EUROPEAN
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FINANCIAL
SERVICES
FORUM

FORUM

BRIEFING PAPER COMPENDIUM ON FINANCIAL SERVICES ISSUES

2008 - 2009

EPFSF

BRIEFING PAPER COMPENDIUM ON FINANCIAL SERVICES ISSUES 2008-2009

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Wolf Klinz MEP
Chair, Steering Committee (2009-)

"The recent financial crisis turned out to be of a truly global nature. If the Member States of the European Union want to participate actively in shaping the future architecture of the financial markets, they have to speak with one voice. The European Parliament will have to take additional legislative measures which should help to defend European interests and at the same time increase market stability and investor protection. To achieve this objective the Members of the European Parliament need a very close and constructive dialogue with members of the financial services industry. The EPFSF is the ideal forum for such a regular exchange of ideas, concepts and practical knowledge. I am delighted to be able to monitor this dialogue as the Chairman of the EPFSF."

Peter Skinner MEP
Vice-Chair, Steering Committee (2009-) and Former Chair (2007-2009)

"As only the third chair and a founding member of the steering committee, it is particularly pleasing to see the EPFSF continue to develop as a platform for a dialogue on financial issues. In an increasingly smaller financial world the impact of regulators' decisions in the EU, and elsewhere, have a direct bearing on the competitiveness of companies and safeguards for consumers. It is no small feat that this platform has successfully facilitated open and transparent discussions of these crucial issues in a timely manner. I look forward to working with my colleagues and the staff of the EPFSF as chair for the remainder of my mandate and for the positive good of the industry and consumers alike."

Guido Ravoet
Chair of the EPFSF Financial Industry Committee (2007-)
Secretary General, European Banking Federation

"As the Chairman of the EPFSF Industry Committee, I have been through a very interesting time with colleagues and Members of the European Parliament. I can only look forward to exchanging more ideas and knowledge on the shaping of the new landscape for financial services, as we are now facing what we hope to be a first economic rebound. Cooperation is crucial for us all, policy makers and industry representatives alike, and only a transparent exchange of views will help shape the best possible new structures, standards and practices to prevent future crises. The EPFSF is a very useful and efficient tool to ensure this transparent dialogue."

About the Forum

History
The European Parliamentary Financial Services Forum was founded in May 2000 to foster a dialogue between the European Parliament and the financial services industry. It provides a forum for an open and informal discussion of the policy issues affecting financial services.

Who are we?
The Forum is a not for profit organization under Belgian law (ASBL). The principal purposes of the Forum are:

- to promote integration of a single European market for financial services across national borders, which is globally competitive and to the benefit of the European economy as well as suppliers and consumers of financial services;

- to provide a focal point and resources for Members of the European Parliament interested in financial services issues as well as a forum for industry-Parliamentary dialogue;

- to deploy the joint expertise of its financial industry Members to spread factual information about financial markets and services to the European Parliament via briefs, meetings, study visits and other regular activities as appropriate.

The Forum's website contains extensive public information about the activities of the Forum, its objectives and how to join. Membership is open to those who meet the membership criteria, including supporting integration of EU financial markets.

What are the main activities of the Forum?
The Forum organises events for an open and informal industry-Parliamentary discussion, and provides a focal point and resources for Members of the European Parliament interested in issues affecting financial services. The EPFSF events, organised on a monthly basis, are attended by MEPs, members of the ECON Secretariat of the European Parliament, Parliamentary assistants, Commission officials and representatives of the financial services industry who are members of the Forum. In practice, two speakers briefly present the issue and MEPs subsequently ask questions and discuss the presentations.

What is the structure of the Forum?
The Steering Committee, composed of MEPs from the EPP-ED, Socialist, and ALDE Groups, gives direction to the activities of the Forum. The Financial Industry Members undertake the task of arranging and inviting speakers, writing short briefing papers, working out a programme, and managing the secretariat. Members elect an Administrative Committee (AC) of no more than 12 members each year at the Annual General Meeting. The AC has been given responsibility for regular liaison with the Steering Committee on the role of the Forum, the agenda of meetings and the progress on meetings; for managing the business of the Forum; for appointing outside consultants, if needed; for deciding on applications for membership; and for convening meetings.

The EPFSF has currently 54 financial industry members (see section on Financial Industry Members or our website www.epfsf.org).

About this booklet

This booklet is intended to provide a report on the activities of the Forum, as well as a briefing pack on recent financial services issues. The Compendium brings together the briefing papers prepared by financial industry members to provide background information for meetings.

The topics of our discussions were chosen to reflect issues relevant for MEPs as the legislative process advanced, but also include more general political issues. They therefore provide a substantive picture of the work of the Parliament over the last year.

Each briefing paper contains factual information on the issue, explaining the political and technical aspects to be taken into account by legislators. The aim is to provide an up-to-date and comprehensive overview on recent developments and initiatives in a short summary laying out the issues of the policy debate.

In this booklet the papers have been ordered chronologically. We hope that they provide a useful tool for reviewing the work carried out in the Parliament, as well as a forward-looking tool for future debates.

2008

PROGRAMME 2008-2009 - Topics and speakers

26 February

EU/US Financial Market Dialogue
MEP Chair: Sharon Bowles
- Steffen Kern, Director, International Financial Markets Policy, Deutsche Bank AG, and Co-Chairman, Capital Markets Working Group, TABD
- Michael Peters, member of the Executive Board, EUREX

26 March

Financial Education and Financial Capability
MEP Chair: Olle Schmidt
- Dara Duguay, Director, Office of Financial Education, Citi
- Diederick van Thiel, Head of Consumer Marketing, Retail Banking Netherlands, ING

1 April

Electronic Payments: Moving to a cashless society?
Joint event with the European Internet Foundation (EIF)
MEP Chair: Piia-Noora Kauppi
- Erkki Liikanen, Governor of the Bank of Finland
- Mark Buitenhek, General Manager, Retail Payments Europe, ING
- Dag-Inge Flatraaker, General Manager, DnB NOR; Chairman, Expert Group on e-commerce and mobile channels and payments (e&m), European Payments Council (EPC)
- Mung Ki Woo, Vice President, Payments & Contactless, France Telecom – Orange
- Olivier Cognet, Vice President, Strategy and Business Development, Nokia

8 May

Financial Turbulence: Lessons to be learned
MEP Chair: Ieke Van den Burg
- Francesco Giordano, Chief Economist, UniCredit
- Freddy van den Spiegel, Chair, Consultative panel, Committee of European Banking Supervisors (CEBS)

3 June

Supervisory Convergence
MEP Chair: Pervenche Berès
- Helmut Bauer, Managing Director/Head of Regulatory Affairs, Deutsche Bank
- Luigi Ruggerone, Head of Country Risk and Foreign Subsidiaries, Intesa Sanpaolo

16 July

MiFID Implementation
MEP Chair: Sophie In't Veld
- Philip Allison, Managing Director, Member of the UBS Investment Bank Management Board, Head of European Client Trading and Execution; Director, Turquoise Services Ltd
- Nigel Kemp, Senior Legal Advisor for MiFID implementation across the EMEA region, Citi
- Adam Kinsley, Director of Regulation, London Stock Exchange

10 September

What are the benefits of Solvency II?
MEP Chair: Piia-Noora Kauppi
- Philip Long, Head of Group Risk, Prudential, Member of the Chief Risk Officers' Forum
- Jos Streppel, Chief Financial Officer, Aegon; Chairman, ECOFIN Committee, CEA

7 October

CRD: Understanding the changes – and why?
MEP Chair: John Purvis
- Jörg Erlebach, Managing Director, Head of Global Credit Risk and Economic Capital Control, Commerzbank Group
- Christian Lajoie, Head of Group Supervision Issues, BNP Paribas

4 November

Will changes to the UCITS Directive open the market?
MEP Chair: Wolf Klinz
- Francis Candylaftis, Chief Executive Officer and General Manager of Eurizon Capital (Intesa Sanpaolo's asset management company)
- Jean-Pierre Hellebuyck, Vice Chairman and Chief Investment Strategist, AXA Investment Managers

2 December

Understanding current commodities markets
MEP Chair: Sharon Bowles
- Paul Horsnell, Managing Director, Head of Commodities Research, Barclays Capital
- Simon Martin, Senior Business Analyst, ICE Futures Europe; and Chair, FESE Derivatives Task Force

2009 PROGRAMME 2008-2009 - Topics and speakers

21 January

Financial Turmoil: Next steps in the EU
MEP Chair: Olle Schmidt
- Bernd Brabänder, Managing Director, Economic Affairs, EU Policy and International Relations, Bundesverband deutscher Banken (BdB), and Chair, Task Force "Financial Turmoil", European Banking Federation (EBF)
- José Luis Escrivá, Chief Economist, Banco Bilbao Vizcaya Argentaria

11 February

A new framework for Credit Rating Agencies
MEP Chair: Ieke Van den Burg
- Ian Bell, Managing Director for European Structured Finance Ratings, Standard and Poor's
- Olivier Irisson, Head of Rating System and Capital, Société Générale

31 March

Protecting EU retail investors: More to be done?
MEP Chair: Manuel Medina Ortega
- Pedro Alonso Gil, Executive and Vice President, Banco Santander
- Heiko Beck, Managing Director and Head of Product Management, Commerzbank
- Thomas Rostron, representative of APCIMS – Association of Private Client Investment Managers and Stockbrokers; Managing Director and Global Head of Retail Investment Products, Barclays Wealth

The Members of the European Parliament who form the Steering Committe of the Forum come from various political backgrounds and Members States. The Steering Committee is an advisory committee and provides input on the general direction of the Forum in the light of the Parliamentarian's needs and the parliamentary work programme. It also advises on the functioning and character of the Forum, and ensures its multi-party outlook.

Zsolt László Becsey MEP
(EPP-ED/Hungary)

Pervenche Berès MEP
(PES/France)

Sharon Bowles MEP
(ALDE/UK)

Daniel Daianu MEP
(ALDE/Romania)

Manuel António dos Santos MEP
(PES/Portugal)

Jonathan Evans MEP
(EPP-ED/UK)

Robert Goebbels MEP
(PES/Luxembourg)

Piia-Noora Kauppi MEP
(EPP-ED/Finland)

Wolf Klinz MEP
(ALDE/Germany)

Astrid Lulling MEP
(EPP-ED/Luxembourg)

Gay Mitchell TD MEP
(EPP-ED/Ireland)

Alexander Radwan MEP
(EPP-ED/Germany)

Dariusz Rosati MEP
(PES/Poland)

Olle Schmidt MEP
(ALDE/Sweden)

Peter Skinner MEP
(PES/UK)

Ieke van den Burg MEP
(PES/Netherlands)

Sophia in 't Veld MEP
(ALDE/Netherlands)

32 major European financial institutions and 22 trade federations are currently Members of the European Parliamentary Financial Services Forum (EPFSF). Membership is open to all those who are able to subscribe fully to the objectives of the Forum, including particularly supporting the establishment of a single integrated European market for financial services. Members prepare the programme of meetings and briefing papers for these events.

Founded in 1990, the Alternative Investment Management Association (AIMA) is the only global hedge fund association representing all practitioners in the alternative investment management industry – including hedge fund managers, fund of hedge funds managers, prime brokers and other service providers. AIMA's membership is corporate and comprises over 1,100 firms in more than 40 countries, with its hedge fund manager members managing in excess of 75% of global hedge fund assets and 70% of global fund of hedge funds assets. AIMA's focus on education, regulation, policy development and sound practices has resulted in a substantial body of work used around the world by members, institutional investors, policymakers and regulators.

AMICE is the Association of Mutual Insurers and Insurance Cooperatives in Europe. Its prime purpose is to ensure that the voice of the mutual and cooperative insurance sector in Europe is heard and that the interests of its members are taken into account in securing a level playing field for all insurers in Europe regardless of their legal form. Currently, AMICE has 125 full members, 2 associate members and 2 observers, from 17 countries.

APCIMS is the Association of Private Client Investment Managers and Stockbrokers, which also incorporates the European Association of Securities Dealers. APCIMS' 200 or so member firms have more than EUR 500 billion under management and undertake 13 million trades a year for the private investor.

The AXA Group is a global player in Financial Protection business. We offer our customers-individuals as well as small, mid-size and large businesses - a wide range of product and services that meet their insurance, protection, savings, retirement and financial planning needs throughout their lives. In 2007, the AXA Group had 174.935 employees. Consolidated revenues for 2008 totalled EUR 91,2 billion, with assets under management of EUR 981 billion. AXA operations are concentrated in Western Europe, North America and Asia Pacific.

Barclays is a major global financial services provider engaged in retail and commercial banking, credit cards, investment banking, wealth management and investment management services, with an extensive international presence in Europe, the USA, Africa and Asia. With over 300 years of history and expertise in banking, Barclays operates in over 50 countries and employs 155,000 people. Barclays moves, lends, invests and protects money for over 48 million customers and clients worldwide.

The British Bankers' Association (BBA) is the leading association for the UK banking and financial services sector, speaking for 223 banking members from 60 countries on the full range of UK or international banking issues and engaging with 37 associated professional firms. Collectively providing the full range of services, our member banks make up the world's largest international banking centre, operating some 150 million accounts and contributing £50 billion annually to the UK economy.

Banco Bilbao Vizcaya Argentaria (BBVA) is a global financial group with a solid position in the Spanish market and a leading franchise in Latin America. The 86,000 people making up the BBVA group look after 35 million customers in 35 countries through a network of 7,000 branches, managing 400 billion euro of assets.

BNP Paribas is a European leader in banking and financial services, with leading positions in Asia and an active presence in the United States. It is the first bank in terms of net income and market capitalisation in the Euro zone. The group has one of the largest international banking networks with a presence in 85 countries and 90,000 employees world-wide.

The CEA has 33 members; the national insurance associations of the 27 EU member states and six non-EU countries (Croatia, Iceland, Liechtenstein, Norway, Switzerland and Turkey). It also has two observer members, Russia and Ukraine. The CEA represents companies that account for approximately 95% of all insurance premium income in Europe. They employ roughly one million people. In 2007 they generated premium income of euro 1 183bn, and invested over euro 7 200bn in the economy. The European insurance market, as represented by the CEA, is the largest in the world with a market share of over 40%, followed by the US with 30%. The CEA aim is to be the voice of the European insurance industry, both within Europe and beyond.

CFA Institute is an international, non-profit organisation of more than 95,000 investment professionals. The growing European membership of about 12,000, with affiliate CFA societies formed in 20 EU member states, provides the organisation with a truly European perspective on financial market issues. CFA Institute runs the Chartered Financial Analyst, or CFA, educational programme and examination leading to the CFA Charter which, with its strong focus on ethics and standards of professional conduct is the global benchmark qualification in the research analysis and asset management sectors. Its mission is to be a leading voice on issues of fairness, efficiency, and investor protection in global capital markets and to promote high standards of ethics, education and professional excellence within the investment community.

Citi, the leading global financial services company, has approximately 200 million customer accounts and does business in more than 140 countries. Through its two operating units, Citicorp and Citi Holdings, Citi provides consumers, corporations, governments and institutions with a broad range of financial products and services, including consumer banking and credit, corporate and investment banking, securities brokerage, and wealth management. Within the EU, Citigroup is the leading pan-EU financial services provider, on the ground in 21 of the 27 member states and providing financial services in every EU country; the company employs some 30,000 people and manages over 6 million client accounts. Additional information may be found at www.citigroup.com or www.citi.com.

With a consolidated balance-sheet total of more than EUR 609.7 bn (as of Sep. 30, 2006), Commerzbank is Germany's second-largest private-sector Bank and one of Europe's leading financial institutions. Its 36,000 employees, 8,200 of whom work outside Germany, look after more than 8 million customers. Apart from the parent bank, Commerzbank AG, the Group consists of numerous subsidiaries in Germany and abroad.

Crédit Agricole S.A. is a leading international banking and insurance group with total assets of EUR 1.414 billion (as of 31 December 2007). It is present in 70 countries worldwide (28 countries in Europe) and servicing more than 40 million customers through a network of 10,700 branches. The group employs 160.000 people worldwide and offers a wide range of financial services, including retail banking, consumer finance, insurance, asset management, private banking, leasing, factoring and corporate and investment banking.

Deutsche Bank is a leading international financial service provider with total assets of EUR 2,061 billion and shareholders' equity of EUR 34.8 billion (as of 30 September 2008). With 81,000 employees, more than half of them working abroad, Deutsche Bank serves 21 million customers in 75 countries.

Deutsche Börse Group is far more than a mere marketplace organizer for the trading in shares and other securities. It is one of the largest exchange organizations worldwide. With advanced technology it affords companies and investors access to the world's capital markets. Its product and service portfolio covers the entire process chain: including securities and derivatives trading and clearing, netting and transaction settlement, custody, the provision of market information, as well as the development and operation of electronic trading systems. With its process-oriented business model, Deutsche Börse increases the efficiency of capital markets. About 3,300 employees service customers in Europe, America and Asia. Deutsche Börse has locations in Germany, Luxembourg, Switzerland, Spain, Czech Republic and the USA, as well as representative offices in Beijing, Chicago, Dubai, Hong Kong, Lisbon, London, Moscow, New York, Paris, Singapore and Tokyo.

The European Association of Public Banks is the only European banking association that represents public banks and funding agencies and their specific tasks at the European level. EAPB has members from various European countries representing about 100 financial institutions. EAPB members constitute an essential part of the European financial sector, in which they play a decisive role with a market share of approximately 15 %, a balance sheet of about EUR 3.5 billion and around 200 000 employees. Members of the EAPB are financial institutions, funding agencies, public banks, associations of public banks and banks with similar interests. The EAPB is a member of the European Banking Industry Committee (EBIC) through which the seven main European banking associations represent their interests collectively towards the European institutions.

The European Banking Federation (EBF) is the voice of European banks. It protects and promotes the interests of over 5000 European banks, large and small, wholesale and retail. Created in 1960, the EBF brings together 31 national Banking Associations, from EU Member States and EFTA countries, as well as 12 national Banking Associations from broader Europe with Associates' status.

The European Fund and Asset Management Association (EFAMA) is the representative association for the European investment management industry. EFAMA represents through its 26 member associations and 44 corporate members about EUR 11 trillion in assets under management of which EUR 6.1 trillion managed by 54,000 investment funds at end 2008.

