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Regulatory Radar

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Newsletter on banking and financial regulation

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The past months a number of interesting documents have been issued on a global and EU level related to financial consumer protection e.g. the Eurobarometer on retail financial services, IOSCO Suitability requirements for complex financial products, the EBA Financial Innovation and Consumer Protection overview and the EIOPA Overview of Key Consumer Trend in the EU.

The European Supervisory Authorities also published its working programs for 2012.

In relation to pensions the European Commission published its white paper on adequate, safe and sustainable pensions and EIOPA its final advice on the IORP Directive Review.

In the area of payments, the Commission released a green paper on integrated European market for card, internet and mobile payments.

A new document on the AIFMD has also been released i.e. ESMA's discussion paper on key concepts of the Alternative Investment Fund Managers Directive and types of AIFM.

Finally, on a somewhat more general note but very relevant, the European Commission published its proposals for a Data Protection Reform package. The proposals consist of a Regulation setting out a general EU framework for data protection (replacing the Current Data Protection Directive) and a Directive on protecting personal data processed for the purposes of prevention, detection, investigation or prosecution of criminal offences and related judicial activities.

We hope you enjoy the reading.

The Editorial Board.

Normative documents

Official Journal of the European Union (OJ)

AML/CFT and sanctions

In February, the following documents related to AML/CTF and sanctions measures were published in the Official Journal:

- Commission Implementing Regulation (EU) No 88/2012 of 1 February 2012 amending Regulation (EC) No 1210/2003 concerning certain specific restrictions on economic and financial relations with Iraq in OJ L 30 of 2 February 2012
- Commission Implementing Regulation (EU) No 97/2012 of 6 February 2012 amending for the 164th time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with the Al-Qaida network in OJ L 35 of 8 February 2012
- Council Implementing Regulation (EU) No 113/2012 of 10 February 2012 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 L 38 of 11 February 2012
- Council Regulation (EU) No 114/2012 of 10 February 2012 amending Regulation (EC) No 765/2006 concerning restrictive measures in respect of Belarus in OJ L 38 of 11 February 2012
- Commission Implementing Regulation (EU) No 116/2012 of 9 February 2012 amending Council Regulation (EC) No 872/2004 concerning further restrictive measures in relation to Liberia in OJ L 38 of 11 February 2012
- Council Implementing Decision 2012/74/CFSP of 10 February 2012 implementing Decision 2010/656/CFSP renewing the restrictive measures against Côte d'Ivoire in OJ L 38 of 11 February 2012
- Council Decision 2012/97/CFSP of 17 February 2012 amending Decision 2011/101/CFSP concerning restrictive measures against Zimbabwe in OJ L 47 of 18 February 2012
- Council Decision 2012/98/CFSP of 17 February 2012 amending Decision 2010/232/CFSP renewing restrictive measures against Burma/Myanmar in OJ L 47 of 18 February 2012
- Commission Implementing Regulation (EU) No 151/2012 of 21 February 2012 amending Council Regulation (EC) No 314/2004 concerning certain restrictive measures in respect of Zimbabwe in OJ L 49 of 22 February 2012
- Council Regulation (EU) No 168/2012 of

27 February 2012 amending Regulation (EU) No 36/2012 concerning restrictive measures in view of the situation in Syria in OJ L 54 of 28 February 2012

- Council Decision 2012/122/CFSP of 27 February 2012 amending Decision 2011/782/CFSP concerning restrictive measures against Syria in OJ L 54 of 28 February 2012
- Council Implementing Decision 2012/124/CFSP of 27 February 2012 implementing Decision 2011/101/CFSP concerning restrictive measures against Zimbabwe in OJ L 54 of 28 February 2012
- Council Implementing Regulation (EU) No 170/2012 of 28 February 2012 implementing Article 8a(1) of Regulation (EC) No 765/2006 concerning restrictive measures in respect of Belarus in OJ L 55 of 29 February 2012
- Council Implementing Decision 2012/126/CFSP of 28 February 2012 implementing Decision 2010/639/CFSP concerning restrictive measures against Belarus in OJ L 55 of 29 February 2012

In January, the following documents related to AML/CTF and sanctions measures were published in the Official Journal:

Commission Implementing Regulation (EU) No 7/2012 of 5 January 2012 amending Council Regulation (EC) No 1183/2005 imposing certain specific restrictive measures directed against persons acting in violation of the arms embargo with regard to the Democratic Republic of the Congo in OJ L 4 of 7 January 2012

Commission Implementing Regulation (EU) No 15/2012 of 10 January 2012 amending for the 162nd time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with the Al-Qaida network in OJ L 8 of 12 January 2012

Commission Implementing Regulation (EU) No 34/2012 of 17 January 2012 amending for the 163rd time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with the Al-Qaida network in OJ L 15 of 18 January 2012

Council Regulation (EU) No 36/2012 of 18 January 2012 concerning restrictive measures in view of the situation in Syria and repealing Regulation (EU) No 442/2011 in OJ L 16 of 19 January 2012

Council Implementing Regulation (EU) No 54/2012 of 23 January 2012 implementing Regulation (EU) No 961/2010 on restrictive measures against Iran in OJ L 19 of 24 January 2012

Council Implementing Regulation (EU) No 55/2012 of 23 January 2012 implementing Article 33(1) of Regulation (EU) No 36/2012 concerning restrictive measures in view of the situation in Syria in OJ L 19 of 24 January 2012

Council Regulation (EU) No 56/2012 of 23 January 2012 amending Regulation (EU) No 961/2010 on restrictive measures against Iran in OJ L 19 of 24 January 2012

Council Decision 2012/35/CFSP of 23 January 2012 amending Decision 2010/413/CFSP concerning restrictive

measures against Iran in OJ L 19 of 24 January 2012
Council Decision 2012/36/CFSP of 23 January 2012 amending Decision 2010/639/CFSP concerning restrictive measures against Belarus in OJ L 19 of 24 January 2012
Council Implementing Decision 2012/37/CFSP of 23 January 2012 implementing Decision 2011/782/CFSP concerning restrictive measures against Syria in OJ L 19 of 24 January 2012

Financial Services and Markets Authorities (FSMA)

Adequacy of the internal control system

On 20 February, the FSMA published Circular FSMA_2012_04 on the senior management's report on the evaluation of internal control, the senior management's report on the evaluation of the internal control relating to investment services and activities, and the senior management's declaration regarding the periodic financial statements (in ➲Dutch and in ➲French). The circular supersedes the existing circular CBFA_2008_12 of 9 May 2008 for the financial institutions which are subject to the prudential supervision of the FSMA (i.e. portfolio management and investment advice companies and management companies of undertakings for collective investment). The circular mainly aims to align the reporting of the effective management on the internal control system with the Twin Peaks supervisory structure. Care has been taken to ensure that the reporting requirements and the content of the circular is aligned with circular NBB_2011_09 of 20 December 2011 which sets out the reporting requirements regarding internal control for the financial institutions subject to the prudential supervision of the National Bank of Belgium (more information on this circular is available here: in ➲Dutch and in ➲French). As such senior management is required to draft two reports with respect to internal control: a general report on the evaluation of internal control and a specific report on the evaluation of the internal control relating to investment services and activities.

Obligations of Issuers

On 11 January, the FSMA published a new version of Circular FMI/2007-02 on the obligations of issuers listed on a regulated market (in ➲Dutch and in ➲French). The Circular provides guidance and sets out the FSMA's expectations with respect to the obligations of issuers listed on a regulated market (i.e. their obligations with respect to the holders of their securities, obligations tied to the prevention of market abuse and disclosure requirements). The updates made to the Circular mainly concern the disclosure requirements regarding profit warnings and the requirements with respect to the annual financial report.

Consultative or informative documents

Bank of International Settlements (BIS)

Financial sector regulation for growth, equity and

stability

In January, the BIS published a ➲collection of the speeches, papers and summaries of discussions of the international conference of central banks and regulators on "Financial regulation and its implications for growth equity and stability in the post crisis world" of November 2011. The conference provided a forum for central bankers, financial sector regulators, academics and practitioners from both developed and emerging markets to deliberate on the issues of growth, equity and stability. The discussions illuminated not only the multidimensional linkages between the financial sector and the sovereign but also the influence of the international financial architecture on global financial stability. The key message that emerged from the discussions is that the costs of financial instability in terms of lost growth and foregone welfare can be huge and that it is therefore right for regulatory reforms to give primacy to securing financial stability. Banks must serve the real sector, and not the other way round. Participants also agreed that the financial sector development which serves the needs of the real sector provides sustainable earnings for financial firms. Higher capital requirements for financial institutions may raise the cost of credit in the short-term. But these costs will fall over time: better capitalized banks will find they can fund themselves more cheaply. They will also be able to increase their market share at the expense of poorly capitalized banks. The benefits of financial stability will surely outweigh the loss of short-term gains. A consensus also developed around the incorporation of equity as an explicit objective of financial policy, especially in countries with a large population of those without access to formal financial services. There was, however, a lively debate on how best to achieve this in practice. Supervisory authorities worldwide have to refine and develop their macro-prudential toolkit. The macroeconomic aspects of systemic risk that arise from global influences require special attention. Pragmatic capital account management will accordingly have to form an integral part of policy in many countries. But such measures should provide a clear and predictable framework of rules that help the private sector nurture the more stable forms of capital movement. International capital mobility offers many gains if the risks are managed effectively.

Council of the European Union

Harmonisation of transparency requirements

On 21 February, the Council published the ➲Opinion of the European Central Bank on a proposal for a directive of the European Parliament and of the Council amending Directive 2044/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and Commission Directive 2007/14/EC. In the opinion, the European Central Bank indicates that it largely agrees with the proposed amendments. It does however make a number of drafting proposals aimed at increasing their effectiveness and

legislative precision.

European Banking Federation (EBF)

Credit rating agencies

On 9 February, the EBF published ➲its comments on the European Commission's ➲proposal regarding the regulation of Credit Rating Agencies (CRAs).

Alternative Investment Fund Managers Directive

On 3 February, the EBF published ➲its comments on ESMA's ➲Final Report on technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive.

Transparency requirements for listed companies

On 26 January, the EBF published ➲its comments on the European Commission's ➲proposal of for a Directive amending Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

European Central Bank (ECB)

Statistical reporting requirements for financial vehicle corporations

On 8 February, the ECB published a ➲guidance note on the definitions of the "financial vehicle corporation" and "securitisation" under Regulation ECB/2008/30 of 19 December 2008 concerning statistics on the assets and liabilities of financial vehicle corporations engaged in securitization transactions. The purpose of the guidance note is to assist national central banks, market participants and statistical reporting agents with the practical application of the definitions by providing advice on the implementation of their different elements.

Liquidity, risk and the global transmission of the 2007-08 financial crisis and the 2010-2011 sovereign debt crisis

On 1 February, the ECB published a working paper, entitled ➲"Liquidity, risk and the global transmission of the 2007-08 financial crisis and the 2010-2011 sovereign debt crisis". The paper analyses the global transmission of the 2007-08 financial crisis and the 2010-11 sovereign debt crisis via shocks to liquidity and shocks to risk. The objective of the paper is threefold. First, it analyses how shocks to liquidity and risk are transmitted to financial markets globally and how they help us understand the dynamics of the two different crisis episodes. The response of asset prices (equity markets and bond yields) as well as of exchange rates and capital flows in equities and bonds are analysed in order to gauge the functioning of the transmission channels. Second, the report looks at how and why the 2007-08 financial crisis and the 2010-11 sovereign debt crisis have been different. And third, it attempts to shed light on the portfolio decisions by investors, and their determinants. Based on the aforementioned analyses, the report makes the following

four key findings. First, the transmission of liquidity shocks and risk shocks is highly heterogeneous, across countries, across asset classes and over time. Shocks to liquidity and to risk exhibited much larger effects on asset prices and on capital flows during the 2007-08 financial crisis than either in the pre-2007 period or the 2010-11 sovereign debt crisis, highlighting that these two crises have (so far) been very different in the way markets have responded. There are also important cross-country differences. Emerging market economies have been affected much more strongly; both in terms of asset prices and capital flows, by shocks during the 2007-08 crisis, often exhibiting a sensitivity to shocks that has been twice as large as that for advanced economies. Second, the findings of the analysis yield clear evidence of a strong geographic flight-to-safety phenomenon during the 2007-08 financial crisis, but much less compelling evidence of such a pattern since 2009. Third, the analysis uncovers evidence for a portfolio rebalancing motive for relatively safe financial assets, primarily for bonds in advanced economies, implying a negative correlation between returns and flows into these assets conditional on shocks to risk. By contrast, there is a mostly positive correlation between returns and flows for relatively more risk assets, portfolio equity assets in advanced economies and especially emerging market economy equities and bonds, akin to a return chasing motive. Fourth and finally, the paper attempts to identify some of the determinants that explain the differences of the transmission of shocks across countries. It finds that the transmission of risk and liquidity shocks across countries was influenced by countries' financial exposure to the US. As a second set of factors, countries' exposure to liquidity and risk shocks is dependent on the strength of countries' own fundamentals. Those economies with a poor sovereign rating and worse economic and political institutions were substantially more affected by risk and liquidity shocks in both crises. These findings have important implications, not just for our understanding of the global transmission of the crisis, but also about what economic policy can do to shield the domestic economy from global shocks.

European Commission

European Company Law

On 20 February, the European Commission launched ➲a consultation on the future of European company law. Input is requested both on the general orientation of European company law and on more specific initiatives that could be envisaged in the future. The following issues are covered in the consultation:

- Objectives and scope of European company law – What should be the main objectives of European company law? Are the current rules fit for today's challenges? In which areas is there need for further evolution? What relationship between company law and corporate governance?
- Codification of European company law – should the existing company law Directives be merged in a single instrument in order to make the

regulatory framework more accessible and user-friendly?

- The future of company legal forms at European level – What are the advantages and shortcomings of European company forms? Do existing company forms need to be reviewed? Should alternative instruments be explored?
- Cross-border mobility for companies – What can be done to facilitate the cross-border transfer of a company's seat? What if a company splits into different entities cross border? Should the rules on cross border mergers be reviewed?
- Groups of companies – i.e. a set of companies under a single management or source of control – Is there need for EU policy action in this field?
- Capital regime for European companies – Should the existing minimum legal capital requirements and rules on capital maintenance be modified and updated?

Response to the consultation can be submitted until 14 May.

Special Eurobarometer on retail financial services

On 17 February, the European Commission published its ➲Special Eurobarometer on retail financial services. The Eurobarometer survey examines public opinion in the area of retail financial services (bank accounts, mortgage credit, consumer credit, stocks/bonds/shares, investment funds, insurance and payments). It analyses the way in which retail financial services are perceived at the EU level and within individual Member States. It also provides cross-country comparisons and socio-demographic analysis to help understand how different sections of society perceive and use retail financial services. The results show large differences in the financial products and services held by European consumers. Moreover, European consumers are extremely immobile when it comes to financial services; many fail to shop around for financial products and the majority have not switched providers for existing products. Given the level of domestic immobility, it is not surprising that levels of direct cross-border activity also remain low. The survey also found a clear need for improving financial literacy amongst EU citizens. Many people who have financial products or services are unaware of the advantages of shopping around for financial products (both within their own country and in other Member States) and similarly seem to not see the potential benefits of switching providers in order to secure a better deal. Many respondents are still dependent on face-to-face purchasing and rely on their providers for recommendations. Encouraging the use of other purchasing channels, such as the internet, or making advice and recommendations more readily available to citizens would enable them to compare products in a way which is perhaps more limited currently. There seems to also be a need for improved regulation in the way that these products are sold with the transparency of the purchasing process a common issue, particularly when it comes to how the salesperson

is being remunerated.

