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Strengthening the EU Financial Supervisory Architecture

On 23rd September 2009, the Commission adopted a [package](#) of legislative proposals creating:

- a European Systemic Risk Board (ESRB) to monitor and assess risks to the stability of the financial system as a whole ("macro-prudential supervision"). The ESRB will provide early warning of systemic risks that may be building up and, where necessary, recommendations for action to deal with these risks.
- a European System of Financial Supervisors (ESFS) for the supervision of individual financial institutions ("micro-prudential supervision"), consisting of a network of national financial supervisors working in tandem with new European Supervisory Authorities, created by the transformation of existing Lamfalussy level 3 committees.

The package consists of four draft Regulations, for adoption by the Council and the European Parliament under co-decision procedure, and one draft Council decision:

- a Regulation creating a European Banking Authority (EBA), replacing CEBS;



- a Regulation creating a European Insurance and Occupational Pensions Authority (EIOPA), replacing CEIOPS;
- a Regulation creating a European Securities and Markets Authority (ESMA), replacing CESR;
- a Regulation creating the ESRB;
- a Council decision laying down the role of the European Central Bank in the ESRB, i.e. entrusting the ECB with the ESRB Secretariat.

These proposals are accompanied by an impact assessment and a Commission Staff Working Paper. The latter highlights potential amendments to existing Community law, in order to align them with the proposed Regulations and define/clarify precise powers of the European Supervisory Authorities in two specific areas for making proposals for binding technical standards. An Omnibus Directive comprising these changes will be proposed before the end of October 2009.

The ESRB will have the power to issue recommendations and warnings to Member States (including the national supervisors) and to the European Supervisory Authorities, which will have to comply or explain why they have not done so. The heads of the ECB, national central banks, the European Supervisory Authorities, and national supervisors, will participate in the ESRB. The creation of the ESRB is in line with several initiatives at multilateral level or outside the EU, including the creation of a Financial Stability Board by the G20.

The new Authorities will take over all of the functions of the level 3 committees, and in addition have certain extra competences, including the following:

- Developing proposals for technical standards, respecting better regulation principles;
- Resolving cases of disagreement between national supervisors, where legislation requires them to co-operate or to agree;
- Contributing to ensuring consistent application of Community rules (including through peer reviews);
- The European Securities and Markets Authority will exercise direct supervisory powers for Credit Rating Agencies;
- A coordination role in emergency situations, with the possibility to take certain decisions in emergency situations (triggered by the Commission).

The proposals have been the subject of extensive consultation both after the publication of the recommendations by a group of experts mandated by President Barroso and chaired by Jacques de Larosière and between the end of May and mid July 2009, after the Commission outlined its proposals to the European Council. The June EU Summit endorsed the new supervisory framework and called for the rapid adoption of the necessary legislative texts. The draft Regulations foresee 2011 as the first year of operation of the ESRB and ESAs, and the draft Regulations should come into effect on 1 January 2011.



Proposal for a Directive on Alternative Funds Managers

The [proposal](#) for a Directive on Alternative Investment Fund Managers (AIFM) adopted by the Commission on 29th April 2009, forms an important part of the EU's regulatory response to the financial crisis, and aims to create a comprehensive and effective regulatory and supervisory framework for 'AIFM' in the EU.

Since the adoption of the draft AIFM Directive the European Commission has entered into the inter-institutional discussions in particular with the Council Working Group (CWG). Under the Swedish Presidency the CWG completed a first read-through and will now enter in discussions about amendments to the Commission draft. Rules on independent valuation and the depositary are, besides the question in how far funds and fund manager located in third countries should have access to the EU internal market, among the most heavily debated issues.

The European Parliament nominated Mr. Gauzes (EPP, FR) as rapporteur for the AIFM proposal. A first discussion took place in the European Parliament's ECON committee on 2 September. The next one will take place on 6 October. The Parliament intends to organize a hearing on 9-10 November. Votes in the Committee and Plenary are respectively scheduled for April and July 2010.

Proposal for the Review of the Prospectus Directive

In line with the "Better Regulation" principles, the European Commission has put forward a [proposal](#) for the review of the Prospectus Directive. The proposal is part of simplification exercise within the Action Program of the European Commission for the Reduction of Administrative Burdens in the European Union. The proposal increases legal clarity and efficiency in the prospectus regime and reduces administrative burdens for issuers and intermediaries. It also bears in mind the importance of enhancing the level of investor protection and ensuring that the information provided is sufficient and adequate to cover the needs of retail investors. It reflects consultation with all major stakeholders. The proposal now passes to the European Parliament and the Council of Ministers for consideration.

The new rules will make securities issues more efficient by making the rules easier to understand (greater legal clarity); reducing administrative burdens for issuers and intermediaries; giving issuers' employees access to a full range of investment opportunities; and helping retail investors more effectively analyse the prospects and risks posed by a security before investing.