The mission of EFAMA is to:

- Support a high level of investor protection through the promotion of high ethical standards, integrity and professionalism throughout the industry;
- Promote the completion of an effective single market for investment management and the creation of a level playing field for competing saving and investment products;
- Strengthen the competitiveness of the industry in terms of cost and quality through seeking and obtaining improvements in the legal, fiscal and regulatory environment.

The European Federation for Retirement Provision represents the national associations of pension funds and similar institutions for supplementary/occupational pension provision. Its membership at large consists of institutions for occupational (2nd pillar) retirement. Some of them are also operating purely individual pension schemes (3rd pillar). The EFRP affiliates 29 national associations across Europe. In the Central & Eastern European region it affiliates Hungary, Romania, Slovakia as well as Croatia. Within EFRP the Central & Eastern European Countries Forum (CEEC Forum) has been established (26 October 2006) to discuss issues common to pension systems in that region. Most EFRP members are non-profit making institutions. Their governance structures usually include the scheme members and beneficiaries representation. Many of them are managed on a paritarian basis between unions/employees and employers. 73 million EU citizens are covered for their occupational pension plan by EFRP Members. Through its Member Associations the EFRP represents approximately 3 trillion euro of assets (2007) managed for future occupational pension payments.

Founded in 1967, the European Mortgage Federation (EMF) represents the interests of mortgage lenders at EU level on both the retail and funding side. It groups national associations and individual lenders from amongst the EU 27 and the Accession Countries. Together, its members grant over 75% of residential and commercial mortgage loans in Europe. The mortgage industry is a key sector in the EU's general economy, with the volume of mortgage loans outstanding exceeding 6.1 trillion euro at the end of 2007. The Federation is the key-talking partner of the European Institutions and other financial services stakeholders on all questions relating to the mortgage industry. In 2004 the EMF established the European Covered Bond Council (ECBC), which represents that interests of stakeholders in the covered bond industry, which was worth over EUR 2.1 trillion at the end of 2007, at the international level. The members of the ECBC include covered bond issuers, analysts, investment banks and rating agencies.

ESBG is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of EUR 4,716 billion (1 Jan. 2005). It represents the interests of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects. ESBG members are typically savings and retail banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their region. ESBG members banks have been reinvesting responsibly in their region for many decades and they are a distinct benchmark for corporate social responsibility activities throughout Europe and the world.

Euroclear is the world's largest provider of domestic and cross-border settlement and related services for bond, equity and fund transactions. Headquartered in Brussels, the Euroclear group comprises Euroclear S.A., Euroclear Bank, Euroclear France, Euroclear Belgium, Euroclear Nederland, Euroclear Finland, Euroclear Sweden, Euroclear UK and Ireland, EMXCo and Xtrakter. The total value of securities transactions settled is in excess of EUR 300 trillion per annum, while assets held in custody are valued at more than EUR 13 trillion.

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world. With approximately 1150 members in Europe, EVCA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics. EVCA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

The Federation of European Accountants (Fédération des Experts comptables Européens - FEE) represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 qualified accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

The Federation of European Securities Exchanges (FESE) represents public Regulated Markets which includes 42 exchanges in equities, bonds, derivatives and commodities from all EU Member States, Iceland, Norway and Switzerland as well as 7 Corresponding Members from European emerging markets. Regulated Markets provide both institutional and retail investors with transparent and neutral price-formation. Securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws.

The Futures and Options Association (FOA) is a London-based European industry association comprising 160 international banks and other major financial institutions, brokerage houses, commodity dealers and energy and power market participants, exchanges and clearing houses engaged in derivatives business. Its primary role is to monitor and respond to legislative, regulatory and tax changes at national, European and international levels; to promote and adopt international standards in regulation and risk management; and to deliver high industry standards through workshops, seminars, courses and the issuance of guidance, practice notes and standardised industry documentation.

Fortis is a leading Benelux-based financial services provider with European aspirations. Total assets are of EUR 523.25 bn (as at 31 December 2003). Fortis has hundreds of branches in more than 50 countries and has a staff of about 54,000 employees worldwide.

Goldman Sachs is a leading global investment firm that supplies a wide range of investment banking, asset management and securities services. We seek to create value for our clients worldwide through innovative solutions that strengthen the global capital markets and support sustainable economic growth. We maintain offices in the major financial centres, including New York, London, Frankfurt, Paris, Tokyo and Hong Kong.

The International Capital Market Association is a unique self regulatory organisation and an influential voice for the global capital market. It represents a broad range of capital market interests including global investment banks and smaller regional banks, as well as asset managers, exchanges, central banks, law firms and other professional advisers amongst its 400 member firms. ICMA's market conventions and standards have been the pillars of the international debt market for over 40 years, providing the self regulatory framework of rules governing market practice which have facilitated the orderly functioning and impressive growth of the market. ICMA actively promotes the efficiency and cost effectiveness of the capital markets by bringing together market participants with regulatory authorities and governments.

ING is a global financial institution of Dutch origin offering banking, investments, life insurance and retirement services. We serve more than 85 million private, corporate and institutional customers in Europe, North and Latin America, Asia and Australia. We draw on our experience and expertise, our commitment to excellent service and our global scale to meet the needs of a broad customer base, comprising individuals, families, small businesses, large corporations, institutions and governments.

The Intesa Sanpaolo Group, the leading banking group in Italy, is the result of the merger, effective as of January 1st 2007, of Sanpaolo IMI into Banca Intesa - two banks that before merging had played major roles in the consolidation process of the Italian banking industry. The Group enjoys strategic coverage and commercial effectiveness in Central-Eastern European markets where it is currently positioned among the top players in several countries. In fact, through its local subsidiaries, the Group ranks second in Albania, Croatia, Serbia and Slovakia, third in Hungary, fifth in Bosnia and Herzegovina and sixth in Slovenia and Ukraine, while it is strengthening the foundations for growth in new areas such as the Mediterranean Basin with the recent acquisition of control of Bank of Alexandria, the third largest bank in Egypt.

The International Swaps and Derivatives Association is the global trade association representing participants in the privately negotiated derivatives industry, a business covering swaps and options across all asset classes (interest rate, currency, commodity and energy, credit and equity). ISDA today numbers over 600 member institutions from 46 countries on six continents.

J.P. Morgan is the investment bank of JPMorgan Chase & Co., a leading global financial services firm with assets of $2.1 trillion and operations in more than 60 countries. Our firm has had a presence in Europe since the middle of the 19th century and has more than 15,000 employees in 17 European countries. The firm is a leader in investment banking, financial services for consumers and small businesses, commercial banking, financial transaction processing, asset management, and private equity.

LCH.Clearnet is the leading central counterparty (CCP) group in Europe, serving major international exchanges and platforms, as well as a range of OTC markets. It clears a broad range of asset classes including: securities, exchange traded derivatives, energy, freight, interbank interest rate swaps and euro and sterling denominated bonds and repos; and works closely with market participants and exchanges to identify and develop clearing services for new asset classes.

London Investment Banking Association (LIBA) is the principal trade association in the United Kingdom for firms which are active in the investment banking and securities industry. LIBA represents the London offices of investment banks from around the world. At 1st October 2008 LIBA counted 57 members.

Lloyd's is the world's leading specialist insurance and reinsurance market and its 80 syndicates wrote almost £18bn of business, covering all classes of business, from more than 200 countries and territories worldwide. Lloyd's is regulated by the Financial Services Authority.

Lloyds Banking Group is a leading UK-based provider of financial services. Its business is organised in four divisions: Retail is responsible for all our retail banking activities, main brands including Lloyds TSB, Bank of Scotland, Halifax, and C&G. Wealth & International is a recently-created division, whose main functions include private banking for high net-worth individuals, asset management through our subsidiary Scottish Widows Investment Partnership, and international banking. Wholesale works with corporate and commercial customers, and operates primarily through Bank of Scotland and Lloyds TSB, also trading through brands such as Lloyds Development Capital and Black Horse. The Insurance division encompasses general insurance and life, pensions and investments activities, main brands including Scottish Widows and Clerical Medical.

MasterCard Europe is the European regional office of MasterCard International. With headquarters in Waterloo, Belgium, MasterCard Europe works with 51 European countries organized administratively into four customer areas: northern, central, eastern and southern. Through its network of local offices, MasterCard Europe can understand and meet the diverse needs of members in the very different types of markets throughout Europe, enabling people to do business in their own way in their own language.

Merrill Lynch is one of the world's leading wealth management, capital markets and advisory companies with offices in 37 countries and territories and total client assets of approximately $1.5 trillion. As an investment bank, it is a leading global trader and underwriter of securities and derivatives across a broad range of asset classes and serves as a strategic advisor to corporations, governments, institutions and individuals worldwide. Merrill Lynch owns just under half of BlackRock, one of the world's largest publicly traded investment management companies with approximately $1 trillion in assets under management.

The NASDAQ OMX Group, Inc. is the world's largest exchange company. We deliver trading, exchange technology and public company services across six continents, with over 3,900 listed companies. NASDAQ OMX offers multiple capital raising solutions to companies around the globe, including its U.S. listings market; the OMX Nordic Exchange, including First North; and the multilateral trading facility (MTF) NASDAQ OMX Europe. The company offers trading across multiple asset classes including equities, derivatives, debt, commodities, structured products and ETFs. NASDAQ OMX technology supports the operations of over 70 exchanges, clearing organizations and central securities depositories in more than 50 countries. OMX Nordic Exchange is not a legal entity but describes the common offering from NASDAQ OMX exchanges in Helsinki, Copenhagen, Stockholm, Iceland, Tallinn, Riga, and Vilnius.

Nordea Bank AB is the leading financial services group in the Nordic and Baltic Sea region and operates through three business areas: Nordic Banking, Insitutional & International Banking and Capital Markets & Savings. The Nordea Group has almost 11 million customers and 1,400 branch offices, and is a world leader in Internet banking, with 5,1 million e-customers.

The Nederlandse Vereniging van Banken (NVB) (Netherlands' Bankers Association) was established in 1989 to represent the common interests of the Dutch banks. Up to that time, the Nederlandse Bankiersvereniging, NBV, established in 1949, and the Discussion Group of the joint banks (College van Overleg van de gezamenlijke banken, CvO), established in 1971, served as a platform for interbank consultations. Since the merger with the Employers' Association for the Banking Industry (Werkgeversvereniging voor het Bankbedrijf, WGVB) in 2001, the NVB also represents socio-economic interests. Virtually all banks operating in the Netherlands, including foreign bank branches, are members of the NVB.

NYSE Euronext is the world's leading, most liquid and diverse exchange group. It offers a broad and growing array of financial products and services in cash equities, futures, options, exchange-traded products, bonds, market data, and commercial technology solutions, all designed to meet the evolving needs of issuers, investors and financial institutions. Spanning multiple asset classes and six countries, NYSE Euronext operates exchanges in the U.S. and Europe including the New York Stock Exchange, NYSE Liffe, Euronext, NYSE Arca, NYSE Amex, and NYSE Liffe US. With over 6,500 listed issues, more than any other exchange group, trading on NYSE Euronext's equity markets represents more than 40% of the world's cash equities volume, the most of any global exchange group. NYSE Euronext also offers comprehensive global commercial technology, connectivity and market data business solutions through its NYSE Technologies unit. NYSE Euronext is part of the S&P 500 index and the only exchange operator in the S&P 100 index.

PayPal is a leading global online payment company with 157 million accounts worldwide, of which over 50 million in Europe. Available in 190 countries and regions around the world, users can transact and hold balances in 19 currencies. PayPal Europe is regulated by Luxembourg's Commission de Surveillance du Secteur Financier (CSSF) as a credit institution. PayPal was founded in 1998 in San Jose, California and acquired by eBay Inc. in 2002.

Established as the Prudential Mutual Assurance and Loan Association in 1848, today we are an international retail financial services company with significant operations in Asia, the US and the UK. Our purpose is to promote the financial well-being of our customers and their families, with a particular focus on saving for retirement and security in retirement. Worldwide we employ over 27,000 people and we are listed on the London and New York stock exchanges. The Group is structured around four main business units: Prudential Corporation Asia, Jackson National Life Insurance Company, Prudential UK & Europe, and M&G. Our portfolio of well-known and respected brands has attracted more than 21 million customers (and policy holders and unit holders) worldwide.

The RBS group is a large international banking and financial services company. Headquartered in Edinburgh, the Group operates in the United Kingdom, Europe, the Americas and Asia, serving more than 40 million customers. The Group provides a wide range of products and services to personal, commercial and large corporate and institutional customers through its two principal subsidiaries, The Royal Bank of Scotland and NatWest, as well as through a number of other well known brands including, Citizens, Ulster Bank, Coutts, Direct Line and Churchill.

Santander is the largest bank in the Euro Zone by market capitalization and seventh in the world by profit. Founded in 1857, Santander has EUR 885,603 million in assets and EUR 1,071,815 million in managed funds, 69 million customers, 11,092 branches and a presence in 40 countries. It is the largest financial group in Spain and Latin America, and is the sixth largest bank in the United Kingdom, through its Abbey subsidiary, and is the third largest banking group in Portugal. Through Santander Consumer Finance, it also operates a leading in 12 European countries (Germany, Italy and Spain, among others) and the United States. In the first half 2007, Santander registered EUR 4,458 million in net attributable profits, an increase of 39% from the previous year.

The Securities Industry and Financial Markets Association (SIFMA) is a non-profit industry association that represents the shared interests of participants in the global financial markets. SIFMA members include over 600 securities firms, banks and asset managers. The Association represents the industry on regulatory and legislative issues and initiatives, and also serves as a forum for outreach, training, education, and community involvement. SIFMA has offices in London, New York, Washington, and Hong Kong, where our sister organisation, the Asia Securities and Financial Markets Association (ASIFMA), is located.

Société Générale is one of the largest financial services groups in the euro-zone. The Group employs 160,000 people worldwide in three key businesses: (1) Retail Banking & Financial Services: Société Générale serves more than 16 million retail customers worldwide. (2) Global Investment Management & Services: Société Générale is one of the largest banks in the euro-zone in terms of assets under custody (EUR 1,115 billion) and under management (EUR 315 billion, December 2004). (3) Corporate & Investment Banking: SG CIB ranks among the leading banks worldwide in euro capital markets, derivatives and structured finance. Société Générale is included in the four major socially-responsible investment indexes.

Standard & Poor's, a division of The McGraw-Hill Companies, is the world's foremost provider of independent credit ratings, indices, risk evaluation, investment research, data and valuations. With approximately 6,500 employees located in 22 countries, Standard & Poor's is an essential part of the world's financial markets and has played a leading role for more than 140 years in providing investors with the independent benchmarks they need to feel more confident about their investment and financial decisions.

UBS is one of the world's leading financial firms. It is a leading global wealth management business, a global investment banking and securities firm and a key asset manager. In Switzerland, UBS is the market leader in retail and commercial banking. UBS, headquartered in Zurich and Basel, employs more than 69,500 people, and has offices in 50 countries and in all major financial centres.

UniCredit is the holding company of UniCredit Group, and holds together with its subsidiaries HypoVereinsbank and Bank Austria Creditanstalt a leading position in one of the richest areas in Europe, including Bavaria, Austria and Northern Italy. This area is the source of stability for the Group. UniCredit provides all range of financial services throughout the European Union. UniCredit is outright leader also in Central & Eastern Europe (CEE). UniCredit operates in 22 European countries with more than 174,000 employees and over 10,200 branches. UniCredit benefits from a strong European identity, extensive international presence and broad customer base. UniCredit's values are the product of all the different banks and companies cultures that have crossed its path over the years. Although different, these cultures share a continual awareness of market developments, an unfailing commitment to the growth of added value, corporate social responsibility as well as staff development and customer relationships.

Visa Europe is a membership association owned by almost 5000 European financial institutions. Visa Europe incorporated in July 2004 and its shareholders are the European banks. It provides payment products, systems and services for banks and other organisations that are members of Visa Europe.

Western Union International Bank GmbH is a credit institution based in Vienna, Austria. It is authorized by the Austrian FMA to conduct banking business. Its business focus is on the retail payments segment in the EU. In that connection, it offers Western Union brand money transfer services both through branch locations and online. In the future it is the bank's intention to become active in prepaid card issuance and offer other banking services to its client base. The bank is an indirect subsidiary of the Western Union Company, which was spun off of First Data Corporation in 2006.

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EPFSF Briefing - «EU-US Financial Market Dialogue: The cooperative approach gains steam»
19 February 2008

Introduction

The transatlantic financial services industry supports nearly 7 million US and EU jobs, nearly EUR 2.8 trillion in direct investment and stock, and bond flows in excess of EUR 35 trillion. It accounts for 80% of global financial services business, and maintains a collective consumer base of 800 million people. Growth in EU-US cross-border trading, increasing demand by investors and issuers to non-domestic products and services and growing recognition that nationally differentiated - and often conflicting rules, are out of step in the transatlantic financial marketplace, have all signalled a turning point in the financial markets regulatory dialogue between the EU and the US.

A year ago, Commissioner McCreevy[(1)] said *«We should get rid of as much regulatory duplication as possible. If US regulators offer an equivalent standard of regulation and equivalent enforcement, we should have the courage to rely on them. And vice-versa»*. That view was echoed by Christopher Cox[(2)], Chairman of the SEC, who said in May last year *"At the same time, as our markets become increasingly interconnected, the regulatory friction from different national regimes becomes more significant"*. Also, the US Treasury holds a similar viewpoint. In its request for public input, in preparation of a blueprint for an improved US financial regulatory structure, it is asking market participants whether *«the US economy and capital market competitiveness would be better served by pursuing greater global regulatory convergence»* [(3)].

The growing US recognition of the need for a more outward-looking approach, coupled with the deepening of the EU's internal single market through the implementation of the Markets in Financial Instruments Directive (MiFID), and the regulator-to-regulator dialogues that exist between CESR with each of the SEC and CFTC, together with the dialogue between CEIOPS and NAIC, have all created the ideal background for advancing the EU-US dialogue on the foundations of a strengthened, cooperative approach.

At the overarching political level, this renewed impetus to work together is evident in the Framework for advancing Transatlantic Economic Integration (FTEI), adopted in April 2007 to strengthen the economic relationship between the EU and US, and encompassing a broad work programme of cooperation to remove barriers to transatlantic trade and investment. The framework states in its Annex on Financial Services that the leaders of the EU and the US are committed to take steps towards the *«convergence, equivalence or mutual recognition»*[(4)], where appropriate, of US and EU financial regulatory standards. The Transatlantic Economic Council (TEC), which was established by the FTEI to oversee, guide and accelerate the implementation of the transatlantic work programmes in the different economic sectors, provides a strong political dynamic to transatlantic integration and ensures that legislators and stakeholders are lined up to achieve that objective.