European financial reform

On 6 February, the European Commission published a booklet, entitled ➲"Restoring the health and stability of the EU financial sector". The booklet provides an overview of all the legislative initiatives that have been taken or are being taken by the EU to meet its G20 commitments and restore the health and stability of the EU financial sector.

Data Protection Reform package

On 25 January, the European Commission published ➲its proposals to reform the European data protection legislation. The proposals consist of a Regulation setting out a general EU framework for data protection (replacing the Current Data Protection Directive) and a Directive on protecting personal data processed for the purposes of prevention, detection, investigation or prosecution of criminal offences and related judicial activities (replacing replacing Framework Decision 2008/977/JHA). They focus on: reinforcing individuals' rights, strengthening the EU internal market, ensuring a high level of data protection in all areas (including police and criminal justice cooperation) ensuring proper enforcement of the rules, facilitating international transfers of personal data and setting global data protection standards. Key changes in the reform include:

- The regulation introduces a single set of rules on data protection, valid across the EU. Unnecessary administrative requirements, such as notification requirements for companies, will be removed;
- Instead of the current obligation of all companies to notify all data protection activities to data protection supervisors, the Regulation provides for increased responsibility and accountability for those processing personal data. For example, companies and organizations must notify the national supervisory authority of serious data breaches as soon as possible (if feasible within 24 hours);
- Organisations will only have to deal with a single national data protection authority in the EU country where they have their main establishment. Likewise, people can refer to the data protection authority in their country, even when their data is processed by a company based outside the EU. Wherever consent is required for data to be processed, it is clarified that it has to be given explicitly, rather than assumed;
- The introduction of a "right to data portability" which will enable data subjects to transfer personal data from one service provider to another more easily;
- The introduction of a "right to be forgotten" which will help data subjects better manage data protection risks online: they will be able to delete their data if there are no legitimate grounds for retaining it;
- A requirement for public sector entities and for

large enterprises to appoint a Data Protection Officer will be introduced. Such an appointment will also be required where the core activities of the controller or processor consist of processing operations which require regular and systematic monitoring;
- Simplification of the procedure for Binding Corporate Rules (BCRs). Upon authorisation, BCRs will be automatically accepted across all EU Member States;
- A new supervisory body, the European Data Protection Board, will supersede the existing Article 29 Working Party and ensure consistency of approach, enforcement in relation to all aspects of the Data Protection Framework, including authorisation of Binding Corporate Rules (BCRs), and the enforcement mechanisms.
- Independent national data protection authorities will be strengthened so they can better enforce the EU rules at home. They will be empowered to fine companies that violate EU data protection rules. This can lead to penalties of up to €1 million or up to 2% of the global annual turnover of a company;
- The new Directive will apply general data protection principles and rules for police and judicial cooperation in criminal matters. The rules will apply to both domestic and cross-border transfers of data.

The publication of the proposals was accompanied by a ➲Communication which sets out the main elements of the reform of the EU framework for data protection.

Integrated European market for card, internet and mobile payments

On 11 January, the European Commission published ➲its Green Paper on card internet and mobile payments. The paper assesses the current landscape of card, internet and mobile payments in Europe, identifies the gaps between the current situation and the vision of a fully integrated payments market and the barriers which have created these gaps. The main
issues identified in the paper concern:

- market access and entry for existing and new service providers
- payment security and data protection
- transparent and efficient pricing of payment services
- technical standardisation
- inter-operability between service providers.

An additional crucial issue, overarching all the aspects above, is the one of proper governance. In other words, how can the remedies for the obstacles identified be best put in place so as to ensure that the benefits materialize in a reasonable time frame.

The publication of the Green Paper was accompanied by a ➲Frequently Asked Questions. Comments on the Paper

can be ➲submitted until 11 April.

European Savings Banks Group (ESBG)

Payments Innovation

On 20 January, the ESBG published a working paper, ➲entitled "SEPA or payments innovation: a policy and business dilemma". The Working Paper compares public policies and related action with respect to payments innovation in the European Union, the United States, Australia, and Canada. It asks why policy makers and/or legislators are concerned about payments innovation, how they define payments innovation, and how they see their role in making payments innovation happen. It also assesses the effectiveness of the different approaches against the relative efficiency achieved by each payment system (as measured in terms of non-cash payment transactions per capita). The Working Paper then reviews recent academic research on payments innovation. This includes the definition of investment strategies for payments innovation, the segmentation of innovation into technology innovation and service innovation, the drivers for providers to innovate, the 3 conditions required for market adoption of new payment instruments, and the 5 possible cooperation models between market participants. It then assesses the policy pursued by European policy makers and regulators against the conclusions from academic research.
Finally, the paper reviews a range of aspirations expressed in recent surveys and consultations by the demand and supply sides of the market.

European Securities and Markets Authority (ESMA)

Credit Rating Agencies

On 24 January, ESMA published ➲the speech its Executive Director, Verena Ross, gave at a public hearing organised by the Committee on Economic and Monetary Affairs of the European Parliament the same day. In the speech, Ms. Ross first detailed ESMA's current work on Credit Rating Agencies (CRAs). She stated that ESMA is currently in the process of fully implementing the provisions of the amended Regulation on credit rating agencies ("Regulation"), also known as CRA2. ESMA conducted a first on-site inspection of the three main CRAs in December 2011, for which we expect to publish an examination report by the end of the first quarter of this year. Furthermore, Ms. Ross indicated that in the course of 2012 ESMA will also finalize the establishment of the reporting data tools provided by the Regulation and of the CEREP central database. ESMA is also in the process of performing the assessment of the regulatory framework of several non-EU countries and agreeing suitable cooperation arrangements with the respective supervisors - something that will ensure the endorsement of the overwhelming majority of third-country ratings currently used for regulatory purposes in the Union. In addition to the above, Ms. Ross commented on the ➲CRA 3 Proposals published by the European Commission in

November 2011. She stated that she personally believe several proposed provisions would have a positive effect on the overall framework for CRA supervision, starting with the new disclosure provisions: a) for instance the fact that issuers, sponsors, and originators of structured finance instruments would have to disclose information on the credit quality and performance of underlying asset pools; or b) that CRAs should disclose to ESMA the fees received from each of their clients and their general pricing policy. Another important contribution of the new proposal concerns the prevention of conflicts of interest. Another area which in her view is positive, is the proposal requiring ESMA to introduce a harmonized rating scale to be used by all CRAs registered in the EU. As has been observed, there may be a limit to the ability of market participants to consider and compare different rating scales and methodologies. The uniform rating scale would establish a comparable metrics for all existing rating scales. Furthermore, Ms. Ross indicated that the requirement that Member States must ensure civil liability for any infringements to the CRA Regulation made with intention or gross negligence, will encourage CRAs to adopt even stronger credit rating processes, which were lacking in the structured product space a few years ago. To conclude, she added a word of caution with respect to the following provisions in the CRA3 proposals:

- the introduction of the requirement for ESMA to assess new draft methodologies as a condition for their entry into force: Given the limited supervisory experience of ESMA, this new proposed role for ESMA could, according to Ms. Ross, create serious tensions with the requirement of non-interference and independence. One possible alternative could be to have detailed principle-based industry standards for rating processes the application of which ESMA could then monitor as part of its on-going supervision process to ensure that the CRAs respect these commonly agreed industry standards;
- the introduction of mandatory rotation for rating analysts and CRAs: According to Mr. Ross the introduction of mandatory rotation could, at least in the short term, introduce the risk that new entrants might compete by offering higher ratings or by lowering prices. This could have a detrimental effect on the quality of the rating process and the reliability of the ratings themselves. If new entrants or smaller CRAs are attracted to bid in the rotation process, it is not clear that - at least in the short term - their professional competence (such as adequate staffing, processes, systems, controls, etc) will be able to live up to expectations;
- the requirement that ESMA annual report shall assess market concentration levels and related risks: As such tasks normally belong to competition supervisors, ESMA would have to adopt entirely new skills and methodologies to assess risks from market concentration levels. Furthermore ESMA might find itself in the uncomfortable position of pursuing possible

conflicting objectives such as ensuring the stability and the competition of the securities markets at the same time;
- the requirement for ESMA to renew by 1 June 2014 the assessment of compliance of third countries with the amendments introduced by the CRA3: By adding in the CRA3 proposals a tight deadline and by making a direct reference to the CRA3 amendments, the proposed (from scratch) assessment would not only run into difficulties since at the moment several of the CRA3 proposals are not part of the G20 and IOSCO framework, but might also create incredulity of ESMA's intentions and good faith in the continuing ongoing third-country assessment process that we are currently engaged in under the existing Regulation.

On 12 January, ESMA published ➲its Annual report on the application of Regulation on credit rating agencies as provided by Article 21(5) and Article 39a of the Regulation (EU) No 1060/2009 as amended by Regulation No 1095/2010. The report summarizes the work carried out by national competent authorities and ESMA during the registration process and presents the supervisory actions that ESMA has undertaken in the course of 2011 in order to ensure that registered Credit Rating Agencies (CRAs) comply with the standards established in the Regulation. It also provides an overview on other policy activities carried out by ESMA under the Regulation during the same period.

ESMA work program for 2012

On 4 January, ESMA published ➲its work program for 2012. The work program describes the goals and deliverables for ESMA in its second year of operation. ESMA’s main goals for 2012 are:

- the establishment of harmonised binding technical standards (TS) in different areas. ESMA needs to draft around 40 Technical Standards in 2012. The key ones are in the areas of Over The Counter (OTC) derivatives and post-trading issues (i.e. EMIR) as well as short selling and alternative investment funds;
- the delivery of advice to the Commission and the co-legislators on areas where new legislative measures are being considered, proposed or debated. In particular, in 2012, this will involve the review of the Markets in Financial Instruments Directive (MiFID), but also UCITS V, Market Abuse Directive (MAD) Review and packaged retail investment products (PRIPS) (the latter together with the other European Supervisory Authorities (ESAs));
- the issuance of guidelines and recommendations to support the operation of the single rulebook and . For example, ESMA is currently envisaging guidelines on remuneration and supervisory co-operation arrangements (under the AIFMD), on ETFs and structured UCITS and liquidity management. The convergence activities required

under MifiD 1 will also continue with the publication of guidelines, Q&As and recommendations including with respect to pre-trade transparency waivers and market micro-structural issues as well as conduct of business rules and other issues related to investment firms;

- the continuation of economic analyses of European securities markets and model the impact of potential market developments. ESMA will inform the European Institutions, the other ESAs and the ESRB on a regular and, if necessary, on an ad hoc basis about its findings. In order to perform its functions properly, in 2012 the Authority will further intensify its relationship with the ESRB. ESMA will also consider how to enhance the data and information it receives and how to deepen its analysis. ESMA envisages issuing at least two reports and briefings on the trends, potential risks and vulnerabilities in securities markets per year. ESMA will also conduct a stress testing exercise in 2012;
- in order to ensure that financial consumers enjoy the same level of protection regardless the point of sale or the product being sold, in 2012 ESMA will start to: 1) collect, analyse and report on consumer trends; 2) review and co-ordinate both financial literacy and education initiatives by national competent authorities; 3) develop training standards for the industry; and 4) contribute to the enhancement of common disclosure rules. In order to allow ESMA to fulfil its financial consumer protection duty across the different policy areas it touches upon, the Authority will develop common methodologies for assessing the effect of product characteristics and distribution channels on the financial position of market participants and on the financial consumer;
- supervision of Credit Rating Agencies;
- carrying out of peer reviews. The currently planned peer reviews to be conducted by ESMA in 2012 cover MAD use of sanctions (Mapping); Prospectus Directive good practices (Peer review); Money Market Fund Guidelines (Peer review), supervisory practices with regard to Market Abuse (Peer review) and supervisory practices with regard to conduct of business rules (Peer review).

European Systemic Risk Board (ESRB)

Macro-prudential mandate of national authorities

On 16 January, the ESRB published a ➲set of recommendations addressed to the EU Member States on the macro-prudential mandate of national authorities. Under the recommendation, Member States should designate an authority in national legislation to conduct macro-prudential policy. The ultimate objective of the macro-prudential authority should be to safeguard the stability of the financial system. The ESRB recommends that EU Member States bestow the macro-prudential

authority with the powers to conduct macro-prudential policy on its own initiative or as a follow-up to recommendations or warnings from the ESRB. Cooperation between the national macro-prudential authorities and the ESRB would be warranted, particularly to enable the timely identification and subsequent discussion of relevant cross-border issues. In order to perform its tasks (i.e. identifying, monitoring, assessing and addressing potential risks to financial stability), the national authority should have full access to all the necessary statistical information and policy instruments. EU Member States are also called upon to confer on the authority the necessary independence for it to fulfil its tasks, to ensure an adequate level of accountability and to reserve the maximum of transparency. In particular, the ESRB recommends that macro-prudential authorities should be able to issue public and/or confidential statements on systemic risk; they should also make public all macro-prudential policy decisions and explain the reasons behind such decisions. Furthermore, macro-prudential authorities should be accountable to national parliaments, but their staff should be legally protected when they act in good faith. Finally, national macro-prudential authorities should be independent from the influence of political and market-players concerning both operational and policy issues.

The ESRB calls on the EU Member States to take the necessary actions before 1 July 2013 and, by June 2012, to communicate their intentions with respect to implementation and to report on developments to date.

