



European Securities News

Newsletter for the European Securities Committee

14 May 2009

Issue N° 1-2009

In This Issue

- Proposals on Remuneration
- Simplification of Company Law, Accounting and Auditing
- Public Consultation on Legislation Concerning Legal Certainty of Securities Holding and Disposition
- Credit Rating Agencies
- Market Abuse Directive
- Investor Compensation Scheme Directive
- MiFID
- Prospectus Directive
- Alternative Investment Fund Managers
- CDR and Securitization
- Solvency II

Prepared by:
Secretariat of the European Securities Committee

Contact:
Emiliano Tornese
Secretary to the ESC
+ 32 2 298 54 00
emiliano.tornese@ec.europa.eu

Proposals on Remuneration

In its Communication dated March 4 to the European Spring Council, the Commission announced that it would strengthen its 2004 Recommendation on remuneration of directors of listed companies and table a new Recommendation on remuneration in financial services to address perverse incentives and excessive risk taking throughout firms.

The Commission adopted the aforementioned Recommendations on 30 April together with a [Communication](#) on these issues (explaining the content of the Recommendations and the next steps). In this first stage the Commission is recommending a series of principles and best practices that Member States should ensure companies apply in the design and implementation of pay policies which reward long-term sustainable performance.

The Commission will follow up these [Recommendations](#) with legislative proposals to bring remuneration schemes into the scope of prudential oversight. In June the Commission will present proposals to revise the Capital Requirements Directive to ensure that regulatory capital adequately covers the risks inherent in banks' trading books, securitization positions and remuneration policies. The Commission is prioritizing legislative measures in the banking and investment banking sector since this is where the evidence of the negative impact of misaligned incentives is greatest. At a further stage, the Commission will examine additional measures in relation to non-banking financial services.

Contact: elies.messaoudi@ec.europa.eu

Simplification of Company Law, Accounting and Auditing

On 22 April 2009, the European Parliament adopted its report on the Commission proposal for a directive modifying the existing EU Directives on mergers and divisions (COM(2008)576 of 24 September 2008). The proposed amendments correspond to the compromise found in the informal *trialogues*, and the Council is therefore expected to approve the directive as soon as the text has been finalized by the lawyer linguists. This can be expected to be the case before the summer. The directive will reduce reporting requirements in the context of mergers and divisions of public limited-liability companies and allow companies to make information related to the merger or division available by electronic means. Regarding the two fast track proposals that were adopted on 17 April 2008:

- modification of the First and the Eleventh Company Law Directives with a view to publication and translation requirements (COM(2008)194) – the adoption of the proposed directive is blocked by a minority of Member States in the Council that support the amendments put forward by the European Parliament on 19 November 2008. The Commission and a majority of Member States cannot accept the amendments of the European Parliament that are more likely to have the effect of increasing administrative burdens than of reducing them;
- modifications of the accounting directives as regards certain disclosure requirements for medium-sized companies and the obligation of groups with only immaterial subsidiaries to draw up consolidated IFRS accounts (COM(2008)195) - the institutions reached an informal agreement on 18 December. The formal adoption of the directive is expected for end April/beginning of May 2009. It will have to be transposed by the Member States by 31 December 2010.

On 26 February 2009, the Commission adopted its proposal to give Member States an option to exempt so called micro entities from the requirements of Accounting Directives (COM(2009)83). According to studies by outside consultants, this could reduce the administrative burden of the micro entities by some 6 bn Euros. Furthermore, this would facilitate aligning the financial reporting requirements of micro entities with their other reporting obligations such as tax accounting. The proposal is currently being discussed within the Council and the European Parliament.

The proposal to remove the requirement on micro-entities to prepare annual accounts is interlinked to the more general overhaul of the Accounting Directives. A [public survey](#) on this overhaul was launched in February 2009. The deadline for replies expired on 30 April 2009. On the basis of the responses and other consultations with the stakeholders, the Commission will start preparing the changes to the Accounting Directives.

