2004
Annual Report of

The Committee of European Securities Regulators (CESR)
to
The European Commission
The European Parliament
The Ecofin Council

In memory of Mr Jacob Kaptein

It was with deep sadness and regret that CESR announced the passing away of Mr Jacob Kaptein on Wednesday, 14 July 2004 at the age of 49. Mr Kaptein is sorely missed by the members of CESR who benefited, not only from his vast contribution to CESR as the representative of the Netherlands Authority for the Financial Markets (AFM), but also, for his personal qualities which made him a particularly valued colleague.

Mr Kaptein played a key part in the founding of CESR and, in particular, was an active promoter of CESR's consultation processes, which have played a central role in establishing how CESR functions. Mr Kaptein's contribution is not only felt within the institution of CESR alone but also, in very real terms by investors throughout Europe who benefit from the greater protection afforded by his work in leading CESR's development of a European set of Standards on Investor Protection, which are now heavily reflected in the MiFID Directive, soon to come into legal effect across Europe. This work will also contribute to bringing about the single market for financial services by ensuring market participants are no longer faced with the need to adapt to widely diverging rules on investor protection across Europe.

Most recently, Mr Kaptein chaired the Market Transparency Expert Group responsible for developing part of CESR's advice to the European Commission to assist in the development of the implementing measures relating to, amongst other things, inter alia the admission of financial instruments to trading and rules concerning in-house trading. On a personal level his own considerable practical experience in industry made his insights and advice within CESR particularly valuable. However, it was his willingness to pose difficult questions with warmth and with great humour that made him particularly effective in moving consensus on within CESR and will leave a lasting impression on his colleagues here at CESR.

Foreword by the Chairman

On behalf of my colleagues at the Committee of European Securities Regulators (CESR) and with the support of the Vice-Chair, Kaarlo Jännäri, I am pleased to present the 2004 Annual Report of CESR.

Markets have returned to more stable levels in 2004 with indexes, volumes and profits suggesting that the previous periods of high volatility and turbulence followed by various crises of confidence are now behind us. Markets are looking forward to new IPO's, innovation of products and mergers and acquisitions. In the securities sector, consolidation and pan-European strategies are acting as a driving force and the recent mergers between exchanges are a reflection of this reality.

Against the background of markets which have begun to stabilize, CESR has devoted most of its efforts to rulemaking activities which will enhance market confidence and transparency. Following considerable achievements by the Irish and the Dutch presidencies to finalise a number of Level 1 Directives, the European Commission requested CESR's advice on a number of implementing measures for EU Directives (such as the MiFID and Transparency Directive etc.).

The last phase of finalising the legislative package of initiatives introduced by the FSAP is now nearing completetion, and by mid 2005 CESR will have delivered all its advice to the European Commission on the Transparency Directive and Markets in Financial Instruments Directive. On the later, CESR is working with the objective of keeping an appropriate balance between the need to avoid over regulation and too prescriptive rules on the one hand, and the necessity to maintain the appropriate level of investor protection that contributes to the international reputation of EU financial markets, on the other hand. Our goal is also to propose implementing measures of the MiFID that maintain an understandable and workable solution for diversified market infrastructures, with sufficient transparency of trades, best execution for client orders and an efficient price formation mechanism.

In the area of investment management, CESR has taken its first steps in elaborating guidelines to facilitate the transition to the UCITS III Directives in very close consultation with the industry. CESR believes that much could be achieved if more flexibility could be provided by these Directives which, does not as yet exist, due to their current pre Lamfalussy status.

2004 will remain as our last year of heavy rulemaking work. In 2005, the focus will clearly have shifted to the implementation and the day-to-day application of these new sets of Directives. Supervisory convergence is now at the top of our agenda. The real question is how to achieve this? CESR has consulted on the short term development of tools to enhance supervisory convergence and even informed the EU institutions and the general public on the medium to long-term challenges regarding the supervision of securities activities in the EU in an integrated single market (through the Himalaya report). The initiative has been welcomed by the European Commission, the European Parliament and the Council's Financial Services Committee, and by the industry at large. Political and practical assessments of the various proposals included in this analytical paper will occur in the course of 2005. Although we all need to time to analyse these important issues, it should be clear that time is running out and that at this moment the EU does not operate under an effective and credible supervisory system that is geared to integrated European Financial Markets.

In at least two areas, the real day to day application has begun. The first example where this can be witnessed is in the area of market abuse, where CESR-Pol has elaborated tools to enhance market integrity and has effectively operated as an umbrella for coordinated pan-European investigations. The second example is the adoption of IFRS in Europe, where CESR-Fin has developed practical tools to facilitate the transition to IFRS for 7000 listed companies in EU exchanges.

Another priority for CESR is to ensure cross-sectoral and global consistency of its work, this is why we are working closely with CEBS and CEIOPS and we have formally intensified our co-operation with the US SEC and the US CFTC to this end.

My report would be incomplete if I did not pay tribute to the immense contribution of Jacob Kaptein, who sadly passed away in July 2004. Let me also thank Stavros Thomadakis, Karoly Szasz, Frantisek Jakub, Blas Calzada and Charles Kieffer for their outstanding contributions to CESR's work and welcome our new fellow colleagues, Paul Koster Alexis Pilavios, Istvan Farkas, Manuel Conthe, Pavel Hollmann and Arthur Philippe. I would also like to take this opportunity to thank the secretariat of CESR for facing courageously and efficiently the enormous workload which has faced CESR this year.

I hope, with this report, to contribute to the openness and transparency in CESR working practices, as well as enhancing the necessary accountability of the Committee vis-à-vis the European Commission, the European Parliament and the ECOFIN Council.

We look forward to taking up the challenges of 2005 and reporting our results.

Arthur Docters VAN LEEUWEN

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The Market Participants Consultative Panel

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The Market Participants Consultative Panel was established by CESR in June 2002, following a suggestion of the European Parliament and the Committee of Wise Men chaired by Alexander Lamfalussy.

The role of the Panel is to:

- Assist CESR in the definition of priorities and work programme;
- Provide comments on the way in which CESR is exercising its role and, in particular, implementing its Public Statement of Consultation Practices;
- Alert CESR on regulatory inconsistencies in the Single Market, identify and suggest areas where CESR should undertake further work to improve supervisory co-ordination (e.g. launch a Level 3 initiative such as providing guidance, development of a common supervisory standard);
- Inform CESR on major developments in financial markets and to identify new elements for preliminary discussion by CESR.

The Chairman and the Vice-Chairman of CESR, the Chairmen of the Expert Groups and CESR's Secretary General meet with the Panel regularly to maintain a dialogue with market participants and update the Panel on CESR's work.

Members of the Panel have also contributed to highlight recent market trends and overall conditions of European financial markets. Notes of the meetings are published on CESR's website a few days after the meeting. The Panel met three times during 2004, in June, March and December.

Meetings of the Panel are organised along the following lines: one technical session devoted to discuss issues of high interest in the regulation of financial securities markets, on which CESR will form its views either in delivering technical advice to the Commission or in adopting regulatory standards at "Level 3" of the Lamfalussy procedure; and another session to discuss aspects related to the Lamfalussy procedure, the consultation policy of CESR, as well as its priorities and working methods.

In the course of 2004, the members of the Panel introduced and discussed the following technical issues*:

- Corporate governance
- Credit Risk transfer
- Equivalence of IFRS
- Credit Rating Agencies
- Hedge Funds
- Evaluating the functioning of the panel
- Discussion of post-FSAP

* the presentations made by the members of the Panel are published with the summary of the meeting on the CESR website.

The Panel consisted of 11 members but was enlarged in June 2004 to 15 members who are appointed in a personal capacity. The members of the CESR's Market Participant Consultative Panel are:

- Pr Luis Miguel Beleza, Consultant of the Executive Board, Banco Comercial Português
- Dott Salvatore Bragantini, Vice-President IW Bank
- Dr Rolf E Breuer, Chairman of the Supervisory Board, Deutsche Bank AG
- Mr Donald Brydon, and Chairman of AXA Investment Managers
- Mr Ignace Combes, Vice-President, Management Committee of the Board of Directors, Euroclear Bank
- Mr P.P.F. de Vries, Director, Association of Shareholders, Vice-President, Eurosharehoders
- Mr Lars-Erik Forsgardh, Chairman of World Federation of Investors and CEO, Swedish Shareholders Association
- Mr Dominique Hoenn, Deputy General Manager of BNP Paribas, Vice-Chair of the Supervisory Board of Euronext
- Ms Sonja Lohse, Group Compliance Officer, Nordea AB
- Mr Theodoros Philippou, General Manager, The Institute of Certified Public Accountants of Cyprus
- Mr Mariano Rabadan, Chairman of the Spanish Association of Investment and Pension Funds (INVERCO)
- Mr Wieslaw Rozlucki (Chair and CEO of the Warsaw Stock Exchange)
- Pr Rüdiger von Rosen, Managing Director, Deutsches Aktieninstitut;
- Pr Dr Emmanuel D. Xanthakis, Non-Executive President, Marfin Bank and Marfin Portolio Investment Company
- Mr Zoltan Zpeder, Vice-President and CEO, OTP Bank RT.

Corporate Governance

Two members of the panel, Lars-Erik Forsgardh and Peter Paul de Vries, set out some of the issues related to corporate governance in two panel presentations and this was followed by a discussion amongst the members of the Panel regarding the regulatory approaches adopted to corporate governance in Europe and the potential way forward. This discussion served the purpose of helping CESR in highlighting priorities for the post-FSAP, in particular as a possible response to the Parmalat scandal, and the work that CESR is likely to conduct under the Action Plan on Corporate Governance adopted by the EU Commission.

The Action Plan on Corporate Governance was supported by the members of the Panel. However, in terms of reaction to the Parmalat case, the members of the Panel argued that frauds can never be avoided and prevented and that regulators should refrain from giving the impression that any future regulatory interventions might prevent the occurrence of new frauds.

The members all agreed on the objective of having a single European code of corporate governance, given the benefits that this will bring particularly for

large companies that currently have to comply with various national codes. However, given the expected amount of time requested to achieve this objective, it was suggested that a more practical approach would consist in establishing a common framework of principles at European level and enforceable by competent authorities. This framework could then be complemented, at domestic level, by company laws and codes of corporate governance, which may differ in terms of internal structures, whilst being consistent with the general principles. The content of the various codes of corporate governance adopted at European level should be coordinated within a European Corporate Governance Forum. The recommendations contained in the code could be of a voluntary nature and follow the "comply or explain" principle. The principles contained in the common framework would need to be selective, based on the Organisation for Economic Co-operation and Development (OECD) principles (currently under revision) and address, as a matter of priority, issues related to transparency and shareholders' protection (including voting rights and shareholders' meetings). Roles of directors and executives' remuneration do not represent priority issues.

Members of the Panel noted the dynamic nature of the process of corporate governance, which therefore needs adequate updating, and its cultural dimension, with particular regard to the more active role and responsibility of shareholders (both individual and institutional investors) in monitoring the performance of the companies.

Credit Risk transfer

Following a presentation by the panel member Emmanuel Xanthakis, the members of the Panel discussed the issues arising from credit risk transfer, with particular regard to the potential impacts for investors. This discussion serves the work that CESR is conducting under a specific mandate received from the Economic and Financial Committee, jointly with the other Committees in the field of banking (BSC) and insurance regulation (CEIOPS).

The members of the Panel discussed the recent ECB report on the credit risk transfer activities of EU banks. They considered that the market for credit risk transfer is still limited but that it is growing fast. The market reality is much more articulated than expected. Opacity of the market segment and in particular of some market participants (such as some hedge funds) was considered a serious issue. Therefore more transparency and disclosure are necessary to monitor the evolution of the phenomenon. Members of the Panel also observed that the management of an eventual crisis would be rather difficult should a cross-border case arise, given that credit risk transfer strategies are increasingly global and not only restricted to EU Member States. Therefore, it was suggested that access to information should not be restricted to EU Members only, but should include at least the US and Switzerland. As such, the Panel suggested regulators should gather information and analyse the information on the basis of risk indicators. Some concerns were also expressed about the potential exposure to counterparty risk of some banks and the potential impact in terms of systemic risks this activity might have.

Equivalence of IFRS

Following a presentation by the panel member Theodoros Philippou, the members of the Panel discussed the equivalence of third countries GAAP vis-à-vis IFRS. This discussion serves to inform the work that CESR is at present conducting under a specific mandate by the European Commission under the Transparency Directive and the Prospectus Directive and Regulation. In his presentation Theodoros Philippou addressed the main points of the mandate that CESR was expecting at this stage to receive and presented three different possible solutions as to the meaning of "equivalence":

a) a *quantifiable test*, which should cover the issues of same scope, same answers and same disclosure of GAAP;

b) a *qualitative approach*, which might take into account whether: i) third country GAAP are already widely accepted in EU markets, ii) subject to proper enforcement mechanisms, and iii) well codified and documented; and

c) a *non-compliant approach*, which provides a quantitative disclosure of the impact of adopting IFRS by reconciling key financial statement components. The last option was presented as the preferred one.

During the discussion some Members of the Panel considered that the assessment of equivalence should take account of cost benefits considerations. There are risks and opportunities in the equivalence project: if third countries GAAP were not considered to be equivalent, EU financial markets might become less attractive to foreign financial players and issuers. From the another perspective, it was recalled that convergence of IFRS and third country GAAP (in particular US GAAP) needs to be promoted.

CESR has not been asked to give terms of GAAP convergence but only to assess the equivalence; this exercise should be general, but not ignoring key differences.

In terms of remedies, some members considered that, as a minimum, an explanation of material differences should be imposed, but not explanation of all possible GAAP differences. Some members underlined that, considering the differences between GAAP, restatement of financial statements from third country GAAP to IAS (or quantitative reconciliations) can result in totally different balance sheets and profit & loss accounts. As a result, it was noted that one must be cautious when choosing the most appropriate remedies, and some members expressed the opinion that reconciliation of key figures and additional explanations would be necessary, at a minimum, if investors and analysts were to be receive proper information. Others underlined that even reconciliation of key figures such as equity and net result will inevitably imply restating all statements and that the proportion of direct investment by retail investors in American, Japanese and Canadian instruments is so limited that this choice did not seem to be justified to some of the panel members.

Credit Rating Agencies

Following a presentation by panel member Salvatore Bragantini and the discussion paper by Rüdiger von Rosen, the members of the Panel discussed the issues arising from activity of credit rating agencies (CRAs). This discussion serves to inform the work that CESR is conducting under a specific mandate received from the European Commission. In his presentation, Salvatore Bragantini addressed the main points of the mandate that CESR received, and presented open questions related to the rating activity. In particular, the presentation covered: the issues of transparency and fairness of the methods and practices applied by the CRAs; the relevance of unsolicited ratings; the complexities of the relationship between CRAs and issuers; the options available to register and supervise CRAs and the efficiency of self-regulation and market forces. Finally, Mr Bragantini also highlighted the oligopolistic structure of the credit rating industry.

Members of the Panel supported the existence of a Code of Conduct Fundamentals for rating agencies set up by International Organisation of Securities Commissions (IOSCO) and issued for consultation in October 2004, and encouraged CESR to follow that approach. Some members highlighted the possibility of an obligation to publish a change in rating methods before a rating is made public. Some concerns were expressed about the right to appeal by issuers opposing the decisions of a rating agency, even if the mechanism of how such an appeal would function should be further explored.

The Panel also indicated that any new rules should be subject to cost-benefit analysis, since they might raise entry barriers to new competitors in the market. Some members mentioned that in case of access to price-sensitive information, this should be made public and that this should be subject to the Market Abuse Directive although there were differing views on this issue. As regards a regulatory framework for CRAs the members of the Panel considered the prescriptive regulation of rating process as inappropriate. Nevertheless, some members considered that, given the significant role played by CRAs in today's financial markets, leaving decisions concerning conduct of business to the agencies themselves may not be optimal. Some members of the Panel expressed general support for a registration of CRAs at EU level, but were much more cautious about regulating day-to-day CRAs' activities. In addition, some of them underlined the opportunity to rationalise the national implicit or explicit registration mechanisms and to have a global approach. In addition, CESR mentioned the discussions conducted with the US SEC who are developing their own regulatory approach on this issue.

As regards the limited number of players in the rating activity, members discussed the difficulty of setting up a new CRA. It was also stressed that there is little appetite to finance a new CRA.

Hedge Funds

Donald Brydon began the discussion on Hedge Funds with a presentation, following which the members of the Panel had a policy discussion on the issues relating to the activity of hedge funds, with particular regard to the protection of investors and retail investors who progressively have greater access to hedge funds through fund of funds.

Members of the Panel agreed that hedge funds are useful tools for the market but that there is a need for some regulatory measures at European level. However, these rules should not cover only EU hedge funds, which could discourage hedge funds from further developing as a result of over regulation by the industry. From the discussion, the following basic rules were identified which could be introduced in relation to funds of hedge funds:

- **a)** a due diligence obligation when selecting the hedge fund (risk monitoring) could be imposed;
- **b)** disclosure of the monitoring process including warning on eligible assets;
- **c)** harmonisation of a diversification rule.

Regarding hedge funds per se the following suggestions were made:

- **a)** advisors should be subject to regulation, and
- **b)** transparency of fees' structures.

Some members noted that any regulatory measure should be based on international consensus in order to be effective.

It was also noted that it is important that through greater transparency, the level of risk of leverage is better understood.

It was also stressed that if hedge fund-type products are made available to retail investors, adequate disclosure of relevant information (e.g. product, leverage, risk, fee structure) has to be assured. Nevertheless, some of the members were of the opinion that the hedge fund-type products should not be available to retail consumers.

Discussion of priorities post-FSAP

Based on the initial activity of the four Forum Groups established by the European Commission, members of the Panel discussed the priorities following the Financial Services Action Plan (FSAP).

In the first part, the priorities for the Post-FSAP were discussed.

From the general discussion, the three main objectives which underpin financial regulation can be summarised as follows:

i) To maintain the trust of investors and eventually, in the event of market failures, to restore such confidence;
ii) To promote competition among market players, and;
iii) To favour the integration of European financial markets.

In order to achieve these objectives, regulation should go in parallel with a sound knowledge of market practices and market trends which should all be carefully monitored by regulators. Furthermore, before introducing new regulation, impacts on regulated entities should always be assessed. More attention should be paid to calibrate the interventions according to the needs of different market participants (namely the needs of retail sector vs. wholesale business) and those of financial products different from equities (e.g. bonds, derivatives). Concrete possible areas of future attention by European regulators include the following: strengthening of the statutory audit function; corporate governance; primary market practices, with particular regard to conflicts of interest, sophistication of products and retail participation in the distribution process; clearing and settlement; credit rating agencies and hedge funds.

Members of the Panel were of the view that before new regulatory initiatives were launched, implementation of the Action Plan should be ensured. Members of the Panel vigorously complained about the gap between progress made at EU level in adopting new laws and their concrete implementation in Member States, where little is perceivable. In particular, the panel members thought it necessary to highlight which immediate and effective actions might be taken against Member States which are not compliant with community law.

Members of the Panel expressed their support for the Lamfalussy procedure and welcomed the recent results of CESR, with particular regard to transparency of its process and the establishment of an effective network; however, some concerns were expressed on the excessive level of detail of some regulatory interventions. It was noted that there is a trade-off between the level of detail and the legal risk; the latter, however, should be ideally confined within an acceptable range, given certain expectations of predictability of decisions taken by regulators.

In the second part, the discussion focused on how to improve the functioning of CESR in order to ensure it can perform its tasks even more effectively.

CESR presented the initial thoughts of the Committee, which include: strengthening the functioning of network at different levels (e.g. by improving exchange of personnel, joint investigations and training sessions). Regarding implementation CESR set out its ideas regarding the establishment of monitoring groups for specific aspects of the single market which could be explored. On CESR's more centralised (permanent) functions, namely CESR-Pol and CESR-Fin, it was felt that they should be encouraged to continue their work on the creation of databases of national regulatory decisions; both operational groups should devote more efforts to discussing individual cases to share supervisory experiences and draw some common conclusions.

Members of the Panel highlighted the following two areas for further improvements: cooperation and consistent implementation of CESR decisions. As regards cooperation, it was suggested that MoUs for cooperation between regulators and supervisors (in particular those concerning the cross-border activities of pan-European players) should be based on common and consistent principles. As regards the consistent implementation of CESR decisions, support was expressed for an internal "mediation mechanism" to facilitate solution of divergent views between CESR members.

In the third part, the discussion focused on the evaluation of the adequacy of the regulatory and supervisory systems at EU level and possible future ways to better respond to challenges posed by the single market.

In terms of priorities, members of the Panel indicated that the finalisation of an integrated regulatory framework and the measurement of the degree of inte-

gration of the market should come before the establishment of a supranational supervisory entity; nonetheless the initiative of CESR to conduct an in-depth analysis was strongly supported. Some members of the Panel saw this issue as a matter of urgency. It was also noted that market participants might have different views, since interests of pan-European financial players differ from those of smaller entities which operate mainly at domestic level versus. The demand of entities operating in all or most of the EU Member States is to reduce the costs of compliance. As such, for these one single set of rules as well as one reporting mechanism would represent an ideal scenario. However, this should not prejudice the existence of national authorities, which are physically closer and can identify their local investors' needs.

Evaluating the functioning of the Panel

Members of the Panel discussed the recent activities of the Panel and means for any possible improvements. Following some bilateral contacts between the members of the Panel on the effectiveness of the Panel, it was generally felt that: meetings are informative and valuable; the diversity of Panel members (in particular the Practitioner/Consumer split) is helpful in tabling a range of perspectives; the quality of the meetings had improved substantially; and presentations by Panel members were welcomed.

Some areas for improvement were also identified. Namely, the early dissemination of background information and presentations by members was thought to be an area that could facilitate the discussion further; CESR could also do more preparatory work on the information material (including some summaries of material). This could also include some feedback on the Panel's impact which would be both helpful and encouraging, including an explanation where certain Panel recommendations are not been taken on board. Overall, the length and frequency of meetings was considered appropriate, though some members would like to extend the length.

It was also agreed that a revision of the Panel effectiveness and working methodology should be conducted at least once a year.

4 Regulatory harmonisation

Level 2 Expert Groups

4.1

Within the framework established by the Lamfalussy process and the Financial Services Action Plan (FSAP), CESR perfoms two fundamental roles: the first is to advise the European Commission on implementing measures of directives (Level 2) and the second, is to ensure that supervisors adopt convergent practices on a day-to-day basis. This Annual report distinguishes these two main activities by discussing the regulatory harmonisation achieved at Level 2 by CESR expert groups (set out in chapter 4.) and the supervisory convergence promoted through numerous Level 3 activities (set out in chapter 5.).

As regards regulatory harmonisation, CESR's agenda in 2004 was heavily dominated by the preparatory work for possible implementing measures of the Markets in Financial Instruments Directive (MiFID) (Chapter 4, section 1), and the Transparency Directive (Chapter 4, section 2). In addition, the European Commission requested CESR to elaborate a policy report on Credit Rating Agencies (Chapter 4, section 3).

4.1 Markets in Financial Instruments Expert Groups (MiFID)

Background

The (Level 1) Directive on Markets in Financial Instruments (MiFID) was adopted on 21 April 2004[1]. The decision to revise the Investment Services Directive (ISD)[2], adopted in 1993, reflects common agreement that structural changes in EU financial markets requires legislation to be adapted in order to advance integration of the single market in financial services. MiFID forms one of the cornerstones of the EU's securities regulatory regime, and is intended to deliver an effective 'single passport' allowing investment firms and regulated markets to operate across Europe.

The new Directive, combined with the implementing measures on which CESR is providing technical advice, broadens the range of investment services for which authorisation is required under the existing ISD. Clarifing and expanding the list of financial instruments that may be traded on regulated markets and between investment firms, as well as introducing rules on the provision of investment advice and conflicts of interest. Standards for regulated markets and multilateral trading facilities, as well as new rules on handling client orders, are included.

In accordance with the Lamfalussy Process, the European Commission (Commission) will adopt Level 2 implementing measures, with respect to a large number of provisions of the MiFID, on the basis of the technical advice given by CESR.

The work plan

CESR received two different sets of mandates under the MiFID. The first set of mandates was published by the Commission on 20 January 2004 with the deadline for delivery of CESR's technical advice being 1 January 2005. On 25 June 2004 the Commission published its second set of mandates. In addition to confirming the provisional first mandate, the Commission asked CESR to deliver advice in the form of an "articulated" text concerning some new areas of the MiFID by 30 April 2005. In releasing these requests for technical advice, CESR published two Calls for Evidence in order to invite all interested parties to submit views as to what CESR should consider in its advice to the Commission.

The Commission, in its formal mandate, also decided to extend the deadline granted to CESR in the provisional mandate requesting advice on: best execution obligations, market transparency obligations (pre-trade transparency disclosure for Regulated Markets and MTFs and post-trade transparency requirements for Regulated Markets, MTFs and investment firms) and admission of financial instruments to trading to 30 April 2005. This extension was given for reasons of coherence between the different rules that are designed to ensure a high degree of competition and efficiency in European markets, and, in particular, to strike an appropriate balance between the transparency and best execution provisions of the MiFID.

As an addendum to the formal request for technical advice on possible implementing measures on the MiFID of 29 November 2004, the EU Commission decided to accept CESR's request and extended the deadline for submission of CESR's technical advice on client order handling rules to 30 April 2005.