Financial Action Task Force (FATF)

Revised FATF Standards and Recommendations

On 16 February, the FATF published ➲its revised Standards and Recommendations. The main changes are:

- The Risk-based approach: Countries need to clearly understand the money laundering and terrorist financing risks which affect them, and adapt their anti-money laundering/countering the financing of terrorism (AML/CFT) system to the nature of these risks – by applying enhanced measures where the risks are higher with the option of simplified measures where the risks are lower. The FATF has established the risk-based approach which will enable countries and financial intermediaries to target their resources more effectively. A well-implemented risk-based approach means that the AML/CFT system will be more effective, and will help countries implement measures to encourage financial inclusion, as called for by the G20;
- Transparency: Lack of transparency about the ownership and control of legal persons and legal arrangements, or about the parties to wire transfers, makes those instruments vulnerable to misuse by criminals and terrorists. The FATF has strengthened transparency requirements in these areas. This means requiring that there is reliable

information available about the beneficial ownership and control of companies, trusts, and other legal persons or legal arrangements. It also means more rigorous requirements on the information which must accompany wire transfers. Measures to improve transparency, implemented on a global basis, will make it harder for criminals and terrorists to conceal their activities;

- International Cooperation: With the increasing globalisation of money laundering and terrorist financing threats, the FATF has also enhanced the scope and application of international cooperation between authorities. The revised Recommendations will mean more effective exchanges of information for investigative, supervisory and prosecutorial purposes. This will also assist countries in tracing, freezing, and confiscating illegal assets;
- Operational Standards: The FATF Recommendations concerned with law enforcement and Financial Intelligence Units have been expanded significantly. The revisions clarify the role and functions of the operational agencies responsible for combating money laundering and terrorist financing and set out the range of investigative techniques and powers which should be available to them, e.g., to obtain and analyse financial information about a suspected criminal's accounts and transactions;
- New Threats & New Priorities: The FATF is addressing new and aggravated threats and responding to the priorities set out by the international community, e.g. through the G20. The key issues addressed are:
    - Financing of Proliferation - The proliferation of weapons of mass destruction is a significant security concern, and financial measures can be an effective way to combat this threat. The FATF has adopted a new Recommendation aimed at ensuring consistent and effective implementation of targeted financial sanctions when these are called for by the UN Security Council.
    - Corruption & Politically Exposed Persons - The FATF Recommendations strengthen the requirements on financial institutions to identify politically exposed persons (PEPs) – who may represent a higher risk of corruption by virtue of the positions they hold. The existing requirement to apply enhanced due diligence to PEPs has been extended from foreign PEPs, with new risk-based requirements applied to domestic PEPs and PEPs from international organisations, and to the family and close associates of all PEPs – reflecting the methods used by corrupt officials and kleptocrats to launder the proceeds of corruption.
    - Tax Crimes - The list of predicate offences for money laundering has been expanded

to include serious tax crimes. This will bring the proceeds of tax crimes within the scope of the powers and authorities used to investigate money laundering. The smuggling offence has also been clarified to include offences relating to customs and excise duties and taxes. This will contribute to better coordination between law enforcement, border and tax authorities, and remove potential obstacles to international cooperation regarding tax crimes.

- Terrorist Financing – The financing of terrorism remains a serious concern for the international community, and remains a major focus of the FATF Standards. The FATF's nine Special Recommendations on terrorist financing have been integrated fully within the Forty Recommendations, reflecting both the fact that terrorist financing is a long-standing concern, and the close connections between anti-money laundering measures and measures to counter the financing of terrorism;
- Clarifying obligations: The FATF has updated its Recommendations to reflect practices in the financial sector (e.g., to set out clearer requirements for financial groups) and to apply the experience gained from the implementation of the FATF Recommendations by countries (e.g., by clarifying customer due-diligence requirements where countries have had practical difficulties with implementation).

On the same day, the FATF also published ➲its response to the key issues raised during the consultation process for the revision FATF Standards and Recommendations.

Jurisdictions with strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies

On 16 February, the FATF published an ➲overview of the jurisdictions with strategic anti-money laundering and combating the financing of terrorism (AML/CFT) deficiencies.

Information sharing

On the same day, the FATF also published a ➲Best Practices Paper on sharing among domestic competent authorities information related to the financing of proliferation. This Best Practices Paper focuses specifically on information sharing and exchange related to the financing of the proliferation of weapons of mass destruction. The paper provides guidance on the implementation of Recommendation 2 ("National cooperation and coordination") and aims to assist jurisdictions in engaging appropriate authorities in order to best exploit financial information and apply financial measures to combat proliferation.

Financial Law Institute

Review of the Takeover Directive

In January, the Financial Law Institute published a working paper, ➲entitled "A New look at the Debate about the Takeover Directive". With a view of the envisaged revision of the takeover directive, the paper calls attention to some items that should be revised. Especially attention is drawn to the mandatory bid rule, the scope of which should restricted to share acquisitions – and not apply to other control changes - , while company law in general should strictly regulate conflicted transactions, thereby eliminating control premia, and hence the need to proceed to a mandatory bid. Multistate takeover should be reregulated, taking into account the new supervisory structure, esp. ESMA. Also some of the blanks should be filled e.g. on squeeze outs, sell outs, and other specific requirements like "acting in concert". As to the most controversial item of defensive techniques, a fundamental revision seems unlikely, but one could be considered to allow these techniques, but subject their effectiveness to a qualified vote in the general meeting, the shareholders voting according to the rules applicable before the bid.

Joint Forum

Intra-group support measures

On 14 February, the Joint Forum published a ➲report on intra-group support measures. The report provides an overview and analysis of the types and frequency of intra-group support measures. It is based solely on information provided by participants through a survey. Responses were verified by supervisors only in certain instances. The report's main findings are as follows:

1. Intra-group support measures can vary from institution to institution, driven by the regulatory, legal and tax environment; the management style of the particular institution; and the cross-border nature of the business. Authorities should be mindful of the complicating effect of these measures on resolution regimes and the recovery process in the event of failure;
2. The majority of respondents surveyed indicated centralised capital and liquidity management systems were in place. According to proponents, this approach promotes the efficient management of a group's overall capital level and helps maximise liquidity while reducing the cost of funds. However, the respondents that favoured a "self-sufficiency" approach pointed out that centralised management potentially has the effect of increasing contagion risk within a group in the event of distress at any subsidiaries. The use of these systems impacts the nature and design of intra-group support measures with some firms indicating that the way they managed capital and liquidity within the group was a key driver in their decisions about the intra-group transactions and support measures they used.
3. Committed facilities, subordinated loans and guarantees were the most widely used measures.

This was evident across all sectors and participating jurisdictions.

4. Internal support measures generally were provided on a one-way basis (e.g. downstream from a parent to a subsidiary). Loans and borrowings, however, were provided in some groups on a reciprocal basis. As groups surveyed generally operated across borders, most indicated support measures were provided both domestically and internationally. Support measures were also in place between both regulated and unregulated entities and between entities in different sectors.
5. The study found no evidence of intra-group support measures either a) being implemented on anything other than an arm's length basis, or b) resulting in the inappropriate transfer of capital, income or assets from regulated entities or in a way which generated capital resources within a group. However, this does not necessarily mean that supervisory scrutiny of intra-group support measures is unwarranted.
6. While the existing regulatory frameworks for intra-group support measures are somewhat limited, firms do have certain internal policies and procedures to manage and restrict internal transactions. Respondents pointed out that the regulatory and legal framework can make it difficult for some forms of intra-group support to come into force while supervisors aim to ensure that both regulated entities and stakeholders are protected from risks arising from the use of support measures. Based on the survey and independent of remaining concerns and information gaps, single sector supervisors should be aware of the risks that intra-group support measures may pose and should fully understand the measures used by an institution, including its motivations for using certain measures over others. In order to obtain further insight into the intra-group support measures put in place by financial institutions within their jurisdiction, national supervisors should, where appropriate, conduct further analysis in this area.

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Credit institutions and investment firms

Consultative or informative documents

Center for European Policy Studies (CEPS)

Capital requirements

On 31 January, CEPS published a commentary, ➲entitled "The Commission's CRD IV requires a deeper reading". The commentary urges the European Parliament and EU Council to undertake a more thorough review of the draft

Capital Requirements Directive IV (CRD IV), which implements Basel III in EU law. The author of the commentary is of the opinion that the European Parliament should take a stronger position on five key points of CRD IV: 1) the maximum harmonisation approach; 2) the maintenance of current risk-weighting of assets regime and, the zero risk weighting for EU government debt; 3) the limited role for the leverage ratio; 4) the reliance on credit ratings in the external credit ratings-based approach 5) and the reduced risk weightings for real estate exposures to ensure more streamlined and tightened legislation. In this respect the commentary makes the following remarks:

- The maximum harmonisation approach has already been criticized by some member states, but it has not been changed so far by the European Parliament's initial report. While the European Commission follows the same approach adopted in other recent EU proposals, it is difficult to maintain in the context of capital. The European Commission argues that it wants to avoid a 'race to the top', but it is difficult to argue in favour of a maximum limit on capital. Why would a bank not be allowed to compete on the basis of higher levels of capital? This would also make the financial system safer.
- The European Parliament and EU Council should give the leverage ratio a much more central role in the capital adequacy assessment of banks than the European Commission has done, which is only indicative and subject to review (Art. 416). The almost unique reliance on risk-weighted core tier 1 ratio, as also the European Banking Authority (EBA) continues to do in its stress tests, gives a misguided view about the health of the European banking sector,
- Contrary to some reports in the media, the European Parliament has not changed the sovereign risk-weighting in its initial report. It only asks the European Commission to submit a report to the European Parliament and the Council proposing options to adjust "that risk weight accordingly as soon as possible". The zero-risk weighting thus remains in effect. The same applies to limits on large exposures, which do not apply for governments and local authorities. The drawback of this method is that it unduly penalises banks with exposures to the 'real economy', as the latest EBA stress test demonstrated. The current system builds in strong disincentives to lend to SMEs as compared to sovereigns, for example.
- The role of ratings agents in the assignment of risk categories has also not been addressed. While the European Commission is correcting the regulatory reliance on ratings agents in the latest amendment to CRA Regulation, ratings agents continue to have a central role in the determination of the risk weights, under the external ratings-based approach. They thus continue to have a regulatory role in the current

proposal.
- Exposure to real estate continues to benefit from a more favourable risk-weighting than other exposures, which and is left to the discretion of the member states (in contradiction with the maximum harmonization approach). The bias towards real estate investments, with the well-known result, is maintained, with a risk-weighting of half (or even less) of the real exposure, even for commercial property. Real estate exposure must be assessed on the basis of its real cost.

Council of the European Union

Deposit guarantee schemes

In February, the Council published the ➲outcome of the European Parliament's first reading and a ➲Presidency compromise on key issues with a view to negotiations with the European Parliament on Proposal for a Directive of the European Parliament and of the Council on Deposit Guarantee Schemes.

Credit transfers and direct debits

In a ➲press release of 28 February, the Council announced the adoption of the Regulation of the European Parliament and of the Council establishing technical requirements for credit transfers and direct debits in euros and amending Regulation (EC) No 924/2009. The regulation sets a migration end-date for credit transfers and direct debits and introduces common standards and general technical requirements for such transactions.

Mortgages

On 20 February, the Council published a ➲Presidency compromise proposal on Proposal for a directive of the European Parliament and of the Council on credit agreements relating to residential property.

CRD IV

On 9 January, the Council of European Union published a ➲presidency compromise on the proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms. The proposed regulation aims to lay down uniform rules concerning general prudential requirements that the credit institutions and investment firms must meet in relation to the following items:

- own funds requirements relating to entirely quantifiable, uniform and standardized elements of credit risk, market risk, operational risk, and settlement risk;
- requirements limiting large exposures;
- liquidity requirements relating to entirely quantifiable, uniform and standardized elements of liquidity risk;
- reporting and disclosure requirements.

On the same day, the Council of European Union also published a ➲presidency compromise on the proposal for a Regulation

of the European Parliament and of the Council on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC of the European Parliament and of the Council on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate (CRD IV).

Eurofinas

Fraud in Consumer Lending and Data Protection

On 23 January, Eurofinas published a ➲report on Fraud in Consumer Lending and Data Protection. The report examines the different types of fraud in consumer lending, discrepancies between national regulations, how lending institutions detect and fight fraud, the role of databases in this process, the size and extent of the fraud problem and the data protection obstacles faced. In anticipation of the European Commission's review of the Data Protection Directive (95/46/EC), with a Proposal for a new data protection framework due to be published at the end of January 2012, the report also makes concrete recommendations.

European Association of Co-operative Banks (EACB)

Capital Requirements

On 24 February, the EACB published the following positions papers with respect the ➲proposed Capital Requirements Regulation and Directive:

- ➲ EACB Key Priorities on CRR (Capital, Liquidity, Large Exposures and Leverage ratio); and CRD IV (Corporate governance);
- ➲ EACB Position Paper on CRR - Capital;
- ➲ EACB position Paper on CRR - Liquidity;
- ➲ EACB Position Paper on CRD IV - Corporate Governance and Sanctions.

Mortgages

On 12 January, the EACB published its ➲comments on the amendments tabled in the ECON Committee of the European Parliament to the European Commission Proposal for a Directive on credit agreements relating to residential property.

European Banking Authority (EBA)

Reporting of large exposures

On 13 February, EBA published a ➲consultation paper on a draft Implementing Technical Standard (ITS) on reporting of large exposures. The ITS set out the format and frequency of reporting on large exposures.

Aggregate assessment of banks' capital plans

In a ➲press release of 9 February, EBA announced that its Board of Supervisors has made a preliminary assessment of banks' capital plans submitted in response to the ➲EBA's Recommendation on recapitalisation. The assessment highlighted the following:

- The total actions give a capital surplus of approximately 26%, creating some leeway in case some actions do not materialize;
- The actions predominantly focus on direct capital measures which account for 96% of the capital shortfall and for 77% of the total amount of actions proposed. The majority of these are capital raising, retained earnings and conversion of hybrids to common equity. Measures impacting risk-weighted assets (RWAs) account for the remaining 23% of total amount of actions;
- After taking account of the measures arising from EU State Aid decisions on banks restructuring or other country programmes, the impact of actions reducing lending into the real economy would be less than 1% of the total amount.

Capital Requirements - Guidelines on AMA extensions and changes

On 6 January, the EBA published its ➲Guidelines on AMA extensions and changes. The aim of the guidelines is to harmonise processes regarding the supervisory approval of such changes and to assist institutions using the Advanced Measurement Approach (AMA) to further develop their AMA models. The Guidelines provide institutions with guidance on how to communicate AMA extensions and changes to the competent authorities and on how to define internal policies for AMA changes in line with supervisory expectations. They do not contain requirements regarding the modelling or risk management of institutions. According to the guidelines, changes to the AMA have to be categorized according to their severity as significant, major or minor change. While extensions and significant changes require a prior approval, major and minor changes need to be notified to the competent authority. Supervisors will review the AMA change policies and ultimately approve or object to any proposed change or extension. The Annex to the Guidelines elaborates on the criteria for the classification of extensions and changes in the different categories.

The EBA expects that the EU competent authorities perform all tasks to implement the Guidelines on AMA changes by 6 March 2012.

EBA work program for 2012

On 4 January, the EBA publishes ➲its work program for 2012. The work program identifies areas of EBA's activities and aims to define the main objectives and corresponding priorities for 2012. The 3 core areas of EBA's activities are regulation, oversight and consumer protection.

- Regulation: The main objective of the EBA in the regulatory policy area is to play a leading role in the creation of the single rule book for the EU banking system. Based upon the current CRD IV/CRR proposals, to be adopted in the course of 2012, about 200 deliverables will be expected from the EBA. Most products are expected to be finalised by 2013-2014, thus, the concentration of

EBA's regulatory work will be very high in the course of 2012. Based upon the capacity available at both the EBA and at the national authorities, the following policy areas have been identified as priority: capital and capital buffers, liquidity, remuneration, leverage ratio. In the context of crisis prevention and crisis resolution, the EBA is expected to set further technical standards but also to coordinate and, where applicable, to actively participate in the management of cross border crisis events. The legislative proposals from the EU Commission are expected soon, with high priority tasks to be undertaken by the EBA.