Contact: corinna.ullrich@ec.europa.eu

Public Consultation on Audit Market

In November 2008, DG MARKT launched a [public consultation](#) on the audit market and the control structures in audit firms (deadline: 28 February 2009). The purpose was to collect ideas on the possible ways forward for finding catalysts towards a more open international audit market. The consultation follows an independent study, prepared by the consultancy firm Oxera, on the ownership rules of audit firms and their consequences for audit market concentration. The current legislation requires that auditors hold a majority of the voting rights in an audit firm and control the management board. Oxera study analyses possibilities to develop an alternative model where audit firms could be held by external investors. Oxera study suggests that liberalising these requirements could help reduce market concentration. The consultation puts forward two options on which catalysts should be put in place for changing the current oligopoly on the audit market: 1) deregulation of the capitalisation of audit firms and 2) other catalysts related to human capital of audit firms, fragmentation of legislation, barriers existing on the demand side. The Commission services received up to 70 responses. In July 2009, a summary of the outcome of the consultation and the ideas put forward by stakeholders will be published.

Contact: karolina.majewska@ec.europa.eu

Public Consultation on Legislation Concerning Legal Certainty of Securities Holding and Disposition

The Commission has recently launched a [public consultation](#) on its future proposal to address legal uncertainties affecting the law regarding securities holdings and dispositions. The Giovannini reports of 2001 and 2003 demonstrated that existing discrepancies of national laws on book-entry securities are a source of important legal uncertainty which affect the cross-border holding and transfer of securities. Such uncertainty leads to inefficiencies and may have a negative impact on the legal position of investors.

The Commission mandated an expert group, the Legal Certainty Group, to advise on how best to tackle these issues. In its 2008 Advice which bears the title *"Solutions to Legal Barriers related to Post-Trading within the EU"*, the Group called upon the Commission to propose an EU-wide harmonisation measure on certain areas of the law of securities. This advice was endorsed by Commissioner McCreevy and the ECOFIN Council, which, in its conclusion of 2 December 2008, invited the Commission to present, as a matter of urgency, the outline of legislative measures for a harmonized legal framework for intermediated securities. The Commission intends to adopt a proposal for such a legislative measure by the end of 2009. However, before finalizing its proposal, the Commission invites interested parties to submit their comments on the basis of a consultation document prepared by its services. The consultation seeks comments on:

- (a) the future legal framework for the holding and disposition of

securities held in securities accounts, both from a substantive and from a conflicts-of-law perspective;

(b) the future legal framework governing the exercise of the investor rights which flow from securities held through a "chain" of intermediaries, in particular in cross-border situations;

(c) the right of issuers of securities to choose the place of the initial entry of their securities in the securities holding structures, essentially through a choice of a CSD; and,

(d) the need for subjecting the activity of safekeeping and administration of client securities to an appropriate supervisory regime.

Interested parties may provide their comments by the 11th of June 2009. Additional information may be obtained at the following web address:

Contact: konstantinos.tomaras@ec.europa.eu

Credit Rating Agencies

As Credit Rating Agencies (CRAs) contributed significantly to the recent market turmoil by underestimating the credit risk of structured credit products, the ECOFIN Roadmap of October 2007 identified them as one of the key focus issues of the EU's response to the financial turmoil. On 12 November 2008 the European Commission adopted a legislative proposal establishing a regulatory framework for credit rating agencies. The proposal was based on the international standards (Code of Conduct of IOSCO – the International Organisation of Securities Commissions), but more precise and/or demanding on a number of, mostly technical, issues.

The objective of the Regulation is the establishment and proper functioning of the internal market in financial services, by laying down conditions for the issuance of credit ratings to recover markets' confidence and increase investor protection. It introduces a registration procedure for CRAs to ensure that their credit ratings can be used by credit institutions, investment firms, insurance and assurance undertakings, collective investment schemes and pension funds within the Community.