As such, on 30 April 2005, CESR will provide technical advice on the second set of mandates and on some mandates of the first set where the deadline for preparing advice was extended. The advice will cover twelve of the main areas, namely: definition of investment advice (Art. 4.1); the list of financial instruments – commodity derivatives (Art. 4 – Annex I section C); conflicts of interest on investment research (Art. 13.3

[1] *2004/39/EC, OJ, 30 April 2004*
[2] *1993/22/EEC, OJ, 11 June 1993*

and 18); general obligation to act fairly, honestly and professionally (Art. 19.1); suitability test (Art. 19.4); appropriateness test (Art. 19.5); execution only (Art. 19.6); professional client agreement (Art. 18.7); best execution (Art. 21); client order handling (Art. 22.1.); display of client limit orders (Art. 22.2); pre-trade transparency-systemic internalisers (Art. 4 and 27); transactions executed with eligible counterparties (Art. 24); market transparency obligations (Art. 28-30, 43-45); and admission of financial instruments to trading (Art. 40).

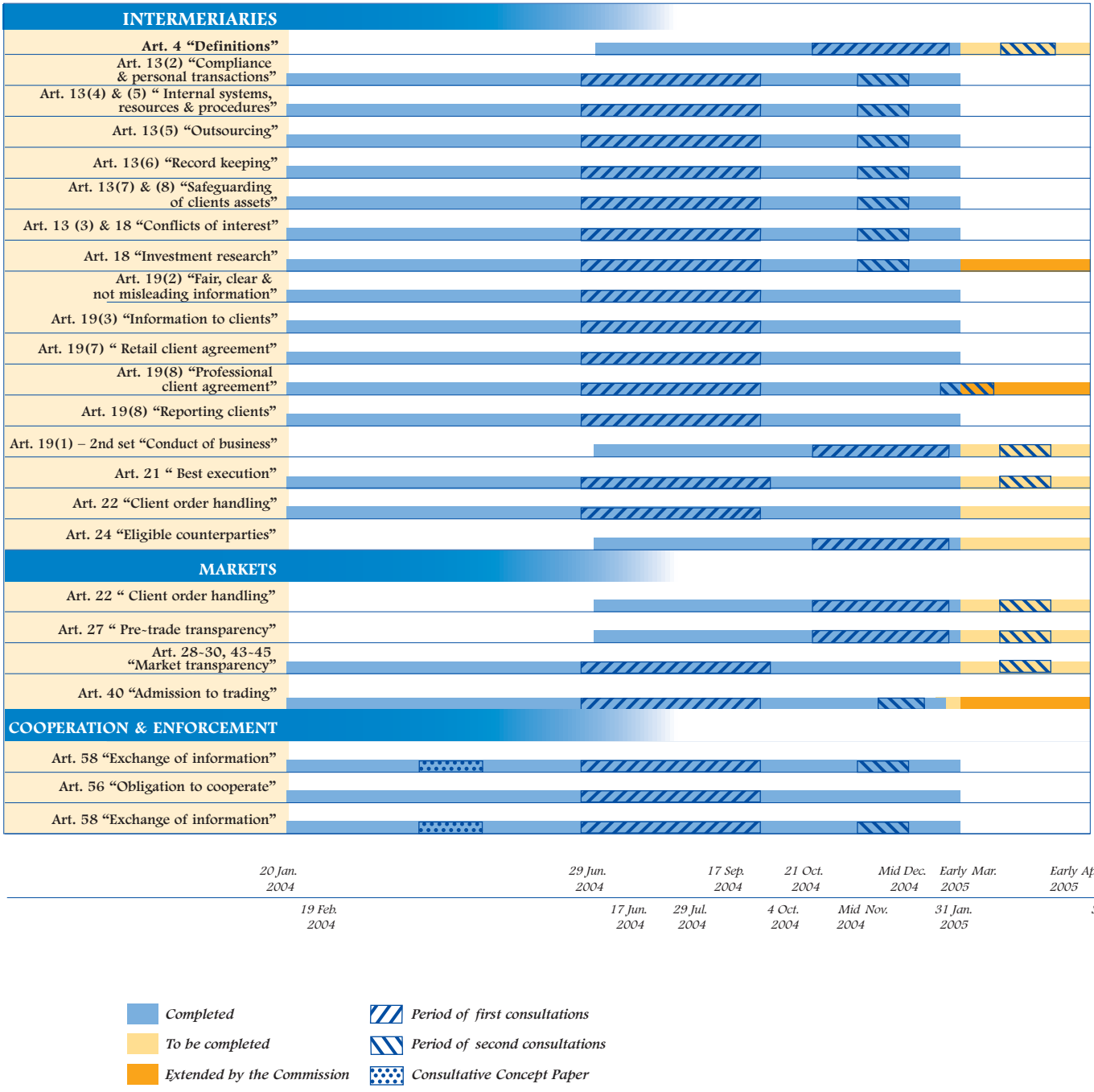
CESR submitted its technical advice (Ref. CESR/05 024c) with a feedback statement (Ref. CESR/05-025) on the first set of mandates on 31 January 2005, in line with the timetable set as amended by the EU Commission. The technical advice covered the following: compliance and personal transactions (Art. 13.2.); obligations related to internal systems, resources and procedures (Art. 13.4 and 13.5 second subparagraph); obligation to avoid undue additional operational risk in case of outsourcing (Art. 13.5 first subparagraph); record keeping (Art. 13.6); safeguarding of clients' assets (Art. 13.7 and 13.8); conflicts of interest (Art. 18 and 13.3); fair, clear and not misleading information (Art. 19.2); information to clients (Art. 19.3); retail client agreement (Art. 19.7); reporting to clients (Art. 19.8); transaction reporting (Art. 25), obligation to cooperate (Art. 56); and exchange of information (Art. 58).

The following sets out CESR's work plan as at 31 January 2005 for each set of specific mandates.

CESR work plan for the mandates under the MiFID

Date	Activity
20 January 2004	Provisional mandates – 1st set of mandates receveid
19 February 2004	Deadline for comments to the "call for evidence" for the 1st set of mandates
1 March 2004	Consultative Concept Paper on Transaction Reporting, Cooperation and Exchange of Information between Competent Authorities
12 April 2004	Deadline for responses to the Consultative Concept Paper on Transaction Reporting, Cooperation and Exchange of Information between Competent Authorities
17 June 2004	CESR's First consultation on the draft advice for the 1st set of mandates
29 June 2004	Formal mandates – 2nd set of mandates receveid
29 July 2004	Deadline for comments to the "call for evidence" for the 2nd set of mandates
17 September 2004	Deadline for comments on the 1st set of mandates
4 October 2004	Deadline for comments on the 1st set of mandates (best execution and market transparency)
21 October 2004	First consultation on the 2nd set of mandates
Mid-November 2004	Second consultation on the 1st set of mandates
Early December 2004	Second consultation on Art. 40 (admission to trading)
Mid-December 2004	Deadline for the second consultation 1st set of mandates
20 December 2004	Call for Opinions on Professional Client Agreement (Art. 19.7)
Early January 2005	Deadline for second consultation on Art. 40 (admission to trading)
21 January 2005	Deadline for comments on the CESR's draft advice on the 2nd set of mandates
31 January 2005	Final approval – 1st set of mandates
Early February 2005	Second consultation on Best Execution (one month)
20 February 2005	Closure of Call for Opinions on Professional Client Agreement (Art. 19.7)
Early March 2005	Second consultation on the 2nd set of mandates (one month)
30 April 2005	Submission of CESR's advice on the 2nd set of mandates

CESR Work Plan for the mandates under the MiFiD



Mandate and structure of CESR's Expert Groups for MiFID

In order to be able to deliver CESR's technical advice to the Commission in an appropriate and timely way, CESR decided to establish three Expert Groups:

- **Expert Group on intermediaries:** This Expert Group is chaired by Callum McCarthy (Chairman of the Financial Services Authority [FSA]); rapporteur of the group is Carlo Comporti. This Expert Group covered the mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best execution; order handling rules, eligible counterparties, definition of investment advice and definition of commodity derivatives.
- **Expert Group on cooperation and enforcement:** This Expert Group is chaired by Michel Prada (President of the Autorité des Marchés Financiers [AMF]); rapporteur of the group is Alexander Karpf. This Expert Group covered the mandates related to transaction reporting between competent authorities and exchange of information.
- **Expert Group on market:** This Expert Group is chaired by Karl-Burkhard Caspari (Vice-President of the Bafin); rapporteur of the group is Jari Virta. This Expert Group covered the mandates relating to admission of financial instruments to trading, post-trade transparency disclosure by investment firms, pre-trade transparency requirements for MTFs, post-trade transparency requirements for MTFs, pre-trade transparency requirements for Regulated Markets and post-trade transparency requirements.

A **Steering Group** has been established to consider horizontal issues and to ensure overall consistency in the advice prepared by the three Expert Groups. This Group is composed of the three chairmen of the Experts Groups and chaired by CESR's Chairman, Arthur Docters Van Leeuwen.

The formation of the MiFID Consultative Working Group

In line with CESR's commitment to work in a transparent manner and in order to have the technical input from external experts to assist the Expert Groups at an early stage, CESR formed a specific Consultative Working Group of market participants drawn from across the European Markets. The Consultative Working Group met with the Expert Groups four times in 2004, and provided the CESR Expert Groups with very valuable assistance in developing drafts of the final technical advice on both sets of mandates.

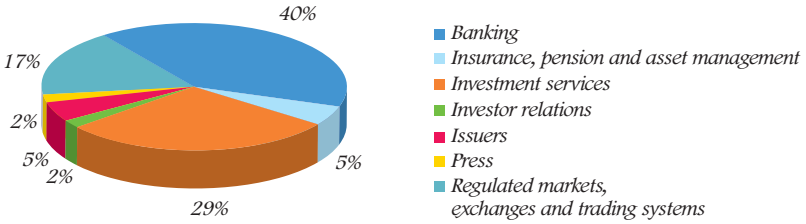
The members of the Consultative Working Group are:
Dr Heiko Beck, DekaBank Deutsche Girozentrale
Dr Michele Calzolari, Assosim and CENTROSIM
Mr Jean-François Conil-Lacoste, Powernext SA
Mr Henri de Crouy-Chanel, Aurea Finance Company
Mr Peter De Proft, Fortis Investments
Mr Mark Harding, Barclays Bank Plc
Mr Brian Healy, Irish Stock Exchange
Mr Henrik Hjortshøj-Nielsen, Nykredit
Mrs Marianne Kager, Bank Austria
Mr Socrates Lazaridis, Athens Stock Exchange
Mr Jacques Levy-Morelle, Solvay SA
Mr Gyorgy Mohai, Budapest Stock Exchange
Mr Peter Norman, Sjunde AP-fonden
Mr Anthony Orsatelli, CDC Ixis
Mr Joao Martins Pereira, Banco Espírito Santo
Mr Frede Aas Rognlien, Enskilda Securities ASA
Mr Roger Sanders, Association of Independent Financial Advisers
Dr Jochen Seitz, Norton Rose
Mr Juan Carlos Ureta, Renta 4
Mr Renzo Vanetti, SIA S.p.A
Mr Jan-Willem Vink, ING Group

Process

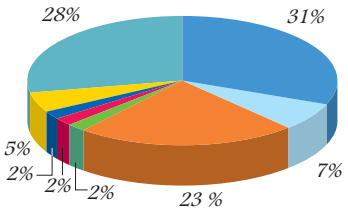
CESR published two Calls for Evidence, on 20 January 2004 (Ref. CESR/04-021) and on 29 June 2004 (Ref. CESR/04-323), seeking input on the key issues which it should consider in dealing with the first set of mandates. More than 40 responses were received for each call.

The pie charts in the following pages set out the total number of responses to each consultation and provide a breakdown (in percentages) of those who responded by sector.

Call for Evidence – CESR starts work on EU Commission provisional mandates on the new Investment Services Directive (Ref. CESR/04-021)
Total number of responses: 42

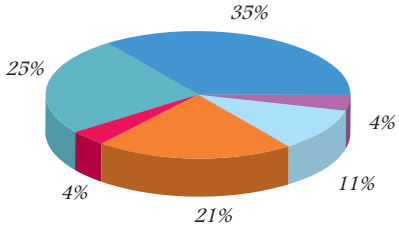


Call for Evidence on the second set of mandates from the European Commission on the legislative measures to implement the MiFID (Ref. CESR/04-323)
Total number of responses: 43



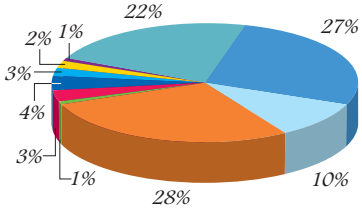
Regarding the issues dealt with by the Expert Group on Cooperation and Enforcement, unlike the other two Expert Groups, which were able to build upon previous CESR work, CESR had to start its work basically from scratch. Therefore, complementing the Call for Evidence, CESR agreed to start the process by preparing a "Concept Paper", in which the general approach and the main orientations addressing the mandates were set out. This was published for consultation (Ref. CESR/04-073b) March 2004, for a six week consultation period.

Concept Paper on the proposed Financial Markets Directive (MiFID), Articles 25, 56 and 58 (Ref. CESR/04-073b)
Total number of responses: 28



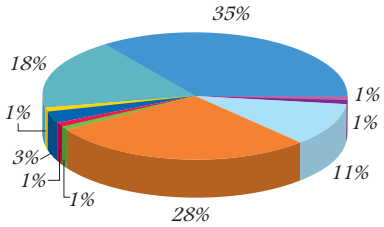
CESR published its first consultation paper on the first set of mandates under the MiFID on 17 June 2004 (Ref. CESR/04-261b). The public consultation closed on 17 September, except for mandates on the best execution and market transparency obligations, for which the deadline was extended until 4 October 2004, since the deadline for these mandates has been postponed to the end of April 2004. On 8 and 9 July 2004 a public hearing was held by CESR.

CESR's Advice on Possible Implementing Measures on the Directive 2004/39/EC on MiFID (Ref. CESR/04-261b)
Total number of responses: 124



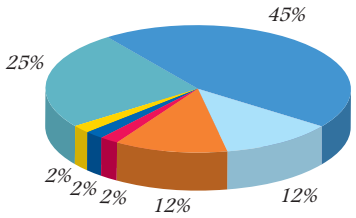
Concerning the first consultation paper on the second set of mandates under the MiFID (Ref.: CESR/04-562), this was released by CESR on 21 October 2004 and a public hearing was held on 19 November by CESR. The public consultation closed on 21 January 2005, and CESR received 90 written responses.

Consultation on CESR's draft advice on the second set of mandates from the European Commission on the MiFID (Ref. CESR/04-562)
Total number of responses: 90



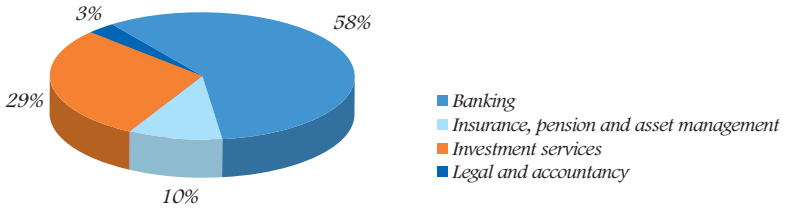
A second consultation paper on the first set of mandates was published by the CESR on 17 November 2004 (Ref. CESR/04-603b). This consultation, which closed on 17 December 2004, focused on key issues of policy identified in the responses to the first consultation and the practical aspects of implementation. CESR received 34 responses to the consultation.

Second Consultation Paper on the first set of mandates regarding possible implementing measures for the MiFID (Ref. CESR/04-603b)
Total number of responses: 41



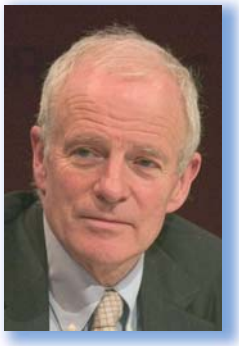
On 22 December 2004, CESR also released a Call for Opinions (Ref. CESR/04-689) on advice to the EU Commission under article 19.7 in relation to agreements between the investment firms and their professional clients. The deadline for this mandate has been postponed to end of April 2005. Call for opinions closed on 20 February 2005, and CESR received 31 responses. On 31 January, CESR published its first final advice to the Commission, entitled CESR's technical advice to the European Commission on the first set of mandates under the Directive on Markets in Financial Instruments (MiFID) (Ref. CESR05-024c) with its feedback statement (Ref. CESR/05-025).

Call for Opinions on CESR's Draft Technical Advice on Possible Implementing Measures of the MiFID - Professional Client Agreements (ref. CESR/04-689)
Total number of responses: 31



On 3 February 2005, CESR published a second consultation paper on the requirements for instruments to be admitted to trading on regulated markets, (Ref. CESR/05-023b). This consultation will close on 3 March 2005.

The CESR Expert Group on Intermediaries



Chairman's message

Callum McCarthy, *Chairman of the FSA, UK*

"The CESR Expert Group on Intermediaries had to work on a wide range of mandates within a very tight timeframe, this represented a challenge for the Group and for CESR. Nonetheless, the previous Standards on Investor Protection that had been developed by CESR provided a strong basis from which to begin, and coupled with the extensive and fruitful consultation with interested parties, the Group is developing its proposal for technical advice on major implementing measures on intermediaries providing investment services. The range of differences across Member States and markets (size and nature of intermediaries, the different services and products, and the varied nature of the clients) added to the different market practices that exist, has made this work very complex and challenging. However, we are confident that the resulting advice will enable intermediaries to exploit the advantages of the Single Market and should benefit investors, by providing them with a common set of rules for their protection which are of a high standard."

As a first step the Expert Group identified some key cross cutting issues, such as timing of implementation, maximum/minimum harmonisation, linkage to existing IOSCO and cross-sectoral co-ordination (such as work undertaken by Basel Committee, the Joint Forum, CEBS and CEIOPS) that may need further work in the future. For example, the Group held contacts with CEBS on its draft advice on some aspects of rules on intermediaries, namely organisational requirements, such as outsourcing and compliance, where the advice might also impact banks and on which supervisors are already conducting parallel work. The Group, therefore, also aimed at ensuring the highest possible degree of consistency with these initiatives.

Regarding CESR's advice on the independence of compliance, it has become clear that the requirements need to be adjustable to suit the size of the investment firms to which they apply. For example, this is particularly the case where there are "one man" firms or very small investment firms where factual independence of compliance may not be possible. Therefore, whilst CESR recognised that the principle of independence of compliance is key, the Group considered how to implement this in a flexible manner to take into account smaller investment firms to ensure these types of firm can comply effectively.

CESR also addressed the proper way to manage conflicts of interest, arising both internally within an organisation and from the angle of disclosure to

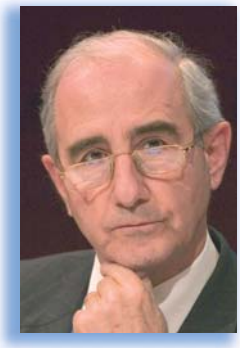
investors. The first issue relates to the arrangements that are required by the Directive in some companies' business areas where the potential for conflicts of interest are more likely to arise, such as in proprietary trading, portfolio management and corporate finance business, including underwriting and/or selling in an offering of securities and advising on mergers and acquisitions. The second aspect of CESR's advice is in regards to provisions of information to clients or potential clients and the development of a conflict of interest policy (to provide an outline of the conflict of interests policy or to notify where this conflicts of interest policy can be accessed). In addition, CESR sets out some advice on notification of conflicts policy and the content of such notifications of conflits policy.

Regarding the second set of mandates, the Expert Group has focused on issues such as the definition of investment advice or transactions executed with eligible counterparties.

To provide this flexibility, the eligible counterparties' regime has been developed as a means of ensuring that certain types of business relationships are not encumbered by unnecessary levels, and that the level of investor protection is appropriately tailored to the investors' knowledge. The Directive lays down a regime for opting-in and opting-out of this classification of eligible counterparty. CESR's advice however considers how this may be brought into effect by selecting the criteria for defining the quantitative requirements for recognising an investor as an eligible counterparty and deals with other issues such as whether quantitative thresholds for undertakings to request treatment as eligible counterparties should be the same as the thresholds for professional clients.

Statistics of meetings in 2004

The Expert Group met 8 times in 2004. The drafting sub group met on five occasions.



The CESR Expert Group on Cooperation & Enforcement

Chairman's message

Michel Prada, *Chairman of the AMF, France*

"Important changes to the whole system of transaction reporting are now afoot, following the development of the regime laid down in the MiFID, and complemented by CESR's proposal for technical advice with respect to transaction reporting (in particular, the principle of home country supervision, supplemented with requirements of transmission/exchange of transaction data between competent authorities). Besides considering the complexity of the technical systems in 25 Member States (to be built or adjusted) and the transposition deadline, there was an urgent need for a more in-depth analysis and work on the technical challenges of how to exchange transaction report data between competent authorities. Our advice therefore achieves some significant progress in streamlining these processes which should assist those reporting to a number of regulators."

The MIFID establishes a market model based on competition between different kinds of trading venues and therefore possible fragmentation. Since the good functioning and integrity of this market model are essential, the MIFID enhances the role of the regulators and organises their cooperation with a view to creating a level playing field and an efficient system of pan-European supervision.

According to the mandates given to CESR by the European Commission, the Expert Group on Cooperation and Enforcement examined two sets of issues.

1. Transaction Reporting (Article 25)

a. Methods and arrangements for the reporting of financial transactions

As the transaction reporting systems are considerably different today, the Expert Group proposed not to impose a unique system to firms, but to build on the existing systems in order to avoid unnecessary costs for investment firms. The exchange of transaction reports between securities regulators would therefore be organised between them only, each regulator having the responsibility to collect necessary transac-

tion reporting data from the firms it supervises, according to its specific arrangements.

In an effort to achieve convergence, CESR proposed a set of principles reporting channels would have to comply with:

- Transaction reports, in principle, must have an electronic format;
- Information should be provided in a timely, safe and reliable fashion;
- Existence of appropriate precautionary measures in case of system failures;
- Sufficient system capacities.

b. Concept of the authority of the most relevant market in terms of liquidity

The Expert Group has addressed this issue by conducting, as a starting point, a fact-finding exercise which had as a result that computing liquidity for the purposes of the implementation of Article 25 of the MiFID would be a costly and burdensome approach, considering the huge number of financial instruments to be assessed. CESR has therefore proposed to follow an empirical approach based on proxies, in particular as the fact-finding exercise demonstrated that the proxy-approach was generally consistent with the case-by-case measurement of liquidity (e.g. the liquidity proxy for shares would be the market where a share was first admitted to trading). As the proxy-approach is not fully accurate in all instances, the possibility of a revision procedure is foreseen, namely to compute liquidity on the basis of volume and/or turnover of the financial instrument considered.

Although the proxy approach renders the determination of the most liquid market much simpler than the computation of liquidity, it will impose a heavy burden on CESR members, both to put the system in place and to maintain and update it.

c. Minimum content of transaction reports

Considering the heterogeneity of existing systems of transaction reporting, it can only be a long-term objective that the content of transaction reports becomes convergent at EU level, an approach generally supported by respondents to our consultation papers. One step in this direction is the proposal for the establishment of a list of information in transaction reports that would have to be required in all Member States. This is going beyond the requirements of the MiFID which is only referring to a limited number of information fields. These fields are considered necessary for achieving the main purpose of transaction reporting, namely the proper monitoring of the integrity of markets by competent authorities. The other step towards convergence is a proposal for a list of information contained in transaction reports that has to be exchanged in a harmonised format between competent authorities.

2. Cooperation and exchange of information (Articles 56(2) and 58)

The second main issue the Expert Group had to deal with concerns cooperation and exchange of information between securities regulators, a topic which is not only crucial for the effective functioning of the CESR network, but also of interest to market participants, which profit from good cooperation between their regulators. As regards Article 56(2) of the MiFID, CESR has proposed criteria under which the operations of a regulated market could be considered as of substantial importance for the functioning of the securities markets and the protection of the investors in a host Member State. Concerning Article 58, CESR proposes the establishment of a general framework for cooperation between competent authorities in order to facilitate the fulfilling of their duties under the MiFID.

Next steps

At Level 3, the Expert Group will work on technical issues related to transaction reporting, such as the standards and formats for exchanging transaction reports and the establishment of the list of the competent authorities of the most liquid market for each financial instrument covered by the MiFID.

Statistics of meetings in 2004

In 2004, there were seven meetings of the Expert Group and three meetings with the Consultative Working Group. Most of the work was undertaken via e-mail or conference calls.

The CESR Expert Group on Markets

Chairman's message

Karl-Buckhard Caspari, *Vice-President of the Bafin, Germany*

"The CESR Expert Group on Markets has worked within an extremely tight timetable (especially on the second set of mandates) and handles some of the most debated and controversial topics of the MiFID. Standardising the level of market transparency information in a way which supports optimum price formation is quite a challenge. When preparing CESR's proposal for a second round of consultation, we have put special emphasis on the overall structure so that all pieces would fit together. To some extent, that means making a choice between highly sophisticated but complicated solutions, and easy and simple but of course less accurate solutions. I would say that the group tends to favour the choice of simple and workable solutions."

CESR's work in this area falls mainly into two separate streams, namely issues related to market transparency and issues related to admission to trading, both of which have their own specificities.

On market transparency, the main issues are how to standardise the content of pre-trade transparency between different market models, and which transactions should have exemptions from immediate transparency. On pre-trade transparency for internalisers, the crucial points include defining which shares should be deemed liquid for the purposes of the article and how to separate when internalisation is done systematically, and should follow the rules of that article, and when it is incidental and outside the article.

In addition, the Group has faced the issue that the development and size of financial markets in CESR members´ jurisdictions vary a great deal, as does the level and speed of integration into a single market. This has therefore meant that there were some additional challenges to make the proposal workable throughout the EU in a way which supports the operation of a single market on the one hand, and ensures a level playing field and similar levels of investor protection on the other.

In addition to the overall timetable, one special difficulty has been to establish the appropriate thresholds which should be used and/or calculated. The Directive (level 1) texts set some parameters as to how this should be done. In some cases the starting point is that different information is available according to other provisions of the MiFID. Nevertheless, in many areas that information is not available at the moment for the Expert Group to base its proposals on. This means that on some areas the proposals will be based on limited amounts and content of information, or even that some simple proxies have been used to develop the advice.