- Oversight: The main two objectives of the EBA's regulatory oversight activities in 2012 are: (i) to deliver independent and high quality analysis of EU banks and the EU banking sector. In the area of risk assessment, in addition to the regular work on monitoring and assessing risks and vulnerabilities from a micro-prudential perspective, the EBA will follow up its Recommendations post 2011 EU-wide stress tests and on banks' recapitalisation. (ii) to promote supervisory convergence and assist National Supervisory Authorities to ensure that colleges are run consistently and efficiently with substantive discussions leading to material decisions being taken which strengthen the resilience of EU cross border banks and prepare them better for crises. Higher quality, more detailed feedback and advice on the functioning of colleges will be focused on the priority 44 banking groups.
- Consumer Protection: The main tasks of the EBA's Consumer Protection work will be the collection, analysis and reporting on consumer trends; the review and coordination process of financial literacy and education initiatives by the competent authorities; the development of training standards and common disclosure rules for the industry; monitoring new and existing financial activities and where appropriate prepare guidelines and recommendations with a view to promoting the safety and soundness of markets and convergence of regulatory practice.

The overall objective of the institutional development of the EBA in 2012 will be the completion and further enhancement of the internal control environment in a period of intensive build-up and growth of the recently established EU institution.

European Central Bank (ECB)

Financial integration, specialization and systemic risk

On 15 February, the ECB published a working paper entitled, ➲"Financial integration, specialization and systemic risk". The paper studies the implications of cross-border financial integration for financial stability when banks' loan portfolios adjust endogenously. According to the paper, financial globalisation of the recent decades has been driven to a significant extent by

a greater integration of interbank markets. But interbank integration not only provides greater scope for risk sharing. It also brings about the risk of cross-border financial contagion. If a regional shock exceeds the risk bearing capacities of a regional bank, it fails and cannot honour its commitments. This can lead to failures of banks abroad, which have lent money to it, are suspected by others to have done so (asymmetric information) or because of a general dry-up of liquidity. The report notes that if there is an integrated and well functioning interbank market available, liquidity shocks can be diversified relatively independently from the lending decision of banks. It is then profitable for them to increase their investment in the high-return industry, as the greater idiosyncratic exposure to sectoral shocks can be shared with banks abroad. So, specialization in lending to different sectors increases both idiosyncratic liquidity risks of banks and their benefits from risk sharing, which arise endogenously. At the same time, however, specialization makes banks more reliant on the liquidity available on the interbank market. When a specialized bank is hit by a sectoral shock it is dependent on payments from the bank in the other country. If this other bank is hit by a country-specific shock itself (or, for example, has some operational problems), so that it is not in a position to make those payments, both banks will ultimately default. As a conclusion, the report finds that integration weakly reduces the probability of individual banking crises, while at the same time it may increase the risk of contagion and thus the probability of widespread banking failures. In particular if the improved ability to pool liquidity risks in an integrated interbank market induces banks to specialize in their lending they become more dependent on interbank market liquidity provision and systemic risk strictly rises. In terms of policy implications, the greater contagion risk still puts pressure on policy makers to adjust supervisory approaches and structures to the geographical scope of banking activities. While supervisory structures should develop to take greater account of cross-border risks the analysis in the report also suggests that financial integration should not be resisted on stability grounds, at least not in industrial countries with relatively well-functioning interbank markets and more limited contract enforcement problems. In fact, greater specialization in lending to the most profitable sectors through better bank risk sharing enhances overall welfare even though the risk of cross border financial contagion rises.

European Savings Banks Group (ESBG)

CRD IV

On 4 January, the ESBG publishes ➲its comments on the ➲proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms and the ➲proposal for Directive on the access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms and amending Directive 2002/87/EC on the supplementary supervision of credit institutions, insurance undertakings and investment firms

in a financial conglomerate.

European Systemic Risk Board (ESRB)

Funding of banks in US dollar

On 16 January, the ESRB published a new ➲recommendation on US dollar-denominated funding of banks addressed to the national supervisory authorities of the EU Member States. In the periods 2007-08 and 2010-11, EU banks funding themselves in US dollars were exposed to vulnerabilities, owing, on the one hand, to maturity mismatches between long-term assets and short-term liabilities in US dollars and, on the other, to the risk aversion of US money market funds at times of enhanced market tensions. The ESRB considers that action should be taken to avoid a recurrence of these strains in US dollar-denominated funding of EU banks in the medium term. The ESRB recommends that the competent authorities intensify their monitoring action to prevent EU credit institutions from accumulating future excessive funding risks in US dollars. In particular, national supervisory authorities are requested to closely monitor maturity mismatches, funding concentration, the use of US dollar currency swaps and intra-group exposures. Furthermore, the supervisory authorities should encourage credit institutions to take action before these risks reach an excessive level. At the same time, any measure to limit exposures should avoid having an adverse effect on existing financing in US dollars. Moreover, authorities should make sure that EU credit institutions enhance their resilience to strains in the US dollar funding markets. To achieve this, the ESRB recommends that national supervisory authorities ensure that EU banks include management actions in their contingency funding plans for handling a shock in US dollar funding. In addition, the national supervisory authorities should assess the feasibility of these plans at the level of the banking sector. Based on this assessment, if there were to be a risk of simultaneous and similar responses by several banks in the face of a crisis, the supervisory authorities should consider action to diminish a potential systemic impact.

The national supervisory authorities must report to the ESRB on their implementation of the recommendations by June 2012.

Financial Law Institute

Consumer credit legislation in Belgium and The Netherlands

In January, the Financial Law Institute published a working paper, ➲entitled "The provision of Consumer Credit after the Directive 2008/48 EC: The Belgian and Dutch legislation compared". This paper (in Dutch) discusses some requirements that govern the provision of Consumer Credit in the Netherlands and Belgium such as the licensing requirements and (pre-contractual) information requirements and makes a comparison between the two regimes. It concludes that the

implementation of the Consumer Credit Directive in Belgium and in The Netherlands has only led to a limited harmonization of the rules applicable on creditors. The paper notes difference in the conditions to obtain a license, the conduct of business rules for creditors and the requirements with respect to the content of credit agreements. These differences hamper the cross-border provision of credit. As such, the harmonization of licensing requirements, conditions to obtain a license and conduct of business rules and the creation of a passport for creditors could be the next the steps in the European integration process with respect to consumer credit. Furthermore, according to the paper, European coordination is necessary to prevent the further fragmentation of the European market for consumer credit.

Appropriateness assessment in Consumer Credit

In January, the Financial Law Institute published a working paper, ➲entitled "Precontractual assistance ex. Article 11, §4 Law on Consumer Credit: Catalyst for an enhance decision and supervision model for consumer credit?". The paper (in Dutch) examines the pre-contractual information and advice obligations in Consumer Credit and in particular the obligation of the creditor to provide adequate explanations to the consumer. It also makes policy recommendation in which it advocates the introduction of a pro- and interactive supervisory model and the introduction of MiFID-like conduct of business rules in Consumer Credit.

Risk Management in financial institutions

In January, the Financial Law Institute published a working paper, ➲entitled "Risk in financial institutions: is it Managed?". The paper provides high level overview of the requirements with respect to management framework and how banks (should) manage their risks. It finds that awareness about the risk issue has increased considerably, partly spontaneously, partly under the pressure of new regulations, esp. the Basel III standards. Risk measurement – "risk appetite" is a management tool, a process and a learning curve, more than a fixed formula. Risk inspired restrictive measures abound, but may overly reduce the credit flow to the economies, making it difficult to strike the right balance between risk stability and liquidity provision. The paper highlights that legal risk deserves more attention and has not been very well explored as it is difficult to recognize ex ante, shows up many years later, ultimately after the courts have handed down their final decision, and often a long time after the board and management have left. The causes can be very subtle (nullity of contracts, unsatisfactory disclosure, biased advice) but the consequences sometimes are destructive for the bank and may even reach a systemic dimension. It also notes that it is striking that the debate about risk management takes place with little or no mention of internal audit and the shareholders. This can mainly be explained on the basis that developing a risk policy is essential an internal management matter.

Financial Stability Board (FSB)

Deposit insurance systems

On 8 February, the FSB published a ➲peer review report on deposit insurance systems (DISs). The report describes the findings of the peer review of deposit insurance systems of FSB Members carried in 2011. During the review the aforementioned deposit insurance systems where benchmarked against the ➲Core Principles for Effective Deposit Insurance Systems. It was found that reviewed DISs are broadly consistent with the Core Principles, particularly in areas such as mandates, membership arrangements and adequacy of coverage. However, there remain some areas where there appear to be divergences from, or inconsistencies with, the Core Principles that need more time and effort to address. These include avoiding unlimited deposit coverage that could adversely affect the DIS's effectiveness; ensuring that resources (including back-up funding options) are adequate and immediately available to meet financing requirements; establishing and publicly communicating a prompt target timeframe for reimbursing depositors; adjusting governance arrangements in deposit insurance agencies to ensure adequate public oversight and to mitigate the potential for conflicts of interest; and formalising information sharing and coordination arrangements with other safety-net participants. Further enhancements of DISs may be necessary in these areas. The report also indicates that there are certain areas in the Core Principles where more precise guidance may be needed to achieve effective compliance or to better reflect leading practices. These include developing benchmarks to monitor the effectiveness and adequacy of coverage levels; identifying instruments and good practices that can help mitigate moral hazard; ensuring that there is effective coordination across systems in jurisdictions with multiple DISs and that any differences in depositor coverage across institutions operating within that jurisdiction do not adversely affect the systems' effectiveness; conducting regular scenario planning and simulations to assess the capability of making prompt payout; exploring the feasibility and desirability of greater use of ex-ante funding; and developing appropriate mechanisms to regularly monitor public awareness of the DIS. Additional guidance in these areas by relevant standard-setting bodies would further enhance the effectiveness of DISs. Given the above, the report sets out the following recommendations:

- FSB member jurisdictions without an explicit DIS should establish one in order to maintain financial stability by protecting depositors and preventing bank runs;
- FSB member jurisdictions with an explicit DIS should undertake actions to fully align their DIS with the Core Principles in areas where there appear to be divergences from, or inconsistencies with, those principles and;
- International Association of Deposit Insurers (IADI) should, in consultation with the Basel Committee for Banking Supervision (BCBS) and

other relevant bodies where appropriate, update its guidance that pre-dates the financial crisis. It should also consider developing additional guidance to address areas where the Core Principles may need more precision to achieve effective compliance or to better reflect leading practices.

National Bank of Belgium (NBB)

Reference framework for the evaluation of the internal control system

On 2 February, the NBB published an updated reference framework for the evaluation of the internal control system for credit institutions (in ➲Dutch and in ➲French). The document provides an overview of the legislation and regulation that must be taken into account when accessing the adequacy of the internal control framework and is part of Circular NBB_2011_09 of 20 December 2011 regarding the reporting of the effective management on the internal control system.

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Investment products and asset management

Normative documents

Financial Services and Markets Authorities (FSMA)

Short selling

In a press release (in ➲Dutch, in ➲English and in ➲French) of 13 February, the FSMA announced the lifting of the ban on net short positions in shares of certain Belgian financial institutions. The FSMA did so by modifying its ➲Questions and Answers on short selling which provides clarification with respect to rules contained in the Royal Decree of 23 September 2008 on certain actions that constitute market abuse. The ban has been replaced by a notification and disclosure obligation for net short positions above 0.25%, and restrictions on uncovered or naked short selling along the lines of the EU Regulation on short selling and certain aspects of credit default swaps (the so-called 'locate rule'). These aforementioned restrictions entail that a short sell relating to shares of covered Belgian financials is in principle only allowed when the investor involved has:

- owned or borrowed the relevant shares before selling them;
- previously entered into securities lending arrangements, on the basis of which the relevant shares will be delivered in time to settle the sell transactions when due;
- has an arrangement with a third party under which that third party has confirmed that the relevant shares have been located and has taken measures vis-à-vis third parties necessary for the investor to have reasonable expectation that

settlement can be effected when it is due.

Alternext market rules

On the same day, the FSMA also announced (in ➲Dutch and in ➲French) the approval of the ➲modified market rules of Alternext Brussels. The new rules went into effect on 15 February.

Consultative or informative documents

Council of the European Union

Short selling and credit default swaps

In a ➲press release of 21 February, the Council announced its adoption of the Regulation of the European Parliament and of the Council on short selling and certain aspects of credit default swaps. The Regulation sets out a common regulatory framework for dealing with short selling. While it covers all types of financial instruments, care has been taken to take into account the potential risks posed by the short selling of different instruments. In particular, for shares of companies listed in the EU, it creates a two-tier model for the disclosure of significant net short positions: While at a lower threshold, notification of a position must be made privately to the regulator, at a higher threshold, positions must be disclosed to the market. For sovereign debt, on the other hand, significant net short positions relating to issuers in the EU would always require private disclosure to regulators. The proposed regime also provides for notification of significant positions in credit default swaps that relate to EU sovereign debt issuers. To tackle the increased risks posed by uncovered short sales, the proposal requires that anyone entering into a short sale must at the time of the sale have borrowed the instruments, entered into an agreement to borrow them or made other arrangements to ensure they can be borrowed in time to settle the deal. However, these restrictions don't apply to the short selling of sovereign debt if the transaction serves to hedge a long position in debt instruments of an issuer. Moreover, if the liquidity of sovereign debt falls below a specified threshold, the restrictions on uncovered short selling may be temporarily suspended by the competent authority. In exceptional situations that threaten financial stability or market confidence in a member state or the EU, the regulation provides that competent authorities should have temporary powers to require greater transparency or to impose restrictions on short selling and credit default swap transactions or to limit individuals from entering into derivative transactions. In such a situation, the European Securities Market Authority (ESMA) is given a key coordination role, to ensure consistency between competent authorities and to guarantee that such measures are only taken where they are necessary and proportionate. ESMA is also given the power to take measures where the situation has cross-border implications.

OTC derivative transactions, central counterparties and

trade repositories

On 26 January, the Council of the European Union published the ➲compromise text on articles 13(2) (i.e. the authorisation procedure for CCPs) and 15(3) (i.e. functioning of the supervisory college) of the Proposal for a Regulation of the European Parliament and of the Council on OTC derivative transactions, central counterparties and trade repositories (EMIR) that was agreed upon by the Council.

MIFID II

On 13 January, the Council of European Union published the ➲opinion of the consultative Working Party of the Legal Services of the European Parliament, the Council and the Commission on the ➲Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (Recast).

European Association of Co-operative Banks (EACB)

MiFID Compliance Function requirements

On 28 February, the EACB published ➲its response to ESMA's ➲Consultation paper on Guidelines on certain aspects of the MiFID compliance function requirements.

MiFID Suitability requirements

On the same day, the EACB also published ➲its response to ESMA's Consultation paper on guidelines on certain aspects of the MiFID suitability requirements.

European Association of Public Banks (EAPB)

MiFID Review

On 10 February, the EAPB published ➲the letter that it together with the European Banking Association, ESBG and European Association of Cooperative Banks sent to the Economic and Monetary Affairs Committee' rapporteur for the review of MiFID. In the letter, the Associations comment on the changes to the rules for investment advice, portfolio management and best execution proposed by the European Commissions.