The main changes proposed are as follows: some types of securities issue will be subject to less comprehensive disclosure requirements (small companies, small lenders, rights issues and government guarantee schemes); the format and content of the prospectus summary have been improved; there are clearer exemptions from the obligation to publish a prospectus when companies sell through intermediaries ("retail cascades") and for employee share schemes; disclosure requirements that currently overlap with the Transparency Directive will be repealed; issuers of all non-equity securities will be able to determine their home Member State; the definition of 'qualified investors' in the [Prospectus Directive](#) will be aligned with the one of 'professional clients' as defined in the [Directive on Markets in Financial Instruments](#).

Negotiations in Council started on 2nd October; the SV Presidency is keen to reach a common approach on this proposal before the end of this term. The European Parliament will appoint the rapporteur for this proposal before the end of October.



Remuneration Policy in the Financial Services Sectors

Following the Commission's April Communication and the two Recommendations on remuneration issues, the Commission adopted on 13th July a [proposal](#) to further amend the Capital Requirements Directive (CRD). The proposal tackles, inter alia, perverse pay incentives by requiring banks and investment firms to have sound remuneration policies that do not encourage or reward excessive risk-taking. This requirement is backed by several principles on sound remuneration policies. Banking supervisors will be required to oversee remuneration policies and given the power to sanction banks with remuneration policies that do not comply with the new requirements. The new rules will apply to all EU credit institutions and investment firms. They cover staff whose activities have material impact on the risk profile of the financial institution.

At international level, the G20 meeting of the finance ministers on 5th September called on the Financial Stability Board (FSB) to build on and strengthen its existing principles on pay (adopted in April), including their incorporation into supervisory measures, in the following areas:

- Greater disclosure and transparency of the level and structure of remuneration for those whose actions have a material impact on risk taking;
- Global standards on pay structure, including on deferral, effective clawback, the relationship between fixed and variable remuneration, and guaranteed bonuses, to ensure compensation practices are aligned with long-term value creation and financial stability;
- Corporate governance reforms to ensure appropriate board oversight of compensation and risk, including greater independence and accountability of board compensation committees.

On 25th September, the FSB adopted new implementation [standards](#) in response to the aforementioned request. G20 leaders at the Pittsburgh summit fully endorsed the implementation standards in their final communiqué. They also tasked the FSB to review actions taken by firms and by national authorities to implement the FSB Principles and these standards and propose additional measures as required no later than March 2010.

Level 2 Measures for the new UCITS Directive

On 24 September 2009 the IMEG accepted the main part of the draft technical advice on the UCITS level 2 measures related to the management company passport and the key investor information (KII) (parts I and II of the mandate). This decision paved the way to the adoption of the advice by CESR Chairs scheduled for 16 October 2009 and handing it out to the Commission before 30 October 2009 as foreseen in the Commission mandate.

CESR's technical advice on level 2 measures related to mergers of UCITS, master-feeder structures and cross-border notification of UCITS, together with the methodology for the synthetic risk and reward indicator and on-going charges (part of the CESR's advice on KII) are to be adopted in December 2009. The Commission level 2 measures related to the risk measurement are to be accompanied by guidelines which CESR plans to adopt by the end of June 2010 so that the 'single package' approach could be maintained.

Soon after the delivery of the first part of the CESR's technical advice, the Commission services intend to engage the ESC into the discussion on the form and content of the level 2 measures.



We also hope to commence an informal dialogue with the European Parliament around the same time.

As the Commission is legally obliged to adopt level 2 measures in the areas of organisational requirements/conflict of interests, conduct of business and risk management by 1 July 2010 we would like to have first, informal exchange of views with the ESC members, based on a Commission working document, already in December 2009. We hope to continue informal consultations in January before we launch the formal comitology process in February 2010.

Packaged Retail Investment Products

The collapse in retail investor confidence during the financial crisis has given new prominence to work the Commission was already doing on level-playing field and investor protection issues in the retail investment market. Retail investors often poorly understand the risks, costs and features of investment products and those selling products can be subject to significant conflicts of interest. Also, existing rules on information for prospective investors and the conduct of those selling to them form a patchwork that exposes significant gaps and inconsistencies in approach depending on the legal form of a product (rather than its economic nature).

The Commission concluded in its 29th April 2009 Communication on Packaged Retail Investment Products (PRIPs) that it was vital, therefore, to take steps to improve regulatory protections for retail investors, so that the appropriate requirements apply irrespective of the legal form a product takes. The Commission committed itself to developing a new, horizontal legislative approach, drawing on the best of existing requirements but applying these to all relevant products and sales channels 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.

Since the Communication did not contain detailed legislative proposals, the Commission has subsequently been working on preparing the ground for more detailed proposals, and is talking to a wide range of stakeholders, including consumer representatives and representatives of the different industry sectors involved. A specific workshop has been organised on 22nd October. The Commission appreciates the cooperation with CESR, CEIOPS and CEBS in the development of this work.