On the issues related to admission to trading the Group has discussed how admission requirements should be covered, broadly by taking into account that there are quite a few other Directives which relate to the operation of issuers whose instruments are admitted to trading (namely, the Prospectus Directive and Regulation, the Transparency obligations under the Transparency Directive, the Market Abuse Directive, and various legislative texts related to Company Law and Accounting). At present (as this is still in the consultation phase), the Expert Group has decided to keep the scope quite narrow, addressing only the items which relate to the instrument itself (and not those relating to the issuer). There are some exemptions relating to issues which are already covered by the Consolidate Listing Directive (CLD) which sets requirements for "official lists". As the work covers different types of instruments, the level of details of the proposal has been adjusted according to the needs of those instruments.

In order to properly address the issue of scope in relation with the CLD, some additional work was needed. As the Group felt it necessary to have a second round of consultation, the finalisation of the final advice was extended to the end of April 2005.

Statistics of meetings in 2004

The Expert Group met ten times in 2004.

4.2 Transparency Obligations Directive

Chairman's message

Andres Trink, *Chairman of the Estonian Financial Supervision Authority*

"The Transparency Directive is an important part of the Financial Services Action Plan to improve investors' access to information about issuers and increasing market transparency on a pan-European basis. Therefore, the quality of CESR's advice to the European Commission on these implementing measures has to be of a high standard, thoroughly consulted and well-suited to the needs of markets.

The Transparency Expert Group is also a key forum in developing standards which will enable EU-wide dissemination and storage of regulated information. This is a challenging task, not only for CESR, but for all Member States and market participants. Our Expert group will make the best of our expertise to advise the European Commission on the next steps in building an efficient dissemination and storage framework in Europe.

European investors need better access to information on issuers and European issuers need wider access to capital. CESR's Transparency Expert Group continues to keep this key goal in mind in its work. I have admired the knowledge and the commitment of the members of our Expert Group and continue to enjoy working on this project."

Background

The Transparency Obligations Directive (Transparency Directive) was approved by the European Parliament on 30 March 2004 and by the European Council on 11 May 2004 and was formally adopted by the Council in the autumn of 2004[3].

The aim of the Transparency Directive is to provide a Level 1 framework of reporting obligations by companies whose securities are admitted to trading on a regulated market (listed companies). One of the key provisions of the Directive, is to ensure that investors receive periodic information from listed companies, including annual and interim financial reports whose content is defined in order to meet investors' needs.

The Directive also includes a number of requirements for the disclosure of information about major shareholdings and encourages better dissemination of information by issuers within Member States and also across Europe.

On 29 June 2004, the European Commission published its first set of mandates requesting CESR's advice on possible technical measures to implement the Transparency Directive. CESR has been asked to submit its advice by 30 June 2005 and the entire package of measures must come into force by the end of 2006.

[3] *2004/109/EC, OJ 15 December 2004*

4.2 Transparency Obligations Directive

Mandate of the Transparency Expert Group

CESR's advice is prepared by an expert group chaired by Andres Trink, Chairman of the Estonian Financial Supervision Authority and supported by a permanent member of the secretariat, Michel Colinet.

This mandate requested advice on a number of different technical issues that can be grouped into three areas. These three areas are as follow:

– Technical issues related to notifications of major holdings of voting rights in companies whose shares are admitted to trading on regulated markets;
– Minimum standards for the dissemination of regulated information and implementing measures on the conditions under which periodic financial reports of issuers must be kept available;
– Technical questions related to half-yearly financial reports and to equivalence of transparency requirements for third countries issuers. This third group also includes the procedural arrangements whereby an issuer may elect its 'Home Member State'.

The European Commission also invited CESR to present a progress report on the conditions for officially appointed mechanisms for storage of information and on possible electronic networks of information about issuers. A first progress report is expected from CESR by March 2005[4]. Based on this progress report, the European Commission will consider whether a second mandate should be sent to CESR requesting technical advice on these issues.

Process

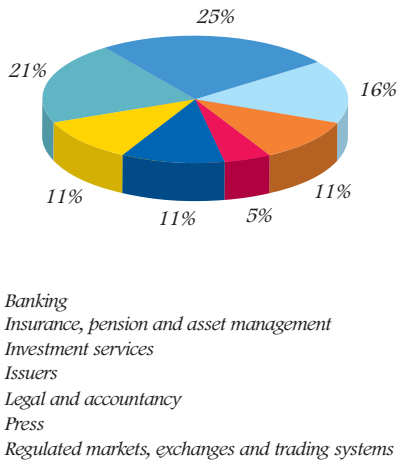
A Consultative Working Group (CWG) of eleven experts, drawn from across the markets and reflecting wide stakeholder interest, was established to assist the Expert Group. The CWG has contributed with useful technical advice and expertise for the working group throughout the drafting process. The members of the CWG are:

Mr Guy Elewaut, Delhaize Group
Mr Bjarne Graven Larsen, Danish Labour Market Supplementary Pension (ATP) and Private Equity Partners
Mr Borja de la Cierva Inditex
Ms Gwenaelle de la Raudière, Eads
Mr Otmar F. Winzig, Software AG Member of Deutsche Börse's sanction committee
Mr Emmanuel I. Voulgaris, S & B Industrial Minerals
Mr Stefano Vincenzi, Mediobanca Professor of Financial Law
Mr Ton Berendsen, ABP
Mr Idar Eikrem, Norsk Hydro
Ms Marianne Nilsson, Robur Ab
Mr Mark Hynes, Pr Newswire

Summary of proposals in CESR's first Consultative paper:

To begin work in this area, CESR issued a Call for evidence on 29 June 2004. Consultation closed on 29 July, and CESR received 19 responses.

Call for evidence regarding the EU Commission mandate on the Transparency Directive (Ref.CESR/04-284)
Total of numbers 19

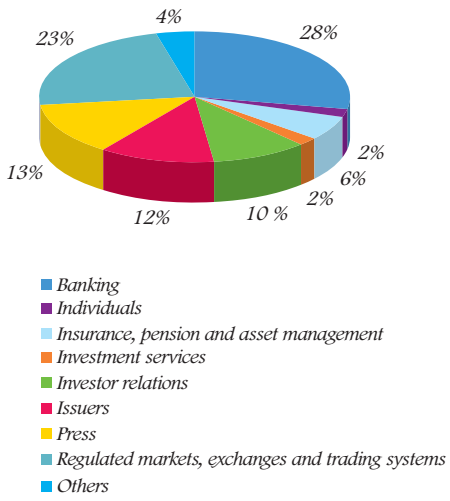


On 27 October 2004, CESR published for consultation its proposed advice on dissemination of regulated information which forms part of the mandate for technical advice requested by the European Commission under the Transparency Directive. It sets out CESR's draft advice on possible implementing measures for dissemination of regulated information and on the conditions under which periodic financial reports of issuers must be kept available. This first

[4] *On electronic networks, CESR is requested to update its February 2005 report by October 2005 and to issue a final report in autumn 2006.*

consultation paper also included a draft progress report to the European Commission on the conditions for officially appointed mechanisms for storage of information and on possible electronic networks of information about issuers. The consultation on this first paper closed on 28 January 2005.

CESR's advice on possible implementing measures of the Transparency Directive (Ref. CESR/04-511)
Total of numbers 52



With regards to:

– **Dissemination of regulated information (such as price sensitive information, half-yearly financial reports, interim management statements, major shareholdings information):** CESR proposes in this draft paper not to require information to be published in any one particular form of media and widens the definition of what it considers to be 'publishing' to include email, fax and other forms of communication. CESR proposes minimum standards that issuers should meet in disclosing information. These standards include that the information is made available to consumers without delay (particularly if the information is of a price sensitive nature); all investors should have access to the information and therefore it should not only be directed at specific categories of investors; it should also be available across Europe and free of charge to investors. CESR recommends that issuers be free to choose to disseminate all regulated information themselves or to outsource this function to an operator. Where this is the case, CESR proposes that the operator must meet minimum standards set for an issuer but that in addition, they must ensure they can meet some more specific minimum standards such as, ensuring an appropriate level of security into their mechanisms to disseminate information and they must be able to operate on a 24 hour basis, 7 days a week and release information at least between the hours of trading in all EU time zones. CESR proposes that issuers should benefit from free competition when choosing media operators to disseminate information.

– **The development of a single access point for EU investors to gain financial information on EU issuers, CESR sets out a number of questions that should be considered and some potential options that exist:** This aspect of the consultation is much broader than for the dissemination issues (on which CESR is mandated to deliver technical advice to assist in the development of implementing measures) and the responses received will enable CESR to elaborate the options and to finalise a first progress report as requested by the European Commission.

On 13 December 2004, CESR published for consultation its second set of advice on possible implementing measures covering different aspects of the Transparency Directive, in particular:

– notification of major holding of voting rights;
– half yearly financial reports;
– equivalence of transparency requirements for third countries issuers;
– procedural arrangements whereby an issuer may elect its 'home Member State' competent authority for the purposes of the Directive.

Through the publication of this second consultation paper, CESR completed the first step in the finalisation of the technical advice that CESR was mandated to deliver by June 2005 to the European Commission so that level 2 implementing measures of the Directive can be completed. The consultation on this second paper will close on 4 March 2005.

The first part of the second consultation paper is dedicated to eight issues which, in the mandate from the European Commission, relate to notification duties of major holdings of voting rights in companies whose securities are admitted to trading on regulated markets. The draft advice notably clarifies the conditions and requirements that management companies and investment firms and, their parent undertakings, should comply with in order to benefit from the exemptions provided by the Transparency Directive. Further important issues covered include the clarification of which person should make the notification when the shareholder and the holder of the corresponding voting rights is not the same person.

4.2 Transparency Obligations Directive

In addition, the advice addresses various questions in relation to notifications of holdings of financial instruments. Finally, the advice also touches on some of the more practical issues such as, the standard form to be used throughout the Community by investors (with major holdings) which are required to make notifications and the determination of a calendar of "trading days" for all Member States for notification purposes.

The second part of the consultation paper covers three specific issues raised in relation to half yearly reporting. Namely, the minimum content of half-yearly financial statements not prepared under IAS/IFRS; the meaning and scope of "major" related parties transactions which must be reported on within the half-yearly reports of issuers of shares; and, the nature of the auditor's review of half-yearly reports (where such a review has been conducted).

The third chapter of the second consultation paper covers the issue of equivalence of third countries' requirements with regard to the disclosure requirements of the Transparency Directive. In this respect, CESR was requested to provide advice on the possible principles that competent authorities should apply in order to, at a later stage, establish a list of third countries which can be considered as equivalent. Briefly, CESR's proposed approach is to test equivalence by looking first at the key principles and objectives of the different disclosure requirements of the Directive and then to establish what a third countries' framework has to include in order to be deemed to be equivalent. It is worth noting that the advice proposed by CESR in this paper should be seen as separate, although consistent, with the advice that CESR will, in parallel, develop on GAAP equivalence.

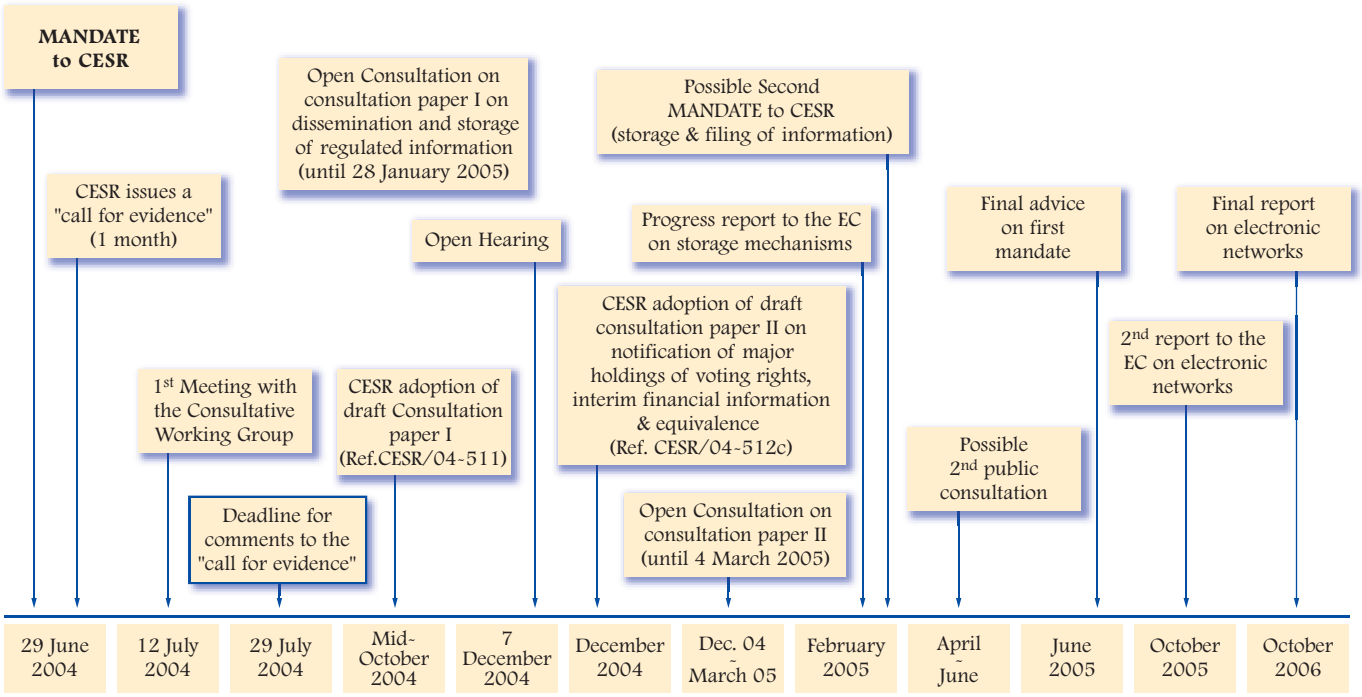
Next steps:

The Expert Group will consider the feedback provided and will assess how best to reflect the comments received from the consultation. A feedback statement will then be prepared along with the final advice for the European Commission.

Statistics of meetings 2004

The Transparency Expert Group met 5 times in 2004, and its Drafting Group met a total of 14 times. It has also held two Open Hearings for interested parties.

Indicative CESR work plan for the mandate and progress report under the Transparency Directive



4.3 Credit Rating Agencies

Chairperson's Message

Ingrid Bonde, *Director General of Finansinspektionen, Sweden*

"The role of credit rating agencies and their importance has grown in correlation with that of our markets, so it is therefore an appropriate moment to take stock to establish if regulation can contribute to the efficiency of the functioning of the market or not, and if it can assist, how and what shape that might take. CESR's work on credit rating agencies has therefore been qualifiedly different in nature. Indeed, CESR's technical advice at Level 2 is given in response to clear parameters and within a framework agreed by the EU institutions. Here, however, CESR is asked to consider the pros and cons of adopting a regulatory approach and if a regulatory approach were to be adopted, to explore the various forms this might take. There are some critical issues to be carefully weighed in the balance, for example, it will be important to consider fully the impact regulation might have on competition, the role of ratings and those of unsolicited ratings, the potential conflicts of interests that might arise for a rating agency and the impact of the rating agency on the issuer and the nature of their relationship and how this might affect market efficiency for good and bad. Debate has been lively and the contributions rich in experience so we look forward to delivering thorough advice"

Mandate of the Credit Rating Agencies Task Force

The European Commission published on 27 July 2004 a call to CESR for technical advice that should be submitted by 1 April 2005.

The advice will focus on six different areas covered by the call for advice, which can be summarised as follows:

- Interests and conflicts of interest for credit rating agencies;
- Fair presentation of credit ratings;
- Relationship between issuers and rating agencies;
- Possible entry barriers to the market for the provision of credit ratings;
- Use of ratings in European legislation and in private contracts;
- Registration of credit rating agencies.

Background

The initiative to analyse whether, and how, credit rating agencies might be regulated, stems from discussions by Europe's Ministers of Finance and Members of the European Parliament following the Enron and Parmalat scandals. In February 2004, the European Parliament passed a resolution on the basis of the report by Mr Katiforis MEP on the role and methods of credit rating agencies. This report calls on the European Commission to submit by 31 July 2005 its assessment of the need for appropriate legislative proposals to deal with this topic.

In view of the July 2005 deadline set up by the European Parliament, CESR was requested to provide advice by 1 April 2005, in order for the European Commission to establish, if a need existed, or not, for introducing European legislation, and to identify the range of solutions and determine what each option may or may not achieve.

In recognition of the fact that the largest credit rating agencies (CRAs), and many companies that they rate, compete in global markets, CESR is carrying out its work in close contact with the United States Securities and Exchange Commission and with IOSCO. The IOSCO Code of conduct fundamentals, which sets out a number of measures that should be included in the codes of conduct of individual credit rating agencies, has been fully taken into consideration by CESR in the preparation of its consultation paper.

Another dimension in CESR work is the forthcoming Capital Requirements Directive, which is in the process of being finalised. The draft Directive provides for the

4.3 Credit Rating Agencies

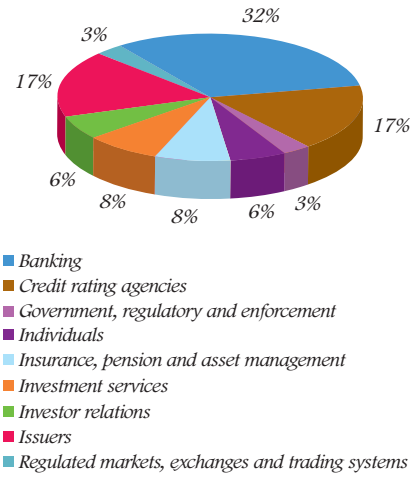
use of external credit assessments in the determination of the risk weights (and consequential capital requirements) applied to a bank or investment firm's exposures. Only the use of assessments provided by recognised External Credit Assessment Institutions (ECAIs) will be acceptable to the Competent Authorities. A recognition mechanism is therefore outlined in the draft Directive, so this factor will be taken into account as CESR weighs up the benefits of the various options and which might be the most adaptive.

Process

CESR set up a Task Force responsible for developing the advice to the Commission. The Task Force is chaired by Ingrid Bonde, Director General of the Swedish Finansinspektionen and supported by Javier Ruiz del Pozo from the CESR secretariat. In addition, representatives from the Commission and from the Committee of European Banking Supervisors (CEBS) take part in the task force as observers.

Following receipt of the mandate from the European Commission, CESR began its work on 28 July 2004 by launching a call for evidence for interested parties to submit comments by 27 August 2004.

Call for evidence on Call to CESR for techincal advice on possible measures concerning Credit Rating Agencies (Ref. CESR/04-394)
Total number of responses: 36

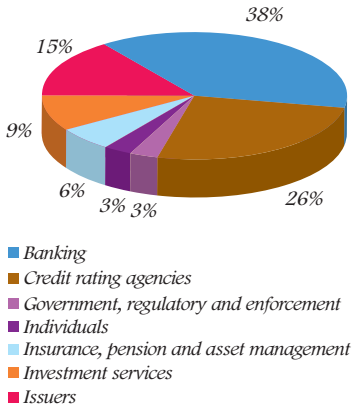


Due to the tight timetable set by the European Commission, it has not been feasible to set up a consultative working group to advise the Task Force. However, in order to have input from market participants at an early stage, a seminar on CRAs, with market participants, was organised at CESR's premises on 8 October 2004. The seminar was divided in to two sessions, one devoted to CRAs and another one with issuers and users of ratings. The seminar provided the members of the Task Force with valuable input of the different interests at stake. In addition, the CESR Market Participants Consultative Panel held a discussion on credit rating agencies during its seventh meeting that took place on 10 November 2004 which also explored the potential options.

On September 2004, the Task Force circulated a questionnaire among CESR members, in order to obtain an accurate description of the current situation in EU jurisdictions regarding the issues put forward by the European Commission.

On 30 November 2004, CESR issued a consultation paper (Ref. CESR/04-612b) on the full range of the issues covered by the mandate. This included a number of specific questions to be answered by respondents. The consultation period closed on 1 February 2005.

Consultation on CESR's technical advice to the European Commission on possible measures concerning Credit Rating Agencies (Ref. CESR/04-612b)
Total number of responses: 34



Work done – an outline of CESR's Consultation Paper

The call for advice to CESR is of a policy nature and as such, CESR's final advice will include a number of possible options with pros and cons. The consultation paper has been drafted in an open ended way, putting forward the different options for the issues included in the call for advice and asking market participants to express their views on the alternatives proposed.

Registration and Barriers to Entry

The consultation paper analyses a number of natural barriers that new rating agencies have to face, and explores whether there are measures that regulators could use to enhance competition. In particular, CESR's advice considers the potential need for registration and/or other regulatory measures at the European level and the impact upon the level of competition in the rating industry that those initiatives might have.

The provision of unsolicited ratings is also investigated, as new entrants to the rating business frequently rely on unsolicited ratings in order to build their reputations. However, for issuers, the provision of unsolicited ratings can pose a problem as they potentially impact on their share value and may force them to buy a rating in the hope of ensuring that this provides a fuller, more accurate picture. Nevertheless, blanket prohibitions on this activity effectively may constitute a barrier to new entrants.

Potential Conflicts of Interest

Under this chapter CESR considered different ways to manage a number of areas that could create potential conflicts of interest for rating agencies. For example, large rating agencies have developed ancillary businesses to complement their core ratings business, such as risk management and consulting services. Credit rating decisions could be impacted by whether or not an issuer purchases additional services offered by the credit rating agency.

Another potential conflict of interest arises from the fact that some credit rating agencies rely on issuer's fees for the vast majority of their revenues. A rating agency could be inclined to downplay the negative information and provide a higher rating, especially if an individual issuer or a few issuers constitute a significant portion of the total revenues of the rating agency.

This section also explored two further aspects of unsolicited ratings. The first one is that investors might wish to know that the rating process behind these unsolicited ratings might lack issuer's input and access to non-public information, as compared to solicited ratings. In addition, concerns have been expressed that rating agencies have put pressure on issuers in order to turn unsolicited ratings into solicited ones.

Finally, the consultation paper also sought views on how to address the conflict of interest that might arise in the event that there are capital links, such as shareholdings or loans, between rated issuers and credit rating agencies.

Quality and Transparency of the Rating Process

CESR has analysed the critical factors that determine the quality of the rating process, in particular, the training and qualifications of the rating agencies' analysts and the methodologies used to develop the credit ratings. Concerning methodologies, users of ratings and issuers have stressed the importance of transparency in the rating process. CESR explored ways to ensure that the market understands the reasoning behind a rating decision and the types of information relied upon by the rating agencies in their analysis.

Relationship between Issuers and Rating Agencies

A further key aspect of the consultation paper is the analysis on how credit rating agencies and issuers might effectively work within the requirements of the Market Abuse Directive, in relation to the handling of confidential and market sensitive information.

This section also explored the need to ensure that issuers have the opportunity to discuss with rating agencies the assumptions and fundamental determinants of their ratings without compromising the need for ratings to be fair and for rating agencies to be independent from the issuers they rate. Furthermore, CESR sought views on whether issuers should have a right of appeal where they disagree with the rating agency's opinion.

Regulatory Options

Finally the consultation paper sought to identify the various ways one could approach the issues put forward by the European Commission and considers the impact this might have on competition in this sector. In particular, it indicates the following policy options which exist, namely, either to:

- Leave to the market itself to self regulate on the basis of codes of conduct that are developed by the market participants (drawing on standards established by IOSCO and others);
- Have some third party assess compliance with the above mentioned codes;
- Draw on the Basel II recognition process for using rating for capital adequacy and to assess the behaviour of rating agencies;
- Put in place a formal registration mechanism and potentially, to establish ongoing supervision, either on a national or EU-wide level where credit rating agencies would be assessed by European securities regulators, on an ongoing basis.

Next steps

As part of the consultation process, an open hearing was held on 14 January 2005. The Task Force will review all comments received in the consultation period and will then discuss the draft advice, building upon the conclusions drawn from the consultation. CESR will seek to finalise its advice by the end of March.

Statistics of meetings in 2004

The Task Force met on three occasions and it held one open hearing.

5 Supervisory Convergence

Level 3

5.1

2004 illustrates a progressive shift in the nature of CESR's work towards greater emphasis on Level 3 activities to ensure increasing supervisory convergence. To fix priorities, CESR has widely consulted on its Level 3 policy (5.1), both to elaborate a work programme for 2005 and, with a more long term vision, to alert the EU institutions on the supervisory consequences of the FSAP by publishing a consultative analytical paper "Which supervisory tools for the EU securities markets?" (Ref. CESR/04-333f). In addition, the monitoring of supervisory convergence has been intensified with increasing technical and methodogical capacities implemented by CESR's Review Panel (Chapter 5, section 2).

Permanent groups within CESR have put in place the necessary tools to move to effective operational cooperation (Chapter 5, section 3) within the framework of the International Accounting Standards Regulation (CESR-Fin) and the Market Abuse Directive (CESR-Pol).

In certain areas, increased transparency on the way in which European securities regulators will supervise certain activities was felt necessary. CESR has therefore developed standards, recommendations or guidelines in the area of Clearing and Settlement, UCITS and Prospectuses (Chapter 5, section 4).

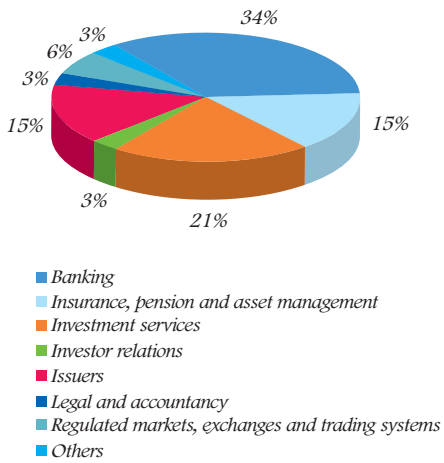
Finally, with the constant need for attention to ensure cross sector and global consistency of CESR activities, closer links have been developed with CEBS and CEIOPS as well as with the US agencies (SEC and the CFTC) (Chapter 5, section 5).