At the financial services sector specific level, the work of organisations like IOSCO at global level and the transatlantic Financial Markets Regulatory Dialogue (FMRD) have directly addressed specific technical issues, and thereby helped to establish a more coherent regulatory approach to cross-border financial services business Since its launch in 2002, the EU-US Financial Markets Regulatory Dialogue (FMRD) has been successful in resolving differences in a number of areas and has become more effective in forward looking pre legislative consultation and discussion. It encouraged relationship building between key officials in both jurisdictions. The ECON dialogue with their US Congressional counterparts has also established good relationships and made important contributions regarding financial regulatory issues of mutual concern.

(1) http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/187&format=HTML&aged=0&language=EN
(2) http://www.sec.gov/news/speech/2007/spch050907cc.htm
(3) http://www.ustreas.gov/press/releases/reports/federalregisternoticehp602.pdf
(4) http://ec.europa.eu/enterprise/enterprise_policy/inter_rel/tec/doc/framework.pdf

For its part, the industry strongly endorses and has contributed to this cooperative approach by politicians, legislators and regulatory authorities and believes that streamlining the regulation of cross-border business and reducing regulatory conflict, duplication and cost is a «win-win» for all the stakeholders in the transatlantic marketplace. There are various routes to achieving these objectives, e.g. regulatory recognition as a means of harmonising regulatory policy and outputs, exemptive relief for cross-border wholesale business, and rules' standardisation where it can deliver enhanced compliance and trading efficiencies. In this respect, the industry particularly welcomes the strong commitment given by the EU Commission and the SEC in their February joint statement to *«develop a framework for mutual recognition discussions»* in the area of securities regulation, based on *«a common interest in developing a cooperative approach to reducing regulatory friction and increasing investor access to investment diversification opportunities and enhancing investor protections».*

Selected current priorities in the Transatlantic Agenda

a) Financial reporting

In April 2007, the President of the European Council, the President of the Commission and the President of the United States agreed to promote and secure conditions for US GAAPs and IFRSs to be recognised in both jurisdictions without the need for reconciliation. The SEC decided last November to allow foreign issuers to file accounts under IFRS without reconciliation to US standards - with estimated savings for EU companies at 2.5bn. Similarly, the EU needs to implement the Transparency Directive requiring foreign issuers to prepare their consolidated financial statements in accordance with IFRS or equivalent foreign GAAPs. The EU will decide whether US-GAAPs can be considered as equivalent. In order to encourage the use of IFRSs and to minimise disruption to markets in the Community, the Commission's Regulation of 21 December states that the EC will take into account commitments of foreign authorities to develop a convergence programme with IFRS.

b) Securities Trading

Mutual recognition for exchanges/broker-dealers between the EU and the US in securities trading is now beginning to materialise, as the early February joint statement between the European Commission and the SEC indicates. A speech by SEC Chairman Cox(5) a few days later (8th February 2008) confirms that the SEC will consider in early 2008 proposals for both mutual recognition for exchanges and greater exemptive relief for broker-dealers.

The joint statement between the EC and the SEC in appears to be respectful in particular of one of the five *«red lines»* that Commissioner McCreevy(6), after consulting Member States and stakeholders, spelled out late in 2007 regarding a possible EU-US deal on mutual recognition for securities: unilateral action by the SEC or bilateral deals between particular Member States and the US are not acceptable insofar as these could fragment and distort the single market. 2008 will likely see discussions on McCreevy's remaining red lines for any possible deal: **(i)** prioritisation of professional/wholesale markets and securing a regulatory basis for giving investment firms (broker-dealers) and stock exchanges improved rights of access; **(ii)** the use of common assessment criteria when determining whether to grant access to firms and markets established in other jurisdictions; **(iii)** consistent application across the EU; and **(iv)** avoidance -where possible and prudent- of extraterritoriality.

(5) http://www.sec.gov/news/speech/2008/spch020808cc.htm
(6) http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/07/776&format=HTML&aged=0&language=EN&guiLanguage=en

c) Banking Regulation

The approval of the final implementation of the Basel Capital Accord rules for big core banks in the US offers supervisory authorities across the Atlantic a key opportunity to apply the principle of mutual recognition in the sphere of banking regulation by recognising EU implementation of Basel II by US banking subsidiaries of European banks and vice versa.

So far, the US implementation rules still include deviations from the Basel Accord (e.g. lack of access to the advanced approaches by significant subsidiaries of EU banks, if it occurred, would be a concern). In addition, some points still need to be clarified, including the recognition of home-country Basel II implementation by European banks under the Federal Reserve's well-capitalized requirement for financial holding companies, as well as US Basel II implementation by smaller banks.

d) Insurance regulation

For the past several years, European reinsurers have pursued changes to current US reinsurance collateral rules on the basis that they are highly discriminatory, unfair, very costly, forcing EU reinsurers to lodge billions of dollars unnecessarily in the US, and fail to take account of the financial strength of individual reinsurers or the quality of their domiciliary regimes. Unfortunately, no progress has been made.

The EU and US should remove existing barriers - and avoid future ones - that discriminate against well-regulated, financially strong, firms trading in and into their markets.

e) Current market volatility

The recent credit squeeze and sub-prime crisis have underscored the interdependence between European and American financial markets, and the urgent need for a close cooperation between monetary, regulatory and supervisory authorities.

Some areas for immediate joint EU-US reflection as recently identified by Commissioner McCreevy are: **(i)** addressing liquidity issues in interbank markets; **(ii)** strengthening prudential requirements or risk management; **(iii)** improving transparency **(iv)** credit rating agencies; and **(v)** finding ways to develop early warning and crisis management tools at global level. Work in these areas is going to be mainly pursued at international fora such as the IMF, IOSCO, the FSF and the G8.

Conclusion

In a time of financial turbulence and more integrated transatlantic economies, greater regulatory coherence and cooperation will enhance market integrity and the capacity to withstand and mitigate shocks. Acceptance of US GAAP equivalence, progress in regulatory recognition in the area of securities and Basel II implementation, improved information-sharing and an efficient framework for regulatory cooperative action will enhance regulatory efficiency, reduce trading costs, deepen market liquidity and deliver wider choice for investors and issuers. It is generally accepted that 2008 will be a *"pivotal year"* in which swift progress can be made, particularly regarding securities. In this respect, it is noteworthy that Chairman Cox and Commissioner McCreevy[7], in their early February joint statement *"jointly mandated their respective staffs to intensify work on a possible framework for EU-US mutual recognition of securities in 2008"*. To bring this initiative to fruition, the strong, consistent mutual support and coordination among interested industry representatives, government officials, regulators and politicians in the transatlantic dialogue will continue to be crucial.

(7) http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/54&format=HTML&aged=0&language=EN&guiLanguage=es

EPFSF Briefing - «Financial Education and Financial capability»

14 March 2008

Introduction

Until 2000, financial education hardly seemed to be an issue. Scarce literature existed mainly originating from the US or the UK. A 2005 OECD study[(1)] is presented as first international research. The scale of the question is vast but its perimeter imprecise. Callum McCarthy observed in 2005[(2)]:

«A study by the Institute of Financial Services showed that eight from ten people did not correctly identify the term APR as describing the interest rate and other costs of a loan; five from ten people admit to not understanding financial products such as mortgages or ISAs. A survey done for the FSA asked the question: "if the inflation rate is 5 per cent and the interest rate you get on your savings is 3 per cent, will your savings be worth as much in a year's time?" – one in five gave the wrong answer.»

The importance of the topic has increased for various reasons. Demographic, economic and policy changes compel individuals to make more financial decisions, when some of them were taken for them in the past (i.e: pensions). Additionally, with the development of financial markets offers, consumers must chose from a much wider range of products. Many international and national surveys have demonstrated generally low levels of understanding of financial matters and basic economics. More worrying, individuals generally feel they know more about financial matters than it is actually the case.

There is to date no common definition of financial education, financial literacy and financial capability. This leads to a tendency to mix up terms and amalgamate education and information. Key elements of a working definition can be found for instance in OECD work, or in the UK where early research was conducted. The European Commission[(3)] defines financial literacy as *«the capability of consumers and small business owners to understand retail financial products, with a view to making informed decision»*. The FSA distinguishes financial education along three lines:

- Financial knowledge and understanding: the consumer knows and understands the different forms, use and functions of money (e.g. cash, cheques, credit cards, loans…)
- Financial skills and competence: based on knowledge, consumers' attitudes are influenced when using, spending and saving money;
- Responsibility: customers understand that their financial decisions will have an impact on others.

The European Commission[(4)] sees financial education as enabling individuals *«to be aware of financial risks and opportunities and make informed decisions in their choice of financial services. It is a life-long issue»*. Benefits are not limited to individuals but encompass the society as a whole and the economy. The HM Treasury defines financial capability as *«a broad concept, encompassing the knowledge and skills that people, including young people, need to understand to manage their own financial circumstances, along with the motivation to engage in financial decision-making».*

(1) Improving Financial Literacy, Analysis of issues and policies, OECD, 2005
(2) Speech by Callum McCarthy, Chairman of the FSA, FSA Office of Fair Trading's European Competition and Consumer Day, 15 September 2005
(3) DG Markt invitation to tender, MARKT/2006/26/H, Annex 1
(4) see : http://ec.europa.eu/internal_market/finservices-retail/docs/capability/communication_en.pdf

National strategies greatly differ throughout the EU. Financial education is becoming a growing priority in certain Member States and at European level, signalling a shift from a curative approach to financial difficulties to a preventive stance. The European Commission supports financial education along a "bottom-up" approach, seen as a complement to measures aiming to ensure provision of information, protection and advice. A recent communication features basic principles based on best practices and announce a handful of initiatives, such as online education tools, including a programme for teachers.

To launch a European debate, questions to be discussed include, inter-alia, reflecting on best channels for successful delivery, best strategies to reach different target audiences, sources of funding and importance of resources devoted, program evaluation, sound data enabling comparisons at EU level, exploration of the relationship between financial education, information and advice, importance to include financial education in school curriculum, teachers training, leveraging on existing programmes…

Selected issues

1. Importance of financial education

Existing surveys converge to show that individuals generally lack adequate financial background and often believe that they are far more literate than is currently the case. At national level, a 2004 study(5) commissioned by the AMF in France finds out that 74% of interviewed said they were unable to read financial press, 58% unable to choose a financial product. As other illustration, the FSA, which has been granted statutory authority to promote public understanding of financial capability commissioned abundant qualitative and quantitative research, many of them based on focus groups. Among others, results showed:

- About eight in ten consumers said they tended to shop around but in practice hardly any of them had actually done so;
- Most consumers undertake little long-term planning or budgeting, and more decisions were rather reactive than pro-active;
- Young people's level of shopping around for financial products was very low in contrast to buying clothes or shopping.

At EU level, the European Credit Research Institute (ECRI)(6) held a seminar, co-sponsored by Visa Europe, which pointed to a major stake of financial education as *«aiming to change attitudes, whether in the area of money management, credit or consumption choices, through the establishment of new value priorities»*.

2. A multi faceted problem with a diversity of interested parties

A range of different issues, audiences, actors are encompassed under the terms «financial education». There can be different needs to receive a financial education: learning how to manage money, plan its future, make choices or receive help. Recent research(7) shows the most common subject of financial education programmes are «money basics», such as how to use a bank account, followed by budgeting skills. Issues such as investment, savings, retirement, insurance and risk management feature far less highly, indicating that these may require far more attention in future.

Needs depend on age, personal situation, gender…They are evolving and cannot be apprehended in a "one-size fits all" approach. The 2007 Evers and Young research finds out that current main target groups are children and young adults. Only few schemes seem to be aimed at specific public, such as pre-retirement, women, ethnic minorities, people on low income… The European Commission considers financial education should be promoted at all stages of life on a continuous basis, and be specifically targeted to meet the specific needs of citizens.

(5) Etude Sofres sur l'éducation financière des français, see : http://www.tns-sofres.com/etudes/comfi/091204_educfinanciere.htm
(6) European Credit Research Institute workshop, Financial Capability: empowering European consumers, June 2006, see: http://www.ecri.be/ecri/public/FinCap_Workshop_I_papers.pdf
(7) Evers Jungs research and consulting, Survey of Financial literacy schemes in the EU27 see: http://ec.europa.eu/internal_market/finservices-retail/docs/capability/report_survey_en.pdf

Financial education can be provided by a variety of actors ranging from financial supervisory authorities to adult literacy agencies, debt advice clinics, social workers, financial industry federations, individual firms, housing authorities and others. A number of financial services companies have already developed programmes aimed at improving financial literacy and financial capability.

A 2007 survey mapped out that national authorities are the drivers of programmes in 11 Member States. It also noted that financial services providers operate one of out six schemes.

3. Overview of existing measures in Member States

There is a great disparity in the provision of financial education in Europe. Evers Jung study found that most schemes were in the UK (32% of core schemes), Germany (22%), Austria (10%), the Netherlands and Italy. By contrast, Bulgaria, Latvia, Luxembourg, Slovenia and Romania seem to be solely covered by trans-national EU programmes. The survey records that 2/3 of existing schemes target children and young adults.

The study selected 10 case studies covering a variety of groups, methodologies and Member States, to provide an overview of existing strategies. These covered schemes for specific population such as children, elderly, or financial literacy at the work place. Certain programmes are designed for migrants in Germany or underachieving groups. In terms of channels, a UK web-based scheme and a trans-national web-based scheme ("Dolceta") and a multi-channel one in France are presented. Finally, as regards providers, the survey shows examples of schemes delivered by public authorities in Hungary, or financial services providers in the Netherlands. This first EU-wide survey shows that many initiatives are already in place: out of 800 questionnaires sent throughout Europe by the consultat, 154 programmes could be identified. Furthermore, desk-research confirmed that a number of existing programmes had not been referenced.

Looking at measures in place, some common features can be identified, such as efforts to introduce financial education in schools and in national curriculum (i.e.: UK, Italy, Hungary…), web-based information with simple and user-friendly material and efforts aimed at raising public awareness.

4. EU strategy

As part of its retail financial policy strategy, the European Commission wants to bring financial education forward. DG Education is involved on measures to improve education, particularly in relation to improving young people's reading abilities and adults' lifelong learning. DG Sanco and DG Markt are also active. A full day conference was organised in March 2007. A Communication[8] on financial education was issued in January 2008 together with a study surveying existing schemes. The Commission supports financial education delivered as close as possible to the citizens, namely through Member States, national and regional authorities, NGOs & the financial services sector.

(8) see : http://ec.europa.eu/internal_market/finservices-retail/docs/capability/communication_en.pdf

The Communication sets out economic, societal and personal benefits of increased financial literacy. It presents basic principles based on best practices. These include active promotion of financial education at all life stages on a continuous basis, education in economic and financial matters starting as early as possible, beginning at school. It recommends national authorities to consider compulsory financial education in schools' curriculum, raising awareness on understanding of financial issues and risks. Trainers should receive sufficient resources and training. When delivered by financial providers, education should be supplied fairly. National coordination between stakeholders should be promoted, to achieve a clear definition of roles, facilitate sharing of experiences, rationalise and prioritise resources. International cooperation between providers should be enhanced to facilitate exchange of best practices. Schemes should be evaluated to be brought into line with best practices.

As part of future initiatives, an online reference database of financial education programmes and research should be issued, the existing «Dolceta» online education tool enhanced to help teachers to incorporate financial matters into school curriculum. The Commission will monitor progress.

Conclusion

This policy strategy to engage in a shift from curative to preventive measures to empower and protect consumers should be welcomed. The stake is about changing people's attitudes towards money spending. It is therefore a long-term strategy. It can be questioned whether financial education must be seen as a complement to measures aiming to ensure the appropriate provision of information, protection and advice as the European Commission sees it, or whether financial education is not rather a deeper element, forming the basis for a lighter need of information, and arguing the case for a better distinction between education, information and advice.

EPFSF Briefing - «Innovative e-payment solutions: A European perspective»
24 March 2008

Introduction

Nobody likes to pay. But at least, Europeans can indulge in an ever growing variety of ways to part with their money. The choice of the payment methods depends on the transaction scenario. Typical scenario fall into four very broad categories :

1. Physical purchases at the point of sale: This is the classical transaction for instance in a store, supermarket, or in a café. For smaller sums (a latte macchiato), cash is still dominant. But cash has its drawbacks. It is often unsafe, inconvenient as well as expensive to handle for both retailers and consumers. By one estimate, banks in the EU-9 spent around EUR 20 bn on handing cash transactions in 2004(1). For micro-payments, a plethora of cash replacements has been tried (many failed) or is being developed. Contactless solutions - probably integrated in mobile phones and bundled with «must-have» characteritics (e.g., a ticket for mass transit) - look promising. For bigger purchases, credit or debit cards are established payment tools and are gradualy replacing cash in many countries.

2. Bill payments: Direct debits and credit transfers account for the bulk of recurring bill payments (e.g. the phone bill) in Europe. Cheques are disappearing. More sophisticated electronic payment forms - such as Electronic Bill Presentment an Payment (EBPP) - offer additional services. However, EBPP is still developing slowly in Europe.

3. P2P payments: They include settlements of online auctions and cross-border remittances. The latter often involves «unbanked» recipients.

4. B2C e-commerce : This covers virtual products (e.g., music, online games) and goods or services bought in an online store or portal. Purchases over the internet are the natural habitat of electronic payments. The bulk of online commerce has settled for established payment methods, such as credit cards, direct debits or bank transfers(2). Yet, an abundance of innovative e-payment solutions tries to gain traction.

There is a trend towards cashless payments. Among others, this trend is driven by the growing popularity of the internet, the emergence of new transaction types (e.g. downloads) and new technologies, such as Near Field Communication (NFC) and SMS, which increase the appeal of cashless payments in offline commerce.

From a European perspective, innovative e-payment solutions are particulary interesting in that they may facilitate (payment solutions) cross-border e-commerce by offering cross-border payment solutions.

Little cross-border e-commerce

B2C e-commerce is set to grow at a high speed. DB Research reckons that by 2010 turnover will reach close to EUR 340 bn in Western Europe, which implies a growth rate of around 27% p.a. – way above growth in brick-and-mortar retail sales. However, online commerce is still rather national. For instance, in four out of five German online shops less than 10% of total sales go abroad(3) . By the same token, only 12.5% of German online buyers have ordered from foreign online shops(4). Yet, differences in tastes, languages, and regulation (e.g., laws on consumer protection) explain to a large part the low share of cross-border e-commerce.