Review of the Prospectus Directive

On 9 January, the EAPB published ➲its response to ESMA's ➲consultation paper on possible delegated acts concerning the Prospectus Directive.

European Banking Authority (EBA)

Financial Innovation and Consumer Protection

On 1 February, EBA published an ➲overview of the objectives and work of the EBA's Standing Committee on Financial Innovation (SCFI) in 2011-2012 in the area of consumer protection and financial innovation. With respect to consumer protection, a survey of national competent authorities was carried out to identify key issues with regard to consumer protection in the banking

sector. Over the coming years, the EBA will enhance its analysis of consumer protection issues and use this analysis to develop its priorities and work program. Based on the outcomes of the survey, the EBA indicated that it has decided to focus its work in 2012 on the analysis of the widespread concerns about consumer detriment in the context of the mortgage market and other indebtedness issues, including aspects such as advice, provisions, credit intermediation, credit cards, transparency, financial education, and complaints handling. On the subject of financial innovation, the survey amongst Member States" supervisory authorities identified a number of products on which the EBA, and more specifically its SCFI, will do further work in 2012, such as collateralized commercial paper, contracts for difference, and convertible bonds. Some preliminary work was also done with regard to the asset encumbrance of covered bonds and other types of secured funding, and this topic will be taken forward by a new subgroup of the Advisory Technical Committee of the ESRB. More in-depth work has been done by SCFI with regard to the so-called exchange traded funds (ETFs), as this is a rapidly growing market, both in terms of size and complexity.

European Banking Federation (EBF)

Short selling and credit default swaps

On 13 February, the EBF published ➲its response to ➲ESMA's consultation on draft technical standards on short selling and certain aspects of credit default swaps.

MiFID II

On 18 January, the EBF published ➲its response to the ➲European Parliament's questionnaire on MiFID/MiFIR II.

On 4 January, the EBF published ➲its comments on the European Commission's ➲MiFID/MIFIR II proposal.

Review of Market Abuse Directive

On 4 January, the EBF published ➲its comments on the European Commission's ➲proposal on MAD/MAR II.

European Central Bank (ECB)

Risk-sharing or risk-taking?

On 10 January, the ECB published a working paper entitled, ➲"Risk-sharing or risk-taking? Counterparty risk, incentives and margins". The paper analyzes hedging in an optimal contracting framework with moral hazard. It shows that a moral hazard problem arises when the protection seller (e.g. an insurance undertaking) finds out his position is likely to be loss-making. There is no moral hazard problem at the beginning of the derivative contract as there are no liabilities on average. But bad news about the hedged risk undermines risk-prevention incentives. The failure to exert such effort may lead to the default of a protection seller. Thus, bad news about derivative positions can propagate to other lines of business of financial institutions and, when doing so, create endogenous counterparty risk for protection

buyers. The paper thus identifies a channel through which derivative trading can propagate risk. It also shows that when the seller's moral hazard is moderate, margins enhance the scope for insurance. Variation margins, compelling the protection seller to liquidate some of her risky positions after bad news, relax the incentive problem and discourage risk-taking. Initial margins discourage the accumulation of excessive derivatives positions, a market failure caused by unregulated trading of hedging contracts among protection sellers. The paper predicts that risk-taking by financial institutions engaged in derivative trading is more likely to occur when their balance sheets are initially perceived to be relatively safe by their counterparties. It also predicts that financial institutions selling protection respond differently to adverse news about hedged risks: those with good risk management incentives reduce their risky exposures and engage in risk-prevention while those with poor risk-management incentives retain or even enlarge risky exposures and engage in risk-taking.

European Commission

OTC derivatives, Central Counterparties and Trade Repositories

In a ➲press release of 9 February, the European Commission announced that the European Parliament and the Council of the European Union have reached an agreement on the Regulation on OTC derivatives, central counterparties and trade repositories (EMIR).

European Fund and Asset Management Association (EFAMA)

UCITS ETFs, total return swaps and strategy indices for UCITS

In a ➲press release of 31 January, EFAMA welcomed the publication of ➲ESMA's Consultation Paper setting out future guidelines on UCITS Exchange-Traded Funds and other UCITS issues.

European Securities and Markets Authority (ESMA)

Systems and controls in an automated trading environment for trading platforms

On 24 February, ESMA published its final ➲"Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities". The guidelines set out organizational requirements for regulated markets, multilateral trading facilities and investment firms with respect to 1) the operation of an electronic trading system; 2) trading in an automated trading environment; 3) the prevention of market abuse (in particular market manipulation) in an automated trading environment and 4) the provision of direct market access or sponsored access. They cover trading in an automated environment of any financial instrument (as defined in MiFID).

The publication of the guidelines by ESMA triggers a transitional period of two months within which national supervisors have to declare whether they intend to comply with the guidelines or otherwise explain the reasons for non-compliance which would be made public by ESMA.

Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM

On 23 February, ESMA published a ➲discussion paper on Key concepts of the Alternative Investment Fund Managers Directive and types of AIFM. The paper covers the following area:

- The definition of AIFM: The discussion paper provides some clarifications on the range of functions that an AIFM must carry out according to the provisions of the AIFMD and to what extent it may delegate these functions to third parties. ESMA considers that an entity performing portfolio management or risk management for an AIF is to be considered as managing an AIF. Such entity must therefore seek authorisation as an AIFM. To obtain such an authorisation an AIFM must be capable of providing, and take responsibility for, both portfolio management and risk management functions. No authorisation is required when the performance of either the portfolio management or the risk management function is done under a delegation arrangement with an AIFM which is in line with the AIFMD. The liability of the AIFM will not be affected by the fact that the AIFM has delegated the portfolio management and/or risk management functions to a third party, or by any further sub-delegation Furthermore, neither of these functions may be delegated to such an extent that the AIFM becomes, in essence, a letter-box entity and can no longer be considered to be the manager of the AIF.
- The definition of alternative investment fund ("AIF"): The discussion sets out proposed criteria to qualify as an AIF, in accordance with the definition of AIF in the AIFMD. AIFs are defined as collective investment undertakings, including investment compartments thereof, which raise capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors. ESMA provides clarification on the various elements of this definition. Guidance is also provided with the respect to the exemptions to the AIFMD.
- The treatment of UCITS management companies: The paper provides ESMA's interpretation on the interaction between the AIFM Directive and the UCITS IV Directive (2009/65/EC). ESMA's analysis is that, after the entry into force of the AIDMF, a UCITS management company which manages AIFs and which is appointed as the AIFM for the purposes of the AIFMD will no longer be subject to

the UCITS Directive for that activity and will instead be required to obtain an additional authorisation under the AIFMD. It will also be possible for a UCITS management company to provide services, including investment management services, to AIFs but not to be the appointed AIFM. In this case all of the UCITS management company's activities will continue to be covered by its authorization under the UCITS Directive and it will not need to seek authorisation under the AIFMD. Furthermore a single entity will be able to hold both a UCITS and AIFMD authorization.

- The treatment of MiFID firms and credit institutions: In the discussion paper, ESMA clarifies that investment firms authorised under the Markets in Financial Instruments Directive (2004/39/EC) ("MiFID") and credit institutions authorised under the Banking Consolidation Directive (2006/48/EC) may not be authorised as AIFMs. However, they may provide investment services, such as individual portfolio management in respect of AIFs, without falling within the scope of the AIFM Directive. This allows MiFID firms and credit institutions to continue to provide services to AIFs under delegation arrangements.

Definition of European Money Market Funds

On 21 February, ESMA published an updated version of its ➲"Questions and Answers - A Common Definition of European Money Market Funds". The document aims to help management companies by providing clarity as to the content of ➲CESR's guidelines on a Common Definition of European Money Market Funds. The updated Q&A contains the following two new questions (and corresponding answers):

- *How should management companies assess the credit quality of instruments that are rated by credit rating agencies?*: According to ESMA, management companies should ensure that they have proper procedures and processes in place to enable them to assess the credit quality of an instrument without relying solely on credit ratings provided by credit rating agencies. In particular, management companies should always conduct an internal assessment of the credit quality as a key element of their decision on whether to invest in that instrument.
- *What should the management company do when an instrument in which a short-term money market fund or a money market fund is invested no longer complies with the criteria set out in the guidelines?*: In case an instrument in which a short-term money market fund or money market fund is invested no longer complies with the criteria set out the abovementioned guidelines, ESMA requires that the management company of the fund immediately assesses how best to bring the fund back into compliance with the guidelines. It should take remedial action as soon as reasonably practicable, taking into account the

best interests of the investors at all times.

Technical standards for the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR)

On 16 February, ESMA published a ➲discussion paper on Draft Technical Standards for the Regulation on OTC Derivatives, Central Counterparties and Trade Repositories (EMIR). The paper outlines the ESMA's preliminary views and seeks industry input on the aforementioned standards. On the basis of the relevant input received, ESMA will prepare draft technical standards to be included in a consultation paper to be published later this year. The discussion paper follows the structure of EMIR, with the first section focusing on OTC derivatives and in particular the clearing obligation, risk mitigation techniques for contracts not cleared by a CCP and exemptions to certain requirements. The second part focuses on CCP requirements, where a number of provisions need to be specified through technical standards. The third part deals with trade repositories and in particular the content and format of the information to be reported to trade repositories, the content of the application for registration to ESMA and the information to be made available to the relevant authorities.

Short selling and credit default swaps

On 15 February, ESMA published a ➲consultation paper on its draft technical advice on possible Delegated Acts concerning the regulation on short selling and certain aspects of credit default swaps ((EC) No XX/2012). The paper contains the technical advice that ESMA proposes to give to the European Commission on a number of possible delegated acts concerning the Regulation mentioned above and the draft regulatory technical standard (RTS) on the method of calculation of the fall in value of a financial instrument, since it is dependent on the provisions of future Commission's Delegated Act on the definition of what is a significant fall in value of financial instruments other than liquid shares. More specifically, it sets out the proposed advice with respect to:

- the definition of when a natural or legal person is considered to own a financial instrument for the purposes of the definition of short sale;
- the net position in shares or sovereign debt covering the concept of holding a position, the case when a person has a net short position and the method of calculation of such a position including when different entities in a group have long or short positions or for fund management activities related to separate funds;
- the cases in which a credit default swap (CDS) transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt and the method of calculation of an uncovered position in a CDS;
- the initial and incremental levels of the notification thresholds to apply for the reporting of net short

positions in sovereign debt;

- the parameters and methods for calculating the threshold of liquidity on sovereign debt for suspending restrictions on short sales of sovereign debt;
- what constitutes a significant fall in value for various financial instruments. The paper also specifies, in the form of a draft RTS, the method of calculation of such falls;
- the criteria and factors to be taken into account by competent authorities and ESMA in determining when adverse events or developments arise.

Central Rating Repository (CEREP)

In a ➲press release of 2 February, ESMA announced the launch of the Central Rating Repository (CEREP). The repository provides standardised statistics on rating activity and the performance of credit ratings, including transition matrices and default rates. The CEREP database will allow investors to assess on a single platform the performance and reliability of credit ratings on different types of ratings, asset classes and geo-graphical regions over the time period of choice.

UCITS ETFs, total return swaps and strategy indices for UCITS

On 30 January, ESMA published ➲a consultation paper on a consultation paper setting out future guidelines on UCITS Exchange-Traded Funds (UCITS ETFs) and other UCITS-related issues. The paper cover both synthetic and physical UCITS ETFs and details the obligations to come for UCITS ETFs, index-tracking UCITS, efficient portfolio management techniques, total return swaps and strategy indices for UCITS. For UCITS ETFs, ESMA proposes the obligatory use of an identifier for all funds that fall within the scope of the harmonised definition. In addition, investors should be provided with more information when the UCITS ETFs does not track an index and is actively managed. Furthermore, ESMA sets out draft guidelines for a regime for secondary market investors, and in particular the possibilities for them to dispose of their shares (either redemption with a market maker or directly with the ETF). Concerning index-tracking (leveraged) UCITS, ESMA proposes additional disclosure requirements on such issues as the index to be tracked and the method of replication and the tracking error. For example, the consultation paper includes draft guidelines on the disclosure required in the prospectus and annual and half-yearly reports of index-tracking UCITS, and the disclosure required in the prospectus and Key Investor Information Document ("KIID") of index-tracking leveraged UCITS. With regard to securities lending, ESMA proposes that collateral posted to mitigate counterparty risk should comply with the criteria set out in ➲CESR's Guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS, while recommending that the diversification and haircut criteria be strengthened. These requirements would also apply to repo and reverse repo activities. Therefore, according to the draft guidelines, collateral

posted in the context of efficient portfolio management techniques should respect the UCITS diversification rules and UCITS should have a documented and appropriate haircut policy for each category of assets received as collateral. With respect to total return swaps, ESMA proposes to apply the same obligations on collateral management as for securities lending. Regarding strategy indices, ESMA proposes to introduce, among other things, detailed disclosure requirements with respect to the index used (e.g. disclosure of the constituents of the index together with their respective weightings, disclosure of the full calculation methodology, disclosure of the rebalancing frequency) and a requirement for the UCITS to carry out an appropriate documented due diligence on the quality of the index.

Comments on the consultation paper can be submitted until 30 March. ESMA expects the final guidelines to be ready for adoption by mid-2012.

Credit Default Swaps

On 24 January, ESMA published ➲a consultation paper on its draft technical standards on the Regulation (EU) xxxx/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps. The paper sets out ESMA's draft technical standards with respect to:

- the agreements, arrangements and measures that adequately ensure that the share or the sovereign debt will be available for settlement (i.e. one of the situations in which short sales of shares and EU sovereign debt instruments are possible);
- the exemptions from disclosure of significant net short positions in shares where the principal trading venue of the shares is outside the EU;
- the disclosures disclosure of net short positions in shares, sovereign debt and credit default swap

According to the ➲Regulation on Short Selling and certain aspects of Credit Default Swaps a natural or legal person may only enter into a short sale of a share admitted to trading on a trading venue or of sovereign debt in three situations. One of these situations is when the natural or legal person has an arrangement with a third party under which that third party has confirmed that the sovereign debt or share has been located or has otherwise reasonable expectation that settlement can be effected when it is due. The draft technical standards determine which types of agreements, arrangements and measures adequately ensure that the shares and sovereign debt will be available for settlement. In this respect, ESMA considers that an approach which provides an exhaustive list of types of agreements or arrangements and the criteria which these must fulfil will provide certainty and clarity. ESMA does, however, emphasize that it is necessary to leave flexibility to cope with market evolutions. Under the Regulation, there is no requirement to disclose significant net short positions in shares where the principal trading venue of the shares is outside the EU. In this regards the consultation paper sets out the

draft technical standards specifying a) the method for calculating turnover to determine the principal venue for the trading of a share, b) the date and period for principal trading venue calculations c) the date by which Competent Authorities must notify ESMA with a list of the relevant shares and d) the date from which the list is effective following publication by ESMA. Finally, with respect to the disclosure of net short positions in shares, sovereign debt and credit default swap, the consultation paper sets out technical standards specifying a) the details of the Information on net short positions to be notified to competent authorities and disclosed to the public, b) the means by which such information may be disclosed to the public, c) the details of the information to be provided to ESMA by competent authorities in a summary form on a quarterly basis on net short positions in shares and sovereign debt and the additional information which ESMA may request at any time from competent authorities and d) the format of information to be provided to ESMA by competent authorities.