5.1 Policy

The role of CESR at 'Level 3' under the Lamfalussy process.

CESR's strategy to develop greater supervisory convergence in the short term was set out in the paper 'The role of CESR at 'Level 3' under the Lamfalussy process' (Ref. CESR 04-527b), a previous version of which CESR consulted upon in April 2004. CESR received 33 written responses to this consultation.

THE ROLE OF CESR AT 'LEVEL 3' UNDER THE LAMFALUSSY PROCESS (REF. CESR 04-104B)
TOTAL NUMBER OF RESPONSES: 33



The Lamfalussy Report defined the role of CESR under the Level 3 as follows:

- To produce consistent guidelines for the administrative regulations to be adopted at national level;
- To issue joint interpretative recommendations and set common standards regarding matters not covered by EU legislation – where necessary, these could be adopted into Community law through a Level 2 procedure;
- To compare and review regulatory practices to ensure effective enforcement throughout the Union and to define best practice.

This paper therefore explored how CESR members might fully exercise its responsibilities within the four level framework and established a number of proposals on how it can develop its role in Level 3 further, whilst also recognising the need for CESR to coordinate its execution of this role with other key players such as the Member States, responsible for transposition of EU law into national legislation and, the role of the European Commission as 'Guardian of the Treaties', whose function includes enforcing by law, any failure to implement legislation (Article 226 of the Treaty) under Level 4 of the legislative framework.

At present, CESR is working towards the fulfilment of this objective in a number of ways which include producing administrative guidelines, developing interpretative recommendations and common standards, undertaking peer reviews and comparing regulatory

practice to improve consistent application and enforcement of EU legislation of the CESR standards concerned.

As such, CESR's existing Level 3 activities fall into three categories and the consultation paper set out examples of existing work undertaken in each of these modes: 'co-ordinated implementation of EU law', measures to improve 'regulatory convergence' and, efforts to increase 'supervisory convergence'. Having reviewed the existing types of activities carried out under these modes of operation CESR went on to propose additional approaches it might adopt to enhance convergence further.

Further measures to enhance ***a co-ordinated approach to implementation of EU law*** included:

– Keeping alive the network of CESR experts who prepared CESR's Level 2 advice to the European Commission.

Further measures which could be adopted to promote ***regulatory convergence*** included:

– Alerting the EU Commission on any need to update EU legislation (in the Level 1 and Level 2 texts);

– Supporting the initiatives of the EU Commission to give, when and where appropriate, more authority to CESR's common approaches.

Further measures which could be adopted ***to promote supervisory convergence*** included:

– Preparing guidelines for members undertaking joint investigations of cross-jurisdictional institutions;

– Exchange of staff and joint training programmes;

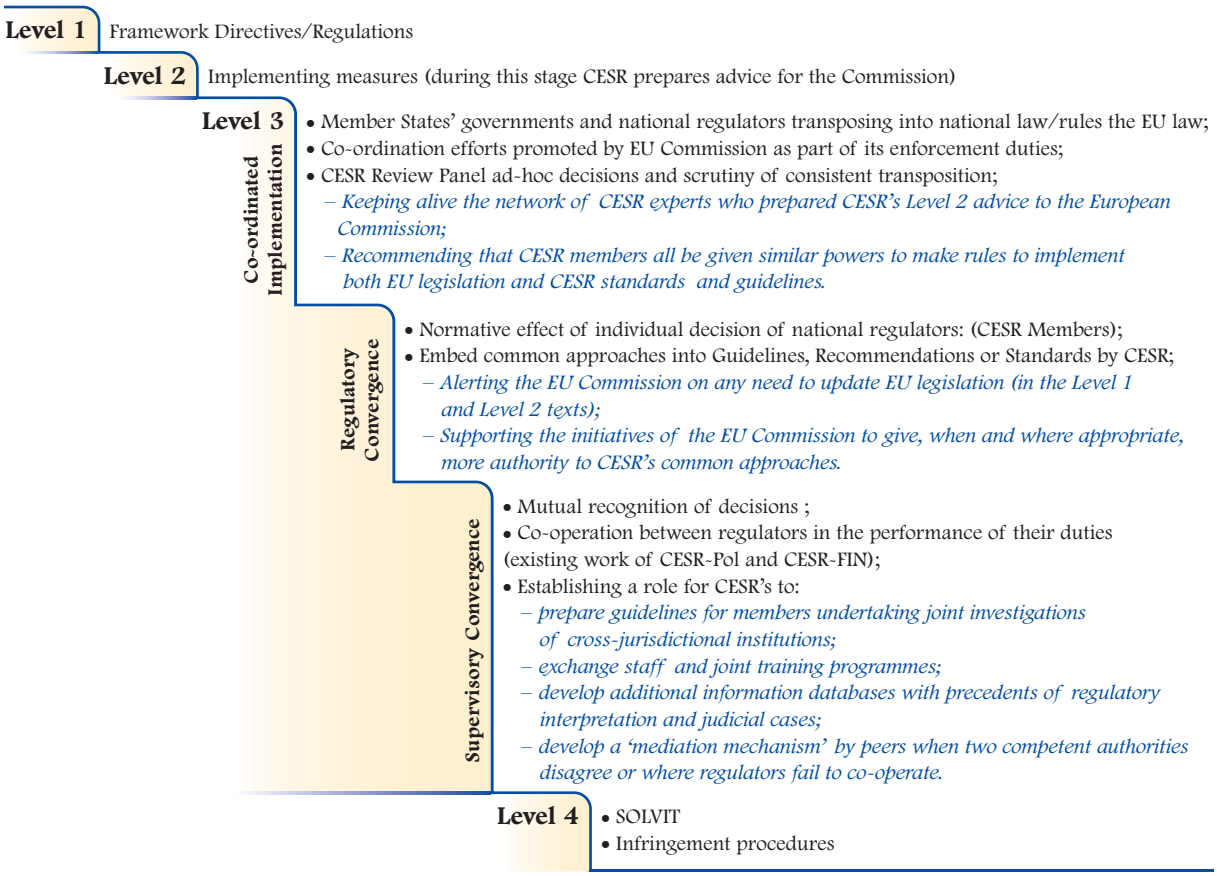
– The development of additional information databases with precedents of regulatory interpretation and judicial cases;

– The development of a 'mediation mechanism' by peers when two competent authorities disagree or where regulators fail to co-operate.

The paper clarifies **the role of CESR standards and guidance** and considers the purpose for implementing standards and guidance. In particular, noting that whilst supervisors across Europe could carry out their functions without co-ordinating with each other, this could lead to very different applications of the same legislation to specific and comparable cases. As such, it is clear that greater co-ordination is valuable if the single market is to function effectively. Given that this co-ordination should take place, it seems only appropriate that this should be done in a transparent manner, hence, the development of standards. However, to ensure these standards are efficient and effective, it seems only appropriate to consult those affected by the implementation of those standards and therefore involve them in what would otherwise be a 'supervisor to supervisor' process.

One of the new functions that CESR will put in place during 2005/6, as part of its Level 3 functions, is **a mediation system amongst regulators to solve conflicts between national securities regulators**. This proposal was strongly welcomed by market participants during the consultation and by the Inter-Institutional Monitoring Group. CESR will develop a mediation system for the purposes of Article 16 of the Market Abuse Directive. This mediation mechanism will also be useful in the mutual recognition of decisions from the Home competent regulator by the Host competent regulator(s) (e.g. licenses of intermediaries and regulated markets, approval of prospectuses or UCITS), where the Directives are drafted in a manner that mutual recognition is an increasingly automatic procedure. Up to now, where the Home and the Host competent regulators (or two Host competent regulators) disagree as to how a Directive should be applied, the normal procedure would have been to refer the case to the European Commission, or even to the European Court of Justice (ECJ), if the matter required an official interpretation of the relevant Directive. However, in order to have a more rapid and a less costly solution, CESR will start putting in place a "mediation" mechanism carried out by peers (other members of CESR) which will seek to provide an acceptable solution for specific cases. This will need, of course, to work in accordance with the speed of markets and, therefore in most cases, would intervene ex post. CESR notes, however, that the existence of a "mediation" system should not be regarded as an incentive to systematically question the increased 'automaticity' of mutual recognition. In addition, any mediation system developed would have to respect, in particular, confidentiality and business secrecy obligations, and any CESR mediation activity that is developed should not overlap with the Commission's enforcement competences.

Level 3 Framework in context and new proposals (illustrated in italics) (ref. CESR/04-527b)



The Himalaya Report: "Which supervisory tools for the EU securities markets?"

CESR also published for consultation an analytical report entitled "Which supervisory tools for the EU securities markets?" (Ref. CESR/04-333f), which took a long term view of what might be necessary to increase supervisory convergence.

The purpose of this preliminary report on the supervision of securities activities in Europe by CESR is twofold. The first objective was to take stock of progress made through the Financial Services Action Plan (FSAP) toward the integration of the EU Single Market for Financial Services in the field of securities. The second objective was to identify and analyse the supervisory tools necessary to implement the FSAP and to anticipate the developments in the next five years so as to allow securities regulators to evolve effectively and by so doing, ensure they can fully play their role in maintaining fair, transparent and secure securities markets in Europe. In order to achieve this objective, a number of possible options exist for solutions to be found, both within, and sometimes, beyond, the current framework of EU law, and these options have been explored with a view to improving the efficiency of the co-operation among regulators and the operation of the CESR Network.

The main ideas put forward in the report are that the degree of integration of the securities markets in the EU, varies significantly, both according to the sectors and categories of market players considered. EU securities regulators should therefore develop an "adaptive" strategy to face the progressive integration of markets. As a consequence, this requires supervisors to evaluate the supervisory tools they will need to react properly and proportionally to the evolving reality of markets. CESR believes that once it has completed the very significant task of dealing with the FSAP measures, there is great scope to adapt supervisory arrangements.

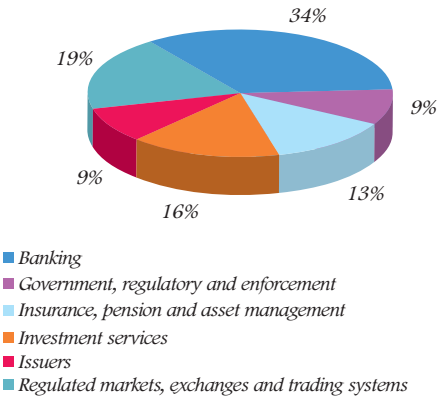
One of the preconditions for CESR members to carry out effectively their new obligations to co-operate under the FSAP is that supervisors should be given equivalent legal and functional capacity to act. The greatest priority of CESR is precisely to deepen the co-operation arrangements under the FSAP to enhance the supervisory relationship between authorities and improve the convergence of approaches and decisions within the Network of securities regulators.

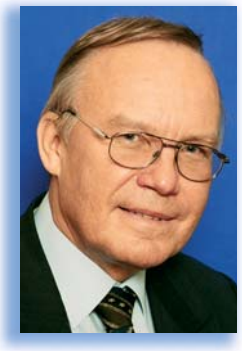
However, this analysis would be incomplete if it did not flag that the need to consider supervisory tools of a trans-national dimension, is closer than it was four years ago when the Committee of Wise Men, chaired by Baron Lamfalussy, was set up. CESR believes that these options should be considered only if it is very clear that the present system cannot be developed to provide proper solutions to the question of supervisory convergence.

This work by CESR should be understood as a preliminary contribution to the debate on the content of the post-FSAP agenda. It does not constitute in any manner a final opinion on this matter but is rather a preliminary analysis of current challenges and possible solutions for which guidance from the EU institutions and comments from the market participants are necessary before reaching a definitive conclusion.

This report was therefore presented to the EU institutions to begin a dialogue on the issues and open to comments from the public until by 31 January. 32 written responses were submitted.

Which supervisory tools for the EU securities markets: Preliminary Progress Report (Himalaya Report) (Ref. CESR/04-333f)
Total number of responses: 32





5.2 Monitoring

Review Panel

Chairman's Message

Kaarlo Jännäri, *CESR's Vice-Chairman, and Director General of the Rahoitustarkastus, Finland*

"The completion of the legislative phase of the Financial Services Action Plan does not leave any room for complacency. CESR members will not simply wait for the improvements of the new legislative measures to materialise. Indeed, one of the key messages of the Lamfalussy Report was that the implementation phase was at least as crucial for the success of the Financial Services Action Plan as the legislative one, and notably that CESR had a key role to play in ensuring consistent and timely implementation of Community legislation. We are clearly now in a crucial phase, given that the transposition date of some of these measures has already passed, for example, in the case of the Market Abuse Directive, or in other areas where it will come into effect soon such as in the case of the Prospectus Directive. During 2004, the Review Panel has demonstrated that it is an indispensable tool and this area of CESR's work is considered to be a top priority in 2005. As a result, the Review Panel has been equipping itself for 2005 and building on the experience gained from its first review of the implementation of standards which proved a useful 'trial run' to test our approach, and we have therefore developed an effective IT tool to assist in this process."

Mandate

The "Stockholm Resolution" adopted by the European Council on 23 March 2001 stated:

'The Committee of European Securities Regulators should also contribute to the consistent and timely implementation of Community legislation in the Member States by securing more effective cooperation between national supervisory authorities', carrying out peer reviews and promoting best practice.'

Source: The conclusions of the Stockholm Resolution was reflected in Paragraph 9 of the Commission Decision establishing CESR (2001/527/EC)

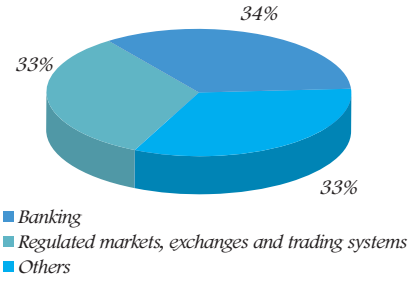
To fulfil this important task, CESR established the Review Panel, in March 2003. The Panel, chaired by Kaarlo Jännäri, Vice Chairman of CESR, is a permanent group comprising the representatives of each CESR Member.

The Review Panel is mandated to **review the implementation (day-to-day application) by all CESR Members of EU legislation and CESR standards and guidelines into national rules**.

First Interim Report

In March 2004, CESR published the First Interim Report of the Review Panel on the review of the status of implementation of the CESR Standards on Investor Protection and the CESR Standards for Alternative Trading Systems (Ref. CESR/03-414b), as well as the so-called "correspondence tables", in which the measures implementing these CESR Standards (all in all more than 200 standards and rules) in all Member States are set out in detail, and "synthesis tables" providing an overview of the status of implementation. Following the adoption of the Directive on Markets in Financial Instruments 2004/39/EC (MiFID) in April 2004, which incorporated a number of provisions of these two CESR Standards, and the publication of the European Commission's mandates for technical advice for implementing measures of the MiFID to CESR, where CESR has been using the Standards as basis for its work under these Mandates, CESR agreed not to continue the review process of the Standards at this stage. However, the information gathered in that process will considerably facilitate any future review of the implementation of the MiFID and its implementing measures.

REQUEST FOR COMMENTS ON THE FIRST INTERIM REPORT BY THE REVIEW PANEL (REF.CESR/03-414B)
TOTAL OF NUMBER OF RESPONSES: 3



Mapping exercise of CESR members' powers in the securities sector

As stated in the CESR paper "The Role of CESR at (Level 3) under the Lamfalussy Process – Action Plan for 2005" (Ref. CESR/04-527b), divergences in the powers of CESR members would be detrimental to the goal of achieving convergence in the securities area, one of the main objectives of the Lamfalussy Process. As a first step, the Review Panel conducted a comprehensive mapping exercise of the powers of CESR members in the securities sector, which was also a contribution to the so-called "Himalaya Report" (Ref. CESR/04-333f), where the results of the mapping exercise can be found, (as part of the exercise, CESR members were also asked to provide information as to other issues, such as their political, administrative, financial and judicial accountability).

The mapping exercise concentrated on six core areas of the securities sector (primary markets, investment services, market infrastructures, investment management, market abuse and issuers), but also considered non-core areas (such as investor compensation schemes or credit rating agencies). It covered rule-making, supervisory, investigatory and sanctioning powers as well as enforcement, including the abilities to share cross-border information and an assessment of the co-operation powers available to CESR members. Each CESR member was asked to assess whether it had sole power in a particular area; whether powers were delegated to or shared with another entity by a CESR member; or to identify whether it had no powers at all.

The results of the findings were encouraging in one area, with CESR Members having sufficient powers in regard to the sharing of information on cross-border information and co-operation. However, as regards delegated rulemaking powers, the results showed that on average more than half of CESR members do not have any powers to adopt delgated binding rules in the core areas of securities law. Regarding the other areas of powers (supervisory, sanctioning and investigatory powers) the results showed greater divergence amongst members, so that no general statement can be made. Since the consistent implementation of the Financial Services Action Plan will bring about considerable changes to the powers of CESR members in a number of areas, the results of the mapping exercise provide a snapshot of the current situation. As such, the Review Panel will to conduct a similar mapping exercises on a regular basis in the future, in order to monitor developments in this respect.

MAD transposition

In line with its mandate to assist CESR in its task of ensuring more consistent and timely implementation of Community legislation in Member States, the Review Panel called an ad-hoc session in early 2004 to discuss the steps taken in Member States by the competent authorities in the implementation of the Market Abuse Directive, which gathered not only CESR members but also participants from relevant ministries, and provided support to the European Commission in its informal transposition meetings on the Market Abuse Directive, where CESR members could also participate.

Review Panel database

Since the Review Panel will be tasked to conduct further reviews of the implementation of CESR and EU measures, it was decided that the work of CESR members in completing the questionnaires in such reviews should be facilitated, and that the presentation of the data gathered should be more easily accessible to the public (although, it should be noted, all the findings are published on the CESR website at present, but in a word format which might not be as easily accessible as a database). As a result, CESR decided to create a special database for the Review Panel, which will go online in the course of 2005.

Next steps

CESR has been asked by the European Commission to conduct a survey on the implementation of the two European Commission Recommendations on UCITS, which deal with the use of derivatives by UCITS (2004/383/EC) and the contents of the simplified prospectus of UCITS (2004/384/EC). In addition, the Review Panel will review the implementation of CESR's Standard No 1 on Financial Information, which deals with the enforcement of financial information, by the end of 2005. Finally, the Review Panel will develop a general methodology for reviews of the implementation of Level 3 measures (e.g. CESR Standards) and other measures (e.g. EU Directives and Regulations and Commission Recommendations).

Statistics of meetings in 2004

The Review Panel met three times in 2004, but conducted most of its work on a remote basis. As the areas of work of the Panel are set to increase again in 2005, most of the preparatory work of the Review Panel will again be undertaken at a distance or through small ad-hoc groups.

5.3 Operational

5.3.1 CESR-Fin

Chairman's message

John Tiner, *Chief Executive of the the FSA, UK*

"Since CESR's last annual report, three topics have been high on CESR-Fin's agenda: the development of the co-ordination mechanism to create an appropriate forum where practical issues of enforcement of financial information can be discussed, monitoring the EU endorsement process of accounting standards as Europe makes the transition to IFRSs this year, and the creation of the Audit Task Force Subcommittee.

We are in a period where major changes are expected in the financial reporting framework and in many cases, these changes will take place over a relatively short time frame. CESR-Fin therefore has a key role to play in ensuring that these changes are successfully implemented. Through the work of our endorsement subcommittee we are working to ensure that standards are robust and deliver an effective level of investor protection. Through our enforcement subcommittee we are helping achieve a coordinated and harmonised approach to enforcement. And finally, via the Audit Task Force, we intend to contribute towards strengthening the quality of audit in the EU."

Mandate of CESR Fin

CESR-Fin is a permanent Operational Group with the role of co-ordinating the work of CESR members in the area of endorsement and enforcement of financial reporting standards in Europe.

CESR-Fin enables CESR to play an effective role in the implementation and enforcement of IAS/IFRS in the European Union (EU) in the context of the EU's new accounting framework that will become compulsory for all European listed companies as of 2005. This allows CESR to participate pro-actively during the formation and implementation of the international accounting standards (IAS/IFRS) through an engaged dialogue with all the key policy makers involved throughout the European endorsement process. Furthermore, CESR-Fin's role is to assist CESR members in delivering a co-ordinated and effective application of IAS/IFRS by EU listed companies, through the preparation of standards and guidelines on supervision and enforcement of financial reporting in Europe.

CESR-Fin has also been tasked with monitoring developments in Europe in the field of auditing.

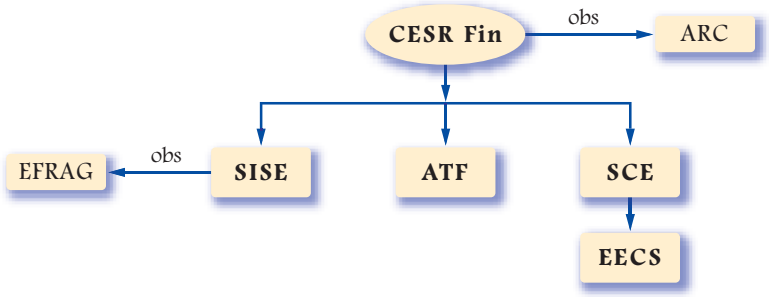
CESR-Fin is chaired by John Tiner, Chief Executive of the UK Financial Services Authority (FSA).

To deliver the objectives outlined above, CESR-Fin has established three sub-committees: the Sub-committee on Endorsement of International Financial Reporting Standards (SISE), chaired by Paul Koster, Board Member at the Netherlands Financial Market Authority (AFM) and, the Sub-committee on Enforcement (SCE) chaired by Lars Ostergaard, Director at the Danish Financial Services Authority (Finanstilsynet).

Another subcommittee has been created in 2004, the CESR Audit Task Force(ATF), whose objective is to monitor developments in the area of audit of financial statements of listed companies in the EU, from the perspective of securities regulators. This subcommittee is chaired by Philippe Danjou, Director of Corporate Accounting at France's market regulator - Autorité des Marchés Financiers (AMF).

The work of these groups is supported by a permanent member of the secretariat, Michel Colinet.

It should also be noted that the European Commission is represented in the meetings of CESR-Fin and its three Sub-committees as an observer.



ARC: *Accounting Regulatory Committee*
EFRAG: *European Financial Reporting Advisory Group*
SISE: *Sub-committee on Endorsement of International Financial Reporting Standards*
ATF: *Audit Task Force*
SCE: *Sub-committee on Enforcement*
EECS: *European Enforcers Co-ordination Sessions*

The activities of CESR-Fin under the "Level 3"

During this year, three issues have dominated CESR-Fin's agenda and that of its three subcommittees, SISE, SCE and ATF, namely the endorsement of IAS 39 on Financial Instruments, the finalisation of the implementation guidance for the co-ordination of enforcement of financial information and the set up of the CESR Audit Task Force and its key projects.

1. EU endorsement of IAS/IFRS – partial endorsement of IAS 39

On 31 March 2004, the IASB published the last IFRS necessary for the "stable platform" of accounting for the transition to IFRS by European listed companies in 2005. The key standards on which CESR-Fin has focused its attention include, IFRS 2 on Share Based Payments, IFRS 3 on Business Combination (phase I), IFRS 4 on Insurance Contracts and final improvements to IAS 32 and 39 on Financial Instruments (subsequently, IASB also published another Exposure Draft on Fair Value Option for Financial Instruments, thereby completing the latest changes to IAS 39).

Background context to CESR-Fin's work:

The endorsement of IAS 39 (*Financial Instruments: Recognition and Measurement*) in view of the introduction of the IAS/IFRS for all EU listed companies as of 1 January 2005 has been the subject of intense debate in Europe for over a year.

The publication by the IASB of an improved version of IAS 39, notably including the possibility to apply hedge accounting on a portfolio basis, has not been sufficient to assuage the concerns of the banking industry, the ECB and prudential supervisors, on a number of issues that the implementation of this standard poses.

At this stage, two issues remained unresolved in the current version of IAS 39:

- The hedge accounting provisions which pose a problem for some European Banks working in an environment of fixed interest rates, as IAS 39 does not allow these banks to apply an accounting treatment that takes into account the way they manage their assets and liabilities. The IASB has set up a special working group in order to re-examine this problem on the basis of an alternative proposal put forward by the banking industry. The IASB hopes that a solution will emerge in April 2005 for a final revision of IAS 39 by the end of 2005.
- The option to apply fair value to all financial assets and liabilities without restrictions. The IASB had recently published a new exposure draft limiting the use of this option in order to respond precisely to the concerns raised by the ECB as well as those voiced by banks and some securities regulators. The most important difficulty outstanding relates to the possibility to offer to apply the fair value to liabilities.

In recognition of the urgent need to have in place all standards necessary for the transition to IAS/IFRS as planned in 2005, in particular, standards that include how financial instruments should be treated, the European Commission proposed in July 2004 three alternative solutions: 1) an endorsement of IAS 39 without the provisions of the controversial parts of the standard; 2) an endorsement of IAS 39 for all companies but the financial institution, 3) a postpone-

ment of any endorsement. The EC clearly indicated its preference for the first solution.

The proposals of the European Commission were debated by the Accovuyting Regulatory Committee (ARC) from July and the ARC formally approved the proposal for a Commission Regulation adopting IAS 39, with the exception of the provisions that allow the use of the fair value option for liabilities and the provisions which prohibit the application of the fair value hedge accounting to portfolio hedges of core deposits (linked to a relaxation of the rules governing the assessment of possible ineffectiveness in hedging relations and the consequent recognition of under hedges in the income statement). This partial endorsement of IAS 39 is expected to facilitate the introduction of the standard for the transition to IFRS in 2005, without the provisions that continue to create problems as indicated above.