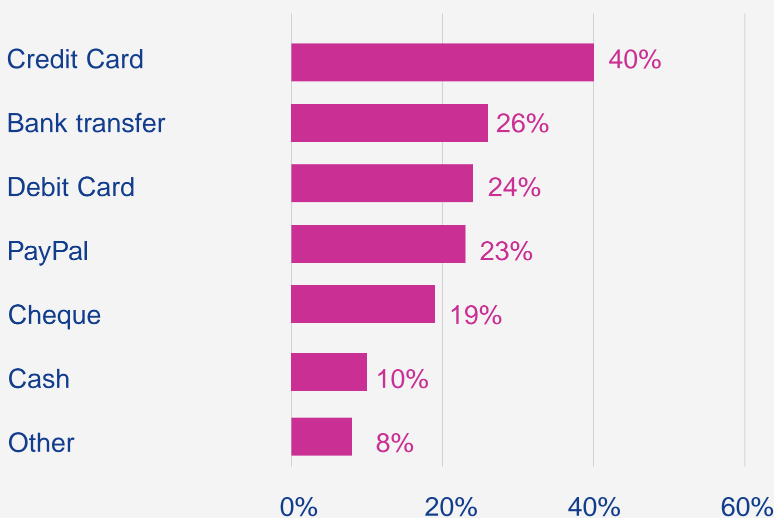
(1) De Ploey, Wouter and Olivier Denecker (2007). Payments in Europe : a Tower of Babel with Construction Problem. McKinsey.
(2) See Heng, Stefan (2007). E-Commerce settles for established payment systems. E-conomics 62. DB Reserach, 2007.
(3) ibi Research (2006). Zahlungsabwicklung im Internet.
(4) EuPD (2007). E-Commerce 2007.

Paying is part of e-commerce

Also, the particular circumstances of distance selling in impersonal virtual reality play a part. For example, there is a wide gap between delivery and payment in online commerce in terms of both location and time. But, business partners who do not know each other personnally are particulary suspicious in practice when it comes to paying. This is even more the case when e-commerce crosses national borders. Thus, the payment transaction is the Achilles' heel of e-commerce. In a survey, less than a fifth of German online shoppers said that online-payment solutions would convey security when buying abroad.

Overall, credit cards are the most frequently used payment method when buying online (see chart). PayPal, a subsidiary of eBay, is the only new e-payment solution which is popular among a large part of European online shoppers. But the preferred payment method varies considerably across countries. 56% of Germans prefer electronic bank transfers, but only 26% like credit cards. The British, on the other hand, prefer credit cards but ignore transfers (see table). This is also a challenge for online retailers who want to target customers abroad. They need to pay attention to national payment preferences and offer different solutions.

Payment method of choice
Which payment method do you prefer when you buy products online?



Basis: EU-7
Source : Forrester 2007

Europeans favour different payment methods
Which payment method(s) do you prefer when you buy products online?

	UK	France	Germany	Spain	Italy	Netherlands	Sweden
Credit card	60%	35%	26%	51%	51%	19%	34%
Electronic bank transfer	3%	3%	56%	20%	14%	43%	43%
Debit/payment card	43%	57%	3%	14%	10%	14%	17%
PayPal	35%	16%	22%	14%	26%	11%	11%
Cheque/accept giro	5%	17%	31%	2%	19%	37%	13%
Cash	3%	3%	10%	32%	19%	16%	24%

Source : Forrester 2007

Innovative e-payment solutions struggle for market share

Handling payments is big business. Little wonder that so many providers of new e-payment solutions want to take a slice from that pie. In Germany alone, there are more than 40 innovative e-payment solutions in operation – but only very few, such as PayPal, Giropay, Click & Buy, have found greater popularity. Very broadly, they are either wallet based (e.g., PayPal) or online-banking based (e.g., Giropay in Germany, iDeal in the Netherlands). There is a large variety in details: Some e-purse solutions are pre-paid (convenient for smaller amounts), others are post-paid. Some solutions use mobile phones, to initiate payments, to add the outstanding amount to the phone bill, or to verify payments via SMS. Online-banking based e-payments are a way to arrange electronic bank transfers automatically. This means, in effect, that online buyers pay in advance with no possibility to charge back.The big hurdle for new payment solutions is that they need to be attractive to merchants and consumers at the same time. This is, firstly, a chicken-and-egg problem (a “network” effect in the jargon of economics) because merchants install only solutions that are widely adopted by consumers. But consumer would not adopt any payment method unless there is something to buy with it.

Secondly, merchants and buyers often want things which may appear difficult to reconcile. Something that is viewed as an improvement by one side may be seen as a disadvantage by the other side. Customers, for instance, want the possibility to dispute claims, whereas merchants want to limit charge backs.

Any new payment solution must offer a clear value added over existing services to gain attraction. Successful new e-payment solutions must keep the interests of merchants and online buyers in balance. They also need to solve the chicken-and-egg problem. Therefore, a strong market position, a large customer base to register up-front or a true «killer-application» are needed.

PayPal owes its success to its integration into eBay. It filled a market niche because it allowed people to transfer money faster and cheaper (particularly across borders) than existing solutions. The need for such P2P transfers was created by eBay’s online auctions. Moreover, PayPal addresses customer concerns about identity theft and online security in general. It assumes the role of a front-end-intermediary so that customers do not have to enter personal data on merchants’ sites.

Innovative e-payments build on existing infrastructure

It is important to bear in mind that most innovative e-payment solutions rely on the existing banking infrastructure for ultimate settlement. PayPal, for instance, clears accounts using credit cards or bank accounts. New e-payment solutions often bring about additional services over existing solutions which increase safety, convenience or other things, merchants and/or customers want. As they operate on the front-end only, changes in the underlying payment infrastructure, such as those caused by SEPA, will have an effect on innovative e-payments, too.

SEPA aims to create a single market for retail payment. Currently, the European Payment Council discusses the creation of a SEPA direct debit eMandate and a SEPA online-payment solution. Both draw on existing online-banking authorisations to validate either a European-wide direct debit or bank transfer.

The net effect of SEPA on innovative e-payments in cross-border transactions may be ambiguous. On the one hand, a more efficient retail-payment backbone may help innovative e-payment solutions to get a European reach. After all, SEPA might facilitate clearing with a customer base that is spread across Europe. On the other hand, things like a European-wide electronic direct debit may crowd out the need for alternative payment systems in the first place.

Few players will win big

The strong network effect plus the fact that online merchants and customers will only hold a limited number of different payment options in their portfolios means that only a few innovative e-payment systems will reach a critical mass across Europe. The rest will disappear, cater only to specific niches or operate on purely national levels. This may raise competitive concerns because the incumbents are not expected to be materially challenged.

EPFSF Briefing - «Recent Market Turbulence: Causes and Consequences»

29 April 2008

Introduction

Global financial markets have experienced a challenging and protracted period of credit market turbulence and some knock on equity market volatility. Market participants, regulators and policy makers now face the challenges of restoring confidence, market liquidity and functioning. Macro-economic, financial sector and individual firm outlooks remain challenged by weaker economic outlooks in some regions, rising commodity prices and inflation pressures, re-pricing risk and de-leveraging, capital raising and restoring the health of balance sheets.

Underlying Causes

The root causes of the current turbulence are the state of the US housing market and the excessive extension of credit to the sub-prime sector. While it is easy to point to the lack of regulation of US-based retail mortgage brokers as a major factor, there are a number of inter-related forces that contributed to the market turbulence.

Global financial markets have been awash with liquidity, reflecting the excess savings from Asia (in particular China) and excess cash from energy producing countries. This liquidity and competitive factors in the financial market-place led to credit risk mis-pricing in key market segments. Financial instruments have also become more complex for a variety of structural, technological and behavioural reasons. Finally, contagion patterns have emerged during the current turmoil, the speed and reach of which have not been witnessed in earlier periods of financial instability.

Underlying weaknesses

The Financial Stability Forum (FSF) published a report on 12 April which identified the following key weaknesses of the financial system.

Poor underwriting standards: Business volumes grew more quickly than did investments in the supporting infrastructure of controls and documentation. Misaligned incentives were most conspicuous in the poor underwriting that proliferated in the US subprime mortgage sector, especially post 2004. The combination of weak incentives, an increasingly competitive environment, low interest rates and rapidly rising house prices led originators and mortgage brokers to lower underwriting standards and to offer products to borrowers who could often not afford them or could not bear the associated risks. Weak government oversight contributed to the rise in unsound practices, especially by mortgage companies not affiliated with banks.

Shortcomings in firms' risk management practices: Some of the standard risk management tools used by financial institutions are not suited to certain types of structured products. A number of financial institutions had weak controls over balance sheet growth and off-balance sheet risks; inadequate aggregation of risk across business lines and functions; and weak understanding of the risks inherent in mitigating those risks.

Poor investor due diligence: Many less sophisticated investors did not sufficiently examine the assets underlying structured investments. Weak due diligence practices further fuelled the issuance of complex structured credit products. In conducting their due diligence, many investors placed excessive reliance on credit ratings.

Credit rating agencies (CRA) performance in respect of structured credit products: The FSF raises concerns about weakness in rating models' methodologies; the level of due diligence of the quality of the collateral pools underlying rated securities; transparency about the assumptions, criteria and methodologies used in rating structured products; information provision about the meaning and risk characteristics of structured finance ratings; and conflicts of interest in the rating process.

Incentive distortions: The FSF has concluded that shortcomings in risk management, risk assessment and underwriting reflected a variety of incentive distortions:

- Originators, arrangers, distributors and managers in the OTD (originate-to-distribute) chain had insufficient incentives to generate and provide initial and ongoing information on the quality and performance of underlying assets.
- The Basel 1 capital framework encouraged banks to securitize assets through instruments with low capital charges.
- Compensation schemes in financial institutions encouraged disproportionate risk-taking with insufficient regard to longer-term risks.

Weaknesses in disclosures: Weaknesses in public disclosures damaged market confidence. Public disclosures did not always make clear the type and magnitude of risks associated with their on-and off-balance sheet exposures.

Feedback effects between valuation and risk-taking: The turbulence revealed the potential for adverse interactions between high-leverage, market liquidity, valuation losses and financial institutions' capital.

Weaknesses in regulatory frameworks and other policies: Limitations in regulatory arrangements, especially pre-Basel II, contributed to the growth of unregulated exposures, excessive risk-taking and weak liquidity risk management.

Responses from policy makers

The FSF makes proposals in the following five areas:

- Strengthening prudential oversight of capital, liquidity and risk management;
- Enhancing transparency and valuation;
- Changes in the role and uses of credit ratings;
- Strengthening the authorities' responsiveness to risks; and
- Robust arrangements for dealing with stress in the financial system.

In addition to these global measures, in October last year ECOFIN agreed a Roadmap prepared with the assistance of the European Commission. The roadmap consists of a working programme, aimed at reviewing, along with the EU's international partners, how to further improve: (i) transparency; (ii) valuation standards; (iii) the prudential framework, risk management and supervision, and (iv) market functioning, including the role of CRAs and the treatment of “non-organised debt markets” (i.e. how MiFID and other Directives (Prospectus Directive, Transparency Directive and Market Abuse Directive) may or may not apply to ABS, ABCP and CDS products). At the informal ECOFIN in April this year, Ministers and Governors issued a statement stating that good progress was being made in the implementation of this road map. In addition the statement detailed the ongoing tensions in international financial markets and the appropriate policy response:

- To improve valuation standards, they urge supervisors and accounting standards-setters to ensure that the financial reporting framework functions properly with clear guidelines on valuation that can be applied consistently across institutions.

- To strengthen further the existing prudential framework and risk management in the financial sector, the Commission will propose a revision of the Capital Requirements Directive in September 2008 for adoption by April 2009 at the latest. The revision will address elements of the prudential treatment of securitization, as well as the large exposures regime and hybrid capital instruments.

- On credit rating agencies Ministers and Governors urge the industry to present as soon as possible a roadmap of planned industry wide initiatives. Before summer 2008 the ECOFIN Council will discuss a Commission assessment of the role of credit rating agencies in structured finance and the process of rating complex financial products, taking into account international developments (such as revisions to the IOSCO Code of Conduct). If market-led solutions prove inadequate Ministers and Governors stand ready to consider regulatory alternatives.

Response from the market

The European financial industry has a stake in ensuring that the market turbulence is resolved as quickly and orderly as possible. There are a number of industry initiatives underway to improve the availability and accessibility of data on structured credit markets for regulators and market participants, including: (1) beginning June 2008, the provision of a comprehensive periodic report containing market data on the EU securitisation market; (2) guidelines on good practice in implementing the securitisation disclosure requirements in the Capital Requirements Directive; and (3) initiatives to improve investor access to deal information in both the term securitization market and the ABCP market.

Beyond market-led solutions on information disclosure and data accessibility, the European financial industry is looking to respond further by developing industry-wide solutions (such as codes of conduct) in addition to individual companies taking measures to enhance risk management, stress testing and risk assessment system etc, themselves.

In addition, CRAs have announced self-regulatory actions to address concerns raised. On valuations there have recently been announcements of market-led solutions by NYSE-Euronext and Reuters, as well as Markit Group’s multi-dealer valuation platform. Markit's system will aggregate valuations and offer buy-side clients access to a composite of sell side valuations. This will allow buy-side clients the opportunity to compare valuations and increase market transparency.

Conclusion

The financial services industry is supportive of the recent policy proposals by ECOFIN and the FSF. The problems in financial markets are international and therefore require global policy responses. It is important that the policy response remains considered and that policymakers stay close to what is happening in the financial markets and understand what industry themselves are doing to improve the financial climate. Delivering results that will enhance market efficiency and financial stability will therefore need a mixture of action by policymakers, industry and individual firms.

EPFSF Briefing - «Supervisory Convergence»
27 May 2008

History of Supervisory Convergence

It is not clear where the term «supervisory convergence» was first used, but the concept has come to greater prominence since the inception of the Lamfalussy Process which established the Level 3 Committees with charters to encourage supervisory cooperation and convergence. The sectoral Committees all built on pre-existing structures of cooperation (e.g. the "Groupe de Contact" in banking and FESCO in securities) and thus the formalisation of the cooperative structure became an opportunity to promote a greater degree of cooperation.

References to supervisory convergence have continued and increased, building on the opportunities created by the Lamfalussy architecture. The EC White Paper on Financial Services policy 2005-2010, the Financial Services Committee Report on Financial Supervision (Francq Report), successive IIMG reports, and ECOFIN conclusions (notably in December 2007) have all included proposals calling for enhanced convergence and cooperation in supervisory practices. The Level 3 Committees too have been active whether directly as in the CESR 2004 Himalaya Report or indirectly through the delivery of the objectives set out in their charters to deepen cooperation and coordination and enhance supervisory convergence.

Defining the Term

Despite this increasing body of official documents and reports by the authorities, «supervisory convergence» is not a term that has been defined. As a result there is probably not a «converged» or common understanding of what the term or the process is expected to deliver. CEBS itself noted in its November 2007 paper contributing to the Lamfalussy Review that the industry expectation of supervisory convergence has appeared to shift over time. In order to debate issues related to supervisory convergence it is clearly important to ensure that all parties understand that the term can be understood to apply in several different ways. Thus Supervisory convergence could mean (i) regulatory and supervisory arrangements that are broadly similar or cover the same ground; or (ii) regulatory arrangements and supervisory practices that differ in detail but deliver the same outcomes; or (iii) regulatory requirements and supervisory practices that are the same in form and application.

In more detail this means that supervisory convergence might relate to a range of features of regulation, for example: the rules themselves; how the rules are interpreted; how the rules are enforced in practice; or how regulated entities are expected to comply with the rules. But a further level of issues needs also to be considered, namely:

- Convergence of what – for example of rules, interpretations, practices?
- How and to what extent is convergence formalised?
- How much latitude is left for different approaches?
- What areas of convergence – for example prudential, conduct of business, reporting?

In each case, it is necessary to consider in a practical way what sort of supervisory convergence is most appropriate. CEBS provides one example of how these issues may be analysed in its November 2007 submission to the Lamfalussy Review. In this document CEBS argued that ex-ante targets for convergence need to be defined, that further tools to enable a convergence process should be delivered and that some topics were ripe for «hard convergence». By «hard convergence» CEBS meant that there would be an identical treatment throughout the EU – for example with respect to prudential reporting.

At the same time, CEBS stated that its view of the industry's attitude in the prudential area was that it had shifted over time from the original objective of enhanced consistency in national approaches and level playing field, to the request that the same business is subject to exactly the same supervisory treatment throughout the EU, so that country neutral arrangements could allow cross-border groups to comply with regulations as smoothly as possible. Therefore, by asking for explicit ex-ante targets, in addition to further supervisory tools, CEBS has proposed an approach that avoids a «one size fits all» solution and which has the capacity to take industry expectations into explicit account.

Some practical examples of where authorities might grapple with setting targets for convergence in the field of prudential supervision include circumstances when individual firms (banks or investment firms) should be subject to a higher than 8% minimum capital requirement; methods of approval for advanced calculation methodologies (e.g. Value at Risk or Internal Ratings); whether on site inspections of firms could be carried out by a single supervisory authority for the whole group (and if so whether by the local supervisor or the consolidating supervisor) or could be delegated to external auditors. These matters are not prescribed in EU legislation, and differing resources, local legislation and systemic implications of major cross border groups are all factors that will come into play when deciding how the coordination and convergence of a particular set of supervisory actions relating to a financial group will be organised.

Why is there an impetus for Convergence?

The FSAP's introduction of major new pieces of regulation, such as MiFID and CRD, and its impetus for the single market, brought a focus on the potential for variation in application of the legislation. To avoid excessive detail within the Directives, which under Article 249 of the Treaty are addressed to Member States in order to bring about a desired outcome, convergence could be seen as an option to deliver consistency of approach without compromising the enshrined rights of Member States to determine how to achieve these outcomes. Supervisory convergence has been seen as a method of encouraging steady convergence that is based to the greatest extent possible on practical experience of the regulators and the industry, rather than attempting to enshrine lengthy ex ante decisions on micro-supervisory practices into legislation. With respect to existing legislation, National Discretions are regarded as both an obstacle to Convergence but also a motivation to greater efforts of convergence. There are some discretions that can be and are being rendered obsolete by converged supervisory practices and decisions but others require further political debate, bearing in mind that the decisions were ratified by the EU political process in the first instance.