Q&A on the operation of the Market Abuse Directive

On 9 January, ESMA published a ➲Questions and Answers on the common operation of the Market Abuse Directive. The purpose of the document is to promote convergent implementation and application of the market abuse regime by providing responses to specific issues raised by the general public, market participants or competent authorities. The Q&A currently only covers the disclosure of inside information related to dividend policy, in particular what is expected in this regard from issuers of shares which are used as underlying of listed derivative contracts. In answering the question, ESMA states that it is aware of the influence that information on expected dividends has on the price of futures and other derivatives. As such issuers should consider any relevant information related to dividend payments and policies as inside information, should this information be likely to have a significant effect on the prices of either the issuer's shares or related derivatives or both. Like any inside information, it should be disclosed as soon as possible, according to Article 6 of MAD, and in a manner which enables fast access and complete, correct and timely assessment of the information by the public, according to Article 2(1) of the implementing Directive 2003/124/EC. These provisions affect various aspects of dividend policies and payments that might have a significant effect on the prices of derivative instruments, such as ex-date, provisional and final amounts, nature of the payment (ordinary or special dividend), any changes on previously announced information, and changes in dividend payment patterns. For instance, the issuer's decision to change the ex-dividend date compared to preceding year's date should be disclosed in a timely manner so that the information is incorporated into the pricing models used on the derivative markets. The disclosure of this type of information should be done promptly, even when the proposals for any change on dividend policy, including dates and nature of the dividend, are still subject to further consideration or approval by the general shareholders meeting. According

to ESMA, investor relations units should take special care when replying to questions posed by investors or firms so as to ensure that only the information that was previously disclosed by the issuer under the MAD obligations is provided in those answers and that selective or unintended disclosures regarding the issuers' dividend policy are avoided.

Federation of European Securities Exchanges (FESE)

Short selling and credit default swaps

On 13 February, the FESE published ➲its response to ➲ESMA's consultation on draft technical standards on the Regulation (EU) xxxx/2012 of the European Parliament and of the Council on short selling and certain aspects of credit default swaps.

MiFID II

On 31 January, the FESE published ➲its comments on the ➲European Commission's MiFID II proposal.

Financial Services and Markets Authorities (FSMA)

Commercialization of structured products

On 10 January, the FSMA published the Opinion of the Insurance Commission (in ➲Dutch and in ➲French) with respect to its Consultation paper on the introduction of a regulatory framework for the commercialization of structured products to retail investors (in ➲Dutch, in ➲English and in ➲French). The Opinion provides an overview of the general comments of the consumer and sector representatives on the FSMA initiative and their answers on the specific questions contained in the consultation paper.

Financial Law Institute

Financial Derivatives

In January, the Financial Law Institute published a working paper, ➲entitled "Regulation and Case law relating to Financial Derivatives". The paper gives a short overview of pending European proposals dealing with derivatives such as EMIR and MiFIR. To reduce risks associated with Financial Derivatives trading, these proposals are mandating the use of central counter-parties, of trade repositories and of regulated trading facilities. The paper also examines the court decisions that have been rendered in relating to derivatives, or structured products in several European jurisdictions, especially opposing local authorities and private investors to banks. In this respect it finds that the world of derivatives is one of the most challenging and most innovative, not only in financial or macro terms but also legally. One sees that courts, at least on the Continent attempts to find a balance between the interests at stake, and especially adopt a protective attitude towards the smaller operators, whose understanding of these techniques often a quite weak, notwithstanding their own

perception. The supreme courts, and the politics demonstrate increasing nervousness and rejection about these practices, that often are too complicated to be understood by the normal user, or investor, but for which no protection is available. The question arises whether one should not regulate them in a sense that they would be less harmful; as is the case with CDS on sovereign debt, there is an argument that some derivatives should only be accessible to those who have a corresponding exposure; for other derivatives a cap on the respective risks might be considered.

International Capital Market Association (ICMA)

Haircuts and initial margins in the repo market

On 8 February, the ICMA published a paper, entitled ➲"Haircuts and initial margins in the repo market".

International Organization of Securities Commissions (IOSCO)

OTC derivative mandatory clearing

On 29 February, IOSCO published its ➲report on the Requirements for Mandatory Clearing. The report outlines recommendations that authorities should follow in establishing a mandatory clearing regime for standardized OTC derivatives in support of the G20's Leaders Commitments to improve transparency, mitigate systemic risk and protect against market abuse in these markets. The recommendations are in relation to:

- Determination of whether a mandatory clearing obligation should apply to a product or set of products;
- Consideration of potential exemptions to the mandatory clearing obligation;
- Establishment of appropriate communication among authorities and with the public;
- Consideration of relevant cross-border issues in the application of a mandatory clearing obligation; and
- Monitoring and reviewing the overall process and application of the mandatory clearing obligation.

Suitability requirements for complex financial products

On 21 February, the IOSCO published a ➲consultation paper on Suitability Requirements with respect to the Distribution of Complex Financial Products. The paper sets out proposed principles relating to customer protections, including suitability and disclosure obligations, which relate to the distribution by intermediaries of complex financial products to retail and non-retail customers. The proposed principles are as follows:

- Intermediaries should be required to adopt and apply appropriate policies and procedures to distinguish between retail and non-retail customers when distributing complex financial products. The classification of customers should be based on a reasonable assessment of the

customer concerned, taking into account the complexity and riskiness of different products and services. The regulator should consider providing guidance to intermediaries in relation to customer classification;

- Irrespective of the classification of a customer as retail or non-retail, intermediaries should be required to act honestly, fairly and professionally and take reasonable steps to manage conflicts of interest that arise in the distribution of complex financial products, including through disclosure, where appropriate;
- Investors should receive or have access to material information to evaluate the nature, costs and specific risks of the complex financial product. Any information communicated by intermediaries to their customers regarding a complex financial product should be communicated in a fair, comprehensible and balanced manner;
- Even when an intermediary sells to a customer a complex financial product on an unsolicited basis (no management, advice or recommendation), the regulatory system should provide for adequate means to protect customers from associated risks;
- Whenever an intermediary recommends to a customer that it purchase a particular complex financial product, the intermediary should be required to take reasonable steps to ensure that recommendations, advice or decisions to trade on behalf of such customer are based upon a reasonable assessment that the structure and risk-reward profile of the financial product is consistent with such customer's experience, knowledge, investment objectives, risk appetite and capacity for loss.
- An intermediary should have sufficient information in order to have a reasonable basis for any recommendation, advice or exercise of investment discretion made to a customer in connection with the distribution of a complex financial product.
- Intermediaries should establish a compliance function and develop appropriate internal policies and procedures that support compliance with suitability obligations, including when developing or selecting new complex financial products for customers.
- Intermediaries should be required to develop and apply proper policies that seek to eliminate any incentives for staff to recommend unsuitable complex financial products.
- Regulators and self-regulatory organizations should supervise and examine intermediaries on a regular and ongoing basis to help ensure firm compliance with suitability and other customer protection requirements relating to the distribution of complex financial products. Enforcement actions should be taken by the competent authority, as appropriate. Regulators should consider the value of making enforcement actions public in order to protect investors and enhance market integrity.

Comments on the proposed principles can be submitted until 21 May.

Principles for Ongoing Disclosure for Asset Backed Securities

On 20 February, the IOSCO published a ➲consultation paper on Principles for Ongoing Disclosure for Asset Backed Securities (ABS Ongoing Disclosure Principles). The principles set out in the paper are designed to provide guidance to securities regulators who are developing or reviewing their regulatory regimes for ongoing disclosure for asset-backed securities (ABS) and are as follows:

- Updated information regarding the ABS should be disclosed in reports prepared on an annual and other periodic basis, as appropriate to the type of information to be disclosed and its usefulness to investors;
- The occurrence of material events and other current or ad hoc information should be disclosed in event-based disclosure reports;
- Periodic and event-based disclosure should contain sufficient information in order to increase the transparency of information for investors and to allow investors to independently perform due diligence in their investment decisions regarding the specific ABS;
- The information disclosed in ongoing reports should be fairly presented, not be misleading or deceptive and should not contain any material omission of information. Moreover, information disclosed in an ongoing report should be presented in a clear and concise manner without reliance on boilerplate language;
- Disclosure should be presented in a format that facilitates the analysis of information by investors;
- The person or entity responsible for publishing the disclosure and the person or entity responsible for gathering the information from other persons or entities involved in the ABS should be clearly identified;
- The information provided in the ongoing report should be disclosed in a timely manner, such that the information is sufficiently current and disclosed with sufficient frequency so as to be of use to investors;
- Material information that is disclosed to any investor, market participant or other third party should be provided to all investors, market participants and other third parties at the same time;
- If securities are listed or admitted to trading in more than one jurisdiction, the material periodic information made available to one market should be made available promptly to all markets in which they are listed;
- Ongoing reports should be filed with the relevant regulator or otherwise made available in compliance with applicable regulations to permit regulators to review the reports, when

appropriate, to ensure compliance with the relevant laws and regulations;
- The relevant law or regulation should ensure that there is storage of the ongoing information in order to facilitate public access to the information.

The principles apply to securities that are primarily serviced by the cash flows of a discrete pool of receivables or other financial assets - either fixed or revolving - that by their terms convert into cash within a finite period of time. As such the principles would not apply to securities backed by asset pools that are actively managed, such as securities issued by investment companies or collateralized debt obligations, or that contain assets that do not by their terms convert to cash.

Comments on the principles can be submitted until 20 April.

CIS Valuation Principles

On 16 February, the IOSCO published a ➲consultation paper on Principles for the Valuation of Collective Investment Schemes (CIS). The paper revises the IOSCO Principles for CIS Valuation, originally developed in 1999, to take into account subsequent regulatory, industry and market developments. It also clarifies some concepts put forward by IOSCO in its report ➲"Principles for the Valuation of Hedge Fund Portfolios", such as the entity responsible for establishing a policy governing valuation and the independence of the valuation duty. The draft revised principles are:

- The Responsible Entity should establish comprehensive, documented policies and procedures to govern the valuation of assets held or employed by a CIS;
- The policies and procedures should identify the methodologies that will be used for valuing each type of asset held or employed by the CIS;
- The valuation policies and procedures should seek to address conflicts of interest;
- The assets held or employed by CIS should be consistently valued according to the policies and procedures;
- A CIS should have policies and procedures in place that seek to detect and prevent pricing errors. Pricing errors that result in a material harm to CIS investors should be addressed promptly, and investors fully compensated;
- The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure their continued appropriateness;
- The Responsible Entity should provide for the periodic review of the valuation policies and procedures to seek to ensure that they are being implemented effectively;
- A third-party should review the CIS's valuation process at least annually;
- The Responsible Entity should conduct initial and periodic due diligence on third parties that are appointed to perform valuation services;

- The Responsible Entity should seek to ensure that arrangements in place for the valuation of the assets in the CIS's portfolio are disclosed appropriately to investors in the CIS offering documents or otherwise made transparent to investors;
- The purchase and redemption of CIS interests should not be effected at historic NAV;
- A CIS's portfolio should be valued on any day that CIS units are purchased or redeemed; and
- A CIS's NAV should be available to investors at no cost.

Comments on the consultation paper can be submitted until 18 May.

Trading of OTC Derivatives

On 25 February, the IOSCO published a Follow-On Report to its Report on Trading of OTC Derivatives of February 2011. The Follow-On Report describes the different types of trading platform currently available for the execution of OTC derivatives transactions in IOSCO member jurisdictions. Where possible, it also notes the differences relating to participant, product and geographic coverage. Based on this description, the report highlights the different approaches global regulators are taking (or envisage taking) to mandate the use of organized platforms for trading OTC derivatives. It also attempt to consider how single and multi-dealer platforms (i.e. platforms with multiple liquidity providers) address key issues such as the ability to customize contracts, the approach to the provision of pre and post-trade transparency information and market monitoring capabilities. In this respect, it found that following nine features reflect key functions of these trading platforms:

- Range of products traded: Both multi-dealer and single-dealer platforms provide a wide range of OTC derivatives products that cover the interest rate, credit, commodity, equity and foreign exchange markets;
- The ability of participants to customize contracts: The ability to customize contracts varies considerably across the different types of platforms with some types of platforms providing minimal customization and others offering a very broad range of customization;
- The degree of automation in the trading process: The degree of automation in the trading process of OTC derivatives varies across the different types of trading platforms and is driven in part by the nature of the products offered on each platform and the needs of market participants;
- Pre-trade transparency: There is a wide variance in the approach that trading platforms for OTC derivatives take to providing pre-trade transparency (i.e., the ability of market participants to see information relating to trading interest prior to transactions being executed);
- Post-trade transparency: Post-trade transparency, (i.e., the dissemination of price and volume information on executed transactions to

participants other than the executing parties) is currently very limited for OTC derivatives transactions, and generally is only available, if at all, to the participants of a given platform;

- Operational efficiency/resilience: This Follow-On Report has not identified any material difference in the ability of single and multi-dealer platforms to provide operational efficiency and resilience;
- Market surveillance: This varies by jurisdiction. Follow-On Report has not identified any material difference in the ability of single and multi-dealer platforms to implement systems and controls designed to detect potential abuse. However in a general sense, multi-dealer platforms have a broad view of dealer activity within a given product market and are able to apply this information to market monitoring;
- Liquidity resilience and impact of stressed market conditions: The task force found that the available anecdotal evidence reflected a range of views as to the trading preferences of market participants during periods of market stress. This Follow-On Report has identified two key factors that may influence the behaviour of market participants at such times: whether the counterparty to the transaction is known prior to the execution of the trade and whether there is an element of voice negotiation in the transaction;
- Links to post-trade processes: In general, the type of trading platform used does not limit the access to post-trade processes available to participants.

Suspension of CIS Redemptions

On 19 January, the IOSCO published its ➲Principles for Suspension of Redemptions of Collective Investment Schemes. The principles, which are based on the CIS responsible entities' basic duty to manage CIS liquidity on an on-going basis so as to avoid suspensions to the extent possible, generally apply to all types of open-ended CIS which offer a continuous redemption right, and apply irrespective of whether they are offered to institutional or retail investors. They are addressed to those entities responsible for the overall operation of the CIS and in particular its compliance with the legal/regulatory framework in the respective jurisdiction and thus for the implementation of the principles. The principles aim to cover all the entire timeframe of a suspension. As such principles are foreseen with respect to procedures for liquidity management that should be implemented to mitigate the risk of suspension, suspension events, the process for the decision to suspend, the time during the suspension (once decided) and the ending of the suspension.