CRAs will have to comply with rigorous rules to make sure (i) that ratings are not affected by the conflicts of interest inherent to the ratings business, (ii) that CRAs remain vigilant on the quality of the rating methodology and the ratings and (iii) that CRAs act in a transparent manner. It also includes an external surveillance regime whereby European regulators will supervise the issuance of credit ratings by CRAs.

The most far reaching topics are the following:

- Scope: The final text of the Regulation includes a broad scope (*i.e.* application to credit ratings issued by credit rating agencies registered in the Community) covering all credit ratings produced or used in the European Union, which are disclosed publicly or distributed by subscription. Four exemptions have been introduced related either to not credit ratings *stricto sensu* or to credit ratings which are not linked at all to the financial crisis. They refer to: private credit ratings; credit scores, credit scoring systems and

similar assessments related to obligations from consumer, commercial or industrial relationships; ratings of export credit agencies and a conditional exemption for central banks subject to an individual Commission decision. Concerning the use of credit ratings, the Regulation covers the use of credit ratings for regulatory purposes by financial institutions and for disclosure purposes in prospectuses by issuers or offerors.

- Treatment of credit ratings issued in third countries: the Regulation provides an endorsement regime and an equivalence mechanism, and ensures that credit rating issued in third countries may be used in the Community only when issuing CRAs, which operate outside the EU, comply with legal requirements which are as stringent as the requirements provided for in the Regulation and are subject to effective supervision in their country of establishment. The endorsement regime is made available for CRAs that are affiliated or work closely with EU-established CRAs. Alternatively, the equivalence mechanism is made available for smaller CRAs from third countries with no presence or affiliation in the EU, provided they are not systemically important for the financial stability or integrity of the financial markets of one or more Member States, and in order to allow the use in the Community of credit ratings related to entities established or financial instruments issued in third countries. This specific registration process, so-called certification, will take into consideration the size of the applicant CRA, in view of the nature, scale and complexity of its business and the nature and range of issuance of its credit ratings, and might allow for exempting such CRA from certain organisational requirements or from the obligation to have a physical presence in the European Union.
- Proportionality: the Regulation introduces a proportionality provision for small CRAs concerning the rotation of analysts and the possibility to exempt CRAs from some obligations concerning the organisational requirements. However, for groups of CRAs, at least one member of the group should comply with all the requirements.
- Supervisory structure: the Regulation introduces a system of supervision based on colleges of competent authorities which gives the possibility to all concerned competent authorities to participate in the process of registration and supervision of a credit rating agency or a group of CRAs.
- Transitional periods: the Regulation includes transitional periods of 9 months for CRAs to submit an application, 12 months for the use of credit ratings issued by registered CRAs by financial institutions, and 18 months, under the endorsement mechanism, for the specific obligation for CRAs established in third countries to be registered and supervised in the third country.

Regulation has been approved by Member States at the COREPER on 23 April 2009 and approved by the European Parliament on 23 April. The Regulation will be formally adopted by the Council during the summer.

Contact: piotr.plizga@ec.europa.eu

Market Abuse Directive

The Commission published its [call for evidence](#) on the review of the market abuse directive on 20 April. It is an important first stage before amending some provisions of the MAD framework. This document forms part of the Action Programme for Reducing Administrative Burdens in the EU. It also addresses some of the issues covered in the Commission communication Driving European Recovery. It is still an open document with no definitive findings and proposals.

It notably addresses the issue of a possible extension of the scope of the MAD; disclosure of inside information by issuers of financial instruments; short selling; insiders' lists (...). The issue of sanctions will be considered in a broader context (the report asked for by the ECOFIN) and we still consider that, if needed, some amendments on sanctions could be introduced in the MAD.

