intervenes in the mechanisms of financial markets and it would mainly hit (retail) investors and issuers. The funding of capital would become more expensive for the economy as a whole. Finally, the Association indicated that it is of utmost importance that the cumulative effect of all recent, present and upcoming EU legislation concerning the financial sector is taken into consideration when assessing a potential additional taxation of the financial sector or financial services. Any double taxation or distortion of the tax system must be avoided.

European Banking Federation (EBF)

Taxation of the financial sector

On 19 April, the EBF published its ➲response to the ➲European Commission's consultation on the taxation of the financial sector. In the response, the Federation stated that it opposes the introduction of additional taxes on the financial sector in the EU because it would have a number of possible adverse implications. Firstly, the introduction would lead to double taxation and the cumulative effect with other requirements, regulations and bank levies may affect banks' capacity to rebuild and strengthen their capital base, impact negatively bank's ability to finance households and businesses, place downward pressure on economic growth expectations and deprive public authorities of a greater source of fiscal income. Secondly, the imposition of an EU wide Financial Transaction Tax (FTT) would immediately erode the tax base because of the migration of transactions outside the scope of the rules. A narrow-based FTT, targeting exchange traded transactions, would, according to the EBF, create a migration of such transactions from the central clearing mechanisms and regulated markets into presumably less secure and transparent channels, with an inevitable impact on the liquidity of EU financial markets. A broad-based FTT will also have negative economic implications since it is unclear what would be the connecting factor for the collection of the tax for the over-the-counter ("OTC") transactions of non exchange traded securities and derivatives. The practical issues and costs associated with enforcing collection and compliance, as well as legal uncertainty for the presumed collectors of the tax are significant and likely to lead to market distortions. Thirdly, the EBF voiced its concerns about the perspective of introducing a Financial Activities Tax (FAT) which would impact liquidity and make cash flows more expensive. The introduction of a new tax based on cash flows and designed outside the scope of VAT would also create an overwhelmingly complex tax system for EU financial institutions. If additional tax measures were to be adopted in the EU, the EBF requested the Commission ensure that double taxation and duplication of domestic bank taxes with any EU fiscal initiative is avoided. Cumulative impacts and interactions with other mitigation measures and resolution banking levies must be appropriately evaluated before and during the implementation of the new tax. The same is true for the competitive implications of new taxes on the EU financial sector. The Commission must ensure a level playing field. Additionally, any additional tax on the EU financial sector should be developed in respect of proportionality and legal certainty principles. Finally, If a tax were introduced based on cash flows, then the Commission should assess the merits of designing it within the VAT framework, so as to ensure an administrable system for financial institutions and to mitigate the unforeseen cumulative effect of the collection of additional taxes on top of irrecoverable input VAT.

European Commission

Discriminatory taxation of foreign investment

In a ➲press release of 6 April, the European Commission announced that it has decided to refer Belgium to the European Court of Justice because of its discriminatory taxation of foreign investment companies. Under Belgian law, domestic investment companies do not in practice pay tax on their Belgian-sourced interest and dividend income as they get a refund for any Belgian withholding taxes paid on their Belgian-sourced interest and dividend income. However, foreign investment companies pay withholding taxes of 15 or 25 % on their Belgian-sourced interest and dividend income and cannot claim a refund. Such discrimination is considered in breach of EU Single Market rules on the free movement of capital and freedom of establishment.

Discrimination against Icelandic and Norwegian investment funds

In a ➲press release of 6 April, the European Commission announced that it has decided to refer Belgium to the European Court of Justice for discriminatory taxation of certain Icelandic and Norwegian collective investment funds in breach of EU rules on free movement of capital and freedom to provide services. In particular, Belgium does not grant an exemption from capital gains tax for sales of shares from certain collective investment funds established in Iceland and Norway whereas it does grant such exemptions in the case of shares from equivalent collective investment funds established elsewhere in the EU.

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