Requirements for OTC derivatives data reporting and aggregation

On 17 January, the IOSCO together with the Committee on Payment and Settlement Systems (CPSS) published the ➲final report of the Task Force on OTC Derivatives Regulation on requirements for OTC derivatives data

reporting and aggregation. The report specifies minimum requirements for reporting data to a trade repository (TR) and for the reporting by a TR to regulators, as well as types of acceptable data formats. The report also discusses issues relating to authorities' and reporting entities' access to data, and disseminating selected OTC derivatives data to the public while taking into account any confidentiality constraints. Further, it addresses data aggregation mechanisms and tools needed to enable authorities to aggregate data in a manner that fulfils their regulatory mandates, including methods, rationale and possible tools to implement data aggregation such as legal entity identifiers. Finally, the report makes the following recommendations with respect to each of these areas:

- Minimum data reporting requirements: the report recommends that, at a minimum, transaction-level data be reported to TRs and that such data include at least transaction economics, counterparty information, underlier information, operational data and event data
- Access to data: The report recommends that TRs implement measures to provide effective and practical access to authorities both for routine data to help them fulfil their responsibilities, as well as for non-routine access in order to permit the authorities to address specific issues that might arise from time to time. In addition, the report recommends that reporting entities and counterparties should have appropriate access to their own data, subject to confidentiality and other legal requirements. Finally, the report notes that public dissemination of data promotes understanding of the functioning of OTC derivatives markets by all stakeholders and facilitates the exercise of market discipline and investor protection. Data publicly disseminated by TRs should include information to facilitate an assessment of market activity and concentration of the market.
- Methodology and mechanism for aggregation of data: As mechanisms for aggregation of data, the report recommends creation of a system of legal entity identifiers (LEIs), continued international consultation regarding implementation of LEIs, and international work to develop an international product classification system for OTC derivatives.
- International LEI development and principles: The report notes that a system of LEIs would be an essential tool for aggregation of OTC derivatives data, and recommends the expeditious development and implementation of a standard LEI capable of achieving the data aggregation purposes discussed in the report. To promote timely development of an LEI system suitable for international use, the report recommends that the industry process include development of an LEI standard and issuance of LEIs under the auspices of an organisation with international membership and appropriate governance that develops and publishes international standards for the financial

sector. It recommends that TRs support the establishment of the LEI system through active participation in development efforts and use of the system once it becomes available. The report further recommends that LEIs follow a set of basic principles that address key functions or attributes of an LEI system needed to allow the LEI to support the data aggregation purposes discussed in the report: uniqueness, neutrality, reliability, open source and extensibility.

- Development of a standard international product classification system: The workgroup recommends that CPSS-IOSCO or the FSB make a public statement calling for timely industry-led development, in consultation with authorities, of a standard product classification system that can be used as a common basis for classifying and describing OTC derivative products. Therefore, the workgroup recommends that the FSB direct, in the form and under the leadership the FSB deems most appropriate, further consultation and coordination by financial and data experts drawn from both authorities and industry, on a timely basis, concerning this work.

Securities and Markets Stakeholder Group (SMSG)

MiFID compliance function requirements

On 28 February, ESMA published ➲the advice of the SMSG on ➲its Guidelines on certain aspects of the MiFID compliance function requirements. In the advice, the SMSG indicates that it supports the adoption of the guidelines and the overall approach of ESMA. According to the Group, the initiative is of high importance to ensure that rules designed to protect investors are effectively applied and do not remain "law on the books". Notwithstanding its support for guidelines, the SMSG does call the attention of ESMA to a number of specific elements. In general, because of the high costs involved with compliance function requirements, the Group feels that ESMA should be mindful of the costs resulting from the proposed requirements. Therefore, some requirements included in the Guidelines, such as reports, staff-training and expertise, should be adapted in order not to prevent investment firms, and especially subject small and medium-sized ones, to enter in the market and to compete with larger firms. It also feels that ESMA should allow more flexibility for small and medium-sized investment firms. The Stakeholder Group does however emphasize that irrespective of the size of the firm, the compliance function has to be performed adequately. In addition to these general remarks, the SMSG also makes following specific comments with respect to a number of topics covered in the guidelines. On the subject of the reporting obligations of the compliance function, the Group notes that there is no need to provide compliance function reports to competent authorities on a regular or periodic basis as this could potentially put a stress on the capacity of the regulator to process and assess the information. Such reports can always be submitted to the

supervisory authority on request or in the course of an on-site inspection. With respect to the advisory obligations of the compliance function to provide training to staff, the SMSG states that the core essence of the compliance function is to monitor, assess on regular basis, advise and assist the relevant persons responsible for carrying out investment services and activities to comply with the firm's obligations under Directive 2004/39/EC. As these are very heavy and responsible obligations by themselves there is a need to be very careful when imposing another major obligation such as extensive staff training in order to prevent the effective compliance function from diluting and diverting its core essence. On the subject of the required knowledge and experience of compliance officers, the very large majority of the Group thinks that all compliance staff should be subject to the same high level standards so as to their level of education, in order to ensure that the compliance function is performed appropriately. Compliance officers not directly engaged in the management of units should be subject to the same stringent formal rules in respect to their education, than heads of units. Regarding the possibility to have exemptions from certain compliance function requirements based on the principle of proportionality, the SMSG emphasized that staff headcount should not be used as a justification for not having an adequate compliance function. Furthermore smaller investment firms making use of the exemption to appoint a separate compliance officer foreseen in the Guidelines should be subject to increased scrutiny and specific attention by the Competent Authority. Finally, on the subject of combining the compliance function with other functions, the Group states that that persons combining the compliance function with other functions should receive the same training and take the same exam (if there is one) as full time compliance officers. The fact that an individual is the CEO or CFO or CIO of a small firm is not sufficient to assume that she/he knows all the rules regarding compliance. However, consistent with the principle of proportionality, the SMSG feels that in the case of small and medium-sized investment firms more freedom should be given to them to structure their compliance function with regard to organization and staff in order for them to minimize costs. The same approach should apply to the overlapping of functions. According to the group, ESMA could consider that, for small and medium-sized investment firms, the overlapping of functions could become the rule rather than the exception. In order to promote this approach, Competent Authorities could also be allowed to issue Guidelines setting standards for categorization of investment firms based on the size and volume of their operations.

MiFID suitability requirements

On the same day, ESMA also published the ➲advice of SMSG on its guidelines on certain aspects of the MiFID suitability requirements. In the advice, the SMSG expresses its support for the adoption of the guidelines as they will contribute to enhancing consumer protection and to establishing a sound, effective and consistent level of regulation and supervision. The Stakeholder Group

does however note that a real and effective “consistent level” of investor protection regulation and supervision will only be achieved if the MiFID suitability provisions and ESMA Guidelines are extended to all other retail investment products. In addition to the above, the Stakeholder Group highlights a number of issues and topics which require further attention from ESMA. The first issue highlighted by the SMSG is the overreliance on questionnaires. Live discussion and interaction between firm and client is the best method for understanding client needs. The Group also advises that the Guidelines include an explicit reference to the need for the investment firm to always exercise judgement and to take into account the human factor when dealing with clients or prospective clients. Secondly, the SMSG expresses its concern that the suitability test is too much focused on one financial instrument that could be recommended to the client. In many cases, especially when first providing investment advice, investment firms tend to advise clients to reconstruct or to shift their portfolios. These portfolio reconstructions do not always lead to a new or different structure of the portfolio. However, the restructuration of the client portfolio leads to a portfolio turnover and potentially to high costs. The same risk lies with portfolio management services. Portfolio restructuration might constitute a perfectly suitable advice as such and should certainly not be discouraged since it is part of the duties to analyse an existing client portfolio. As a consequence, the Group suggests extending the suitability test. Every recommendation must be suitable, whether it is a recommendation to buy, to hold or to sell. Thirdly, the Group indicates that the requirement for investment firms to ensure that staff involved in material aspects of the suitability process have the skills and the expertise to discharge their responsibilities, should be applied in a sensible and cost effective way. Therefore, investment firms should not be subject to rules forcing them to hire experts which meet certain requirements. Employees engaged in this type of activity should be trained and qualified, but it should be clear that such training and qualification can also be acquired in the course of discharging their obligations, as well as through practical work and by means of training provided by the investment firm in a cost efficient way. In this regard, the Stakeholder Group strongly recommends that professional qualifications requirements for relevant staff be implemented. In addition to the above, the SMSG expresses its concern regarding the fact the Guidelines seem to identify "risky or illiquid financial instruments" only as requiring the collection of particular and detailed client information. The Group is of the opinion that that this distinction should not be made, and that the particular and detailed client information should be collected in all suitability assessments. Furthermore, the SMSG notes that the distinction proposed by the guidelines between investment advisory services and portfolio management regarding the information to be collected by investment firms should not be given too much importance. On the contrary, there is an even greater need for protection of clients in case of

discretionary advice. In the case of portfolio management services, this protection implies not just that the client "understand the overall risks of the portfolio and possess a general understanding of the risks linked to each type of financial instrument that can be included in the portfolio" but that the investment firm also gain a very "clear understanding" and an "in-depth knowledge" of the profile of the client, of its psychology and of its investment strategy. With respect to the "suitability" assessment, the Group believes that the Guidance places too much emphasis on "relevant risks". The concept of risk is very abstract and is, too often, subject to underestimation by investors and investment firms alike. The capacity of an investor to bear a permanent loss should instead be used (or at least to a similar extent) by investment firms. The loss-sustaining capacity of the investor should be considered carefully, and in a practical manner. The age of the investor should also be given more importance. To conclude, the SMSG suggests that the Guidelines should provide a more explicit explanation on how conflicts of interest should be prevented, rather than confine itself to a general comment on this point. This very important point with respect to conflicts of interest should also be made clearer and more practical. In order to do so, ESMA should collect, through its consultation process, concrete suggestions to how these "conflicts of interests" can be prevented.

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Insurance, reinsurance and pensions

Normative documents

Financial Services and Markets Authorities (FSMA)

Reporting requirements for institutions for occupational retirement provision

On 3 February, the FSMA published Circular FSMA_2012_03 on the annual accounts, statistics and accompanying documents for the accounting year 2011 (in ➲Dutch and in ➲French). The circular replaces Circular CBFA_2011_04 on the annual accounts, statistics and accompanying documents for the accounting year 2010. Both Circulars set out the modalities for reporting by institutions for occupational retirement provision (hereinafter IORPs) with respect to their annual accounts (including statistics and other accompanying documentation). Overall the differences between the two circulars are minor. They mostly take the form of additional clarifications and information requirements. The most important changes are:

- the introduction of a requirement for the Board of Directors and/or the General Meeting of the IORP to discuss and provide justification with respect to the discount factors used in the financing plan and/or the parameters used in the continuity-test tied to these discounts factors;

- IORPs must now indicate with respect to their management functions (i.e. administration, accounting and portfolio management) whether the function is carried out internally or externally (i.e. it has been outsourced). For each function, the responsible operational body, natural person or legal person who/which carries out the function must also be mentioned;
- IORPs must now mention, for each pension arrangement it manages, the duration of its obligations;
- the introduction of a requirement for IORPs who have shortfalls with respect to the short term technical provisions, increased with the solvability margin, to commit themselves to immediately resolve the shortfall.

Consultative or informative documents

Bank of International Settlements (BIS)

Sustainability of pension schemes

On 3 January, the BIS published a ➲working paper on the sustainability of pension schemes. The paper aims to provide quantitative guidance for the design of sustainable pension schemes by taking a simple actuarial model to estimate the costs involved in supporting occupational defined benefit (DB) schemes and public pension schemes while outlining the economic motivation behind the choice of the input variables in the model. The actuarial cost is referred to as the service cost and is expressed as a percentage of the salary bill. The service cost provides the basis for determining what the total contribution rate (as a per cent of salary) to the pension fund should be to meet the pension commitments. The service cost can also be used to set the target return on pension assets in funded schemes if the contribution rate is fixed. Alternatively, given reasonable assumptions about the target returns on pension assets that can be generated, appropriate levels of the contribution rate required to support a certain level of pension payments as a per cent of the final salary can be estimated. This exercise will shed light on what might be sustainable pension promises that could then influence policy discussions on the design of occupational and public pension plans. The paper also sheds light on how proposed derivative market reforms and changes to pension accounting standards might influence occupational pension plan design and post-employment benefits. Although the analysis in this paper focuses on the major industrial economies, similar issues arise for emerging market economies. In contrast to DB schemes, defined contribution (DC) schemes do not require pension liabilities to be computed as the assets in such schemes are managed more like mutual funds. Therefore, the service cost concept does not apply to DC schemes. Nonetheless, plan beneficiaries may contribute to the D scheme with certain expectations about the post-employment income they can receive by converting the pension assets into an annuity at the time of retirement.

This paper also introduces a simple model for linking the contribution rates to DC plans to the expected retirement income they can deliver as a function of the final salary.

European Commission

Third Country Equivalence under Solvency II

In February, the European Commission published ➲a letter it sent to the EIOPA with respect to third Country Equivalence under Solvency II. In the letter, the Commission informed EIOPA that it has informally discussed a potential transitional regime for third country equivalence under Solvency II with the competent supervisory authorities of Australia, Chile, Hong Kong, Israel, Mexico, Singapore and South Africa. The Commission emphasized that discussions with these third countries are still ongoing and EIOPA is not asked in carrying out a technical analysis to come to a conclusion about the eligibility of a third country for the transitional regime. In the letter, the Commission also mentioned that, in addition to the third countries listed above, the Commission has had initial discussions with Brazil, China and Turkey on the issue of a transitional regime for third country equivalence. Decisions on the inclusion of third countries in a transitional regime will not be taken until next year.

Adequate, safe and sustainable pensions

On 16 February, the European Commission published its ➲White Paper on adequate, safe and sustainable pensions. The paper looks at how the EU and the Member States can work to tackle the major challenges that confront our pension systems. It puts forward a range of initiatives to help create the right conditions so that those who are able can continue working - leading to a better balance between time in work and time in retirement; to ensure people who move to another country can keep their pension rights; to help people save more and ensure that pension promises are kept and people get what they expect in retirement. The White Paper proposes, in particular, to:

- Create better opportunities for older workers by calling on the social partners to adapt work place and labour market practices and by using the European Social Fund to bring older workers into work;
- Develop complementary private retirement schemes by encouraging social partners to develop such schemes and encouraging Member States to optimise tax and other incentives;
- Enhance the safety of supplementary pension schemes, including through a revision of the directive on Institutions for Occupational Retirement Provision (IORP) and better information for consumers;
- Make supplementary pensions compatible with mobility, through legislation protecting the pension rights of mobile workers and by promoting the establishment of pension tracking services across the EU;

- Encourage Member States to promote longer working lives, by linking retirement age with life expectancy, restricting access to early retirement and closing the pension gap between men and women;
- Continue to monitor the adequacy, sustainability and safety of pensions and support pension reforms in the Member States.