What are the challenges?

With a landscape of disparate supervisory histories and practices born out of different national experiences, it is easy to recognise that supervisory convergence, however defined, could not be achieved overnight. However, depending on the form and extent of supervisory convergence that is attempted, in reducing the divergences and uncertainties (for example, uncertainties in relation to the competent authority whose rules should be followed under the market abuse and takeover regimes) that arise, and in streamlining the supervision of multi-jurisdictional entities, the following factors may also need to be taken into account: legal or even constitutional barriers to tasks being performed in a certain way; a clear analysis and agreement on the detailed objectives of supervision (at a high level, these objectives are probably easy to agree upon); a clear understanding of the priority placed by the different Member States on different aspects of supervision, or risks which require particular attention; committed agreement on the structure, timing, and manner in which supervisory action and surveillance is delivered; and comparable resources.

Tools, mechanisms and structures to support Convergence

It has been recognised since the outset of the debate on supervisory convergence, that supervisors need tools and structures to assist them. The creation of the Level 3 Committees was one very significant formal step but further efforts have been deemed necessary. The Francq Report outlined a number of practical steps that the Committees have sought to implement and which harnessed the momentum of the work they were already undertaken. Continued work has focused on analysing the mechanisms for fostering joint inspections, common training programmes, staff exchanges, mediation and peer review among supervisors. Thus the current focus of attention is on supporting and enhancing operational networks and colleges of supervisors, which ECOFIN Conclusions from December 2007 and May 2008 have endorsed and which the Commission has also supported. Work by the Level 3 committees on home-host cooperation is a further and continuing vehicle for intensified efforts.

The ECOFIN has proposed ways to improve the efficiency and effectiveness of the Level 3 decision-making process within the existing structure of powers and accountability. In December 2007, the ECOFIN requested the Level 3 committees to introduce in their charters the possibility to apply qualified majority voting, coupled with a comply or explain procedure. In May 2008, the ECOFIN stated that the EU dimension should be taken into account in the national mandates of the supervisors, which should intensify work towards enhanced supervisory convergence and consider financial stability concerns in other Member States in exercising their duties.

Next steps

Supervisory convergence will remain a topic of interest for industry and regulators alike. There are a range of supervisory initiatives arising from Level 3 Committee activity which are also underpinned in legislation that will encourage supervisory convergence to continue. Thus further attention will be paid to developing home-host relationships, creating colleges of regulators (where they do not already exist) and deepening operational networks that will deliver more regulatory coordination and facilitate ever greater consistency of approach.

EPFSF Briefing - «MiFID Implementation»
7 July 2008

Introduction

On 1 November 2007, the Markets in Financial Instruments Directive, the so-called MiFID(1), along with its European implementing provisions(2) and national implementing measures, entered into force in the 30 EEA States, replacing the Investment Services Directive (ISD). The ISD, adopted in 1993, was the first piece of legislation which sought to develop a European regulatory framework for investment services.

MiFID goes further in advancing the integration and development of EU financial markets by setting up a more comprehensive and homogeneous regulatory framework. It aims to cope with, and further enable, the increased level of cross-border investment transactions. It is one of the most important and challenging reform projects in the financial sector set to overhaul regulation of EU financial markets with a view to enhancing the competitiveness of EU investment services industry in today's increasingly globalised markets and boosting the EU's economy.

The difficult path to MiFID's implementation

MiFID introduces a wide spectrum of new and innovative requirements oriented towards three major objectives: fostering competition, increasing market efficiency and improving investor protection. The resulting new framework implies in practice a double-faceted reality for the financial industry. On the one hand it introduces more opportunities by allowing new competition among financial intermediaries at all steps of a security's transaction cycle, from the provision of investment advice to the practical execution and settlement of the transaction. On the other hand, it imposes more constraints on firms by providing for increased transparency and information requirements as well as for a strengthened investor protection regime.

This overhaul has required a considerable mobilisation of time and resources both by Member States to transpose the MiFID provisions into national legislation and by the financial industry to comply with the new rules. MiFID has entailed important changes in the way markets players conduct business, involving significant financial investments. To put into place the procedures and processes required by MiFID, banks and investment firms had to substantially review their organisational and reporting structures as well as to adapt and upgrade their IT systems as MiFID requires an incremental storage of data. Moreover they had to devote extra resources for retraining staff and testing their MiFID compliance programmes.

In view of the scale and complexity of the changes involved, and delays in finalising implementing measures, the Commission decided in June 2005 to modify the original timetables, delaying the deadline for transposition of MiFID by Member States from April 2006 until January 2007. Similarly, firms and markets have had an extended period until November 2007 (originally April 2007) to make their organisation and procedures compliant.

(1) Directive 2004/39/EC of the European Parliament and the Council of 21/04/2004 (OJ L 145, 30.04.2004).
(2) Commission Directive 2006/73/EC of 10/08/2006 implementing Directive 2004/39/EC with regard to the organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive (OJ L 241, 2.09.2006) and Commission Regulation (EC) No 1287/2006 of 10.08.2006 implementing Directive 2004/39/EC as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive (OJ L 241, 2.09.2006).

MiFID's implementation complicated by transposition delays

Despite the deadline extension - as shown by the European Commission's «MiFID transposition state of play» table[3] - only three Member States were able to meet the new transposition date of 31 January 2007 and, on 1 November 2007, still five Member States had not fully complied with their transposition obligations.

Today, transposition is still awaited from two Member States. These delays in transposition have considerably shortened the time span available to firms to adapt to MiFID new requirements, putting additional pressure on the financial industry. They have also resulted in potential difficulties, legal uncertainties and competitive disadvantage for firms located or operating in these Member States.

Nevertheless, on the whole, the effects of these delays on the wider market should be minimal since the Member States that are most active in financial markets have all transposed the Directive. Furthermore, to ensure business continuity and minimal disruption in cross-border business to be possibly caused by late transposition of MiFID, a number of measures[4] were set out by CESR[5] aimed at smoothing MiFID's implementation. In this vein, CESR issued amongst others practical arrangements allowing firms from late transposing countries to continue using 'passports' granted under the ISD.

Major changes following MiFID implementation

Abolition of the "concentration rule": Member States can no longer require investment firms to route orders only through regulated markets. Exchanges are now exposed to competition of two additional types of trading venues: Multilateral Trading Facilities (MTFs) and Systematic Internalisers (SIs). MTFs and SIs – of which so far not many exist - are subject to separate rules intended to meet similar pre- and post-trade transparency requirements as the exchanges. In choosing among trading venues, the intermediary is obliged to comply with a new set of best execution rules. These measures are intended to ensure a level playing field between the exchanges and their new competitors that should favour the emergence of a more integrated and competitive trading infrastructure. The MiFID leaves the consolidation of data to market forces.

Updated and expanded "single passport": To keep pace with new market realities, MiFID extends the list of services and financial instruments that can be 'passported' across the EU on the basis of a single authorisation from the home Member State. These include for instance the provision of investment advice, the new activity of operating an MTF, or investment services and activities relating to derivative instruments, including commodities-related products. Moreover the use of the passport is further facilitated by the more thorough application of the principle of the exclusive application of home country regulation in the free provision of services and by the ban on host country regulators to impose additional requirements on EU foreign financial services providers.

New investor protection regime: Investor protection rules are strengthened and harmonised at high level so that investors can feel confident that they enjoy the same level of protection in using the services of investment firms, wherever those services originate in the EU. The elimination of overlapping requirements from the country of the investor gives investors access to a broader choice of investment service providers and, consequently, to a wider range of services and products. In return, investment firms are expected to comply with conduct of business rules on suitability, appropriateness, best execution, and acting in the best interests of the investor. Altogether this should attract new investors to EU capital markets and, more particularly, increase the participation of retail investors in capital markets.

(3) http://ec.europa.eu/internal_market/securities/isd/mifid_implementation_en.htm
(4) CESR's Statement of 22.10.2007.
(5) CESR – Committee of European Securities Regulators

Challenges following MiFID implementation

Since its entry into force, MiFID's implementation appears to be a source of concerns for the industry on two major grounds: first, delays in adopting MiFID Directive have left some firms ill-prepared forcing them to quickly adapt to the new rules; second, firms which are making important efforts in order to be compliant with the new framework, may be now facing new difficulties due to Member States' possible different interpretations, or gold-plating, of some provisions. The Commission's role in this context will be of utmost importance in enforcing proper implementation of the Directive, as will CESR's promoting regulatory convergence.

Indeed, a major challenge in tackling MiFID implementation comes from the fact that MiFID consists of a mixture of both fixed rules and more general principles. On one hand, MiFID seeks to ensure maximum harmonisation of transposition provisions[6] . On the other hand, it leaves firms a certain room for manoeuvre to meet their compliance obligations. Terms such as «adequate», «effective», «sufficient» or «appropriate» give firms the proper flexibility to design solutions that best fit their business and organisation. It is important that firms can do this without being constrained by Member States possibly diverging and restrictive interpretation of these terms, that would put MiFID's level playing field at risk.

Today however, eight months after MiFID's entry into force, it is still premature to assess possible significant discrepancies in Member States interpretation of MiFID's provisions. So far, the main challenge seems to be the profoundly innovative character of MiFID, which introduces a wide range of new requirements in many Member States - such as "best execution" and post-trade transparency rules - that require some time to be fully digested by firms as well as properly embedded in their culture. The degree of consistency in the supervision of these rules also remains to be seen. Another challenge lies in MiFID's complexity that has prompted the Commission as well as CESR to create a MiFID Q&A facility to address the numerous practical questions arising in MiFID implementation and help firms integrating as easily as possible the new complex rules in their daily business. In this respect, a clarification of the status of CESR's MiFID Q&A as well as its interaction with the Commission's MiFID Q&A is urgently needed.

Conclusion

MiFID is far from being a «one-shot» reform, but rather a lengthy and complex process. Adapting to new regulatory requirements is never easy and MIFID implementation is particularly challenging given its wide-ranging scope and numerous innovative provisions. Likewise the full impact of MiFID on the architecture of European financial markets and the financial services industry will only become tangible over time and so will the real consequences and changes in the market dynamics.

Today, there are still lots of details to work out and implementation will require continued efforts, especially to examine the impact of any discrepancies and inconsistencies in national interpretation and application of the MiFID. There is no doubt however that MiFID has the potential to create new opportunities for markets players and to significantly foster financial market efficiency by injecting fresh competition as well as to yield substantial progress in market integration and transparency. In this respect, the ability to reap the full benefits from MiFID will clearly depend on its effective and homogeneous implementation. To that end, it is crucial to ensure consistency of approach by Member States as well as increased cooperation between securities regulators and continuing convergence of supervisory practices.

This is also important from the perspective of broader transatlantic and international capital markets integration. MiFID will be a central directive in the comparability assessment of trading and investment rules between Europe and the US in the context of the discussions on mutual recognition. A consistent approach to MiFID implementation will play a significant role in the successful outcome of these discussions.

(6) Art. 4.1 of Dir. 2006/73/EC provides that "Member States may retain or impose requirements additional to those in this Directive only in those exceptional cases where such requirements are objectively justified and proportionate so as to address specific risks to investor protection or to market integrity that are not adequately addressed by this Directive (…) and subject to two conditions."

EPFSF Briefing - «Solvency II: outstanding issues»
5 September 2008

Introduction

The second half of 2008 will be crucial for the Solvency II project. The European Parliament and the Council are expected to reach agreement on the Level 1 framework Directive, and CEIOPS will process and publish the results of the fourth Quantitative Impact Study (QIS 4). In the process, key decisions will have to be taken, decisions that will shape the European regulatory environment for insurance companies for the years to come.

There is agreement among stakeholders on both the objectives and the key risk-based principles of the Solvency II framework. Several key issues however remain to be solved. It is a challenging task to find suitable satisfactory solutions to these issues that will meet stakeholders' concerns while strengthening and completing the framework and enabling Solvency II to reach its objectives. Moreover, with Parliament elections and a new Commission in 2009, time is becoming a factor, and delay cannot be an option.

General support

Objectives: The press release that accompanied the publication of the draft Directive called Solvency II a *«ground-breaking revision of EU insurance law designed to improve consumer protection, modernise supervision, deepen market integration and increase the international competitiveness of European insurers»*. This is a clear statement on objectives, and one that has been endorsed by market participants, consumer representatives, supervisors and representatives of the European institutions and Member States alike.

Risk-based principles: Furthermore, there is also widespread - if not unanimous - agreement on the foundations of the Solvency II framework, as the draft Directive:

- introduces a total balance sheet approach; assets and liabilities are valued using a market consistent approach, consistent with IFRS.
- adopts an economic risk-based approach where supervisory tools and interventions will depend on the risk profile of the company.
- distinguishes two solvency requirements: the Solvency Capital Requirement (SCR) and the Minimum Capital Requirement (MCR). The SCR covers all quantifiable risks and will function as a day-to-day target solvency level based on a 99,5% confidence level over a one year period. In the calculation of the SCR both diversification across risks as well as risk mitigation are taken into account. The MCR is a threshold below which policyholders are exposed to an unacceptable degree of risks.
- allows the SCR to be calculated by using either a standard formula or an internal model. Use of the latter is subject to supervisory approval.
- introduces more efficient supervision of groups, as important as solo supervision.
- introduces a supervisory review process that entails the review and evaluation of strategies, processes and reporting procedures, as well as the risks a company is taking on and the ability of a company to assess and manage those risks. The supervisor will use a company's mandatory Own Risk and Solvency Assessment (ORSA) as a basis for this process.

Key issues remaining: With agreement on key foundations in place, 5 issues in particular are still under debate in order to seek a solution that will be satisfactory to all involved and that will strengthen and complete the Solvency II framework.

i.) Group support regime: In the context of group supervision regulation, the provisions of the draft Directive on group support are much welcomed by industry as they aim to make supervision more efficient, bringing it more in line with economic reality. The insurance industry supports the group support procedure as it allows for group diversification as well as (a degree of) capital mobility within a group. While sharing this assessment, the mutual insurance sector admonishes that to achieve this aim the group definition should be flexibilised/adapted/amended. To other stakeholders however, group support is a source for concern as they suspect a mismatch in supervisors' restricted role and limited powers in the supervision of cross-border groups on the one hand, and their responsibility for the local consumer and full (political) accountability on the other hand. Moreover, some stakeholders are concerned about the legal enforceability of the group support instrument as they are not convinced it provides sufficient guarantees.

ii.) MCR structure and calibration: For the calibration of the MCR, three different approaches have been put forward so far:
- Modular approach: calculates the MCR as an aggregate of capital charges for different risks. This approach was tested in QIS 2 and 3, and did not fully meet expectations.
- Linear approach: calculates the MCR as a fixed percentage of the technical provisions. This approach (and the related corridor approach) is being tested in QIS 4. Some stakeholders support it for its simplicity, while others point to the fact that this approach is not risk sensitive.
- Compact approach: calculates the MCR as a percentage of the SCR. Widely supported by industry as it is the only risk sensitive approach that allows for a useful ladder of intervention, and therewith, allows for diversification. Opponents want the highest possible MCR due to its political nature.

iii.) Surplus funds: Surplus funds are widely used in a number of European countries and these countries aim to have these funds recognized as own funds. This topic also raises a level playing field debate. Stakeholders question the extent to which recognition is consistent with the economic principles of the calculation of technical provisions, and the potential distorting impact for groups.

iv.) Treatment of equity risk: The draft Directive's statement on equity risk is questioned by stakeholders. Supporters of the current wording argue that equity risk declines over time and that capital requirements should reflect that rather than a 1-year horizon. Others disagree, questioning this assumption and fearing a departure from the solvency framework of the directive and from the principle of market consistent valuation.

v.) Pension funds: In some national markets occupational pension funds and life insurers offer similar products/services within the second pillar pension provision. So far according to the IORP Directive (IORP = Institutions of Occupational Retirement Provision) Solvency I rules apply to a number of pension funds whereas all the life insurers offering pension products/services will come under the Solvency II regime. The question could be raised whether Solvency II should be made applicable also to those IORPs that are currently under the Solvency I solvency margin rule. Even if it is difficult to establish which solvency regime could do justice to pension funds' singularities, the Commission review of the IORP Directive will aim at addressing this issue. Some stakeholders would like to address the question of a level-playing field between pension funds and life insurers offering similar occupational pension services. However, other stakeholders hold that more in depth research and fact finding has to be done to establish the respective playing fields in private pensions while taking into account Member States' competence in devising pensions policy.

Conclusion

Many of the bricks of the Solvency II structure are already in place. Several difficult tasks still lie ahead however for the structure to become a building. Beams will have to be put in their place, and a firm roof needs to be constructed. Fulfilling these tasks, making the Solvency II building an acceptable place for all to live in, while adhering to the original floor plan and timetable, is what is at stake. The building must be finished for all to take benefit from.

EPFSF Briefing - «CRD: Understanding the changes – and why?»
29 September 2008

Introduction

In advance of the general CRD[1] review of 2012, the European Banking Committee has decided to make targeted changes to the CRD to address specific shortcomings of the current framework, as well as incorporate the results of the large exposures review. Some of the changes also relate to the ECOFIN Roadmap responding to the financial turmoil. Following work carried out by the Commission working group on the CRD as well as by CEBS, the Commission launched a public consultation on changes to the CRD which ran from mid-April to mid-June 2008. A recent addition to the package of proposals is the Commission's consultation on incremental risk in the trading book. It is proposed that the changes to the CRD will be adopted by October 2008 with a view to ratifying them under the current parliamentary legislature, i.e. by April 2009.

The Commission proposals will comprise two different legislative instruments: one co-decision procedure to amend the core rules of the CRD (Lamfalussy Level 1) and one comitology procedure to make technical changes to the CRD annexes – except Annex III of Directive 2006/48/EC - (Lamfalussy Level 2).

Amendments to the CRD are planned in six sections:

- Large exposures
- Hybrid capital instruments
- Supervisory arrangements
- Waivers for cooperative bank networks
- Technical amendments to Directive 2006/48/EC
- Technical amendments to Directive 2006/49/EC

Large exposures

The CRD provided for a review of the large exposures regime because it was not amended as part of the original CRD package and is 15 years old. The review covered such areas as the objective for the large exposures rules, divergent application across the EU, measurement of exposures, risk mitigation and reporting requirements.