The document is now open to consultation till 10 June. The Commission wishes to be able to propose amendments at the end of the year. Preliminary findings are as follows:

a) Main issues principally linked to simplification and regulatory burden reduction

1. Insider lists of persons having access to inside information: these lists are very useful to deter abuse and to investigate them; however the obligation to draw up lists is very burdensome. Ways to reduce the regulatory burden may need to be considered. At least a greater alignment of national implementing measures could be achieved by replacing the minimum requirements of the directive by an exhaustive set of requirements.
2. Transaction reporting by managers of listed issuers: even if the measure is very useful, its scope is probably too broad which reduces its efficiency. One approach could be to restrict the scope of the obligation to report managers' transactions so that, for example, trades decided on the account of managers but without their intervention would not be concerned. Other options could be to consider increasing the threshold of €5000, making a clearer distinction between reporting to the regulator and disclosure to the markets and clarifying the treatment of specific categories of trades.
3. Commodity derivatives: notably in the energy sector, issuers of commodity derivatives are "technical issuers" (exchanges) that are not in a position to possess inside information that they are obliged to disclose; as a consequence they could be relieved from the obligation to disclose inside information.

b) Main issues aiming at achieving greater efficiency of the MAD framework

1. One will have to carefully consider a possible extension of the scope of the MAD. It could concern, on the one hand, the application of insider dealing and market manipulation prohibitions to MTFs and, on the other, extending the market manipulation prohibition to practices involving financial instruments the value of

which depends on another instrument admitted to trading on a regulated market.

2. The rules which authorize issuers to delay the disclosure of inside information do not appear to be sufficiently clear and adapted to exceptional circumstances. A delay of disclosure when the financial viability of an issuer is at stake may be needed. There may also be a need to clarify the criteria for delaying disclosure of inside information and notably the criteria stating that it has to be verified that an omission of disclosure "would not be likely to mislead the public".
3. Telephone and data traffic records: competent authorities are sometimes limited by e-Privacy rules when seeking access to these sources for supervisory purposes. This issue could point to a need to amend the MAD.
4. Finally, European Commission could propose measures on short selling.

Contact: bertrand.legris@ec.europa.eu

Investor Compensation Scheme Directive

The Directive requires Member States to ensure that minimum safeguards are in place to compensate investors (essentially for smaller investors) in the case of failure of a firm providing investment services (bank or investment firm), where the firm proves unable to refund to investors the money or securities belonging to them. The Directive does not provide for compensation for losses incurred as a result of customers' investments losing market value.

The Directive requires Member States to ensure that at least 90 % of each investor's claims are met by the compensation scheme. Member States may set a ceiling on the level of compensation but such a ceiling cannot be less than a certain amount. The Directive leaves Member States totally free to decide about both the internal organisation of the scheme and the way it is financed.

The Directive requires the supervisory authorities of the investment firm's home country to be responsible for the investor compensation arrangements, even in cases where firms are established and/or offering services in several Member States. This serves to reinforce the 'home country control' principle which is the basis for the single licence for investment firms.

In this context, a [call for evidence](#) on the Investor Compensation Schemes Directive (ICSD) has been launched on February 2009 and closed on April 8, 2009. In fact, the ICSD, modeled on the Deposit Guarantee Schemes Directive (94/19/EC - DGSD), has been adopted in 1997 as a complement to the existing Investment Services Directive (93/22/EEC - ISD). However, in the meantime: 1) the MiFID has been implemented (and repealed the ISD); 2) a proposal to amend the DGSD has been presented by the Commission in the context of the turmoil; 3) the Commission has received some complaints concerning the functioning of the Directive on the ground. The call for evidence

focused on the following:

- the scope of the Directive in terms of services covered, also in the light of the implementation of the MiFID;
- the amount of compensation (in particular, the need to align it to the new coverage proposed for the Deposit Compensation Schemes Directive);
- the funding of the compensation schemes which represents a crucial part of the functioning of the mechanism. Due to the nature of the ICSD as a minimum harmonisation directive, we consulted on the need to harmonize somehow the ways in which the national schemes are to be financed;
- other technical aspects which may hamper the efficient and timely functioning of the schemes.