European Insurance and Occupational Pensions Authority (EIOPA)

IORP Directive Review

On 15 February, EIOPA published ➲its final advice on the review of the IORP Directive. A key element of EIOPA's advice is the "holistic balance sheet", as a way to achieve the Commission's aim for harmonisation. It will enable IORPs to take into account the various adjustment mechanisms (conditional indexation, reduction of accrued rights) and security mechanisms (regulatory own funds, sponsor support, pension protection funds) in an explicit way. In other words, the approach proposed by EIOPA is to acknowledge the existing diversity of occupational pension systems in the EU Member States, while capturing all these systems into a single balance sheet. In its advice EIOPA also underlines the importance of a quantitative impact study (QIS) because it is crucial to further explore the possible impact on the financial requirements for pension funds that the holistic balance sheet and the various policy options within that approach might have. EIOPA is currently preparing for a QIS exercise and aims to publish results in the second half of 2012. Besides the quantitative requirements, EIOPA's advice also contains proposals to enhance qualitative requirements in such areas as governance and risk3management. These have been modelled on Solvency II with the necessary adjustments for IORPs. Furthermore, EIOPA's advice calls for the strengthening of fit and proper criteria and for a proportionate, i.e. adjusted for the nature, size and complexity of IORPs, implementation of robust internal and external controls and sound risk management frameworks. In addition, the document addresses information provision and member protection, particularly in defined contribution (DC) schemes. According to EIOPA advice, information needs to be relevant, correct, understandable and not misleading. Finally, EIOPA calls for the introduction of a Key Information Document for all defined contribution schemes which would allow members to have confidence in the scheme irrespective of where it is located in the EU.

The advice is accompanied by the ➲opinion of the EIOPA Occupational Pensions Stakeholder Group.

Action Plan 2012 for Colleges of Supervisors

On 13 February, EIOPA published its ➲Action Plan 2012 for Colleges of Supervisors. The two key targets of the Action Plan 2012 are preparation for the implementation of Solvency II and exchange of information within

colleges. The Plan foresees that colleges of supervisors will establish a work plan related to the activities of the college for an insurance group's internal model application. The colleges will also have to summarize the tasks that should be performed in relation to group supervision under Solvency II. The Action Plan 2012 envisages that supervisors start implementing EIOPA's guidelines on a regular exchange of quantitative and qualitative information within colleges. They are also expected to set up a coordination arrangement for their supervisory activities. According to the Plan, colleges of supervisors should also set up an emergency plan of information exchange and crisis management in case of financial turbulence that a group or a solo undertaking might face.

Report on the Functioning of Colleges and the Accomplishments of the 2011 Action Plan

On the same day, EIOPA also published ➲its report on the Functioning of Colleges and the Accomplishments of the 2011 Action Plan. Based on its observations as a member of the colleges draws the following key conclusions:

- Substantial efforts were made by supervisors in preparing, organizing and contributing to the college;
- The exchange of the results of the fifth Quantitative Impact Study (QIS5) and the second European insurance stress test in most of the colleges enhanced the quality of the discussions and improved the supervisors' common understanding of the undertakings' risk exposure and solvency position;
- Similarly, the discussion of financial conglomerate aspects, where relevant, helped to improve college members' awareness about the financial strength of the groups as a whole;
- Concerns or legal constraints in some Members States related to the exchange of confidential information hampered the scope and quality of discussions in colleges;
- Differences were observed between colleges regarding:
    - Scope, content and the frequency of information exchange in colleges; and
    - Preparation and focus of presentations by, and discussions with, firms' representatives.
- These are areas for improvement regarding the implementation of consistent, coherent and effective EEA-wide supervision of cross-border groups;
- The emergency infrastructure test was successfully completed by most of the colleges;
- Despite the still outstanding decisions at European level regarding the implementation of Solvency II and the lack of a final legal text, the colleges are making great efforts to prepare for the implementation of the new regulation, in particular the pre-application process for the approval of

internal model use.

Key Consumer Trends in the EU

On 1 February, EIOPA published ➲its overview of Key Consumer Trends in the EU. The report identifies the following three key consumer trends:

1. Consumer protection issues around payment protection insurance;
2. Increased focus on unit-linked life insurance products;
3. Increased use of comparison websites by consumers.

With respect to the increased use of comparison websites by consumers, EIOPA notes that significant drawbacks have been identified with regard to over" reliance by consumers on the price of products, rather than understanding the underlying terms and conditions. In addition, in some Member States, misleading information may be provided to consumers due to conflicts of interest stemming from close commercial links between insurers and commercial comparison websites. Commercial comparison websites may also not necessarily be suitable for certain types of products such as life insurance, where more information is required than usually obtained through the short set of questions typical on such sites. Furthermore there is some evidence that commercial comparison websites are often unaware that they may fall under the scope of existing EU insurance regulation such as the Insurance Mediation Directive and might have difficulties in adapting to the demands of regulation.

Implementation of Solvency II

On 1 February, EIOPA published ➲the letter its chairman sent to Commissioner for Internal Market and Services, Michel Barnier, regarding the implementation of Solvency II. In the letter, the chairman expresses his concern on the current development in the Solvency II project. He indicated that the current delays in the approval of the Omnibus II Directive and the Level 2 implementing measures are increasing the constraints EIOPA is facing to conduct its public consultations on the standards and guidelines which will complement the new regulatory framework. Furthermore, the chairman stated that it is his conviction that any further delays will lead to the development of national solutions to keep the momentum achieved by supervisors and undertakings in preparing for Solvency II. Such a development is contrary to the development of the single rule book and will hinder the efforts for achieving European convergent practices. Given the aforementioned, he stressed the importance of having a vote on Omnibus II in the the Economic and Monetary Affairs Committee and urged the European Parliament, the Commission and the Council to agree within the context of the trilogue on a clear timeline, which ensures the entry into force in 2014 with sufficient assurance for a due process to prepare the Solvency II implementation.

EIOPA work program for 2012

On 23 January, EIOPA published ➲its work program for 2012. The work program describes the goals and deliverables for EIOPA in its second year of operation. EIOPA's main focus areas for 2012 are:

- Solvency II: In 2012, EIOPA will deliver implementing and regulatory technical standards as well as guidelines in the different work streams, according to specific needs to complement the principles and regulation issued by the European Commission. EIOPA will focus on the following work streams: 1) Valuation of assets and liabilities, including technical provisions; 2) Solvency capital requirements and own funds; 3) Internal models; 4) Reporting and disclosure; 5) Governance; 6) Supervisory review process and 7) Group issues. The concrete scope and timing of the deliverables are pending the final decision on the Omnibus II Directive (OMDII) as well as the approval of the final Delegated Acts implementing Solvency II;
- Third Country Equivalence: EIOPA will continue to assist the European Commission in preparing equivalence decisions pertaining to supervisory regimes in third countries by way of producing final, fully consulted upon advice;
- Occupational pensions: EIOPS will continue to assist the European Commission with its review of the IORP Directive. EIOPA's recommended approach to a future harmonized and risk based supervisory and regulatory framework for the Institutions for Occupational Provision (IORPs) is based on the concept of a holistic balance sheet, which will allow to record and measure on a consistent basis the obligations and resources (including both asset and security mechanisms) of an IORP. EIOPA will develop, in cooperation with the industry, methodologies for quantifying the various security mechanisms included in the holistic balance sheet. This work is essential before any Quantitative Impact Study (QIS) can be conducted. EIOPA will then develop specifications and carry out a targeted QIS exercise in order to support the Commission's proposal for a revised IORP Directive;
- Information and Financial stability: EIOPA will monitor, in accordance with art. 32 of EIOPA Regulation, structural developments in the sectors as well as risks related to specific products where relevant. Further development and monitoring of a risk dashboard in cooperation with the ESRB and other ESAs are to be carried out. Also, in 2012, a harmonized, pan-European stress test for the insurance sector will be carried out in cooperation with the ESRB, ECB, and EBA. As in previous years, EIOPA will deliver, in the autumn of 2012, an annual assessment of sector developments, highlighting implications for financial stability;
- Consumer protection: In accordance with its mandate, EIOPA will further develop and pursue its role in promoting transparency, simplicity and fairness in the market for consumer financial

products and services across the internal market. This will be done by developing more standardized and comparable information about the risks and costs of products, relevant regulatory requirements and complaints handling procedures.

- Financial innovation: EIOPA will continue its monitoring and assessment of new or innovative financial activities, release good practices reports and, where deemed appropriate, make proposals for the adoption of guidelines and recommendations with a view to promoting the safety and soundness of markets and convergence of regulatory practice. By way of exemplification it is noted that an important new major strand of work will be to assess the impact of the Solvency II framework on product developments. Work is also expected to be carried out under the Joint Committee on the development of common disclosure rules and selling practices, including possibly providing advice to the Commission with regards to the above-mentioned revision of the IMD and the regulation of the disclosure and sale of Packaged Retail Investment Products (PRIPs);
- Insurance Guarantee Scheme: EIOPA will continue to provide input into the Commission's work pertains to the area of Insurance Guarantee Schemes (IGS).
- Cross border crisis management: EIOPA will continue to develop the crisis management framework. Building on the framework developed in 2011 through the Task Force on Crisis Management, EIOPA will further develop the pre-emption element of the framework in 2012. It is also planned to develop analytical tools to be used in decision making, as well as completing the monitoring and peer review process. Later in 2012 a simulation exercise to test the operation of the new framework will be carried out. EIOPA will also contribute to the work of the European Commission in developing crisis management proposals for insurance, along with the work of the IAIS on resolution tools for systemically important insurance undertakings.

International Capital Market Association (ICMA)

Solvency II

On 20 February, the ICMA published ➲its response to EIOPA's ➲Consultation paper on the Draft proposal on the add-on Quantitative Financial Stability Reporting Templates.

Insurance Europe

Adequate, safe and sustainable pensions

On 17 February, Insurance Europe published ➲its comments on the Europeans Commission's ➲White Paper on adequate, safe and sustainable pensions.

Review of IORP Directive

On 3 January, Insurance Europe published ➲its comments on EIOPA's ➲draft response to the European Commission's ➲call for advice on the review of the 2003 IORP Directive

International Association of Insurance Supervisors (IAIS)

Supervisory Cooperation and Information Exchange

On 28 February, the IAIS published its ➲first report from the process of thematic self-assessments and peer reviews focused on Supervisory Cooperation and Information Exchange. The report summarizes the results of a pilot project conducted in 2011, examining Members' observance of the related IAIS Insurance Core Principles (ICP). A wide majority of IAIS members participated in the pilot study. While the report indicates an overall healthy compliance with the related 2003 ICPs and includes detailed results by region as an aid to prioritizing regional level support initiatives, there are however still areas for improvement. In this respect, the report sets out a number of recommendations in order to improve the effectiveness of cooperation and information exchange.

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Tax

Consultative or informative documents

Belgian budget 2012

Measures concerning extra-legal pension schemes - Erratum

The information provided in Regulatory Radar - Issue 40 (November - December 2011) with respect to the measures in the Belgian budget 2012 concerning extra-legal pension schemes is unfortunately no longer up-to-date as the measures have been amended since they were agreed upon in November. The final rules are still being decided upon.

Belgian Tax Authorities (FOD Financiën)

Branch 21 insurance products

In January, the representative of the Minister of Finance answered ➲several questions of members of parliament (see pp. 33-35) regarding the application of insurance tax and withholding tax in case of subscription to supplemental branch 21 insurance contracts.

European Commission

Venture Capital Tax

In a ➲press release of 27 February, the European Commission announced that it has asked Belgium to amend its legislation on tax credits for investing in venture capital. Belgian legislation grants a personal income tax credit to individuals investing in shares and units of ARKimedes funds. This tax credit is only granted on the condition that these investors are resident in the Flemish region. Residents of other Member States cannot benefit from the mentioned tax credit even if they are fully taxable in Belgium because they derive all or almost all of their personal income in Belgium. According to the Commission, this legislation is incompatible with the Treaties, as it discourages the free movement of workers and self-employed persons which is guaranteed by EU rules (articles 45 and 49 TFEU and 28 and 31 EEA). These provisions also go against the case-law of the EU's Court of Justice that taxpayers who are tax residents of other Member States of the EU or EEA but derive all or almost all of their income in Belgium should be entitled to the same tax benefits as Belgian residents.

If the rules are not brought into compliance within two months, the Commission may refer the matter to the Court of Justice of the European Union.

Notional interest deduction

On 26 January, the European Commission officially requested Belgium to amend its legislation on the notional interest deduction (in ➲Dutch, in ➲English and in ➲French). Current Belgian rules provide that a notional interest deduction is granted for Belgian real estate and permanent establishments, while no deduction is granted for foreign real estate and permanent establishments.

The Commission considers that this is contrary to EU rules as laid down in the Treaty on the Functioning of the European Union (TFEU). The freedom of establishment (Articles 49 and 54 TFEU) prohibits the exclusion of foreign permanent establishments, and the free movement of capital of (Article 63 TFEU) prohibits the exclusion of foreign real estate. It should be noted that the Commission does not challenge the notional interest deduction as such, only its discriminatory application. Notional interest is fictitious interest on own assets. Belgium allows to deduct such interest to take into account the risk of investing own assets in a business activity.

The request takes the form of a reasoned opinion which is the second stage of an infringement procedure. If the rules are not brought into compliance within two months, the Commission may refer the matter to the Court of Justice of the European Union.

VAT rules for independent groups of person

On the same day, the European Commission also ➲requested Luxembourg to amend its VAT rules in the case of independent groups of persons. Luxembourg's current rules are incompatible with European Union law, according to the Commission.

Under Luxembourg law, the services provided by an independent group to its members are exempted from VAT provided that the members' taxed activities do not exceed 30% of their annual turnover (or 45% under certain conditions). Group members are also allowed to deduct the VAT charged to the group on its purchases of goods and services. Lastly, operations by a member in his or her own name but on behalf of the group are regarded as non-taxable. The Commission considers that these arrangements infringe the EU VAT Directive (2006/112).

Under EU VAT law, in order to be exempt from VAT the services provided by an independent group to its members must be directly required for their non-taxable or exempt activities. The Luxembourg rule providing for a ceiling for taxed operations does not, therefore, fulfill this condition. The group's exempt activities must be linked exclusively to the exempt activities of group members. Moreover, group members should not be allowed to deduct VAT charged to the group. Finally, the Luxembourg rules do not take account of VAT rules in EU law applicable to operations by intermediaries.

European Fund and Asset Management Association (EFAMA)

Financial Transaction Tax

On 27 February, EFAMA published ➲a report analyzing the potential impact of the Financial Transaction Tax on the European fund industry.

FATCA

In a ➲press release of 14 February, EFAMA welcomed the proposed regulations under the Foreign Account Tax Compliance Act ("FATCA") published by the U.S. Treasury Department and Internal Revenue Service ("IRS") and the joint statement by the United States, France, Germany, Italy, Spain, and the United Kingdom announcing a possible framework for intergovernmental agreements pursuant to which financial institutions would report the information required by FATCA to their local authorities, rather than directly to the IRS.

Insurance Europe

Common Consolidated Corporate Tax Base

On 27 February, Insurance Europe published ➲its comments on the ➲proposal for a Council Directive on a Common Consolidated Corporate Tax Base.

Financial transaction tax

On 23 January, the CEA published ➲its comments on the European Commission's ➲proposal for a Directive on a common system of financial transaction tax.

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