In a draft declaration of the EC and Members States, it has been made clear that these two carve-outs are temporary and could shortly be eliminated depending on the outcome of the work that the IASB has undertaken on these two issues.

CESR- Fin's work in this area:

CESR-Fin and its sub-committee on endorsement (SISE) have closely followed and participated in the discussions which preceded the endorsement decision of the ARC.

As the partial endorsement is basically a temporary solution, CESR-Fin will continue to monitor closely the future developments on these issues. In terms of enforcement, the implementation of the partial IAS 39 will also need increased attention from regulators.

As far as endorsement is concerned, CESR-Fin also expressed its support for the adoption in Europe of IFRS 2, Share Based Payments. Considering the potentially significant impact of share based payments (including stock option plans) on existing shareholders and the very nature of such operations, the expensing of these payments as required by IFRS 2 is justified in view of investors' protection. IFRS 2 was finally approved on 20 December 2004.

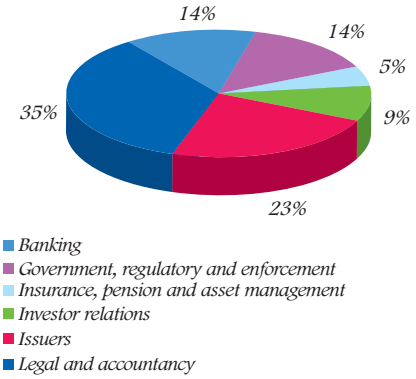
2. Enforcement of financial information: finalisation of the co-ordination mechanism

a. Standard No 2 on Co-ordination of enforcement

The purpose of Standard No 2 (ref. CESR/03-317b), as adopted by CESR in March 2004 was to contribute to the creation within Europe of consistent enforcement of the financial reporting framework to be implemented by 2005. Before adopting the standard, CESR held a consultation that closed on 7 January 2004.

CESR Draft Standard N°. 2 on Financial Information - co-ordination of enforcement activities (Ref. CESR/03-317b)

Total number of responses 22



In particular, Standard No 2 sets out the establishment of a co-ordination mechanism for enforcement at a pan-European level. The key principles introduced by Standard No 2 include:

- Discussion of enforcement decisions and experiences within a formalised structure which will involve all EU National Enforcers of standards on financial information, being CESR Members or not ('European Enforcers Co-ordination Sessions' - EECS);
- The principle that all supervisors should take into account existing decisions taken by EU National Enforcers Additionally, CESR proposes that where practicable within constraints of time and confidentiality, discussions with other EU National Enforcers should take place before significant decisions are taken;
- The development of a database as a practical reference tool which sets out decisions taken by EU National Enforcers, to provide a record of previous decisions reached in particular cases. The database of enforcement decisions will set out the principles upon which decisions have been taken by EU National Enforcers.

b. Final implementation guidance and feedback statement of the public consultation

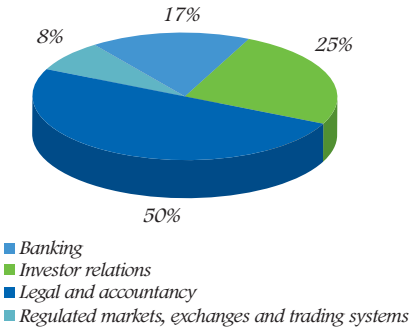
After the finalisation of Standard No 2, the SCE focused its activities on the implementation of this standard. In this regard, the SCE prepared the draft guidance for implementation and the draft Terms of Reference of the above mentioned European Enforcer Coordination Sessions (EECS).

CESR approved the draft Implementation Guidance in June 2004 upon which CESR then consulted (ref. CESR/04-257). This guidance set out how the discussions of real enforcement decisions/cases would be organised (through EECS, which is an extended

session of sub-committees on enforcement [SCE]) and involves CESR members and non-CESR members who are entrusted with national responsibilities in enforcement of financial information). The guidance also set out the characteristics of the database of enforcement decisions that will be created and managed by CESR in order to facilitate the harmonisation of enforcement practices in the EU.

GUIDELINES FOR IMPLEMENTATION OF CO-ORDINATION OF ENFORCEMENT OF FINANCIAL INFORMATION (REF. CESR/04-257B)

TOTAL NUMBER OF RESPONSES 12



CESR-Fin reviewed the 12 responses received through the public consultation on the draft guidance and in the light of comments received adapted the guidance.

The Implementation Guidance (Ref. CESR/04-257b) along with a feedback statement on the public consultation (Ref. CESR/04-447) was published in October 2004.

In the first months of 2005, CESR-Fin, (through the work of the SCE), will continue to put in place the necessary tools for the actual start of the activities of the EECS and for the creation of the database of enforcement decisions. The most important issues will be to identify the best solution for allowing exchange of confidential information between CESR Members and non-CESR members and to ensure the IT technical aspects of the database effectively meet the needs of the users.

Going forward, the discussion of enforcement decisions on financial information as envisaged in Standard No 2 supplemented by the implementation guidance will become the core activity of CESR-Fin (as operational CESR group). For that reason, implementation of the necessary tools for this co-ordination mechanism should become a priority for the group.

c. Co-ordination of enforcement of financial information (database and EECS)

Over the last months of 2004, CESR-Fin, (through the SCE), continued to put in place the tools and safeguards which are necessary for organising effective discussions of enforcement cases and practical issues in relation to financial reporting.

In this context, the SCE developed further the IT specifications of the database on enforcement decisions. The IT specifications of the enforcement database should be finalised in the beginning of 2005. The SCE also reviewed the important issue of exchange of confidential information within the EECS and with input and access to the database. This confidentiality aspect stems from the fact that the EECS and the database will not be accessible to CESR members only, but also to non-CESR members who are national enforcers of financial information with a view to protection of investors on financial markets (see CESR Standards N° 1 and 2 on enforcement of financial information).

Basically, the database is designed for keeping track of enforcement decisions taken by supervisors. The overall objective is to avoid inconsistent application of reporting standards throughout Europe. Considering this aim, the group considered that discussion of emerging issues or questions put to supervisors by issuers/auditors on the application of the reporting framework should not be ignored, especially when it contributes to better information of investors. The Standards N° 1 and 2 on enforcement do not exclude general discussions of this nature. EECS discussions (in meetings and between meetings) will also encompass such practical questions, when they arise. Beyond this basic approach, other aspects will need further analysis in the broader context of interpretation of IAS/IFRSs for EU operators. Examples of aspects to be considered are: the fact that supervisors are not standards/interpretation setters, the principle-based nature of IAS/IFRSs, the overall institutional landscape in the accounting area and CESR's policy on publication of its views on accounting matters (which has to be developed in any case for reporting purposes).

3. Transition to IAS/IFRS

CESR published a paper in 2003 recommending a series of milestones for companies to make information available to the markets on their preparations for 2005. CESR suggested that the 2003 annual accounts should explain the work being done to prepare for the change; 2004 accounts should if possible quantify the effects of the change; the 2005 interim accounts should be based on IAS principles.

Late 2004, SISE undertook a survey in order to assess how the Recommendation had been disseminated by CESR members nationally and for identifying issues raised in relation to the implementation of this recommendation.

SISE concluded that this recommendation was still valid and did not need additional measures from CESR as regards the transition to IFRS as a whole. A specific issue was however identified, on which the group will work further in the following months. This is related to the implementation of IAS 39 (and more generally to situations where IAS/IFRS offer critical options to reporting entities) in particular in situations where issuers, in accordance with EU endorsement decision, do not apply the complete set of provisions and stringent requirements provided by IAS 39 on hedge accounting.

4. CESR's Audit Task Force

CESR-Fin decided in its March meeting to set up an ad hoc Audit Task Force entrusted to fulfil the mandate given by CESR to CESR-Fin in the area of audit. The CESR Audit Task Force of CESR-Fin held its first meeting in July 2004.

The objective of the Audit Task Force will be to monitor developments in the area of audit of financial statements of listed companies in EU, from the perspective of securities regulators. The audit work contemplated for this purpose is related to the implementation of the EU Directives on Prospectus and on Transparency, and includes the audit of both the individual and consolidated accounts, and where appropriate, the procedures applied on the interim financial reports.

Against this backdrop, the CESR Audit Task Force has decided to focus its attention on general issues related to the quality of the audit of financial statements of listed companies in the EU. However, its approach will not include undertaking detailed reviews of all technical aspects of the auditing standards, as this work is more appropriately performed at the international level through IOSCO (Standing Committee n°1). Rather, in order to contribute to the establishing of the necessary framework for a high quality financial reporting by listed companies in the EU, the Task Force will focus its attention on the following topics: application of common auditing standards in the EU, independence of auditors and oversight of the profession. The oversight of the profession is of high importance to CESR as it contributes to the proper application of auditing standards by EU auditors.

The priority of the Audit Task Force will be to actively monitor the modernisation of the 8th Directive Company Law. The Task Force will also inquire on the developments taking place in the above mentioned areas at international level (e.g. at the level of IAASB) and in other relevant non-EU jurisdictions and will take or propose to CESR/CESR-Fin appropriate specific action(s) where necessary, i.e. when the subject is important and relevant for the EU markets.

To develop the mandate given by CESR, CESR ATF has developed a work plan for the coming years in order to achieve the objectives set by its mandate. This 2005-06 work plan is expected to be approved by CESR- Fin in the first quarter 2005.

Statistics of meetings in 2004

CESR-Fin groups met eleven times in 2004, and held one open hearing.

5.3.2 CESR-Fin: Assessment of Equivalence of third country GAAP

Chairman's message

John Tiner, Chief Executive of the FSA, UK

"CESR was asked by the European Commission to deliver technical advice on the equivalence between third countries GAAP (specifically the US, Japan and Canada) and IFRS and to describe the enforcement mechanisms in place in the countries under consideration. This is a challenging exercise but we have made significant progress since we received the mandate, firstly by setting out how we will define 'equivalence' in a Concept Paper and setting out what we propose might be done where an aspect of third country GAAP is not found to be equivalent. We are now moving on in 2005, to form a global and holistic assessment of the quality of the financial information provided by the accounting system in question. However, this assessment should be carried out from a technical perspective and independently from any international convergence project aiming at a single set of accounting standards."

Mandate on equivalence between US, Canadian and Japanese GAAP and IAS, and for a description of enforcement mechanisms in these countries –Concept Paper on Equivalence

CESR-Fin on 29 June 2004 received a mandate from the European Commission (Ref. CESR/04-305) in which it requested CESR to provide technical advice on the equivalence between third countries GAAP (Generally Accepted Accounting Principles) and IFRS. The mandate also required CESR to describe the enforcement mechanisms in place in the countries under consideration, namely the US, Canada and Japan.

In giving its advice, CESR was requested in the Mandate to take full account of the following key objectives:

- When assessing as to whether financial statements prepared under third country GAAP provide a true and fair view of the issuer's financial position and performance, the priority should lie on assuring the protection of investors;
- A global and holistic assessment of the quality of the financial information provided by the accounting system in question should be carried out from a technical point of view and independently from any international convergence project aiming at a single set of accounting standards, such as the project currently conducted by the International Accounting Standard Board and the US-Financial Accounting Standard Board;
- The global and holistic assessment should be based on the entirety of the third country GAAP in force as of 1 January 2005. The assessment should focus only on the significant differences between IAS/IFRS as endorsed at EU level and the third country GAAP in question;
- The assessment should not relate as to whether the third country GAAP in question might be conducive to the European public good. This is a criterion for endorsing IAS/IFRS at European level pursuant to Article 3 (2) of the IAS Regulation, but not for assessing equivalence;
- The assessment should also be carried out independently of whether the third country concerned already recognises IAS/IFRS as equivalent to their domestic GAAP.

5.3.2 CESR-Fin ~ Equivalence

The European Commission has requested CESR's advice by 30 June 2005 to allow sufficient time for parties affected by the application of the Prospectus Directive (which will take place from 1 July 2005) and the Transparency Directive (to be transposed by 20 Jannary 2007) to adapt if necessary. CESR is invited to assess the equivalence of US GAAP, Canadian GAAP, and Japanese GAAP.

In addition, CESR was invited to undertake a global assessment as to whether the financial statements prepared under the third country GAAP provide equivalently sound information to investors when those investors make investment decisions on regulated markets across Member States. Furthermore to provide advice on an early warning mechanism in case of significant changes to the third country GAAP occurred after 1 January 2005; and finally to describe the mechanisms (outside the areas of audit and of corporate governance) provided ensuring that the third country GAAP mentioned above are respected.

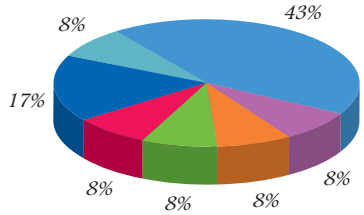
Should CESR not be able to confirm that the third countries' GAAP is equivalent, CESR is invited to consider what kind of remedies should be applied by the competent authority of the home Member State.

Background

CESR-Fin has proposed to fulfil this important mandate in two steps. The first step, i.e. the drafting of a concept paper on equivalence, has now been completed and CESR-Fin adopted the concept paper (Ref. CESR/04-509) in January 2005 after publishing it for public consultation in November and December 2004. The concept paper was preceded by a call for evidence, which closed on 29 July. The second step, which relates to the technical assessment of GAAP equivalence and analysis of enforcement mechanisms, began at the end of January 2005. However, the concept paper is an important milestone in the process as it describes the methodology that CESR will follow when conducting the technical work. It also indicates which criteria will be used to establish equivalence and will serve as an objective reference throughout the process of any GAAP equivalence assessment.

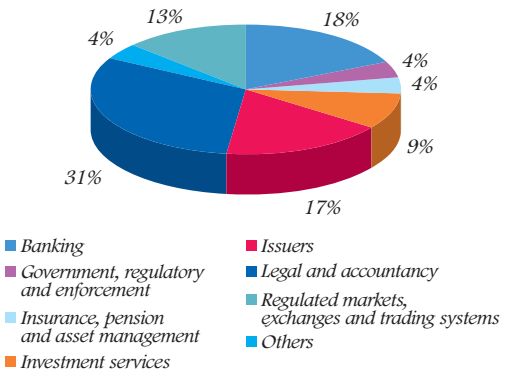
Call for evidence regarding the EU Commission mandate on equivalence between certain third countries' GAAP and IAS/IFRS (Ref. CESR/04-305)

Total number of responses: 12



Concept Paper on how CESR intends to measure equivalence between Third Country GAAP and IAS/IFRS (Ref. CESR/04-509)

Total number of responses: 23



Basic principles of the concept paper

The most important issue is to determine what is meant by "equivalence". CESR-Fin is of the view that equivalent should not be defined as meaning 'identical'. However, equivalent would be interpreted as meaning when financial statements are prepared under such third country GAAP, investors will be able to take at least similar decisions in terms of whether to invest, hold or divest, as if they were provided with financial statements prepared on the basis of IAS/IFRS. In effect that the potential differences that might exist between third country's GAAP and IAS/IFRS would not give rise to differing investment decisions.

The concept paper develops the assessment of equivalence around three fundamental elements:

- A **review of general principles** and adequacy of the third country GAAP for financial reporting in EU. In this context, CESR proposes that it will take into consideration the primary objectives of the GAAP, their conceptual frameworks and their relevant general characteristics. Evidence about investors needs' will also be gathered at this stage of the assessment.
- A **technical assessment** of the significant differences between accounting standards. In this regard, the assessment should not aim at identifying every difference between third country GAAP and IAS/IFRS. The cost of undertaking an exercise at this level of detail would outweigh the benefits to investors. The main challenge however will be to identify what the "significant differences" are. As this largely depends on issuer's activities and financial position, the only possible approach is to limit the scope to differences commonly found to be significant by practitioners and users of information. Hence, this will require detailed questions to third countries.

- **Appropriate remedies** to meet investors' needs in case of non-equivalence. The Prospectus Regulation does not provide for any remedy other than restatement for non-equivalence (i.e. publication of a full IAS set of financial statements instead of the third country based financial statements). The EC mandate requires CESR to analyse possible other remedies and indeed, it is not excluded that the assessment process gives rise to differentiated instances between mere equivalence (where no remedy is necessary) and non-equivalence (where restatement is the only possible answer).
- In this framework, and considering the need to meet investors' needs and to avoid burdensome restatement requirements for issuers, CESR-Fin believes that there should be a hierarchy of potential remedies that are designed to achieve the objective of equivalence. The remedies differ according to the nature of the difference between the accounting models and their application depending on the issuers' activities and financial position. Basically, three remedies have been identified: additional disclosures, statements of reconciliation and supplementary statements (which are less than full restatements). CESR proposes that issuers and their auditors be primarily responsible for identifying the applicable remedies.
- For the part of the mandate that relates to the enforcement mechanism of third countries, the solution proposed in the concept paper (section 2.2) is to use the CESR Standard No 1 on Financial information as a "reading grid" for describing the third countries mechanisms (without assessing the appropriateness of such mechanisms).

For this mandate, proper consultation of market participants is a key element to identify of the relevant GAAP differences and to establish the needs of investors in order to establish appropriate remedies. An ad hoc Consultative Working Group (CWG) was set up for this purpose. Of high importance is the presence in this CWG of experts in financial reporting who can appropriately represent the users of financial information (e.g. financial analysts, credit rating agencies or of course, retail and institutional investors – such as representatives from investment and corporate departments of banks, insurance companies or from investment firms). The members of the Consultative Working Group are:

Mr Freddy Méan, Petrofina
Mr Antoni F. Reczek, PwC
Ms Lynda Tomkins, Ernst & Young
Mr Per Thorell, Ernest & Young
Mr Peter Sampers, Philipps International B. V.
Dr Dieter Silbernagel, Allianz Lebensversicherungs AG
Mr Harald Petersen, Schutzgemeinschaft der Kapitalanleger e.V.
Mr Laurent Decaen, Deloitte
Ms Sue Harding, Standard & Poor's
Mr Kevin John Valenzia, PwC
Mr Mark Merson, Barclays Bank PLC
Mr Ralph Ter Hoeven, Deloitte Netherlands
Mr Jan Buisman, PwC
Mr Olivier Azieres, Deloitte
Mr Stephane Lagut, Ernst&Young
Ms Paula Presta, KPMG
Ms Conie Tang, KPMG

Next steps

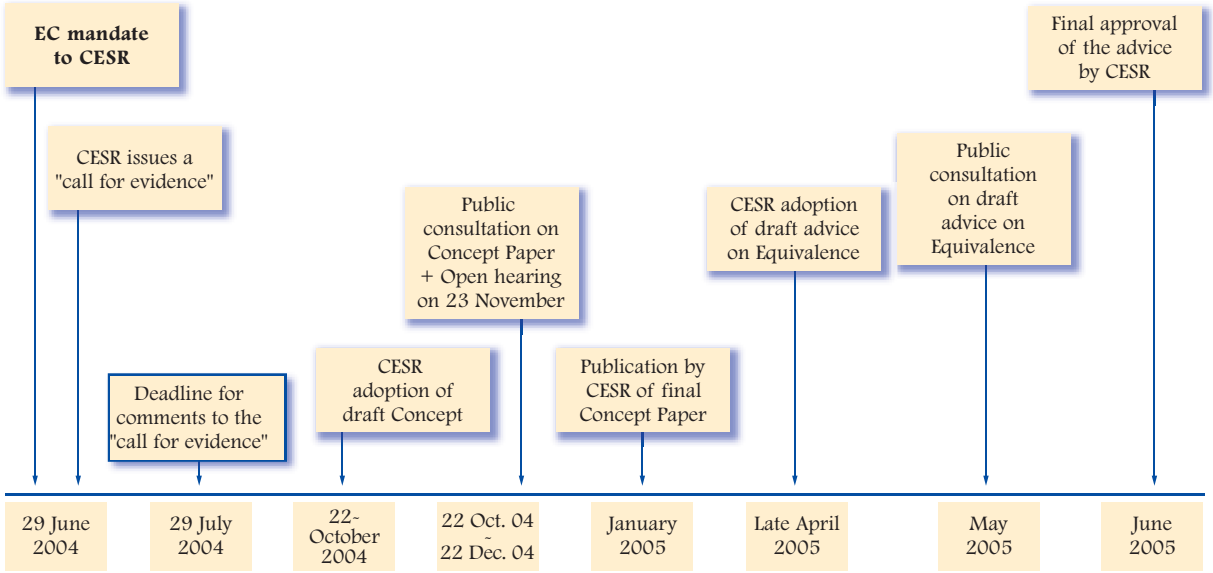
CESR-Fin called on each of the relevant third country standard setters and regulatory agencies to provide information so that CESR can obtain an appropriate and meaningful understanding of the third countries' GAAP, their equivalence with IAS/IFRS and of the third countries' enforcement mechanisms. CESR has requested the relevant third country standard setters and regulatory agencies to assist them by answering a questionnaire in order to gather the necessary information to assess the potential difference between the third countries' GAAP. Answers to these questionnaires will allow CESR to begin its assessment and develop its dialogue with each third country standard setter and regulator to clarify any areas further. A full timetable which sets out the phases of the work is set out on page 42.

Statistics of Meetings in 2004

The Expert Group on Equivalence met 3 times in 2004, and held one open hearing.

5.3.2 CESR-Fin ~ Equivalence

CESR work plan for the mandate on equivalence between certain third country GAAP and IAS/IFRS



5.3.3 CESR-Pol

Chairman's message

Kurt Pribil, *Executive Director of the Financial Markets Authority, Austria*

"2004 saw CESR-Pol given the pivotal task of overseeing all of CESR's Level 3 work on the Market Abuse Directive. I am pleased to say that much significant work has been done to help to ensure the consistent and appropriate implementation of this Directive which will positively enhance the integrity of our markets. CESR-Pol will continue to concentrate on this in 2005 as well as striving to further enhance the co-ordination of enforcement and surveillance activities among CESR members."

Mandate

CESR-Pol is a permanent operational group within CESR. It is made up of senior officials, from each CESR member, who are responsible for the surveillance of securities activities and the exchange of information.

CESR-Pol's purpose is to facilitate effective, efficient and pro-active sharing of information, in order to enhance co-operation upon, and the co-ordination of, surveillance and enforcement activities between CESR members. CESR-Pol's key objective is to make information flow across borders between CESR members as rapidly as it would be internally and, by so doing, to enhance the transparency, the fairness and the integrity of European markets as a whole. The ability of CESR-Pol members to co-operate in the field of enforcement has been established by their signature of the CESR multilateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (MoU) in January 1999.

Kurt Pribil, Executive Director of the Austrian Financial Market Authority (FMA) was appointed Chairman of CESR-Pol in September 2003. The group's work is supported by two members of the CESR secretariat, Christian Dier and Nigel Phipps.

Work Done

CESR-Pol's main priority in 2004 has been to ensure the effective and harmonious day-to-day application of the Market Abuse Directive at level 3 of the Lamfalussy process.

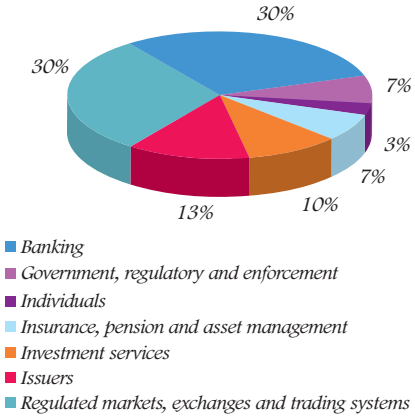
The Market Abuse Directive

Market facing issues

The Market Abuse Directive came into effect on 12 October 2004 and while some delays in the transposition of this legislation into national law had been anticipated, CESR kept moving forward to prepare the ground for the implementation of the new regime by ensuring a common approach to the operation of the Directive throughout the EU amongst supervisors.

One of the steps in this process was the issuance of the consultation paper on 28 October 2004 (Ref. CESR/04-505) by CESR entitled "Market Abuse Directive: Level 3 – preliminary CESR guidance and information on the common operation of the directive" which was open for public consultation until 31 January 2005. CESR received 30 written responses which are available on the website.

Consultation on Market Abuse, Level 3 - preliminary CESR guidance and information on the common operation of the Directive (Ref. CESR/04-505)
Total number of responses: 30



5.3.3 CESR-Pol

The paper was produced by a sub-group of CESR-Pol. It was designed to provide assistance by giving further clarity to market participants regarding the operational requirements of certain significant areas of the Directive.

The three main areas covered by the guidance on "Accepted Market Practices" are:

- the establishment of a common framework to assess such practices;
- further clarity on practices that CESR members consider to be market manipulation;
- the establishment of a common format for reporting suspicious transactions, including appropriate guidance.

In the event of a person (or persons) manipulating a market, the Directive provides a defence if the transaction was legitimate and in accordance with market practices accepted by the competent authority – the so called Accepted Market Practices (AMPs). The paper includes the following AMPs that are currently being considered in three EU jurisdictions:

- Bond valuation transactions both in Germany and Austria;
- The first price of an IPO when issuing on more than one German exchange;
- The obligations on long position holders on the London Metal Exchange.

The paper also sets out a standard format that will be used by the national regulators when assessing AMPs.

In the second part of the paper, CESR members identified types of market manipulation which have occurred in recent years and which, in the view of CESR members would breach the prohibitions on market manipulation contained in the Directive. The examples of types of practice set out in the paper are deliberately described in non-legal technical terms and it is emphasised that the descriptions are not intended to affect the scope of interpretation of the Directives.

Finally, the Directive introduces the obligation for market participants to report suspicious transactions to the competent regulator. The paper also offers guidance as to what might be the indications of suspicious transactions which may involve insider dealing or market manipulation. Furthermore, the paper proposes a standard reporting format which should be used by market players to report suspicious transactions to the relevant authority.