CEBS outlined the purpose of a large exposures regime as being to protect against the risk of a regulated institution incurring traumatic loss (from an unforeseen event), likely to threaten its solvency, as a result of the failure of an individual clients or group of connected clients. Although a wide-ranging review was undertaken, the proposed changes mainly amend the existing regime (based on a hard limit of 25% of own funds in the banking book and capital charges in the trading book) and aim to simplify and harmonise the regime by deleting a number of national discretions and further aligning it with the solvency regime.

Inter-bank exposures with a maturity of less than one-year are currently exempted from the 25% limit. The Commission has proposed to remove this preferential treatment on the basis that contagion effects could cause failures of other connected institutions thus potentially creating systemic instability. The whole financial industry has repeatedly expressed concerns in relation to the negative impact this change could have on liquidity management and the interbank markets.

(1) The Capital Requirements Directive covers Directives 2006/48/EC (Article 156) and 2006/49/EC (Article 51)

«Intra-group exposures» has also been a significant issue due to the numerous related national discretions and the growing number of cross-border banking groups in the EU. While the Commission initially suggested harmonising the treatment of intra-group exposures, it is expected that it will propose to retain one of the existing national discretions while awaiting its ongoing work on cross-border intra-group assets' transferability.

Hybrid capital instruments

The current framework does not provide rules for the recognition of hybrid capital instruments (instruments with characteristics of both equity and debt) as Tier 1 regulatory capital. Therefore national regulators implemented the 1998 Basel Agreement («Sydney Press Release» - SPR) in an inconsistent manner, creating an unlevel playing field across the EU. Because of the importance of hybrid instruments as a major funding source for banks, the Commission suggested a common, principle-based approach regulation to implement the SPR in the EU.

The proposed rules duly reflect the three main eligibility criteria set out in the SPR: flexibility of payments, permanence and subordination. However, they do not define the loss absorption principle, which is presented as an additional eligibility criteria rather than the outcome of the three first ones. The proposed rules set clear limits for the recognition in Tier 1. It is key that the Commission maintains such a principle-based approach in order for local supervisors to be able to implement the directive in conformity with their respective corporate, fiscal and insolvency laws.

Financial industry requested the Commission to provide more clarifications on items eligible for recognition as Tier 1, and in particular for non-cumulative preferential shares. If too much discretion is left to Member States concerning items included in the definition of own funds or concerning items others than those established in the CRD to be included as deduction, it could hinder the harmonisation of supervisory practices and the levelling of the playing field among financial institutions.

Supervisory arrangements

The refinements of the CRD in this area relate to the need to progress on supervisory convergence and in the implementation of a responsibility and accountability framework for the supervision of banking groups. Cooperation arrangements in both going concern and stress situations, and in particular the task of the consolidating supervisor, are currently not clearly defined in the CRD.

The Commission has proposed introducing, into the CRD, the concept of college of supervisors for cross-border banking groups, together with provisions on its composition, tasks and decision-making process. Colleges would enhance supervisory cooperation and information exchange thus avoiding duplication of work and rationalising supervisory reviews and assessment thereby increasing supervisory efficiency. Colleges already exist in practice; therefore this proposal represents a formalisation and potential extension of the terms of operation of colleges in the EU. However, few important financial groups operate solely in the EU, therefore any system introduced in the EU need to be capable of integrating into global supervisory arrangements, i.e. take account of third countries, without however interfering with the efficiency of any EU arrangement.

In terms of decision-making, while it is pretty clear that consensus-based joint decision would prevail, it is less clear how to proceed in cases when common decisions cannot be reached as regards Pillars II & III matters. Many representatives of the industry and to some extent the current thinking of the European Commission are supporting the "last say" of the home supervisor principle. There certainly is a role for CEBS to play here: in its policy-setting capacity, CEBS' advice to any of the parties during the decision-making process could facilitate ironing out possible disagreement among supervisors and reaching a joint decision; it should in any event be duly considered. CEBS would furthermore be referred to in the Directive to bring about convergence across colleges.

Securitisation

The ECOFIN Roadmap for drawing the lessons from the crisis identified some issues relating to securitisation. The Commission has proposed changes in the CRD aimed at enhancing risk management practices, increasing banks' transparency on their transferred risks and complex instruments and addressing concerns about the incentives for lending banks in the securitisation process. Regarding incentives it has consulted twice on a proposal to require firms to retain 'skin in the game'. These consultations received overwhelming criticism from both industry and Member States on grounds of the negative economic impact this is likely to have on the EU, on damage to investors' ability to access markets, and that it will not achieve the Commission's own desired aims. The Basel Committee is also re-examining the Basel II securitisation framework and the industry has urged the EU authorities to make sure that any changes are global in nature and do not fragment capital markets at a time when confidence is most needed.

Incremental risk in the trading book

The Commission has recently issued a detailed and technical consultation on incremental risk in the trading book and asked for comments by 15 October. This is purportedly in parallel with the Basel/IOSCO Committee work which has been underway via frequent dialogue with the industry for a number of years. It is important that Basel and IOSCO complete their work before the Commission proposes related CRD amendments to avoid the possibility of regulatory arbitrage between different jurisdictions and competitive implications for European industry. The proposals address the fact that Value at Risk models did not capture all the losses sustained in the trading book as a result of recent events and are intended to insert more extensively within the authorized internal model the credit and event risk dimension and to extend to 1-year the time horizon. These changes may significantly increase the capital requirement for trading book activities.

EPFSF Briefing «Revision of the UCITS Directive: Towards a Competitive Regulatory Framework for Europe's Investment Funds»

29 October 2008

Introduction

The UCITS directive (Undertakings for Collective Investment in Transferable Securities, UCITS) is a key facilitator to the successful development of the European investment funds industry by providing a globally recognised quality label for investment funds. Over 11.5% of European household financial assets were already invested in UCITS funds in 2007 and around 40% of UCITS originating in the EU were sold in third countries like Asia, the Gulf region and Latin America. In terms of market share, UCITS compliant funds account for around 75% of Europe's investment funds market with total assets of around EUR 6 trillion(1). Despite this enormous success, there is an urgent need to adapt the UCITS regime to today's market needs and, hence, to allow fund managers to fully exploit the potential of Europe's single market for investment funds. In recent years, UCITS have encountered increased competition from substitute retail investment products with some commentators taking the view that UCITS funds have become disadvantaged by the more flexible regulatory frameworks of retail structured products and insurance linked investment products - especially when it comes to the time and costs to market new products(2).

Intensive consultation laid the ground for the UCITS revision

In order to keep pace with the rapidity of innovation in financial markets the Commission released a Green Paper in 2005 to initiate a public debate on how to foster the competitiveness of Europe's investment fund industry. Following on from this and based on the feedback received from various stakeholders, the Commission proposed a set of targeted modifications to the UCITS directive in a white paper in 2006 and held an open hearing in April 2007(3). In March 2007 the Commission released another consultation document on the priorities for the UCITS revision and organised another public hearing in April 2008. Afterwards, concrete proposals for legislative amendments were released by the Commission on 16 July 2008. These measures were also accompanied by an impact assessment. It is expected that the proposal might be adopted by the EU Council of Ministers and the European Parliament in the second quarter of 2009. Ultimately, the provisions might come into effect in mid 2011.

The Commission's proposals

The Commission's proposals aim at erasing regulatory barriers for the cross-border distribution of funds, creating a framework for mergers between funds domiciled in different countries and introducing master-feeder structures. In addition, the Commission intends to intensify the cooperation mechanisms between national supervisors and to replace the simplified prospectus by a new concept of key investor information.

a) Cross-border distribution of UCITS funds

In day to day business, notification requirements are still an immense obstacle to the efficient cross-border distribution of UCITS funds.

(1) See EFAMA.
(2) The Commission explores potential competitive distortions in a call for evidence initiated on substitute retail investment products. A feedback statement was released on 3 April 2008 and an open hearing took place on 15 July 2008. The Commission intends to release a communication in autumn 2008 that shall explain whether it identified a need for legislative action or not. See press release IP/08/500.
(3) Besides, three expert groups on market efficiency, hedge funds and private equity were set up in 2006. In July 2008 another expert group report on open ended real estate funds was subject to a public consultation and an open hearing on non-harmonised retail investment funds took place in April 2008.

Rules on notification are not interpreted uniformly across member states and some national authorities require additional information, translations and sometimes the appointment of a local representative. In addition, the length of the procedures diverges significantly and regularly exceeds the maximum time frame of two months stipulated by the UCITS Directive. By contrast, more recent European directives on comparable investment products, such as the prospectus directive applying to securities, have abolished the requirement for a separate notification procedure altogether. This puts UCITS funds at a severe competitive disadvantage.

The proposed legal amendments of the Commission aim at lowering costs and avoiding delays for the notification of foreign funds. Under the amended regime, a duly authorised UCITS can be offered in another member state upon notification without any further delay. These amendments erase the ex-ante control capacities of host supervisor before the marketing of a fund can be started. In addition, information is to be exchanged electronically between regulators and, hence, will allow for a significant reduction of direct annual costs of notification and also shorten the time-to-market period for foreign funds significantly. This approach is welcomed very much by market participants as it not only fosters the creation of the internal market for investment funds but also allows for a more efficient and timely distribution of investment funds across borders.

b) Fund mergers and master-feeder structures

Unlike the US market, the EU fund market is highly fragmented and investment funds are on average of a suboptimal size that is five times smaller than in the US. On average, European funds hold assets of EUR 178 million while their US counterparts have AuM of EUR 974 million in 2006. Around 54% of UCITS funds even have AuM of less than EUR 50 million(4). As a result, the average total expenses ratio of cross-border equity funds in Europe is nearly twice as high as in the US. Experts consider that both investors and fund managers still fail to benefit from substantial scale effects that are estimated between EUR 3.1 and 8.6 billion annually(5).

The Commission is aware of this situation and intends to achieve greater economies of scale by introducing a legal framework for both national and cross-border fund mergers. The amended article 35 provides for the basic principle that all UCITS funds irrespective of their legal form are entitled to merge. This new merger regime will be applicable for both cross-border and domestic mergers and their authorisation procedure will be harmonised as will the required level of information to be provided to investors. Fund manager welcome this approach as it will facilitate daily fund operations significantly and allow for the achievement of economies of scale. These might even ultimately lower the costs of fund management for retail clients providing that the operational aspects of the mergers are also covered by the Directive.

The proposed master-feeder structures will allow a feeder fund managers to invest between 85% and 100% of the fund's assets into one other fund (so-called master fund). By doing so, the investment manager of the feeder fund purchases units in the master fund on behalf of the feeder fund. This situation translates into various benefits. First, economies of scale can be achieved by the feeder fund thanks to the pooling of assets. Secondly, the fund management resources can be centralised in a single team of fund managers allowing cost savings and the further standardisation of processes, although fund sponsors will need to be alert to the need to disclose double-charging and «layering» of expenses. Thirdly, similar funds offered to different types of investors and with individual fee structures can be combined in one entity while at the same time the local presence of the feeder funds still allows clients to be served locally. Finally, in case of a merger of fund management companies, similar funds can be pooled in one master fund while different fund labels are maintained. From an industry perspective, these suggestions are very helpful and would contribute to achieving significant economies of scale. These also translate to cost savings that might ultimately reduce total expense ratios for investors. If the Directive correctly addresses the operational aspects linked to those new measures, these will effectively translate to cost savings that might ultimately reduce total expense ratios for investors.

(4) European Commission
(5) See Invesco (2005). Benefits of an integrated European Fund Management : Cross-border merger of funds, a quick win?

c) Key investor information

The simplified prospectus did not live up to its full expectation in recent years for either retail investors or funds managers. In practice, it proved to be too complex and did not allow average retail investors to compare funds across borders. For fund managers, the simplified prospectus was at the same time relatively costly and time-consuming for the industry. In addition, domestic regulators often require further layers of information to be provided in the simplified prospectus which was over and above the de minimus position applied across most Member States (so called gold-plating).

The exposure draft introduces a completely new approach by introducing the concept of key investor information (KII). The aim of KII is to provide in a short document all key facts to retail investors in a clear and understandable manner. Notably the standardisation of key contents of the KII will enable retail investors to truly compare funds and, hence, to make an informed investment decision. From a fund manager's point of view, it is crucial to inform clients in a meaningful and cost-efficient way. Hence, this proposal has been well-received by the fund industry.

d) Cooperation mechanisms between national supervisors

The enhanced cooperation between national supervisors is a key requirement for the successful implementation of proposed amendments of the UCITS directive. The Commission intends to draw largely on provisions already in force in other financial services directives. These will probably include the equivalence of powers of competent authorities, the creation of mechanisms relating to exchange of information and the implementation of arrangements for verification of information and investigation on the territory of another Member State.

The management passport: a political hot potato

The introduction of a management company passport (MCP) is still under discussion. Although the MCP can raise the flexibility and efficiency in daily fund management significantly by enabling funds authorised in one member state to become managed by a management company registered in another member state, the Commission sees potential supervisory and investor protection concerns. For example, according to the Commission problems in allocating responsibilities between different supervisors could hamper the enforcement of rules, in particular in the case of cross-border management of contractual funds. The Commission has decided to seek advice from the Committee of European Securities Regulators (CESR) on this issue. CESR has already published for public consultation its draft advice which carefully addresses these concerns and has also arranged a public hearing. CESR will deliver its conclusion by 1 November 2008. Afterward, the Commission is expected to take into consideration CESR's conclusion and release a modified legislative proposal.

Conclusion

The Commission's legislative proposal is the result of a long process of analysis and intensive consultation. Generally speaking, it provides a sound framework for a successful revision of the UCITS directive and to update the UCITS regime to current market needs. The Commission rightly addresses the most crucial items such as funds mergers, asset pooling and simplification of cross-border distribution rules. These measures are conducive to strengthening the functioning of the internal market for investment funds, to enhance market efficiency and should ensure that investment funds can compete on a level playing field with substitute retail investment products. At the same time investors stand to benefit from streamlined information standards (KII), providing full transparency in respect of cost and risk/reward. Finally, as often recommended by the fund management industry the opportunity to improve the European investment fund market by introducing the MCP based on CESR's recommendations should not be missed, providing that the implementation schedule for UCITS IV is adhered to.

EPFSF Briefing - «Commodity Trading»
25 November 2008

Introduction

Commodity derivatives trading started to enable farmers to protect themselves from the risk of the value of their crop falling below cost of production. The industry has evolved to include a wide range of products, participants and functions. In recent years, higher food and energy prices have provoked considerable interest and a number of initiatives from regulators and politicians, including in Europe.

How and where are commodities traded?

A wide range of commodities are traded on wholesale markets, including
- «Softs»: agricultural commodities such as grains, coffee, cocoa, sugar, cotton.
- Base Metals e.g. copper and aluminium, and precious metals e.g. gold, silver, platinum.
- Energy e.g. electricity, gas, oil and other energy derivative products.
- So-called «exotics», allowing market participants to hedge risks linked with specific variables affecting costs/profitability in their business e.g. weather, freight costs.

These commodities are traded in two main types of contract:
- Derivatives: Commodity derivatives derive their value from changes in the value of the underlying commodity, index, or rate, transferring price risk from one counterparty to the contract to another. These may be settled by transfer of cash, or in some cases the underlying commodity.
- Physical trading: Trading of the physical commodity, often involving scope for physical delivery of the relevant commodity e.g. in «spot» trades, involving immediate delivery of the commodity.

Commodity trading takes place on two principal types of venue:
- On-exchange: traded on exchanges' or on alternative electronic trading platforms, where standardized contracts are cleared and traded on a centrally regulated market. The vast majority of these trades are cash-settled futures and options.
- Over-the-counter (OTC), off-exchange, where bilateral contracts between counterparties can be customised according to the needs of the counterparties, or where the underlying commodity is not traded on an exchange i.e. the only liquid market is off-exchange.

1,684 million commodity contracts were traded on-exchange in 2007, up by over one-third on 2006 levels. Agricultural products accounted for 46% of this total, energy 35% and metals 19%. The notional amount of OTC commodity derivative contracts outstanding was $9 trillion as of-end 2007 (although this amounts reflects hedging and offsetting contracts entered into to further reduce risk). The real risk (before netting, further reducing risk, had taken place) related to these contracts was between 4 and 8% of the notional volume.

What function does commodity derivative trading serve?

Risk transfer and management: The key function of all derivative contracts is the transfer and management of risk. In commodity derivative contracts, commercial market participants can mitigate risks posed to their business by movements in the price of important commodities.

(1) IFSL Research: Commodities Trading 2008, June 2008: http://www.ifsl.org.uk/upload/CBS_Commodities_2008.pdf
(2) BIS figures

Thus, for example,
- Agricultural producers can 'lock in' a stable price for their produce;
- Energy producers can make necessary investments in infrastructure, content that these investments will not be undermined by falling energy prices making their business unprofitable; and
- Corporates can secure prices for supplies, protecting their cost base against price changes.

In this context, the role of non-commercial market participants in commodity markets is key. The presence of different types of non-commercial participant (e.g. banks, pension funds, hedge funds etc) in wholesale commodity markets adds diversity to the spectrum of ways in which dealers can then lay off their risk. This allows risks taken from hedgers to be dispersed more widely in a way minimizing the impact on market prices.

Portfolio diversification: Commodities trading can also offer a useful means of portfolio diversification. Fund managers and other «non-commercials» use commodity derivatives on the basis that commodities behave differently at different times in the economic cycle to other financial instruments (e.g. shares or bonds). This is investment responding to market conditions however, with, limited impact in terms of 'amplifying' price changes (recent falls in commodity values underline that flows of capital into commodities cannot override the effect of demand exhaustion). It should be noted that pensions and UCITS funds are limited quantitatively in their investment in commodity derivative contracts.

What are the benefits of trading OTC and exchange-traded commodity derivatives, respectively?

In the OTC commodity derivatives business non-commercial participants can act as 'dealers', customising bilateral contracts with commercial participants to meet their risk management needs, and themselves taking on some of the risks that 'commercials' are exposed to in their core commercial activities. The ability to customise (e.g. in terms of delivery dates or locations, cash flows) is the real added value of OTC commodity derivatives – individual contract terms are altered according to the exact risk management needs of the counterparties.

Exchange-traded derivatives, on the other hand, offer the advantage of a central mechanism for real-time price discovery and valuation in liquid markets (meaning it is always easy to trade), standardisation, transparency, and capital advantages in terms of counterparty risk.