The call for evidence has also offered the occasion to consult on the issue of the treatment of money market funds, investments traditionally perceived as a safe investment; in particular, the call for evidence called for views on any needs to give a special attention to this kind of funds.

Around 65 contributions to the call for evidence have been submitted. The Commission is now assessing them in order to propose next steps.

Contact: salvatore.gnoni@ec.europa.eu

MiFID

MiFID is a cornerstone of the Financial services Action Plan for an integrated European capital market. It entered into force on 1 November 2007.

The Directive establishes a harmonized regime for the provision of investment services (brokerage, advice, dealing etc.) in Europe by investment firms and banks. It contains strong rules on conduct of business (suitability and appropriateness), best execution and conflicts of interest in order to ensure investor protection. MiFID also regulates important organizational aspects concerning the provision of services.

The Directive gives investment firms a strengthened single “passport” for providing investment services in 27 EU Member States and 3 EEA States on the basis of authorization by the home state regulator.

The concentration rule is abolished, providing for free competition between exchanges and new venues (multilateral trading facilities and systematic internalizers). Detailed pre- and post-trade transparency provisions, with limited exemptions, apply to share trading irrespective of venue. Transaction reporting is to be done to local competent authorities for all financial instruments admitted to trading on a regulated market. The data is shared among EU supervisors to ensure adequate supervision.

MiFID is expected to drive innovation and structural change in financial markets. The increase in competition should increase trading volumes, create deeper, more liquid and integrated capital markets and lower capital costs for issuers and investors. A range of new services and venues have emerged in trading and in trade reporting and there has been consolidation among traditional exchanges in an effort to upgrade their services. Over time, the upfront costs should be outdone by the long-term benefits.

A review of various provisions of the Directive should take place in 2010. We anticipate this review to focus on examining some of the major changes and challenges which have emerged in post-MiFID equity markets such as the fragmentation of liquidity and market data. Another key area will involve looking at whether provisions on transparency, investor protection and regulatory oversight are sufficient as regards complex financial instruments such as derivatives.

Contact: hannes.huhtaniemi@ec.europa.eu

Prospectus Directive

The European Commission has launched a [public consultation](#) on a proposal for the modification of the Prospectus Directive (PD) on January 9, 2009. The proposal is presented in the context of the Simplification Exercise (Action Programme for the reduction of administrative burden in the EU - Stoiber Group) and as a consequence of the review of the Directive required by Article 31 of the PD.

The proposal has been subject to public consultation until 10 March. We have received 125 contributions. Stakeholders have shown great interest and there is great support for the proposal. Issues covered by the proposal were selected from the issues highlighted in the report from CESR about the functioning of the Directive (delivered in June 2007), the reports from ESME (a general one delivered in September 2007 and two other reports on specific issues delivered in June and November 2008) and the Study from the Centre for Strategy & Evaluation Services (June 2008). DG Markt services have held dialogues with stakeholders (associations of issuers, intermediaries, investors, employee share schemes promoters, etc).

Contact: emiliano.tornese@ec.europa.eu

Alternative Investment Fund Managers

Following a public consultation on hedge funds and a high-level conference on hedge funds and private equity on 26-27 February, the European Commission adopted a [proposal](#) for a Directive on Alternative Investment Fund Managers on 29 April. The proposal aims to create a comprehensive and effective regulatory and supervisory framework for AIFM in the European Union. It seeks to strengthen the surveillance at European level of macro-prudential risks stemming from the activities of AIFM through enhanced regulatory reporting requirements and information sharing between Member State authorities.

The proposed Directive will cover the managers of all types of alternative investment fund (AIF), defined as those funds that are not covered by the UCITS Directive, with exemptions for smaller AIFM managing less than €100m (or less than €500m for the managers of funds that do not employ leverage and lock investors in for at least five years). The proposal requires AIFM to be authorised and to notify competent authorities of all AIF managed. AIFM will be required to comply with ongoing requirements on risk and liquidity management; organisational arrangements; asset safekeeping and valuation; conflicts of interest; investor disclosure; and regulatory reporting. The proposal includes additional provisions for those AIFM managing

leveraged AIF, and AIF acquiring a controlling interest in companies.