Co-operation and enforcement issues

CESR-Pol continued to work on developing the framework on supervisory and enforcement co-operation which are of equal importance to ensure that the Market Abuse Directive successfully meets its objectives. CESR-Pol has therefore established an ad-hoc group, which has been examining co-operation and enforcement issues. Initial draft papers have been prepared on: information exchange; an urgent issues group; best practice guidelines for requests to open an investigation and procedures for joint investigations in cross-border cases; best practice guidelines for the taking of statements; a database of enforcement cases and mediation mechanisms as foreseen in the Market Abuse Directive for the cases where two or more competent authorities have diverging views regarding the exchange of information or cross border cooperation.

Integration of Accession Countries

In 2004, CESR-Pol has worked to effectively integrate the members from the accession states into the work of CESR-Pol. A major achievement in this regard was the fact that the CESR Memorandum of Understanding on (MoU) was signed by all new members to allow the fullest mutual co-operation with all other CESR members from the first day of their accession to the EU. In addition, to foster understanding amongst the Accession Countries, CESR-Pol organised a seminar in Budapest on 26 February 2004, for the new members to set out the scope and value of the CESR MoU, as well as to explore the meaning and required steps to co-operate effectively under the CESR MoU.

Surveillance of Securities Activity on the Internet

CESR-Pol continues to examine internet surveillance activities and automated tools for detecting illegal securities activities and has established a network of persons responsible for internet surveillance.

Request Format and Scope of Cooperation

In 2004 CESR-Pol revised and enhanced the CESR Standard Format Request to be used by members when requesting information from each other. A Service Level Guidance paper was developed and this details best practice, using the experience of CESR Members who have conducted joint investigations. This work follows on from the 'Service Level Agreement' adopted in 2003.

Warning Notes

In addition, during 2004, the members of CESR drew extensively on the CESR-Pol network to inform other CESR members of unauthorised offers of financial services by investment firms or individuals without

being licensed to do so. The secretariat regularly circulates warning notes issued by CESR members to all other CESR members. This allows identification of those illegitimately providing investment services by the same provider in multiple jurisdictions in a quick and efficient manner and enables CESR-Pol to intensify co-operation and to identify where it might be appropriate to act in a joint manner. Additionally, this warning mechanism also serves to equip CESR members with timely information to alert potential investors in their jurisdiction and therefore to minimise the risk of consumers being defrauded.

Work in relation to non-EU jurisdictions

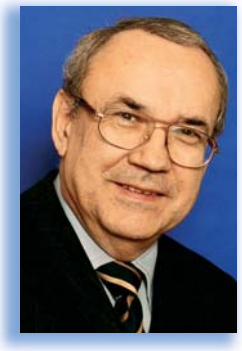
Kurt Pribil has established contact with IOSCO to encourage co-operation with regard to work on uncooperative jurisdictions and to avoid any duplication of resources. CESR-Pol has also continued the dialogue with the Crown Dependencies (Jersey, Guernsey and the Isle of Man), inviting representatives to the CESR-Pol plenary meeting in December 2004. Meetings with authorities from Liechtenstein and Switzerland are planned for 2005.

Next Steps

CESR-Pol will continue to work on ensuring the effective and consistent implementation of the Market Abuse Directive. Finalisation and further work in these areas will continue in 2005.

Statistics of meetings in 2004

CESR-Pol met four times during 2004 as well as working on a virtual basis i.e. electronically. In addition to thats the sub-groups and the ad-hoc groups met independently. A seminar for the Accession Countries was also held by CESR-Pol.



5.4 Level 3 Expert Groups

5.4.1 Clearing and Settlement

Co-Chairman's Message

***Eddy Wymeersch**, President of the Belgian Banking, Finance and Insurance Commission*

"The adoption in 2004 of the Standards for Securities Clearing and Settlement in the European Union has been a major step in the area of clearing and settlement although enforcement of these Standards will not take place until the assessment methodology has been defined. This methodology aims to provide national authorities with the tools to review compliance with the Standards. This will be an important part of our assignment for 2005. In addition, we will also work on other follow-up issues, such as expanding the guidance for central counterparties and the elaboration of a number of technical issues which were left open in the Standards. To achieve these goals, we will continue the dialogue with the industry and we appreciate its active role with the provision of further analysis of current market practices. In doing so, the industry enables us to better understand the business. Last, but certainly not least, we will keep a close eye on the developments at the level of the EU institutions, for instance on the outcome of a post-FSAP debate, in order to keep our regulatory efforts fully in step with the political reality."

The joint CESR/ESCB Clearing & Settlement Expert Group to establish a set of Standards for Securities Clearing and Settlement in the European Union

With the adoption by CESR and the Governing Council of the ESCB in October 2004 and the subsequent publication of the Standards for Securities Clearing and Settlement in the European Union, based on the CPSS/IOSCO Recommendations in the same area, CESR and the ESCB have completed an important part of work which started with the announcement of this initiative in October 2001.

During 2005 the Joint Expert Group will continue its activities in a number of areas. This follow-up work will mainly consist of:

- The development of an assessment methodology in order to provide a tool for assessing the implementation of the Standards;
- Further work in the area of central counterparties;
- The elaboration of a number of open issues, in particular the concept of "significant custodian."

Objectives

The deepening and strengthening of the CPSS/IOSCO Recommendations to adapt these to the European context, took place against the background of the following objectives:

- To build confidence in the markets by providing clear and effective standards;
- To foster the protection of investors and, in particular, retail investors;
- To limit and manage systemic risk;
- To promote and sustain the integration and competitiveness of European markets by encouraging efficient structures and market-led responses to developments;
- To ensure the efficient functioning of securities trading markets and the cost-effective settlement of their transactions;
- To enhance the safety, soundness and efficiency of clearing and settlement of securities and, where applicable, other financial instruments;
- To provide a consistent basis for the adequate regulation, supervision and oversight of securities clearing and settlement systems and other relevant securities service providers in the EU, by having a single set of standards that provide a clear and competitive regulatory framework which does not impose undue costs on market participants;

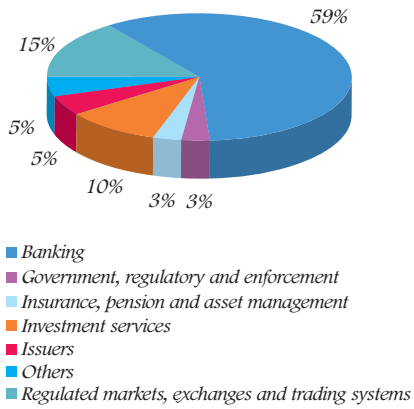
– To ensure compatability of the standards with the CPSS/IOSCO Recommendations for securities settlement systems.

CESR will take these objectives into account when conducting its follow-up work.

Activities in 2004: the key issues

During the first months of 2004, a full set of revised draft Standards was completed which took into account the comments given during the public consultation of autumn 2003. The most-debated issue in that consultation related to the future role of the Basel II framework in the context of the risk management requirements as proposed in the draft Standards. In May 2004, CESR and the ESCB published an amended version of the draft Standards for a second public consultation (Ref. CESR/04-226). In this version, CESR/ESCB widely acknowledged the important role of Basel II in the management of risks, provided all risks identified in the process of clearing and settlement of securities would be properly addressed in the latter framework. The report was also discussed at a public hearing at the end of May 2004. Most respondents expressed strong support for the initiative although reservations remained with regard to the five following general issues; (1) the risk of duplication with other regulatory initiatives, (2) the scope of application; (3) the respective role of custodians and central securities depositories; (4) the definition of significant custodians; and (5) the implementation of the Standards.

CESR/ESCB Draft Standards for Securities Clearing and Settlement Systems in the European Union (Ref. CESR/04-226)
Total number of responses: 39



CESR/ESCB summarised its position on all these, and a number of standard-specific issues in its Summary of Responses which was published simultaneously with the publication of the final version of the Standards at the end of October 2004 (Ref. CESR/04-572). The above mentioned issues have been addressed as follows. Firstly, in response to the risk of duplication, CESR/ESCB have been keen not to weaken the transposed CPSS/IOSCO Recommendations. In that way, compliance with the Standards would automatically imply compliance with the CPSS/IOSCO Recommendations and would therefore avoid the risk of duplication. As far as a risk of duplication would emerge as a consequence of any possible future EU-initiative in this area, CESR/ESCB have underlined repeatedly that no pre-empting of such an initiative is intended and, if necessary, the Standards would be amended accordingly. Duplication with Basel II will equally be avoided. Secondly, on the scope of application, it has been clarified to which entities each specific standards would be applied. The standards also address how other financial instruments other than securities would be approached. Thirdly, CESR/ESCB explained that its initiative could have only been based on the present situation and legal framework in the EU which allows for a combination of the banking and the settlement function. Intervening in that market-structure was not in the remit of CESR/ESCB. Fourthly, with a view to the objective of the Standards to limit and manage systemic risk, a method will be developed in the follow-up phase to determine if, and when, a custodian should be considered as significant. Finally, concerns voiced by the industry on the immediate effect of the Standards have been covered with the pledge that no formal assessment of the Standards would take place before the assessment methodology has been developed. Member States and industry should, however, take into account that the CPSS/IOSCO Recommendations in this area are already fully applicable.

Wider context

The work by CESR and the ESCB has been carried out in full awareness of the many (regulatory, market-practice and political) initiatives and competences of other (public and private) authorities in the field of clearing and settlement. Among many other initiatives, the European Commission conducted two consultative efforts in this area in 2004. All relevant developments have and continue to be closely followed, and CESR is keen to remain in a constant dialogue with the European Commission and all the other relevant stakeholders.

For CESR, the central place for a dialogue with stakeholders regarding the preparation of the Standards, is through the open consultation process. However,

further exchanges of views also took place in the form of (in-) addition, formal contacts on an ad-hoc basis, presentations and by the participation of other standard setters who participated as observers. CESR holds for example an observer seat in the European Monitoring Committee of the Group of Thirty which is entrusted to promote and monitor the implementation of its twenty recommendations. During the course of the consultation in 2004 and ahead of the adoption of the Standards in the autumn, the industry stressed the need for early involvement and offered its expertise to CESR and the ESCB, in particular for those areas which were still open for further analysis.

At the end of April 2004, DG Internal Market of the European Commission published its Communication Paper "Clearing and Settlement in the EU – the way forward" for public consultation. The consultation closed at the end of June 2004. Although there was widespread support in the responses to this paper for a Directive that focuses on access rights and the establishment of a regulatory and supervisory framework, it was decided by the Commission to conduct an impact analysis before any formal proposal will be put forward. This analysis will take place during 2005. As such, CESR holds an observer seat in the Clearing and Settlement Advisory and Monitoring Expert Group (CESAME) which (among other tasks) will provide the Commission with technical advice where requested.

In addition, DG Competition of the European Commission published a final report in February 2004 by London Economics with an overview of 25 EU securities trading, clearing, central counterparties and securities settlement arrangements for comments by interested parties. This consultation closed mid-December 2004. It is important to stress once again in this context, that the issue of intervention in the market structure has been raised several times with CESR and the ESCB, that intervention in the existing market structure is not within the scope of the mandate and any possible proposal in that direction will be left for decision making at the appropriate political level of the EU institutions.

Next steps

Since the end of 2004 and early 2005, the Joint Expert Group has continued its follow-up work to a large extent dedicated to the development of an assessment methodology. This methodology aims to provide a tool for the national authorities to assess the compliance with the Standards once they are in force. The format of the methodology will be similar to the format developed by CPSS/IOSCO for the assessment of its Recommendations. On the basis of the key-elements identified in each of the Standards, precise questions will be formulated allowing national authorities to assess the compliance with the Standards according to an agreed standardised methodology.

A second strand of follow-up work for 2005 will consist of providing further guidance for the role of central counterparties. Before the adoption of the CESR/ESCB Standards that CPSS/IOSCO has announced that it expected to publish a separate set of Recommendations for central counterparties by the end of 2004. Against that background, CESR/ESCB decided early in the process that the deepening and strengthening of Standard 4 on central counterparties would be limited to the issue of cost-benefit analysis and that risk-management issues would be kept unchanged awaiting the final report of CPSS/IOSCO for this type of intermediaries.

The third strand of follow-up work is linked to the elaboration of a number of definitions used in the text of the Standards. This relates to technical issues such as the need to harmonise settlement cycles and the effects of central securities depositories to engage as principals in securities lending. As far as the concept of significant custodian is concerned, it is envisaged to investigate whether a set of criteria could be developed which would help national authorities to identify if and when a custodian is of significant importance.

A third public consultation on these follow-up activities is envisaged for July 2005.

Statistics of meetings in 2004

The Joint Working Group met six times before the publication of the Standards at the end of October.

In addition to these Joint Working Group meetings, an information session for the securities regulators and central bankers from the new Member States was held in Prague on 4 March 2004 in which the co-chairs and the secretariat of the Group participated. Finally, on 18 March 2004 a delegation of the Joint Working Group met with a delegation of the BSC in Brussels

From November 2004 onwards five different Task Forces started to work on three follow-up issues (as identified earlier). Each of these Task Forces met two times in 2004 (subtotal 10 meetings). In addition, a (coordination) meeting of the chairpersons of all Task Forces was held on 15 November in Brussels.

5.4.2 Investment Management

Chairman's Message

***Lamberto Cardia**, Chairman of CONSOB, Italy*

"The work of the Expert Group has gained considerable momentum since its inception in April 2004. The guidelines on the transitional provisions of the UCITS amendments prepared by CESR, represent a significant accomplishment since it received this new area of responsibility, and reflects impressive progress, given, in particular, that it represents a solution which found unanimous support amongst CESR members, and in the public consultation also received broad support from the European asset management industry. At the request of market participants, CESR has used its capacities under Level 3 to develop tangible and pragmatic solutions to these transitional uncertainties, to foster convergence between regulatory practices.

In addition, the report on investigations on mis-practises in the European investment fund industry in turn shows that abusive business practises such as late trading or market timing which exploit the investment funds for the benefit of some privileged investors are rare in Europe at present. This is encouraging, but it should not, however, lead to complacency. The European securities regulators will certainly be focusing on this aspect looking ahead to ensure high level of investor protection in the European investment funds. Looking ahead to 2005 we will continue working forward on our challenging working programme, especially to advise the Commission on the eligible assets of UCITS and to simplify the registration procedure for investment funds."

Mandate of the Investment Management Expert Group

CESR began working on investment management issues in April 2004 following the transfer of these responsibilities (in practice) from the UCITS Contact Committee which had been established by the European Commission on the basis of Article 53 of the UCITS Directive 85/611/EC. This transfer of powers followed the final report of the Economic and Financial Committee (EFC), endorsed by the Ecofin Council on 3 December 2002, and a formal Commission proposal on the extension of the Lamfalussy process and subsequent arrangements to other financial services sectors, including UCITS. This proposal was approved by the European Parliament and Council early 2004. The transfer of responsibilities will formally come into effect when the legislative package is published, presumably early 2005.

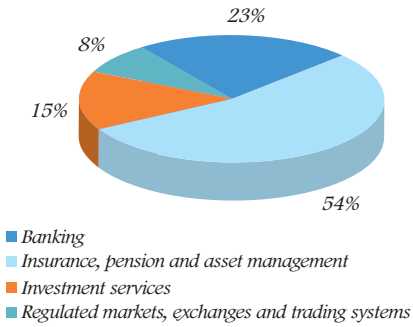
Following consultation via a paper entitled "The role of CESR in the regulation and supervision of UCITS and asset management in the EU" with market stakeholders and their support, CESR felt it appropriate to start working in the area of UCITS and asset management, to provide a coherent response to regulation and supervision across Europe. To carry this work forward CESR established a provisional Expert Group on Investment Management.

The Group is chaired by Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione nazionale per le società e la Borsa (CONSOB). A permanent member of the CESR Secretariat, Jarkko Syyrilä assists the Chairman and acts as rapporteur of the Expert Group. The Expert Group convened for the first time in April 2004.

The mandate (Ref. CESR/04-160) and work programme for the Group was approved by CESR in June 2004. Drawing heavily on the responses from the consultation and the needs expressed by market stakeholders, it was decided, that the short-term priority of the group would be to focus on ensuring that the single market on investment funds is fully functional. The Expert Group would therefore concentrate initially on two aspects related to the harmonised implementation of the UCITS Directives, namely the application of the transitional provisions of the amending UCITS Directives and clarification of some key definitions in the Directives.

5.4.2 Investment Management

Call for evidence on CESR's mandate on Investment Management (Ref. CESR/04-160)
Total number of responses: 13



CESR's work will focus next on the simplification of the registration procedure for UCITS, conduct of business rules in collective investment management, outsourcing and issues related to non-harmonised funds. For example, the requirements for fund registration and the documents required differ from market to market. CESR therefore intends to streamline fund registration by building on the initial work undertaken in relation to transitional provisions and in this second phase, to develop consistent standards for the registration requirements foreseen by the UCITS Directives. A further example of the work foreseen relates to non-harmonised funds which at present are not able to benefit from the Single Market. CESR proposes to undertake an inventory of non-harmonised collective investment schemes marketed throughout Europe, which will prepare the ground for a common view on certain issues such as, prudential rules or rules on adequate disclosure.

CESR's work will also focus on the consistency between the UCITS Directives and other EU Directives and ensuring the convergence of supervisory systems in the different jurisdictions.

The formation of a Consultative Working Group

CESR set up a Consultative Working Group (CWG) on Investment Management composed of market participants and consumers in this sector to provide technical expertise and advice to the Expert Group.

The members of CESR's Consultative Working Group are:

Mr Martin Burda, Investicní spolecnost Ceské sporitelny
Mr François Delooz, BNP Paribas Asset Management
Dr Stefan Duchateau, KBC Asset Management
Mr Göran Espelund, Lannebo Fonder
Mr James Firn, Russell Investment Group
Mr Rafik Fischer, Kredietbank S.A. Luxembourgeoise
Mr Felix López Gamboa, BBVA Gestión
Dr Wolfgang Mansfeld, Union Asset Management Holding AG (Mr Mansfeld will join the Group after the end of his term as President of FEFSI)
Mr Marco Mazzucchelli, Credit Suisse First Boston
Mr Zoltán Nagy, Europool Investment Fund Management
Mr William Nott, M&G International Investments
Mr Jean-Pierre Paelinck, Euroshareholders
Mr Vesa Puttonen, Helsinki School of Economics
Mr Peter Reisenhofer, C-Quadrat Investment
Mr E. Willem van Someren Gréve, Robeco Asset Management
Ms Ana Rita Viana, AF Investimento – Fundos Mobiliários

Summary of work done by the Investment Management Expert Group:

– Investigating mis-practises in the European investment fund industry

The Expert Group on Investment Management prepared a report, published in November 2004, setting out the findings of CESR members following their investigations into the possibility of abusive mis-practises such as late trading or market timing in the European investment fund industry. CESR's members had conducted extensive investigations to assess whether mis-practices were prevalent in Europe's investment fund industry, following the US regulatory authorities' findings in autumn 2003, in which they found evidence of abusive practices in the US mutual fund market.

The conclusion of the report was that abusive business practises which exploit the investment funds for the benefit of some privileged investors are rare in Europe. CESR considers this is encouraging but that it should not, however, lead to complacency. Indeed, a key finding of the investigation was that internal processes of some management companies should be improved as this may be a source of potential weakness in the future which could lead to cases of mis-practices developing.

Therefore, CESR's members have chosen to take a proactive stance to try to hinder these types of mis-practises emerging in the future on the basis of this investigation, by tackling the question of internal

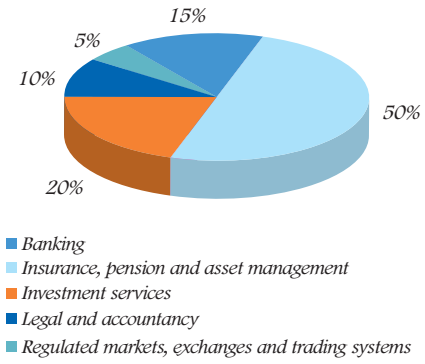
controls as well as reviewing other measures. The report (Ref. CESR/04-407), is available on CESR's website under investment management and sets out in further detail the actions taken by CESR members nationally following their findings.

– *Clarifying the transitional provisions introduced by the amending UCITS Directives*

Member States had to transpose and apply the amending UCITS Directives (2001/107/EC and 2001/108/EC) Directives in their domestic laws or regulations not later than 13 February 2004. These amending Directives contain transitional provisions i) for UCITS and ii) management companies established under the original UCITS Directive 85/611/EEC. As a result of divergent approaches developed by Member States on these transitional issues, the situation regarding the UCITS implementation was characterised by uncertainty.

After consultation with the European asset management industry and in full consistency with the work programme established by the European Commission and the European Securities Committee, CESR decided that the uncertainties in the practical application of the Directive had to be resolved as a matter of urgency, and that the Expert Group on Investment Management should work to solve these issues as a matter of high priority.

Consultation on guidance for regulators on how to apply transitional provisions introduced by the UCITS 3 Directive (Ref. CESR/04-434)
Total number of responses: 20



The guidelines (Ref. CESR/04-434b) prepared by the Expert Group and published in February 2005 aim in particular to clarify:

- Issues related to the marketing of funds and the simplified prospectus (e.g. in case the home Member State regulator has not yet issued detailed guidance on the simplified prospectus);
- Issues related to the scope of permissible activities of grandfathered management companies (e.g. with respect to the launching of "passportable" UCITS III funds);
- Issues related to UCITS launched after February 2002 which benefit from a "grace period" (e.g. smooth convergence to the new UCITS regime, coordinated approach to a transitional treatment by statements of conformity etc.); similar issues related to grandfathered UCITS I umbrella funds which have launched further sub-funds after February 2002;
- Practical questions related to the scope of the European passport and problems resulting from the relationship between the management company's passport and the fund's passport.

The guidelines provide a balance between taking into account the difficulties the industry and the authorities have faced, but at the same time, encouraging greater compliance with the UCITS III Directive. The content of the guidelines represents the common view of CESR members on the solutions to the practical problems related to the day-to-day regulatory practices concerning the application of the amending UCITS Directives. These common solutions have been elaborated in order to converge and streamline the different administrative practices Member States have developed and to put an end to the uncertainties.

In relation to the main issues, CESR guidelines state that:

- **A UCITS I umbrella fund**, where the question has been whether an existing 'grandfathered' and passportable UCITS I umbrella fund can subsequently launch new UCITS I sub-funds, i.e. sub-funds applying the rules of the UCITS Directive 85/611/EEC prior to its amendments by the Directive 2001/108/EC.

  According to CESR guidelines existing grandfathered UCITS umbrella funds can launch sub-funds under the previous UCITS regime only until 31 December 2005. This time limit will urge such UCITS I umbrella funds to adapt to the amended UCITS Directive within a realistic time frame. The Member State authorities (CESR members) will treat these requests for approval as a first priority. However, following this deadline the new rules adopted in February 2002 will apply. This would apply whether the umbrella fund was itself authorised before 13 February 2002 or between 13 February 2002 and 13 February 2004.
- **Simplified prospectus requirements** which were introduced by the amending UCITS legislation, but resulted in different interpretations as to whether those funds which received a passport under the obligations of the UCITS I, have to implement the new simplified prospectus or will otherwise lose their registration.

According to CESR guidelines UCITS I funds should have a simplified prospectus available as soon as possible and no later than 30 September 2005. After this deadline, host Member State authorities will not be obliged to accept the UCITS I without a simplified prospectus. In situations where the host State has existing legislation in place which requires the simplified prospectus and the home State has not yet required this, CESR recommends UCITS to provide additional interim information based directly on the Directive requirements on simplified prospectus.

CESR received 20 responses to its consultation on the draft guidelines. In general the industry considered CESR's proposal as a practical and market-oriented solution, and the guidelines are welcomed as an effective means to end the existing uncertainty. A key issue raised by the majority of respondents is the unsatisfactory content of the management company passport in the industry's view established by UCITS III. This relates to the fact that a UCITS management company can not set up UCITS funds managed by the management company itself in other jurisdictions than its home jurisdiction. A significant part of the respondents therefore agreed with the CESR members' view as set out in the consultation paper which urged the European Commission to consider an amendment that would clarify the position on this issue under the UCITS Directive.

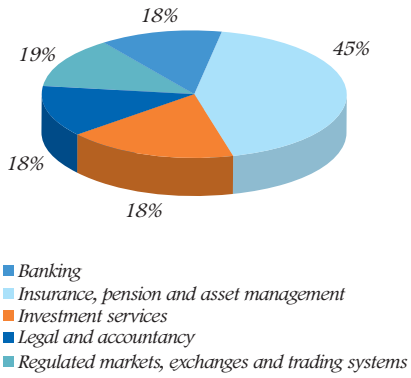
–*Responding to a Level 2 mandate on clarification of definitions of the eligible assets of UCITS*

CESR received a mandate from the European Commission at the end of October 2004 (Ref. CESR/04-586) for advice on possible modifications to the UCITS Directive in the form of a clarification of definitions concerning eligible assets for investments of UCITS.

The Expert Group has started to work quickly on the mandate to meet the deadline of October 2005 given to CESR by the European Commission. The key issues and questions have already been indicated, and CESR is working to analyse more in-depth the various alternatives and their implications.

CESR received 16 responses from the asset management industry to its Call for Evidence on the European Commission's mandate. Many respondents supported the clarification of the sphere of instruments to which UCITS can invest their assets. At the same time the industry expressed its concerns that the Level 2 work should not lead to too detailed rules which would endanger product development among the European asset management industry.