Exchange-traded commodity derivatives (and some OTC commodity contracts, including some energy derivatives) are traded as «cleared» contracts, with a Central Counterparty becoming the intermediary in the trade and taking on the risk of counterparty default in return for clearing fees and the holding of margin submitted by the counterparties.

What regulations apply to commodity derivatives trading?

In Europe, financial institutions engaged in trading of commodity derivatives are subject to the 2004 Markets in Financial Instruments Directive (MIFID). Specific aspects of MIFID and of other EU financial services legislation (e.g. the Market Abuse Directive) apply to such firms to the extent to which they trade in commodity derivatives falling within the definition of MIFID financial instruments(3). They are required to get authorization to provide investment services or activities, and are subject to the same requirements that apply to other regulated business, including obligations to act honestly, fairly and professionally. These firms benefit from a «passport» for their activities across EU markets.

(3) Including commodity derivatives that may be forcibly settled in cash; physically-settled commodity derivatives traded on MTFs / regulated markets, physically-settled commodity derivatives not entered into 'for commercial purposes', and that are like other financial derivatives (e.g. they are cleared in clearing houses and subject to regular margin calls), and cash-settled 'exotic' (weather, freight, emissions allowances) derivatives and other derivatives cleared in clearing houses and subject to regular margin calls.

Specialist commodity firms (e.g. oil firms, food producers - not part of a bank group - engaging in commodities derivatives trading to manage commercial risks) can currently benefit from exemptions from the MIFID and from the Capital Requirements Directive. However, they do not benefit from a 'passport' for their activities in the EU. This is reflected in varying approaches to regulation of commodity firms' wholesale trading in the EU (e.g. the UK requires many commodity firms exempt from the scope of MIFID and the CRD to apply for a license under the OMP and EMP[4] regimes).

The major exchanges trading commodity derivatives in Europe (e.g. ICE, EEX, LIFFE, Nordpool, LME) are regulated markets under MIFID and as such are subject to rules governing management and operating requirements, admission of instruments and participants to trading, and pre-/post-trade transparency.

It should be mentioned that regulated markets are given considerable responsibility by regulators in policing market behaviour. Regulated markets must report transactions in MIFID commodity derivatives traded on exchange to regulators. The Market Abuse Directive applies to all commodity derivatives traded on regulated markets (or linked to instruments traded on regulated markets), and charges regulated markets with watching for signs of abuse.

Another tool available to regulators is competition policy. The European Commission's recent Energy sector enquiry revealed a number of concerns about competitive conditions in gas and electricity markets, particularly excessive market concentration, inadequate levels of unbundling between network and supply interests, and market mechanisms favouring incumbents. While some issues were tackled in the 3rd Energy Package, more vigorous application of competition policy to these market structure challenges would address many of the problems that prompt political figures to query the benefits of commodity trading.

What regulatory initiatives are under way dealing with commodity derivatives?

Fluctuating food and energy prices have placed commodity derivatives trading in the spotlight.

There is considerable evidence to suggest that these rises were largely the result of altered and more sophisticated patterns of supply and demand in recent years, in particular

- Greater and more diverse demand for food and energy from developing economies such as China, India, Brazil, Russia;
- Trade and export constraints in many countries, limiting supply;
- A failure to invest sufficiently in years past in energy infrastructure, and recent investment in energy sources which reduce food supply (biofuels);
- A natural «lag» in the ability of energy and food producers to meet accelerating demand.

Nevertheless the activities of commodity «speculators» have attracted political and regulatory interest.

The Commodity Futures Trading Commission (CFTC), which regulates commodity derivative trading in the US, has looked at this issue throughout 2008, concluding (as part of an Interagency Task Force) in June 2008, that higher crude oil prices were due to altered supply and demand. A September CFTC 2008[5] report on the activities of swap and index traders (types of «non-commercial» participant in markets: index traders[6] in particular have been much blamed for driving prices up) that increases in net notional value of commodity index business in crude oil futures, were due to *«an appreciation of the value of existing investments caused by the rise in crude oil prices and not the result of more money flowing into commodity index trading».*

(4) OMP - Oil Market Participant, EMP – Energy Market Participant.
(5) «CFTC Staff report on Commodity Swaps Dealers and Index Traders with Commission Recommendations» Sep2008:http://www.cftc.gov/stellent/groups/public/@newsroom/documents/file/cftcstaffreportonswapdealers09.pdf
(6) Traders (including pension and endowment funds) that seek exposure to commodities through passive long-term investment in commodity indexes

Nevertheless, the report proposed changes including a change to the classification of swap dealers for reporting purposes, more detailed reporting for large futures traders, and reduction of scope of «hedging» exemptions (from regulation) for swap dealers. This report came after considerable pressure from the US Congress. Political pressure also led the CFTC to impose US-style regulatory reporting on an EU Exchange on threat of excluding trading screens from the US.

In the EU, the European Commission published a Communication on food price rises in June 2008[7], laying the blame on supply and demand, but pledging to watch developments in commodity-related financial markets. An October 2008 report on oil markets by the French Presidency (assisted by the European Commission), came to similar conclusions, ascribing higher prices to changes in supply and demand, but adding that *«financial markets are…likely to have played a role in more recent volatility»*.

So are EU regulators considering greater regulation of commodity derivatives trading?

The exemptions from MIFID and Capital Requirements Directive are under review, although there appears to be some regulatory support for the principle that commodity firms participating in these markets for commercial purposes, and who do not deal with retail investors (who do not typically participate directly in these markets), should continue to benefit from exemption. A report (for consultation) outlining policy options, is expected from the European Commission in December 2008.

The boundaries of regulation of wholesale and electricity and gas trading are also the subject of review by financial and energy regulators, working with the European Commission, in the context of the 3rd Energy Package. This review is assessing the case for new record-keeping, market abuse, transaction reporting and transparency rules for physical and derivative markets in electricity and gas, and requires close cooperation between the European Commission Directorates-General for the Internal Market and for Transport and Energy, in view of the potential overlap of financial and energy regulation.

Lastly, the EU Market Abuse Directive (MAD) is also under review by CESR. A consultation document is expected in the coming weeks, and may broach issues including the scope of commodity derivative instruments covered by the MAD, as well as the operation of current commodity-specific aspects of the Directive, such as the definition of inside information for commodity derivatives.

(7) http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2008:0321:FIN:EN:PDF

Conclusion

Commodity derivatives play a vital, but often misunderstood role in commodity markets. The core purpose of commodity derivatives is helping market participants to manage important business risks.

It is tempting to blame price volatility on speculation in commodity markets, but there is evidence that recent price rises are largely the result of an imbalance in the relationship between supply and demand for many commodities, resulting from changing global economic and demographic patterns, and in many cases, government intervention. The role of supply and demand in these price changes has been recognised by many international and national regulatory or quasi-regulatory organizations.

Regulatory interest in these issues is justified, given the impact of commodity price changes in ordinary peoples' lives. It is important, however, that regulators take decisions based on sound economic assessment, in order to avoid any possibility of unforeseen and unintended consequences negatively impacting producers, manufacturers corporate users and consumers alike.

EPFSF Briefing - «Financial Crisis: Next Steps in the EU»

9 January 2009

Introduction

Since last September, strains in the financial system have increased significantly. Governments worldwide have been forced to take emergency measures such as recapitalising banks and guaranteeing their liabilities to alleviate tensions in financial markets. In the EU, these measures amount to EUR 1,800 billion in government guarantees and EUR 280 billion in recapitalisation schemes. The European Commission (EC) is obliged to ensure that such measures serve the rest of the economy and do not create distortions of competition.

The effects of the emergency measures on the functioning of credit markets - especially the interbank market - will take some time to fully materialise. The EC has said that it wants to be pragmatic and offer Member States as much flexibility as possible in designing their aid schemes. The increasing participation of the state in the capital of financial institutions gives rise to important questions about how the European financial services sector can return to normal, privately funded operation as quickly as possible.

Whilst emergency measures have been instrumental in the partial restoration of financial stability, they have not prevented the financial crisis from affecting the «real» global economy. As the 2 December ECOFIN meeting conclusions have recognised(1), economic activity in the EU as a whole has contracted in the third quarter of 2008 and could have contracted further in the fourth quarter. At this stage, European governments debate how to best contain the effects of the financial crisis on the real economy, fundamentally through monetary and fiscal measures. A package in the magnitude of 1.5% of GDP is being considered to provide a stimulus to the European economy.

Against this background, the financial regulatory reform agenda - promoted by the EC and coordinated at the international level through the Financial Stability Forum (FSF) and the governments of the G20 - continues to make progress, on many occasions at such a high speed that crucial better regulation principles are unintentionally overlooked, thus giving rise to reasonable concerns regarding regulatory effectiveness. A raft of regulatory proposals emerged in the autumn of 2008 i.e. proposals on capital requirements, deposit guarantees and credit rating agencies, as well as new rules on accounting. A second phase of work, currently under preparation, will come forward in 2009. As the EC indicates in its Legislative and Work Programme for 2009(2), this package of initiatives will likely include proposals to regulate and supervise all financial actors - including all significant capital market investors - and will cover executive remuneration and derivative markets among other issues. The outcome of the High Level Expert Group on EU financial supervision (the “de Larosière group”) set up by the EC may also feed into this regulatory process.

(1) http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/104457.pdf
(2) http://ec.europa.eu/atwork/programmes/docs/clwp2009_en.pd

Consequences of public support for the financial sector

In October, the emergency measures agreed to help restore the stability of the financial system were decided on at national level but within a coordinated framework and on the basis of a number of EU common principles[3]: essentially that the interventions had to be targeted, proportionate and temporary. The EC's DG COM ensured that such measures did not generate unnecessary distortions of competitions between financial institutions operating in the market or negative spillover effects on other Member States.

Amidst significant criticism on the way the EC has assessed the various national emergency measures, DG COM has prepared further guidance[4] based on the following broad principles: **(i)** the individual situation of each financial institution should be taken into account; **(ii)** the schemes must include incentives for the State capital to be redeemed; and **(iii)** behavioural safeguards are needed to limit distortions of competition.

Going forward, the EU authorities are seeking to ensure that enhanced guidance and closer coordination between Member States can appropriately balance the primary role of national treasuries in crisis management with the need to ensure that national measure are consistent with EU, and global, stability. It is also important to ensure that the national approach is consistent with the single market, taking into account that Member States have not endorsed a European recapitalization / guarantee fund. Lastly, there is the need to ensure that the implementation of state aid commitments of Member States preserves a competitive level playing field in the European financial sector.

The regulatory reform agenda going forward

The EU institutions have acted swiftly on regulatory reforms, with further progress on the ECOFIN Road Maps on financial stability and supervisory cooperation, and important legislative proposals scheduled for approval before the end of the current European Parliament (EP) mandate. Regulatory activity concentrates on four main areas.

a) Transparency on the markets

The EC has made a proposal for a Regulation on credit rating agencies (CRAs) broadly based on the IOSCO Code, but with some additional requirements. The proposal also includes a registration regime for CRAs, unique European arrangements for CRAs supervision and, more controversially, the scope of the proposal is such that it would prevent the use of non-EU CRAs' ratings by EU authorised institutions, and prohibit the execution, by certain EU authorized financial institutions, of client orders in respect of non-EU-rated financial instruments.

In the area of accounting standards, further proposals may be forthcoming as the International Accounting Standards Board (IASB) explores the possibility of technical solutions to a number of pending issues around the application of fair value measurement: reclassification out of the Fair Value Option category; difference in treatment of synthetic collateralised debt obligations (CDOs) between IFRS and US GAAP; and impairment of available for sale (AFS) items. The EC has already raised these issues bilaterally with the IASB.

With regard to investors' information and transparency in the securitisation markets, the ECOFIN has acknowledged that banks have improved the disclosure of financial information related to their exposures, losses and write-downs arising form the financial crisis. For its part, the industry has now implemented most of its 10 initiatives to improve transparency in the securitisation markets as per its commitment letter to the EC in February 2008[5].

(3) (i) Interventions should be timely and the support should in principle be temporary; (ii) Member States will be watchful regarding the interests of taxpayers; (iii) Existing shareholders should bear the due consequences of the intervention; (iv) Member States should be in a position to bring about a change of management; (v) The management should not retain undue benefits — governments may have inter alia the power to intervene in remuneration; (vi) Legitimate interest of competitors must be protected, in particular through the State aid rules; and (vii) Negative spill-over effects should be avoided.
(4) http://europa.eu/rapid/pressReleasesAction.do?reference=IP/08/1901&format=HTML&aged=0&language=EN&guiLanguage=en
(5) http://www.europeansecuritisation.com/Advocacy/Market_Standards/Industry-letter-08Feb08.pdf

b) Strengthening of prudential rules

The proposed amendments to the Capital Requirements Directive (CRD), whose approval is scheduled for April 2009, are designed to enhance the management of liquidity risk; improve the quality of bank's own funds; review the large exposure regime; harmonise (by 2012) the formats, frequencies and dates of reporting for banks; and introduce new requirements relating to the originate-to-distribute model. In the insurance field, the new risk-sensitive prudential requirements introduced via the Solvency II Directive are designed to provide incentives for good risk management and better taking into account the risks taken by insurance undertakings.

Prudential rules are also rightly being discussed at a global level. A capital monitoring exercise is in place with analysis of the first data submissions being made available to the Basel Committee in the first quarter of 2009. The challenge therefore is how to match the initiative that the EU is taking in prudential regulation with the indispensable need to achieve outcomes which are, over time, harmonised with those in other significant jurisdictions.

c) Reinforcement of the European supervisory framework

Both the CRD and Solvency II directives are expected to enhance the supervision of cross-border financial groups, with the formalisation of colleges of supervisors and an increased coordination between supervisory authorities on key decisions. Coordination between supervisors will be enhanced by the modification of national mandates of supervisors at the national level to ensure that they are able to take into account the EU dimension in the performance of their duties, including having regard to the financial stability concerns in other Member States.

In addition, the ECOFIN has agreed to strengthen and improve the functioning of the EU committees of supervisors: their decision making will be facilitated by the possibility to adopt measures by qualified majority voting, coupled with a "comply or explain" mechanism. The EC will also modify by the end of this year the Decisions on the 3L3 Committees, so as to give a more formal role to them in relation to specific tasks, such as, for example, mediation, providing non-legally binding recommendations and guidelines, and training and staff exchange.

In parallel, the EC has established a high-level group on supervision chaired by Jacques de Larosière. This group has been tasked to make proposals on how EU supervisory arrangements should be organised, how to strengthen EU cooperation on financial stability oversight, and how EU competent authorities should cooperate with other major jurisdictions. The group is expected to report by end-February 2009.

d) Further strengthening of financial stability

The ECOFIN anticipates work in 2009 in the following areas: measures to alleviate potential undue pro-cyclical effects of the prudential and accounting rules; alignment of incentives in executive pay systems; early intervention tools for financial crisis management; counterparty and risk mitigation in Credit Default Swap (CDS) markets; and transparency enhancement in OTC derivatives markets.

The global perspective

On 2 April 2009, G20 Finance Ministers will report on the implementation of a number of immediate actions, agreed at the 15th November Washington summit, aimed at the stabilisation of financial markets. The G20 action plan contains measures in seven different areas:

1. Transparency and accountability
2. Sound regulation
3. Prudential oversight
4. Risk management
5. Integrity in financial markets
6. International cooperation
7. International Financial Institutions (IFIs) reform

The G20 action plan comes after the FSF's April 2008 recommendations for financial markets regulatory reform, which were in turn consistent with the October 2007 ECOFIN Roadmap. Although direct comparison between the G20 communiqué and the FSF report is not uniform, e.g. G20 measures to reform IFIs and on the integrity of financial markets are specific to the G20 action plan, there is a strong similarity of approach. However, it can be expected that, going forward, the FSF recommendations will closely reflect the mandate from G20 governments.

Conclusion

The EU financial services industry will be profoundly affected by the increased public sector involvement in recapitalisation and guarantee of liabilities, and by regulatory reforms as they develop. On the one hand, an avalanche on new - and in certain corners, controversial - EU regulatory proposals will re-write the rules and guidelines that govern the provision of financial services. Given the ongoing nature of the crisis and the speed with which those regulatory proposals are progressed, there is a risk that the latter fail to take account of all the lessons to be learned from the global financial crisis. At the same time, major public intervention in the financial sector gives rise to concerns about how trust and confidence between financial institutions and between the financial sector and the «real» economy will evolve in the short to medium term. These variables will profoundly affect the development of a single financial market in the EU. The G20 warned against the dangers of 'turning inward' (i.e. the dangers of rising protectionist sentiments). As a key priority going forward, the existing, and new, EP and EC will need to continue to work carefully to ensure an effective, proportionate, and globally consistent European policy response that promotes the integration and openness of international financial markets.

EPFSF Briefing - «A new framework for Credit Rating Agencies»
30 January 2009

Background

The financial market turmoil has raised questions regarding the methods and models used by credit rating agencies (CRAs), in particular as they pertain to the rating of structured finance instruments. Consequently, many commentators consider that CRAs have contributed to the current financial market turmoil. As a result, market participants' confidence in the performance of CRAs and in the robustness of ratings has suffered, prompting policymakers to review the role of CRAs. Given the global nature of credit ratings, such work has been coordinated internationally through the Financial Stability Forum (FSF). The FSF seeks to ensure a globally consistent approach to oversight and regulation of CRAs and avoid a fragmentation of CRAs' role across financial markets. Accordingly it is following not just the EU's proposals but also developments elsewhere, including at IOSCO and the SEC. The FSF has focused on addressing concerns in the following areas:

- The quality of the rating process
  CRAs should improve the quality of the rating process and manage conflicts of interest in rating structured products.

- Differentiated ratings and expanded information on structured products
  CRAs should differentiate ratings on structured finance from those on bonds, and expand the initial and ongoing information provided on the risk characteristics of structured products.

- CRA assessment of underlying data quality
  CRAs should enhance their review of the quality of the data input and of the due diligence performed on underlying assets by originators, arrangers and issuers involved in structured products.

- The uses of ratings by investors and regulators
  Investors should address their over-reliance on ratings. Investor associations should consider developing standards of due diligence and credit analysis for investing in structured products[1].