On the basis of authorisation in one Member State, AIFM will be entitled to manage and market AIF throughout the EU, to professional investors only. Retail access to AIF investment may be permitted under national law. The possibility to market offshore AIF, to use third country service providers (administration, asset safekeeping and valuation) and the possibility for third country AIFM to operate in the EU will be subject to strict conditions and will only become available after three year transition period, so as to allow time for the appropriate safeguards to be put in place. In the intervening period, national arrangements will continue to apply.

Contact: rostislav.rozsypal@ec.europa.eu

Packaged Retail Investment Products

On 29th April 2009 the Commission published a [Communication](#) on Packaged Retail Investment Products (PRIPs). This sets out the Commission's conclusions on consumer protection and level playing field issues in the retail investment market, and outlines the steps the Commission will now take to address these issues. The aim is to make important improvements to investor protection measures for the main retail investment products bought by retail investors.

PRIPs cover the core of the retail investment market, which recently totaled around €8 trillion. They include insurance investment products and retail structured products. They can be difficult for investors to understand, and there is a concern that variations and gaps in existing investor protection standards have led to detriment for investors and threatened to weaken the retail investment market. The financial crisis has also underlined the importance of transparency and fair sales processes that investors feel they can trust following a collapse in retail confidence.

The Commission has been working on these issues following a request from the ECOFIN council in 2007, and has concluded that pre-contractual product information requirements and rules on product sales need to be updated to set consistently high standards for all PRIPs, regardless of their legal form or how they are sold. The Communication does not contain detailed legislative proposals, but outlines the Commission's commitment to developing a new, horizontal legislative approach, drawing on the best of existing requirements but applying these to all relevant products and all sales channels for these products so as to achieve a consistent and coherent overall approach.

The Commission recognises that this is a challenging project that cuts across existing sectors and legislation. However, facing these challenges is essential to address the identified issues and lay a sound regulatory foundation for the PRIPs market.

The Commission will now begin work on preparing detailed proposals for this new approach, and intends to publish an orientation on the work by the end of 2009

Contact: karishma.parmar@ec.europa.eu

CDR and Securitization

Along the lines of proposals published by the Basel Committee in January, the European Commission will table a [proposal](#) to further strengthen capital requirements for banks and investment firms in June. This proposal in June will cover the following elements:

- making sure that remuneration policies in banks and investment firms do not contradict the objectives of sound risk management;
- strengthening capital requirements for complex securitisations that have other securitisations as underlying assets and trying to discourage institutions' investments in the most complex and risky of these products;
- enhancing disclosure requirements regarding securitisation related risks, most notably also covering securitisation risks in the trading book; and
- complementing existing capital requirements for market risk in the trading books of banks and investment firms by elements aimed at capturing (1) distressed market conditions, (2) credit default and deterioration risk and (3) the specific risk of tranching exposures. These latter three elements taken together will provide for equivalent capital charges in banking and trading books and will render capital charges in the trading book less cyclical and sensitive to stressed market conditions.

Contact: kai.spitzer@ec.europa.eu

Solvency II

On 22 April 2009, the European Parliament adopted with 593 in favor, 80 against and 3 abstentions the framework Directive on Solvency II, thereby concluding the negotiations with the Council in one single reading. The Solvency II Directive is a framework Directive which introduces a modern solvency regime for Insurance and Reinsurance undertakings. It will enter into force by 31 October 2012. Implementing measures are now being prepared by the European Commission so as to adopt them during the course of 2011. With the adoption of the Solvency II Directive, the EU now has the most modern solvency regime for the Insurance industry, which can serve as a model for similar regulatory reforms in third countries and which addresses some of the concerns which have appeared as a result of the Financial crisis.

Contact: emmanuel.sokal@ec.europa.eu