The Commission aims to publish a further orientation on the work by the end of 2009.

Consultation on Depositories

On 3 July 2009, the Commission launched a public consultation on the tasks and responsibilities of the UCITS depository. The decision to launch such a consultation was taken in the context of the post Madoff fraud by which UCITS investors have been affected by the loss of their assets transferred to the fraudulent entity in the US. This situation has underlined divergences in the understanding of the duties and the level of liability applicable to UCITS depositories in several Member states.

The Commission consultation also refers to the proposal for a Directive on Alternative Investment Fund Managers. This proposal includes stronger requirements governing depositories and their liability.

The consultation addresses the following issues: depository's tasks and duties, the responsibility regime, organisational requirements, eligibility criteria and supervision. The consultation also covers issues which are not directly linked with depositories duties but which are particularly



relevant for ensuring an increased level of investor protection within the UCITS framework (for example valuation).

This consultation is an important step towards the identification and shaping of the European response to vulnerabilities emanating from the UCITS depositary sector, with a view to improving the level of protection for UCITS investors.

Deadline for contributions expired on 15 September. So far, about eighty contributions have been received and are currently being processed. A feedback statement will be published by the Commission in November.

Public Consultation and Conference on Derivatives Markets

The publication of the Communication on "Ensuring efficient, safe and sound derivatives markets" marked the launch of a public consultation. The consultation sought views from interested parties both on the issues and the possible solutions to those issues highlighted in the Communication and the consultation document. The Commission received a total of 112 replies. Those replies for which approval for publication was granted can be found at http://ec.europa.eu/internal_market/consultations/2009/derivatives_en.htm.

The consultation period was concluded with a conference organised by the Commission on 25 September in Brussels. The conference was attended by over 400 participants. High level speakers from European and US authorities, as well as industry and academia presented their views on the issues and on potential solutions and ensured a lively debate with the audience. The next steps involve the Commission publishing a Communication by end-October in which broad policy orientations will be indicated. Concrete legislative proposals will most likely follow in 2010 under the next Commission. The reviews of MAD and MiFID will proceed in parallel, covering relevant parts of the work which needs to be carried out.

Latest Developments on Credit Default Swaps (CDS)

The major dealers have delivered on their commitment to start clearing European referenced index credit default swaps (CDS) on European CCPs by 31 July. They still need to meet their commitment to start clearing European single-name CDS and to put legacy contracts onto a CCP. The Commission will closely monitor that these parts of the commitment will be respected as well.

Currently, two European CCPs provide clearing solutions for CDS: London-based ICE Clear Europe and Frankfurt-based Eurex Clearing. ICE Clear Europe started to clear CDS indices on 27 July. It has so far cleared 7,502 contracts accounting for €377bn in volumes (in the US, ICE Trust has cleared USD2.2 trillion since its launch in March this year). Eurex Clearing launched on 30 July for CDS indices and a number of single names contracts. So far it has cleared only 4 transactions with a notional value of €90m, of which one single name.

Promising Results at G20 Pittsburgh Summit

On 24 and 25 September, the Pittsburgh G20 Leaders summit was held, focussing on the need for a global coordinated response to the financial crisis. The summit was a success; it added another milestone to a globally coordinated financial services reform process. But much work



still lies ahead. The EU and other jurisdictions have to implement the agreed measures quickly and consistently.

The main decisions taken at Pittsburgh are the following:

- On banking prudential rules, the G20 countries have agreed to develop international rules before the end of 2010 to improve the quality and the quantity of bank capital and to discourage excessive leverage. All major G20 financial centres committed themselves to adopt the internationally agreed rules on banking prudential requirements, known as Basel II, by 2011, in order to avoid regulatory arbitrage.
- On compensation in the financial industry, they reached a comprehensive agreement facilitated by the Financial Stability Board (FSB) to align compensation with long-term value creation. Detailed implementation standards were developed on pay structure, corporate governance arrangements and enhanced disclosure on remuneration policies. The strict monitoring of the implementation by all financial firms will now be crucial to ensure a global level playing field.
- On derivatives markets, the G20 decided that standardised contracts should be cleared through central counterparties, trade transactions should be reported to trade repositories and non-centrally cleared contracts should be subject to additional capital requirements. Increased price transparency of different trading centres is also important. The Commission will release detailed propositions on these issues before the end of the year.
- The FSB, created as a result of the London G20 Summit of April 2009, played a key role in preparing the financial services agenda for the Pittsburgh summit.
- The FSB will continue to build on this momentum. It will exert a tight monitoring of the commitments, apply peer pressure and report to the next G20 meetings any delays or any incomplete implementation. DG Internal Market and Services will continue to represent the Commission in the FSB as an active and committed participant. A coordinated, quick and consistent implementation of the G20 commitments is of paramount importance.