CALL FOR EVIDENCE ON POSSIBLE MODIFICATIONS OF THE UCITS DIRECTIVE (REF. CESR/04-586)
TOTAL NUMBER OF RESPONSES: 16

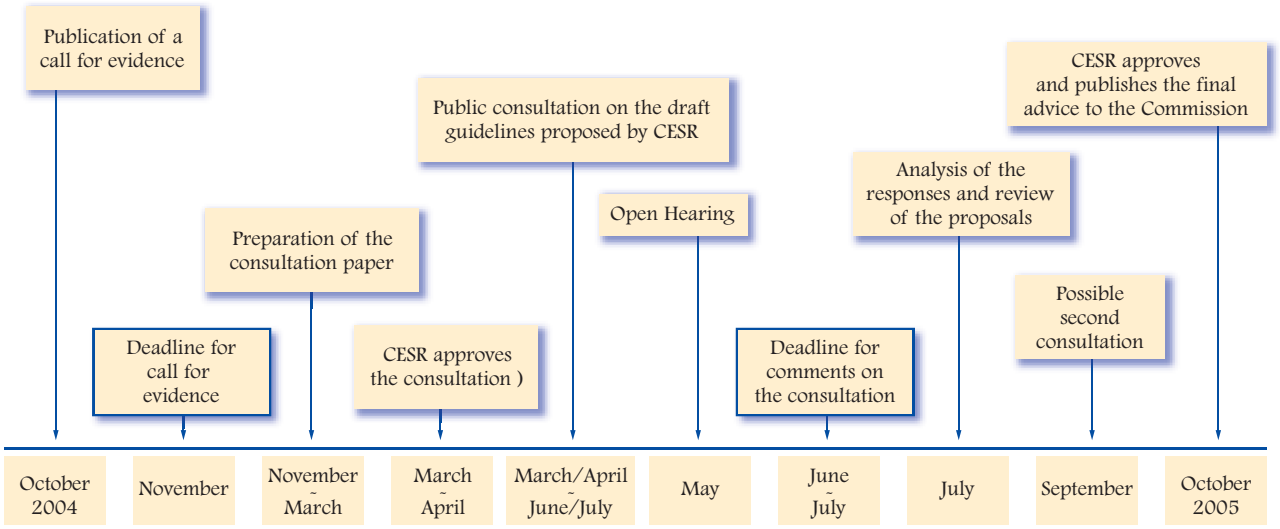


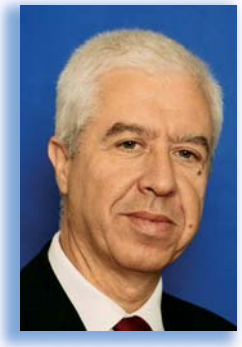
The timetable for CESR's work is set out on page 53.

Statistics of meetings in 2004

The Expert Group met on three occasions in 2004, and the Consultative Working Group had one meeting. The Group also held one open hearing.

Indicative CESR work plan on the clarification of definitions of the UCITS Directive
The European Commission's Level 2 Mandate





5.4.3 Prospectus

Chairman's Message

Fernando Teixeira dos Santos, *Chairman of the Portuguese Securities Market Commission*

"The new regime for prospectuses will be effective within the EU on 1 July 2005. The importance of this piece of legislation in opening up the Single Market for financial services cannot be underestimated. Cutting red tape for issuers by enabling them to seek approval for their prospectus from their local regulator and then, being able to use this prospectus to raise capital in all the European markets, without having to re-apply for approval, should be a significant incentive to think EU- wide when raising capital. Consumers can also be assured of more consistent and standardised information and benefit from the wide choice of investment opportunities that this will provide, enabling them to diversify their portfolios more effectively.

From a regulatory perspective, having given our detailed technical advice for the level 2 Regulation, our attention has shifted to ensuring that there is clarity for users as to how regulators will apply this and convergence in application across the EU. The Level 3 guidance we have therefore developed in on-going dialogue with market participants should help ensure that we deliver consistent application in a way that provides stakeholders with sufficient security to develop their business strategy to exploit this new streamlined regime to its full potential."

Mandate

This Expert Group has been given a mandate by CESR's Chairman to develop guidance on the various disclosure requirements soon to be established under the implementing measures of the Prospectus Regulation. The Expert Group is therefore working in a 'level 3' capacity (as defined by the Lamfalussy process) and as a result, the outcome of this Expert Group's work will be reflected in common guidelines which do not constitute European Union legislation. Once completed, this guidance will be included in the regulatory practices of CESR members. To ensure continuity of the work carried out by CESR on Prospectus in a 'level 2' capacity (in other words, when preparing advice for the European Commission), CESR agreed that the Chairman, rapporteur and expert group members should remain the same as those who prepared the advice on level 2 measures. However, a new consultative working group was formed to assist the group now working in this new capacity.

Background

The European Commission adopted on 29 April 2004 the Regulation n° 809/2004 implementing the Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading (Prospectus Directive). The Regulation will take effect from 1 July 2005 which is also the date by which Member States must implement the Prospectus Directive.

Both the Prospectus Directive and the Regulation for Prospectus will replace Europe's existing legislation in this area which has been in force for more than twenty years and only sets out disclosure requirements for shares, bonds and depository receipts.

This will therefore be a major change, introducing a harmonised format for prospectuses across Europe, enabling companies to use this prospectus to list on all European markets. This is likely to lead to a greater range of products available to consumers and will encourage European companies to list and offer on a number of exchanges or markets due to the strengthening and simplification of the regulatory regime.

The Prospectus Directive sets the overarching content requirements, but the detail is being set within the Level 2 Regulation. In addition, CESR is expected to issue Level 3 recommendations as to how its members expect the provisions at Level 2 to be applied, the decision to develop some Level 3 recommenda-

tions has arisen following responses to the CESR consultation from market stakeholders who requested greater practical information as to how certain elements would be applied. CESR therefore agreed to ensure more clarity on certain disclosure requirements which would also assist in convergent application whilst also ensuring that this does not impose further obligations on issuers.

Process

The Prospectus Group that prepared the advice for the European Commission, upon which the Level 2 Regulation was built, was also charged by CESR with the task of preparing the Level 3 recommendations. The Expert Group is chaired by Fernando Teixeira dos Santos, Chairman of the Portuguese Securities Commission and assisted by the rapporteur Javier Ruiz del Pozo from the CESR secretariat. In addition, the set of recommendations that relates to financial information disclosures where specific technical expertise in the field of financial reporting and accounting issues was needed, was carried out jointly by the Prospectus Group and CESR-Fin.

A Consultative Working Group (CWG) of twelve experts, drawn from across the markets, was established to assist the Expert Group. The CWG contributed with useful technical advice and expertise throughout the drafting process.

The members of the Consultative Working Group are:

Ms Deborah ter Beek, ABN AMRO Rothschild

Mr François Bavoillot, ARCELOR

Ms Catherine Denis-Dendauw, the High Council of the Economic professions and the Commission for Accounting Standards and of the sub-Commission IAS/IFRS

Mr Kevin Desmond, Price Waterhouse Coopers

Ms Carmen Barrenechea Fernandez, European Securitisation Forum Executive Committee and Intermoney Titulización, SGFT

Mr Axel Forster, Luxembourg Stock Exchange

Mr Wolfgang Gerhardt, Sal. Oppenheim jr. & Cie. KgaA, Frankfurt am Main

Mr Alain Gouverneyre, Ernst & Young, France

Mr Svante Johansson, Stockholm University and Linklaters, Stockholm office

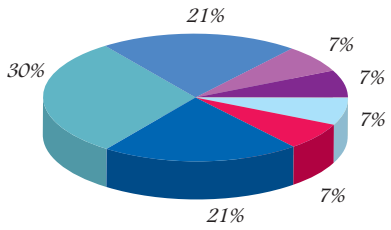
Mr Spyros Lorentziadis, Ernst & Young, Southeast Europe.

Ms Eva Maria Sattlegger, Raiffeisenzentralbank

Mr Nunzio Visciano, Italian Stock Exchange

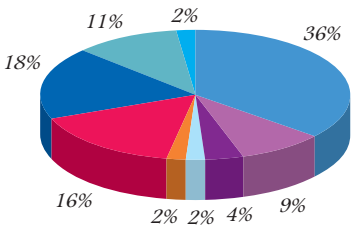
One of the objectives of the recommendations is to ensure that the views from market participants are fully considered in the process of implementation of the new rules. Therefore, on 4 March 2004, CESR published a call for evidence (Ref. CESR/04-057) for interested parties to submit comments.

Call for Evidence on CESR Guidelines for the Consistent Implementation of the Proposed Commission Regulation on Prospectus (Ref. CESR/04-057)
Total number of responses: 14



Comments made to the call for evidence and the contributions from the CWG helped the Prospectus Group to draft the recommendations (Ref. CESR/04-225b) that were released for public consultation on 24 June 2004. The consultation closed on 18 October 2004. In addition, a public hearing was held on 7 September 2004 to facilitate the dialogue with market participants.

CESR's recommendations for the Consistent Implementation of the European Commission's Regulation on Prospectus n. 809/2004 (Ref. CESR/04-225b)
Total number of responses: 45



Objective of the recommendations

The aim of the recommendations is to facilitate the understanding of certain disclosure requirements, not to impose further obligations on issuers. The adoption of the recommendations should therefore contribute to convergence across the EU on the application of the provisions of the Level 2 Regulation. The consultation has also ensured that the market participants and end-usersview have been fully considered.

The recommendations do not constitute Community legislation and will not require national legislative action. CESR members will introduce these recommendations in their day-to-day regulatory practices on a voluntary basis. In addition the way in which

- *Banking*
- *Credit rating agencies*
- *Government, regulatory and enforcement*
- *Individuals*
- *Insurance, pension and asset management*
- *Investment services*
- *Investor relations*
- *Issuers*
- *Legal and accountancy*
- *Press*
- *Regulated markets, exchanges and trading systems*
- *Others*

5.4.3 Prospectus

these recommendations will be applied will be reviewed regularly by CESR.

Summary of the work done: an outline of CESR's recommendations

The Prospectus Regulation sets out different disclosure requirements depending on the type of security and the type of issuer. CESR has also adapted its recommendations to the different types of schedules.

Specialist issuers

CESR has issued recommendations in order to facilitate co-ordination among competent authorities when applying Article 23 of the Regulation. This Article gives competent authorities the power to require adapted and additional information to some "specialist issuers" operating in certain specific sectors outlined in the Regulation (property, mineral, investment, scientific research based, start-up and shipping companies). CESR has outlined in its recommendations what information may be required for each type of issuer, with the exception of investment companies.

Clarification of the content of certain disclosure requirements

In order to facilitate the understanding of certain disclosure requirements and with the aim of avoiding any kind of ambiguity that could lead to different interpretations of the rules and, therefore, hamper the functioning of the Single Market, CESR has drafted recommendations about some of the disclosure requirements included in the schedules.

Some of the recommendations deal with financial information requirements. The purpose of these recommendations is not to provide interpretations of International Financial Reporting Standards (IAS/IFRS) or Member States' local GAAP, but to contribute, by clarifying certain disclosure requirements, where market participants, especially from the accounting profession, have requested some clarification. Among these are a selected number of financial information requirements, in particular in relation to: operating and financial review; capital resources; profit forecasts or estimates; restatements of historical financial information; pro forma financial information; financial data not extracted from the issuer's audited financial statements; interim financial information; working capital statements and capitalisation and indebtedness.

In addition, recommendations are included on a number of non financial information items, such as: property, plants and equipment; compensation; related party transactions; acquisition rights and undertakings to increase capital; options agreements; history of share capital; description of the rights attaching to shares of the issuer; statements by experts; information on holdings; interests of natural and legal persons involved in the issue and clarification of the terminology used in the collective investment undertakings of the closed-end type schedule.

Issues not related to the schedules

Article 4 of the Prospectus Directive sets out a number of exemptions from the obligation to publish a prospectus provided that a document is made available containing information on the number and nature of the securities and the reasons for and details of the offer.

Exemptions are granted in cases such as shares offered free of charge to existing shareholders or their admission to trading; dividends paid out in the form of shares; securities offered to directors or employees or their admission to trading.

Following issuers' requests, CESR has also issued recommendations on the content of the above mentioned document.

Next steps

The new regime for prospectuses will be effective within the EU on 1 July 2005. During the consultation process market participants have stressed the importance of having these recommendations published as soon as possible in order to have enough time to prepare themselves for the new regime.

CESR approved the recommendations on 27 January, and they were published on 10 February 2005, so that issuers and their advisers have certainty about the disclosure requirements for prospectuses in good time before 1 July 2005.

CESR acknowledges the fact that there are many areas that have not been tackled where recommendations might be useful. However, CESR is also aware that the real assessment of consistent implementation across the EU can only be made effectively once the legislative measures will come into effect. Once CESR members have experience on the practical operation of the new rules and legislation, CESR will be in a position to assess whether the recommendations need to be updated and how to address any problems of co-ordination that might arise.

Statistics of Meetings in 2004

The Expert Group met two times and held another meeting with the members of the Consultative Working Group.

The drafting groups met four times. In addition, a great deal of drafting was done at distance, via the network of CESR members.

One open hearing took place on 7 September 2004.

5.5 Supervisory Convergence beyond CESR

5.5.1 The Three Level 3 Committees (3L3)

Following the extension of the Lamfalussy process in May 2004 to the banking and insurance sectors and the creation of the new Level 3 committees (3L3), CESR has begun a close and ongoing dialogue with the two Level 3 sister committees: the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Banking Supervisors (CEBS) which were established on 24 November 2003 and 1 January 2004 respectively.

Practical aspects of co-ordination

Contact between the '3L3 Committees' staff takes place at all levels. More formalised meetings between the secretariats take place at regular intervals to review each committee's respective work plans and to keep under review new areas where closer co-operation or co-ordination may be necessary and to establish how this might be organised effectively. The three committees also regularly submit comments to each other on the development of technical advice or standards as the work is underway. To improve this regular interchange, members of the secretariat also attend each others' working groups as observers where the issues under consideration are of mutual interest. For example, a member of CEBS secretariat has participated in CESR's expert group on Credit Rating Agencies due to the new role that ratings agencies will be given under the new Capital Requirements Directive (CRD).

Joint work undertaken in 2004

CESR and the fellow committees have already begun to work together on a number of issues, in particular:

- Credit Rating Agencies (as covered in chapter 4, section 3).
- Conglomerates
- Off-shore centres
- Credit Risk Transfers by EU Finacial Institutions

Conglomerates

The three Level 3 committees were asked by the European Commission to set out how we might organise a cross-sectoral committee (of a Level 3 nature) to prepare technical advice for the European Commission and the European Financial Conglomerates Committee on the supervision of financial conglomerates. The European Financial Conglomerates Committee was established by the Financial Conglomerates Directive. In October 2004 CESR, CEBS and CEIOPS put forward to the European Commission, some initial informal organisational suggestions, regarding the structure and membership of the Committee. Discussion on these suggestions continues but should be finalised during 2005.

Off-shore centres

The three Level 3 committees have also been asked by the Economic Financial Committees' Financial Stability Table to prepare an assessment of the need for common EU principles towards off-shore centres. CESR, CEBS and CEIOPS have created a small task force to prepare this advice. The first stage of this work would be to assess the types of problems encountered in dealing with off shore centres from a regulatory perspective. A report by the International Monetory Fund (IMF), expected shortly, will be taken into account in this context.

Credit Risk Transfers by EU Financial Institutions

In response to a request from the Economic and Financial Committee (EFC) in September 2003[6], CESR, CEIOPS, and the European Central Banks' Banking Supervision Committee (BSC), began to co-operate intensively to investigate the use of credit risk transfer (CRT) instruments[7] and developed these findings in two reports in March 2004 and August 2004. As CEBS had only just been formed when the work began it was not directly involved, however, it provided comments as the reports were developed and endorsed its conclusions.

The surveys conducted by CESR, CEIOPS and the BSC found that, in the EU, the involvement of some major intermediary banks in credit risk transfer (CRT), as well as a rather limited set of other banks and insurance companies, was significant at that stage in time (i.e. September 2004). Other regulated financial institutions had not yet developed major activities in this area.

Hedge funds and US monoline insurers seem to have a relatively large involvement in CRT markets, but the lack and/or opacity of information did not allow the activities and risks involved to be assessed explicitly.

In summary, the reports main conclusions which are set out below will be the focus of further policy issues for discussion which will continue in 2005.

[6] Letter of 23 September 2003 by the EFC president Koch-Weser asked the three Committees "to prepare a special report from the EU perspective on the risks associated with the expanding use of risk transfer mechanisms and ways to evaluate better the concentration of risks on a regular basis".

[7] The co-operation (including a meeting and teleconferences) has taken place amongst the representatives the BSC, CESR and CEIOPS and the Chairmen of the Task Forces established by the three Committees to work on the topic.

5.5.1 The three Level 3 Committees (3L3)

- The work conducted has not pointed out shortcomings in financial institutions' internal risk management in the CRT area. However, the innovative and dynamically evolving nature of the CRT markets suggests that supervisory authorities should give some priority to monitoring banks', insurance companies' and potentially other institutions' use of CRT instruments where the level of involvement is relevant.
- The nature of the issues identified at present, calls for adequate attention by supervisory authorities and central banks, rather than any specific or urgent regulatory response.
- There is a need for public authorities to enhance the information available on CRT markets, covering the activities of all relevant market participants (including hedge funds and monoline insurance companies) and significant cross-sectoral risk transfers.
- Taking into account the efforts at the global level, further data collection from major European market participants (especially the banks most involved in the activity) could be considered (as is being done by the Banking Supervisory Committee [BSC]).
- It was considered that a more fruitful approach to establish the extent of the involvement of hedge funds (rather than approaching hedge funds directly), could be to require banks to disclose the extent to which hedge funds form part of their portfolio of CRT counterparties. Supervisory authorities also might wish to engage in co-operation with the US insurance supervisors to understand better the potential risks related to monolines. Finally, due to the recent liberalisation of the regulatory regime for UCITS, it may be useful to review in the future whether CRT market participation by UCITS has become significant. An effort to determine the level of participation by retail investors in CRT activity could be made as part of any future stock taking exercise.
- Authorities should pay adequate attention that conditions to ensure the smooth functioning of CRT markets are in place. This refers foremost to the progress in limiting legal, documentation and settlement risks, and mitigating the risks due to significant market concentration.

Next steps

Furthermore, the three Level 3 Committees have also discussed (and will continue to discuss) issues of common interest such as the development of CESR's advice to the European Commission on rating agencies and CESR's advice on the MiFID Directive.

The 3L3 Committees will also work closely to report to the FSC on their plans for fostering convergence of supervisory practices, within an accountability framework intended to exercise an enhanced monitoring of Level 3 activities.

In addition, CEBS will undertake some initial work in the area of crisis management and subsequently, this will be extended through dialogue between CESR and CEIOPS during the 2005/2006.

5.5.2 EU/US dialogue

Recognising the increasing interdependence between Europe's markets and the critical need to establish secure financial markets which foster transatlantic business, CESR has launched during 2004 a practical dialogue with both the US's Securities and Exchange Commission (SEC) and the Commodities and Futures Trading Commission (CFTC).

The purpose of these formalised dialogues is to ensure a forward looking exchange of ideas on shared priorities, regulatory developments and practical initiatives, to explore market developments which raise shared concerns and to assist CESR members, the SEC, and the CFTC respectively to develop converging or consistent solutions in a timely manner.

Both dialogues are taking place within the cooperative framework which will complement other multilateral efforts to collaborate with respect to securities regulation, including work carried out in the International Organisation of Securities Commissions (IOSCO), the Council of Securities Regulators of the Americas, the Financial Action Task Force, and the US EU Financial Markets Regulatory Dialogue.

CESR-SEC dialogue

The dialogue with the SEC was first announced by the SEC Chairman William H. Donaldson in a speech in Brussels, and formalised on 4 June 2004 in Amsterdam by the CESR Chairmen and by the SEC Commissioner Roel C. Campos. The terms of reference set out two primary areas of work:

1. Identification and discussion of regulatory risks present in US and EU securities markets.

The cooperation and collaboration will provide an opportunity to identify risks developing in US and EU securities markets.

CESR members and the SEC will share their views regarding these emerging regulatory risks relating to multinational market participants active in the US and EU financial markets (including broker-dealer groups, issuers, exchanges, fund complexes, etc.). Such cooperation should serve as an early warning system about potential problems.

This enhanced cooperation may also allow CESR and the SEC to develop a strategy for addressing the risks in a coherent fashion. In particular, CESR members and the SEC will, as necessary, put in place appropriate information sharing links in case of market events that may affect the normal functioning of US and EU markets (crisis management).

CESR members and the SEC will share experiences regarding enforcement matters involving multinational market participants active both in the US and EU financial markets. Where necessary, CESR members and the SEC will coordinate their efforts to increase the ability of uncooperative and under-regulated jurisdictions to exchange information.

2. Early discussion of potential regulatory projects in the interest of facilitating regulatory convergence.

The CESR - SEC cooperation will afford the opportunity to discuss, at an early stage, issues of regulatory concern in the US and in Europe. The purpose of these discussions is to facilitate converged, or at least compatible, approaches to regulatory issues.

CESR and the SEC will provide an annual indicative list of regulatory areas to be discussed in the course of the coming year.

Possible further areas of work

CESR members and the SEC may undertake additional areas of work in the future for the purpose of supplementing the early warning system regarding regulatory risks to be advanced through this dialogue. This may include a more articulated regulatory information-sharing mechanism and an expanded memorandum of understanding regarding cooperation on enforcement matters. CESR members and the SEC will consider these and other possible areas of work once meetings addressing the above issues are underway.

For the purpose of discussing issues of regulatory concern in the United States and in the European Union, the SEC and CESR members have established the following indicative list of areas for discussion during both 2004 and 2005:

- Market structure issues (the SEC's review of the US national market structure and the CESR work on the implementation of the MiFID);
- Future mutual fund regulation, including with respect to stale price arbitrage, late trading, and corporate governance;
- Development of an effective infrastructure to support the use of International Financial Reporting Standards, in particular with respect to consistent application, interpretation and enforcement of these standards with the final objective of avoiding reconciliation with local GAAPs;
- Credit Rating Agencies;
- Financial Analysts.

This indicative list may be revised if new regulatory issues affecting the EU and US markets emerge in the course of the year.

CESR - CFTC Initiative

CESR and the United States Commodity Futures Trading Commission (CFTC) announced on 11 October 2004 the launch of a Transatlantic Cooperation Initiative. The purpose of the Initiative is to:

- Institute regular communication on matters of regulatory developments of common concern;
- Heighten each respective region's attentiveness to the need for early and effective consultation;
- Explore where areas of convergence, and of common interest, permit the development of practical EU-wide mechanisms to enhance the existing bilateral relationships between the CFTC and individual CESR members.

5.5.2 EU/US Dialogue

The Initiative is based on several discussions culminating in this announcement by CFTC Acting Chairman, Sharon Brown-Hruska and CESR Chairman, Arthur Docters van Leeuwen that have occurred at the highest levels of each organisation. Under this Initiative, CESR and the CFTC have agreed to hold regularly scheduled meetings of relevant staff counterparts to share views on regulatory issues of common operational concern, particularly with respect to facilitating:

- Cross-border transactions by exchanges and firms in our respective markets through the promotion of appropriate convergence, and developing practical operational arrangements to ease access to each others markets and to avoid unnecessary obstacles or duplicative supervisory requirements;
- The exercise of CESR and the CFTC's respective supervisory responsibilities with regard to cross-border conduct by intermediaries, exchanges and clearing organisations and the identification of common evolving issues from our respective enforcement experiences;
- The early identification, discussion and resolution of regulatory issues arising from the CESR's and CFTC's regulatory initiatives.

The Initiative is intended to complement and improve upon the existing bilateral relationships and programme between the CESR and CFTC members and not as a substitute for such arrangements.

CESR and the CFTC agreed as a preliminary step to host a Round Table at CESR's headquarters in Paris on 10-11 February 2005. This was attended by 60 market participants and senior regulators. The purpose of the Round Table was to hear the issues affecting those actively involved in transatlantic business in exchange traded derivatives and related transactions, and to establish key areas where improvements can be made. Drawing on the experiences shared by attendees, regulators will establish a common work programme of practical measures to be implemented over the next 3 years that is intended to meet the needs of all stake holders while fostering a transatlantic environment that is consistent with supervisors' regulatory objectives.

As part of the two-day Round Table, chaired by Sharon Brown-Hruska, Acting Chairman of the CFTC and Fabrice Demarigny, Secretary General of CESR the regulators and industry officials participated in three separate panel discussions covering regulatory issues relevant to intermediaries, issues relating to exchanges and issues relevant to end-users. Each panel was moderated by a senior regulator: Walter Lukken, CFTC Commissioner, Michel Prada, Chairman of the French AMF, and David Lawton, Head of Markets Policy at the UK FSA. Jochen Sanio, Chairman of BAFIN, co-chaired the regulators' segment on Friday. The European Commission and the US Treasury participated as observers.

In each of these panels, participants identified issues they confront in transacting transatlantic business, such as their experiences in relation to transparency of rules and access procedures, recognition when operating in multiple jurisdictions, and requirements following recognition.

Having listened to these discussions, CESR and the CFTC agreed to establish a task force of senior regulators to follow up on the issues identified by participants. The first public output of this work in March will be a draft work programme to enhance transparency of regulatory information, to facilitate cross border filings for recognition or authorisation and to improve the efficiency of regulatory oversight overall. This work programme will be open to comment from interested parties for a period of 6 weeks, following which it will be finalised and the task force will set about exploring and where appropriate, implementing, the various proposals according to the time frame set out in the work programme.

Visit by US Senator Richard Shelby

On 8 November 2004, CESR also had the honour of the visit of Senator Richard Shelby, Chair of the United States Senate Baking, Housing and Urban Affairs Committee. The discussion provided a unique opportunity to discuss key aspects of the US/EU financial Services dialogue and, in particular, the envisaged cooperation of CESR with its US counterparts, the SEC and the CFTC. The discussion was also focused on regulatory developments on both sides of the Atlantic.