Existing framework under which CRAs operate

IOSCO

In 2004 the International Organization of Securities Commissions (IOSCO) published a Code of Conduct Fundamentals for CRAs (the IOSCO code), which was designed to address regulatory and industry concerns over the conduct of business of the CRAs.
The IOSCO code, which was updated in June 2008, contains provisions to promote business controls, address concerns over conflict of interest in the rating of structured finance products, drive more robust assessment of data quality and create greater transparency of the methodologies and limitations of credit ratings.

(1) See joint ESF, EFAMA and IMA guidelines of 11/12/2008 at http://www.europeansecuritisation.com/dynamic.aspx?id=1658

IOSCO will report further (planned for January 2009) on developing mechanisms by which national regulators can coordinate their monitoring of CRAs with the substance of the IOSCO Code of Conduct and on setting the terms and conditions of information exchange and cooperation. At the same time, it will also publish its review of CRAs' adoption of codes of conduct based on the revised IOSCO Code.

SEC

The US Securities and Exchange Commission (SEC) operates a recognition system for CRAs as NRSROs (Nationally Recognised Statistical Rating Organisations), a concept going as far back as 1975. Following the adoption of the Credit Rating Agency Reform Act of September 2006, the SEC promulgated rules, in June 2007, regarding public disclosure, recordkeeping, financial reporting, and substantive requirements to ensure that CRAs conduct their activities with integrity and impartiality.

In December 2008 the SEC approved further measures to strengthen its oversight of CRAs by imposing additional requirements on CRAs, in particular related to structured finance ratings. The SEC also proposed additional measures related to transparency and competition concerning CRAs.

Existing EU regulation

Currently, CRAs are not directly regulated in the EU. CRAs are currently monitored by CESR for their self-regulatory compliance with the IOSCO Code of Conduct. CESR reports the findings annually to the European Commission. In addition, the Capital Requirements Directive (CRD) outlines a formal process for supervisory recognition of rating agencies as "External Credit Assessment Institutions" (ECAIs) where banks wish to make use of external ratings for the calculation of capital requirements. To ensure consistent application of the ECAI recognition criteria CEBS has produced "Guidelines on the recognition of external credit institutions" which cover the recognition process; implementation of the CRD recognition criteria; and criteria for mapping external credit assessments to the CRD risk weights.

European Commission proposal for a Regulation on Credit Rating Agencies

On 12 November 2008 the European Commission put forward a legislative proposal for a Regulation on CRAs[2], which lays down the rules designed to ensure high quality credit ratings. The proposed Regulation is partially inspired by the IOSCO code and includes the following features:

- CRAs may not provide advisory services;
- CRAs will not be allowed to rate financial instruments if they do not have sufficient quality information to base their ratings on;
- They must disclose the models, methodologies and key assumptions on which they base their ratings;
- They will be obliged to publish an annual transparency report;
- They will have to create an internal function to review the quality of their ratings;
- Prescriptive requirements for independent board directors;
- A rotation mechanism for analysts restricting the duration of the relationship with an issuer;
- CESR is given a powerful role, being the single point of entry for registration, but home Member State Regulators (of CRA subsidiaries in the EU) coordinate the ongoing supervision. One of those home Member State regulators would act as «facilitator»;

(2) http://ec.europa.eu/internal_market/securities/docs/agencies/proposal_en.pdf

- In order for a CRA to operate within the EU, it must act through an EU incorporated legal entity which has to be registered in the EU. In case of groups each separate EU incorporated legal entity subsidiary must register;
- The scope of the Regulation is stated to limit the use of credit ratings for regulatory purposes or otherwise. EU-regulated financial institutions may only use credit ratings issued by CRAs established in the EU and duly registered (consequently even highly rated non-EU securities are likely to be treated as unrated for EU regulatory purposes);
- MiFID-authorised firms are prohibited from executing orders on rated financial instruments, if such ratings are not provided by a duly registered CRA (thus investors will be forced to execute trades in such instruments through non MiFID brokers);
- CRAs must publish a description of how rating methodologies differ for structured finance instruments or adopt a clearly differentiated rating category; and
- The independence of the analytical content of ratings is explicitly protected (though the inclusion of methodology in this protection of independence is only found in the recitals).

It should be noted that this proposal is framed as a Regulation rather than a Directive and hence will become effective without requiring to be transcribed into Member State law.

Developments since publication of the Draft Regulation

Industry participants have detailed a number of concerns and suggested amendments. These can be usefully viewed as an attempt to address the following more general concerns:

Extraterritoriality

Extraterritoriality concerns arise from Article 4 by which the EU would exercise global control over the credit ratings industry. As currently drafted EU regulated financial institutions could not make use of non-EU incorporated CRAs for regulatory purposes, even where currently non-EU incorporated CRAs are recognized as ECAI. Furthermore, European investors will be substantially limited in their flexibility to invest in regional (e.g. Asian) securities that are rated by local CRAs that lack the resources or desire to establish an EU-registered subsidiary. This will impede those emerging markets which are seeking to develop credible and effective local CRAs. At the same time, the measure places a nearly impossible compliance duty on MiFID-authorised firms.

Global consistency and coordination

Global consistency and coordination are critical for users of credit ratings operating in a global market. As recognized by the G20, it is important that regulatory frameworks across markets yield ratings that are the product of consistent global standards. Creating, within the regulation, an express role and framework for global communication and coordination, could support global consistency – in particular given established international standards and cooperation through IOSCO.

Market disruption

Market disruption can be anticipated upon inception of the Regulation. This will also be so in case of requiring CRAs to withdraw an existing rating, (as is provided for in certain circumstances) thereby forcing institutional investors with applicably defined mandates, or subject to capital adequacy/solvency requirements, to divest unrated securities. Current markets are not well-positioned to weather such disruptions.

Allocation of regional and sectoral authority

Allocation of regional and sectoral authority between CESR, «home states» (any Member State in which a CRA has a subsidiary), a «facilitator» (the «home state» which coordinates CRA group oversight), and «host states» (Member States in which a rating issued by a CRA is used) is loosely-defined and creates a potential for conflict arising out of uncoordinated, unilateral action. The regulatory landscape is further complicated by the existence of EU legislation targeted at the use of ratings for regulatory purposes. Furthermore the need for coordination with CEBS's and CEIOPS's is not adequately reflected.

Potential liability for opinions

While it is fully recognised that CRAs should be held accountable in the event of established breaches of their regulatory obligations, moves to make CRAs and their analysts legally liable for their opinions raise a very worrying precedent and directly undermine analytical independence. Quality of ratings would suffer as CRAs would potentially take a more conservative approach with analysts mindful of legal exposure.

By the end of 2008 the French Presidency had tabled a compromise text that addresses some of these concerns. The incoming Czech Presidency has made completion of the work on the CRA Regulation one of the priorities for its term. It has immediately started soliciting Member State opinion on various possible policy options and continues to lead forward discussion of these in the applicable Council Working Group. One significant example of such further work is the examination of a possible equivalence regime, to alleviate the continued concern over the extraterritorial effect of Article 4.

Conclusion

Whilst there are already various elements of existing supervision relating to CRAs the need for further regulation to address identified concerns is broadly accepted. Legitimate concerns remain about the final form of the CRA Regulation and work to completion of this exercise will require diligence and care. In particular this should consider that structured finance ratings represent the primary area that led to concern, whilst the proposed response impacts all CRA ratings activity, with consequent impacts for rated entities and their securities, and the use of ratings by EU regulated financial institutions. The common goal for all involved needs to be the achievement of a practical outcome, that at the same time provides a robust basis upon which CRAs can regain a trusted and valued role in the eyes of other market participants.

EPFSF Briefing - «Protecting Retail Investors: More to be done?»
23 March 2009

Introduction

European Commission research shows that a majority of retail consumers in the EU appreciate aspects of the European Single Market in general. In one survey before the financial crisis 67% of respondents believed that competition had increased beneficially as a result of Single Market developments, while 53% thought consumer protection in the EU had become stronger.

Despite this generally positive assessment, however, direct participation by retail consumers in the Single Market in Financial Services is limited. Only 3% of consumers have ever considered buying a financial product or taking out an insurance contract in another EU country. But indirect retail participation through pooled vehicles, especially UCITS, is much higher.

Variations in the Degree and Nature of Retail Investor Protection in the EU

This direct/indirect distinction in the nature of retail participation in the EU financial services market creates distinctions in the degree and type of protection available to consumers. But it is only one of a number of kinds of difference that arise. Further variations in protection are caused by differences in the type of financial product that consumers buy. Purchases of equities, UCITS, or insurance products are all mediated by different Directives with varying degrees and kinds of consumer protection. There may be local rules in individual countries which augment the conduct of business standards set out in directives, especially MiFID, and alter the client protection achieved. Harmonised régimes for particular product categories, especially UCITS under the UCITS Directives, create a degree of uniformity but even so cross-border purchases can be subject to variations in the way Directives are nationally implemented. Most retail products are non-harmonised with commensurately greater distinctions in treatment. Finally, compensation in the event of default or market abuse may vary between member states and with the product (only bank deposits are subject to a minimum standards Directive, currently under review), cross-border enforcement may encounter legal or information sharing difficulties that place a retail consumer in another member state at a disadvantage, and the tax position may well be different between member states.

All this adds up to a highly fragmented picture of the EU's retail financial services market and the protections available to consumers. In one sense this is unsurprising: retail financial markets are notoriously localised even in territories with a single main language, a relatively homogenous financial and business culture, a single system of law and a single currency. The problem is compounded in the multi-country, multi-cultural and polyglot EU.

The Financial Crisis

While the lack of retail uptake of cross-border possibilities in EU financial services could also be said to show the scale of untapped potential, the financial crisis has brought its own difficulties to bear. Most significantly, it has highlighted that the risks faced by ordinary citizens, many of whom have suffered severe losses to pension funds and other forms of savings and investment, are unusual in the current exceptionally dangerous and volatile market conditions. In the light of their recent experiences it will require substantial effort to regain their confidence and bring them back to market. Part of achieving this must be to reassure them that their investments are secure and will not in future be exposed to excessive and irrational risk taking.

Recent Concerns about the EU Retail Financial Services Market

But another part of achieving this goal is more mundane and independent of the crisis. Work is required to ensure that consumers are confident that they will enjoy the same rights, regardless of the location in the EU of the financial institution and of the selling mode chosen. They must feel that they are being well advised with the right type and amount of information, that they are being properly protected against being misled or mis-sold products, that they can seek redress as appropriate in the event of a fraud or a bankruptcy, that they have a clear understanding of the risks inherent in a product before they buy it, and that the financial institutions with whom they are dealing are sound and safe. They must also be addressed in their own language or another in which they are highly proficient.

Work by the EP, the European Commission and others to develop the EU's retail financial market should review how far existing legislation has led us in achieving these objectives, and where there are potential gaps in legislation or implementation of existing rules. So what has been done, and what more is there to do? And how does the current crisis affect this evaluation?

The Commission's Green Paper on "Retail Financial Services in the Single Market" of 30 April 2007 briefly analysed the sector and set out certain objectives for future work:

- bringing concrete benefits for consumers notably in terms of prices, choice, and quality;
- ensuring properly regulated open markets and strong competition;
- enhancing consumer confidence by ensuring they are properly protected and that providers are financially sound and trustworthy;
- empowering consumers to make the right decisions for their financial circumstances.

Proposed approaches to achieving these goals included an improved competition framework, a reduction in differences between national regulatory, taxation and other requirements governing similar products, further reduction in market protectionism through, for example, the imposition of bureaucratic obstacles to product marketing such as unjustified «general good» rules, and ensuring that product innovation can flourish.

Regulation and Investor Protection

A swathe of regulatory means was also identified. These focused on creating an equivalent level of consumer protection throughout the EU which gives consumers the confidence to choose from a range of providers wherever they are in Europe and the ability to understand and compare products wherever they are sourced. While this has not yet been fully achieved a number of Directives have begun to lay the groundwork by establishing minimum standards in all member states.

Examples include the Consumer Credit Directive, which seeks to promote a single market in consumer credit while ensuring a high level of consumer protection, and the Directive on the distance marketing of financial services which aims to boost consumer confidence in using the internet or telephone in cross-border financial service transactions.

The Shareholders' Rights Directive[1] facilitates the exercise of voting rights by shareholders of listed companies in the cross-border European environment by setting an appropriate EU legislative framework and addressing a range of other issues including the abolition of obstacles to electronic participation in General Meetings, the right for shareholders to question and be answered by company management, and the abolition of constraints impeding the easy appointment of a proxy holder.

(1) Directive 2007/36/EC

The industry is also playing its part, for example in the form of a significant cross-sector industry grouping that aims to set standards providing for efficient communication between shareholders and issuers. The ultimate goal is to enhance shareholder participation in general meetings, especially in the cross-border EU environment, and to avoid situations in which information does not reach the ultimate investor.

This is important in identifying the ultimate owner of shares: publicity has been given to cases in which the authorities were unable to achieve this, or where the fund manager was not able to locate his/her deposited stocks. The Lehman Brothers and Madoff cases generated, unfortunately, some concerns: for example in the Madoff case it turned out to be impossible to locate the securities and identify their owners in some markets.

The generation of market confidence by consumers depends on resolving problems such as these.

MiFID

An important element of protection concerns rules designed to prevent and compensate for possible mis-selling of financial products. Quality of advice and information provided to clients are paramount to this protection.

The Markets in Financial Instruments Directive (MiFID) has introduced a harmonised comprehensive set of operating conditions applicable to both investment firms and credit institutions that regulates the relationship between them and their clients when they offer investment services. This is encapsulated in the conduct of business, best execution and client order handling rules, as well as the inducements and conflicts of interest provisions. Specific attention to retail clients is given in the MiFID's retail regime which imposes on the firm reinforced fiduciary duties and the requirement to place the client's interests first. This overall approach protects consumers by enhancing responsible behaviour towards them by regulated firms in the financial services sector.

Consumers may also be indirectly protected through professional indemnity insurance that ensures that, in the event of financial loss owing to negligent advice or other professional misconduct by insurance and investment intermediaries, damages or settlements may be claimed.

UCITS

It would be inappropriate to dwell at length on the EU's UCITS framework in this paper as it is a separate subject on its own. But UCITS are the key retail investment vehicle for millions of EU citizens, especially in cross-border business, so some summary reference should be made.

There is little doubt that UCITS has been a considerable success and the brand and underlying concepts are now used worldwide. Throughout Europe approximately 5 trillion are invested in collective investments of which about 70% are UCITS. With nearly 25 years' experience of operating the UCITS régime in the EU many of the cross-border problems have been identified and dealt with in successive development of the original Directive. The aim of UCITS, to allow specifically defined collective investments schemes to operate freely throughout the EU on the basis of a single authorisation from one member state, has not however been easy to achieve. There remain difficulties, for example in distribution and marketing, resulting from additional regulatory requirements above the Directive in individual member states. UCITS III and now UCITS IV have been addressing both these kinds of issues and the need to broaden the range of financial instruments in which a UCITS can invest. These have included money funds, derivative funds, index-tracking funds, and funds of funds.

The next step in gradually opening the pan-EU market further to UCITS and as part of increasing choice but also information and transparency to consumers, is the introduction of the Key Investor Information document (replacing the simplified prospectus) throughout the EU to facilitate the marketing of UCITS and enhance consumer confidence in what they are buying.

The UCITS model has been held up as one to which to aspire in the development of pan-EU markets in nationally regulated, non-harmonised products and services. This has proved difficult to achieve without the specific product structure and other definitions that underpin the UCITS régime.

Cross-Border Redress

There are additional issues. Ensuring access to adequate cross-border redress for consumers has been problematic. The two main options of bringing a dispute to court or using out-of-court alternatives such as an ombudsman or consumer complaints board are complicated for consumers in cross-border disputes, since they need to be aware of the existence and details of foreign schemes or court procedures and there may well be language difficulties.

Legal Certainty

The provision of cross-border legal certainty for retail consumers in the EU's financial services market has also been complicated. The MiFID passporting system has helped to provide counterparty certainty in contracts with properly authorised and passported firms. But overall European regulation of the law applicable to contractual obligations is in the Rome Convention of 1980 and a subsequent Regulation. In many but not all EU member states the law applicable to a financial services contract (excluding insurance policies) is the law of the country where the consumer resides habitually provided the provider pursues commercial activities there. But in other countries it may be the law chosen by the provider (i.e. the provider's national law) as described in the standard terms and conditions. This complex situation can be daunting for consumers seeking certain legal underpinning to their transactions.

Market Confidence and Financial Institutions

The promotion of sound and safe retail financial institutions has become very important following the global financial crisis and economic recession. With a number of EU-based banks having to be rescued by national governments, customers have feared for the safety of their deposits. The value of key assets such as equities, commodities, and property has plummeted, funds of vital importance to individuals such as retirement or pension savings have diminished, and consumers have experienced a substantial loss of confidence in financial markets and institutions.

Global, regional and national work is being undertaken by public authorities including regulators to rectify matters. This activity should target issues that need addressing and should aim to shore up consumer confidence and trust in financial service providers and markets.

Independent retail financial services firms are mostly specialised organisations such as private wealth managers, agency or execution only stockbrokers, discretionary and non-discretionary portfolio managers for private clients, or financial advisors. They do not in general take deposits and the risks incurred in their business are not systemic. Many of them work closely over the long term with clients to ensure that their best interests are met. This often involves standards of client care that go beyond the requirements of the MiFID and other directives. The work of these firms helps to build and maintain retail consumer trust.

In considering the future of the retail financial services sector in the EU it will be important to recognise this role of retail providers and not to impose on them burdensome, inappropriate, and disproportionate new regulation which will increase the cost of business but not improve investor protection or strengthen retail consumer confidence in the financial markets.

Future regulation

Much research and investigation has been conducted into the retail financial services market in the EU, including three public hearings arranged by the EC. The difficulties outlined in the Commission Green Paper persist and the market continues to be characterised by low volume activity, wide variations in prices between countries, restricted product diversity and choice, large variations in market performance, differing regulatory and tax frameworks, divergent consumer protection policies and practices, and legal and economic barriers to market entry that stifle cross-border activity and product innovation.

Untangling this web while maintaining appropriate consumer protection and confidence will take time. Relevant directives, including the MiFID, must have the chance to take effect across all EU jurisdictions. Experience of how they impact on the retail sector will be a significant factor in determining what more should be done to restore trust and improve investor protection while opening more widely the cross-border EU retail market in financial services. A Commission White Paper on this market is expected in April 2009. Further consideration to the issues should be given in the light of it, including important policy reflection on the aftermath of the crisis.

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