CESR's 2005 Work programme

6

Fabrice Demarigny, *Secretary General of CESR*

"The 2005 work programme will be dominated in the first half of the year by several sets of advice that CESR must deliver to the European Commission on Credit Rating Agencies and on the implementing measures of the Markets in Financial Instruments Directive (MiFID), and the Transparency Directive. The two latter sets of advice will complete the remaining regulatory activities (of a level 2 nature) deriving from the Financial Services Action Plan. Focus is now clearly on the implementation and day-to-day application of this set of EU measures. Following a very open and transparent process, CESR is progressively developing the tools for supervisory convergence to ensure that CESR members provide similar responses to similar questions across Europe. Cross-sectoral and global consistency is also high on CESR's agenda, closer links with our sister committees CEIOPS and CEBS will be developed and more intense dialogue with our US counterparts (SEC and CFTC) will also take place. Putting our action in a more long-term perspective, the Himalaya report is contributing to the post-FSAP debate that will continue throughout the forthcoming year."

CESR's priorities are reflected in our work programme.

Table 1 provides a list with indications of timings and Table 2 illustrates through statistics of the number of meetings, the increasing intensity of CESR's work which depends upon the active participation of its members.

The work load of the secretariat has increased again in 2004, with a number of expert groups preparing CESR's level 2 advice for the European Commission, run in parallel with an increasing number of implementation and operational groups on the adopted Directives. The role of CESR as facilitator of EU solutions will become more and more important in 2005. As such, this might lead CESR to undertake IT feasibility studies to assess the potential for centrally accessible regulated information.

CESR also organised for the first time a large paying conference. The conference was very well received and succeeded in attracting both very senior speakers and a broad range of senior industry attendees from across Europe. The conference was not intended to make a profit but succeeded in covering almost all the costs.

Regarding CESR's budget for 2004, CESR members accepted that given the increasing workload foreseen during 2004, the additional resources of the annual contributions (brought about by the addition of the new Members States), should be absorbed into CESR's budget for 2005. Thanks to this, the staff of the secretariat has expanded (to 16 people in 2004) and will continue to grow in a structured manner in 2005. The budget will amount to 2.4 million euros in 2005 (compared to that of 2.2 million euros in 2004). Table 3 provides an overview of the audited 2004 Financial Statements.

Table 1: CESR 2005 Work programme

a) CESR

Areas of work	Description	Timing
"3L3" Committees	Identification of areas for common work with the other Level 3 Committees, CEBS and CEIOPS	Q1/Q2
Strategic Task Force	Follow-up to the Consultative Paper and liaison with the EU institutions	Q1/Q2
Evaluation of the Lamfalussy process	Contribution to the Inter Institutional Mountains Group (IIMG)	Q1/Q2
Macro-economic conditions	Participation at the EFC stability round table	Q1
Rating Agencies	Work on the Technical advice to the EU Commission and follow up to the IOSCO report.	Q1
Market Participants Consultative Panel	Partial renewal of the composition	Q2
Financial Conglomerates	Participation by CESR to the establishment of a Level 3 cooperation on Financial Conglomerates	
Task Force on "non-cooperative authorities"	Participation by CESR to the "3L3" Task Force to propose an issues paper for the EFC	Q1
Cooperation with US counterparts (SEC, CFTC) To facilitate Trans-atlantic	Dialogue • Ongoing dialogue with the SEC. • Establishment of a CSER/CFTC Task Force	Q1/Q2

b) Level 2

Areas of work	Description	Timing
MiFiD Directive 1st and 2nd set of mandates	Finalisation of technical advice by 31 January and 30 April 2005	Q1/Q2
Transparency Directive	Finalisation of technical advice	Q2
Equivalence of Third Countries GAAPS	Publication of final concept paper on equivalence and assessment of third Countries GAAPs	Q2
UCITS Directive	Finalisation of technical advice under the mandate on eligible assets.	Q2/Q3

c) Level 3

Areas of work	Description	Timing
Level 3	Implementation of the actions adopted under "The role of CESR at 'Level 3' under the Lamfalussy process". Mediation mechanism and databases.	Q1/Q2
Clearing and Settlement	Follow up work of the approval of the CESR/ESCB Standards for Securities Clearing and Settlement Systems in the European Union: assessment methodology	Q3
Review Panel Activities	• Review of Standard No.1 on Enforcement; • Develop mechanisms of peer-pressure; • Common peer review on "Cold Calling" • Review of the Commission Recommendations on UCITS	Q2 Q2/Q3 Q1
Investment Management	• Follow up to the approval of the guidelines on transitional measures; • Work on the simplification of the registration procedure.	Q2/Q3
Transaction Reporting	• Work of the Technical Task Force in the field of transaction reporting under the MiFiD; • Feasibility of an EU database.	Q1/Q2
CESR-Fin **~ Audit** **~ SISE** **~ SCE**	• Audit Task Force which will deal with issues related to the audit of financial statements • SISE dealing with issues related to the endorsement of IAS/IFRS in Europe • SCE dealing with issues related to the enforcement of financial reporting under IFRS • Database on enforcement of IFRS	Q1/Q2
CESR-Pol	Assessment of the consequences of the adoption of the Market Abuse Directive	Q2
Prospectus	Recommendations to complete a prospectus	Q1

Table 2: Statistics on meetings 2002-2004

Group	Meetings 2002	Meetings 2003	Meetings 2004
CESR Plenary Meetings	5	4	
Strategic Task Force (Himalaya)			4 (4)
Expert Groups (drafting/sub-groups)			
• Market Abuse	2	5 (8)	(see CESR-Pol-Market Abuse)
• Prospectus	1	8 (10)	3 (4)
• Clearing and Settlement	4	4 (6)	8 (10)
• ISD Intermediaries		4	8 (5)
• ISD Markets		7 (2)	10 (4)
• ISD Cooperation & Enforcement		2	7 (6)
• ISD Steering Group		1	4
• Investment Management		1	3 (3)
• Credit Rating Agencies			3
Permanent Groups			
• CESR-Pol	3	3	4
– Market Abuse			3 (5)
• CESR-Fin	2	2	3
– SCE	4	5	5
– SISE	4	5	3
– Equivalence			3
– Transparency			5 (14)
Review Panel		2	3 (2)
Ad-hoc Groups			
• Investor Education		1	
• Financial Markets Research		2	
• Press Officers		1	
• Macro Economic			1
• Credit Risk Transfer			1
Market Participants Consultative Panel	1	3	4
Public Hearings	3	8	8

NB: – The first number indicates the number of meetings of an expert group.
– The number reflected in brackets represents drafting group meetings (and may be a subset of members of the expert group).
– The number of meetings represented here does not reflect meetings with the Consultative Working Group or Open hearings.

Table 3: 2004 Audited Annual Financial Statements

As at 31 December, 2004 (In Euros)

REVENUES	Contributions from Members	2 177 426 €
	Annual conferences	112 800 €
	Profit on marketable securities	32 399 €
	Other	26 €
	Total revenues	**2 322 651 €**
EXPENSES	Salaries and employee benefits	1 005 066 €
	External staff	236 254 €
	Rental	429 515 €
	Travelling	130 334 €
	Office supplies	20 645 €
	Organization and follow up of meetings	146 108 €
	Telecommunications	26 181 €
	Transportation and communication expenses	0
	Printing	19 794 €
	Computer & IT development	67 931 €
	Professional fees	53 184 €
	Depreciation of fixed assets excluding computer	32 801 €
	Miscellaneaous	9 830 €
	Total expenses	**2 177 642 €**
	Excess of revenues over expenses	**145 010 €**

7 Annex

7.1 CESR – A summary snap shot of CESR's role

CESR is an independent Committee of European Securities Regulators. The role of the Committee and its operational arrangements are set out in the CESR Charter (available on CESR's website). The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/527/EC). It is one of the two committees envisaged in the Final Report of the Committee of Wise Men on the regulation of European securities markets, chaired by Baron Alexandre Lamfalussy. The report itself was endorsed by Heads of State in the European Council (Stockholm Resolution of 23 March 2001) and the European Parliament (European Parliament Resolution of 5 February 2002). The role of CESR is to:

- **Improve co-ordination amongst securities regulators:** developing effective operational network mechanisms to enhance day-to-day consistent supervision and enforcement of the Single Market for financial services; having agreed a Multilateral Memorandum of Understanding (MoU), CESR has made a significant contribution to greater surveillance and enforcement of securities activities;
- **Act as an advisory group to assist the EU Commission:** in particular in its preparation of draft implementing measures of EU framework directives in the field of securities;
- **Work to ensure more consistent and timely day-to-day implementation of community legislation in the Member States:** this work is carried out in particular by the Review Panel under the Chairmanship of CESR's Vice Chairman.

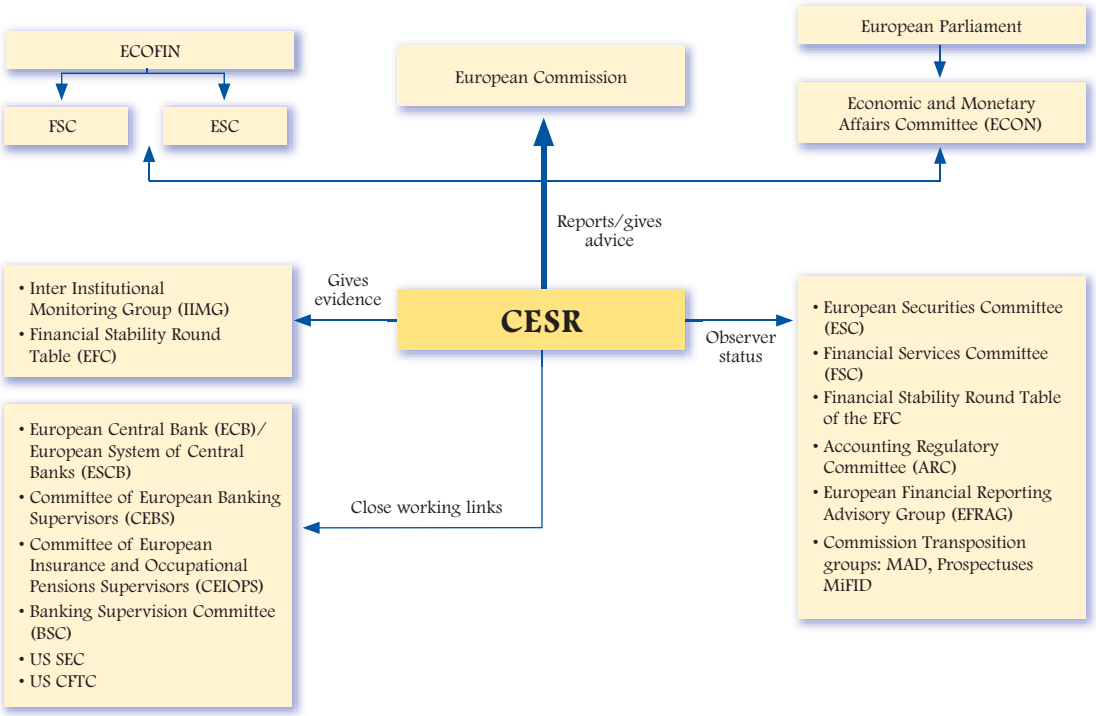
The CESR Chair and Vice-Chair are elected from among the Members for a period of two years. The Committee meets at least four times a year, with expert and operational working groups of national experts meeting on a regular basis and working at a distance as necessary. CESR works with the support of a secretariat conducted by a Secretary General. A representative of the European Commission is entitled to participate actively in all debates (except in confidential discussions related to individuals and/or firms). CESR forms part of the Lamfalussy approach that can be summarised very briefly as follows: Level 1 measures set out the high level objectives that the securities legislation must achieve. Level 2 measures set out some of the technical requirements necessary to achieve theseè objectives. Level 3 measures are intended to ensure common and uniform implementation by the use (amongst others) of common interpretative guidance and standards agreed amongst regulators in CESR. Level 4 measures relate to the enforcement of the legislation. CESR is therefore particularly active in carrying out functions described under Level 2 and 3 of the Lamfalussy process. A detailed explanation of the Lamfalussy process can be found in the Annex (Chapter 10). CESR has close relationships with European Institutions, and has expanded during 2004, the range of it's working relationships with several EU Committees. CESR submits an Annual Report to the European Commission, which is also sent to the European Parliament and the Council. The Chair of CESR reports regularly to the European Parliament and maintains strong links with the European Securities Committee.

CESR is now invited to contribute to the bi-annual analysis on macro-economic trends of European financial markets conducted by the Economic and Financial Committee (an advisory body of the European Council) (see Chapter 4).

CESR was also called on to contribute to the work of the Inter-Institutional Monitoring Group (IIMG) to assess the evolution of the Lamfalussy procedure. CESR has observer status in the following European Committees: the Financial Services Committee (FSC), the European Securities Committee (ESC), the Accounting Regulatory Committee (ARC) and the European Financial Reporting Advisory Group (EFRAG).

CESR has requested that it be given the same status in the future committee which will be formed following the reform of the 8th Company Law Directive in the field of auditing. In addition to these committees, CESR attends working groups led by market participants in various fields of financial market's regulationas an observer; these include the Forum Groups established by the European Commission on Financial Analysts; the Groups on Post-FSAP (securities and asset management); and, the ACI-STEP Task Force on Short-Term European Papers. CESR will also co-operate with the other Level 3 Committees recently established by the European Commission. The first concrete example of this co-operation was realised in the field of credit risk transfer on the basis of a mandate given by the Economic and Financial Committee to finalise a report in 2004. CESR also has close contacts with the European Central Bank (ECB) and the European System of Central Banks (ESCB), particularly in the field of securities clearing and settlement systems, where a joint group was established to adopt standards at EU level.

7.2 CESR in context: CESR's inter institutional relationships



7.3 CESR's consultation practices

CESR and its Expert Groups are committed to working in an open and transparent manner. In its 'Public Statement of Consultation Practices' (issued in December 2001, Ref. CESR/01-007c), CESR established the way in which it will consult and stressed the need to consult widely, and at an early stage, with market participants, consumers and end-users. The Public Statement on Consultation practices notes that:

The aim of consultation is to build consensus, where possible, between all interested and affected parties on what legislation or regulation is appropriate and to improve the decision making process of CESR by:

- benefiting from the expertise of market participants and operators, consumers and end-users, notably in assessing and analysingregulatory issues and possible solutions;
- assisting determination of whether a problem exists which requires a regulatory action, and if so, what form of regulatory actions is appropriate;
- providing opportunities for alternative approaches to a given issue to be considered;
- obtaining information and views on the potential impact of proposals;
- obtaining feedback on CESR's work;
- promoting understanding of the work of CESR and its role.

To deliver this aim, CESR emphasises:

- **the need for all involved to "play a co-operative game".** This places mutual obligations on CESR and those consulted to work in a manner that promotes the success of the process. This has particular significance at Level 2, where the scope and timetable of CESR's work is determined by mandates from the European Commission;
- **the need for a flexible and proportionate approach to consultation** that can be adapted according to the significance of an issue.

Notwithstanding the need for flexibility, CESR is guided by the following principles:

CESR members aim through the consultations to:

- target the full range of interested parties, including market participants, consumers and end-users;
- make consultation proposals widely known and available through all appropriate means, in particular, the Internet;
- consult at national, European and international levels.

CESR practice when consulting is as follows, CESR:

- publishes an anticipated annual work programme so that all interested parties know when to expect output from CESR;
- publishes any mandate received from the European Commission as soon as practical after receipt;
- organises upon request informal discussions at an early stage with those most likely to be directly affected;
- consults at a sufficiently early stage to enable CESR to take the responses into account;
- allows those consulted adequate time to respond, given the complexity of the issueand the time available. For significant issues,CESR will aim to allow a three month consultation period.

CESR is committed to:

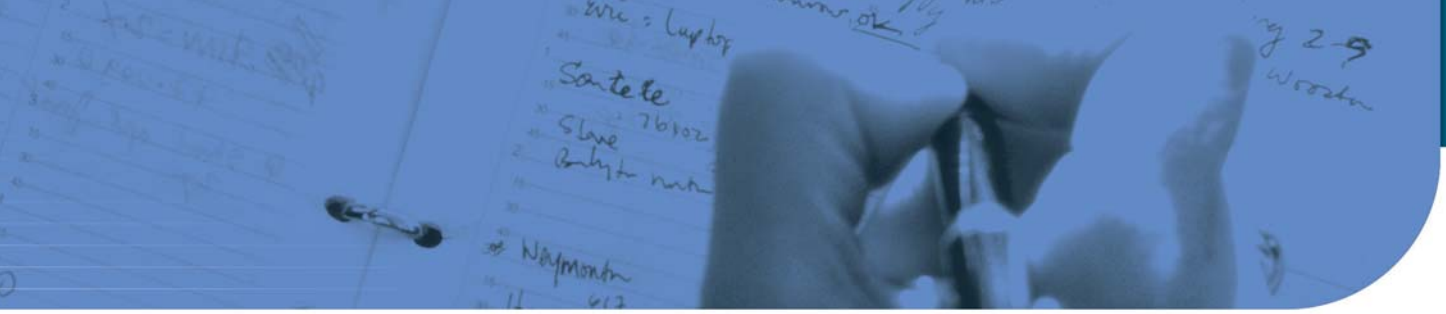
- provide an opportunity for interested parties to make submissions on receipt and publication by CESR of a mandate from the European Commission;
- when necessary, CESR will release its thinking at various stages, this may include the use of concept releases;
- produce reasoned consultative proposals, based on thorough analysis of the issues and objectives of the proposal and, where possible, on statistical information, expressed in concise and clear language, and, if possible, include in proposals preliminary information on their impact;
- establish working consultative groups of experts where appropriate;
- consult using a variety of media, including public hearings/roundtables, written and Internet consultations. In the interests of efficiency, use of the Internet will be encouraged and facilitated;
- use appropriate processes when necessary to target consultations more effectively and to engage specific parties affected (this can include for example, face-to-face meetings).

On how it responds to consultation, CESR will:

- give due consideration to responses received;
- make public all responses to formal consultations, unless the respondent requests otherwise, or make public a summary of the responses received;
- publish a reasoned explanation addressing all major points raised (Feedback Statements);
- consult for a second time if the response to the first consultation reveals significant problems, or where revised proposals are radically different from the original proposals on which consultation was based;
- publish all formal proposals and advice, including advice to the European Commission given under Level 2.

If it is not possible for CESR to follow the principles described above, CESR will publish its reasons. When necessary, CESR will review the statement of consultation practices.

Broadly speaking, after two years of experience, the consultation policy of CESR has proven very efficient. The possibility for market participants (practitioners, consumers and end-users) to anticipate and input the EU regulatory work, has significantly increased. For each specific area of work, this annual report provides illustrative examples and figures of the consultative process. It is CESR's objective to improve its consultation policy on a continued basis and in particular to follow the recommendations of the Inter-Institutional Monitoring Group (IIMG) in this regard.



7.4 Lamfalussy Process

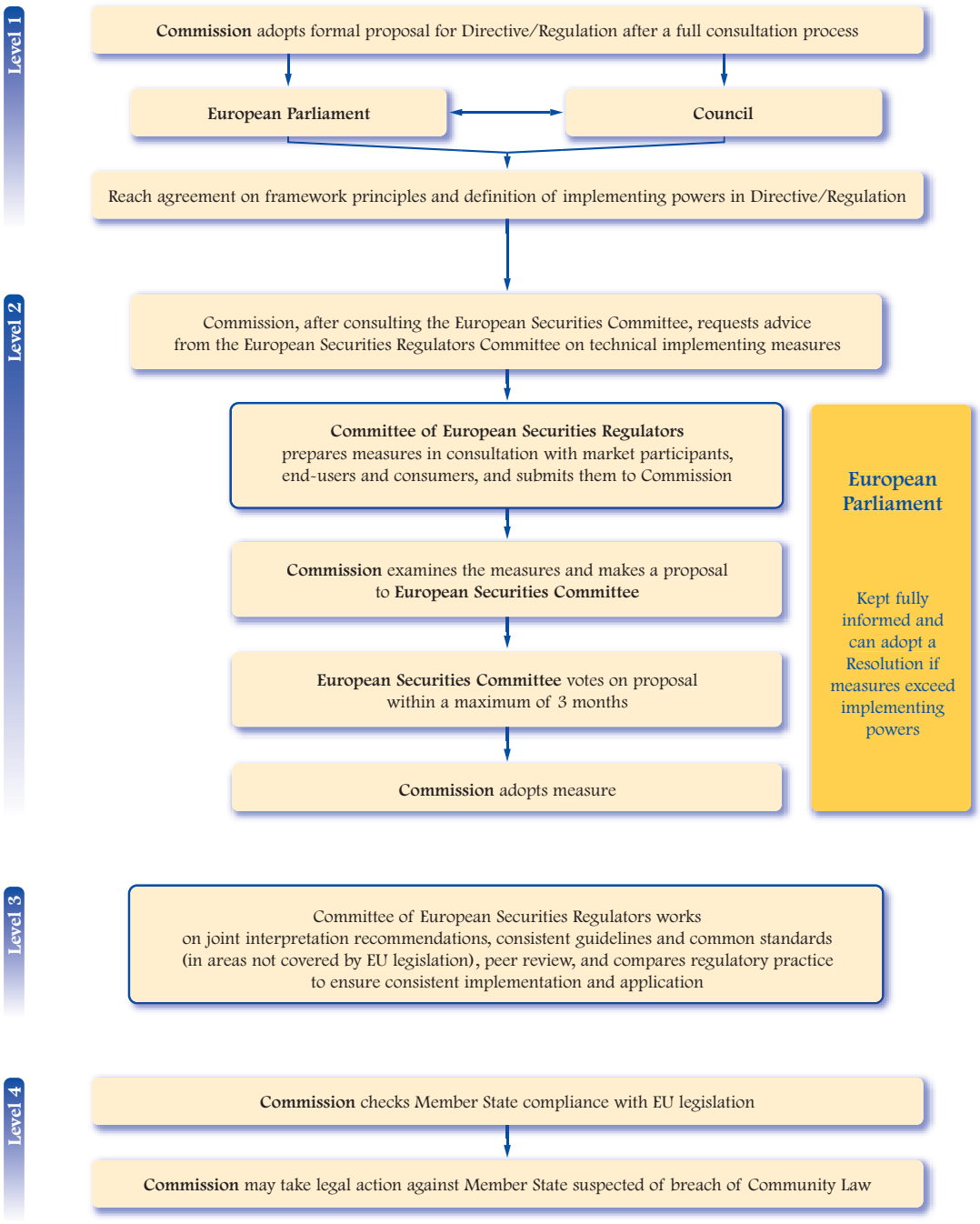
In the European Commission's Financial Services Action Plan of November 1999 strategic objectives were set out to create an integrated EU capital market by April 2004 (a single EU financial services market, open and secure retail markets, state-of-the-art prudential rules and supervision).

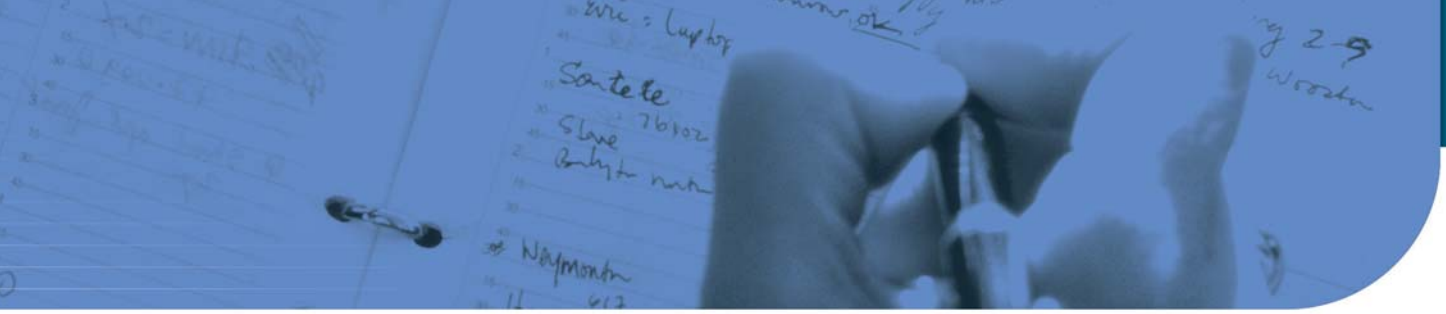
The Committee of Wise Men (Committee), chaired by Baron Alexandre Lamfalussy outlined in its report of 15 February 2001 several shortcomings in the legislative system for securities. The report proposed a four level approach with regard to the legislative process in order to solve these problems.

Europeans Securities Committee (ESC):
The Committee proposed the creation of the European Securities Committee (ESC), which has a primarily regulatory function, was formally established in June 2001. The ESC has three main roles: i) act as a regulatory committee under Article 202 of the Treaty, ii) act in an advisory capacity to the Commission in particular on level 1 legislation and, iii) advise the European Commission on level 2 mandates for CESR. The members of the ESC are nominated by the Member States and the European Commission chairs the ESC. CESR has the status of observer in the ESC.

CESR:
The Committee proposed the creation of CESR which was formally established in June 2001 and met first in September 2001. On level 2 CESR acts as an advisory committee to the European Commission. On level 3 CESR acts as a fully independent committee of national regulators to ensure more consistent implementation of Community law. The members of CESR are the heads of the competent authorities for securities regulation and/or supervision. The chairman is elected by the members of CESR. The Secretariat of CESR should keep close operational links with the European Commission for the work on level 2. The European Commission informs CESR of the political priorities and discusses emerging ideas with CESR. CESR produces an annual report on its work and forwards this report to the European institutions.

THE FOUR-LEVEL APPROACH RECOMMENDED BY THE COMMITTEE





Level 1

The Committee expressed the view that all European services and securities legislation should be based around a conceptual legislative framework of essential principles. The advantage of this approach is that the legislative process can speed up as the level 1 political co-decision negotiations between the European Commission, the Council of Ministers and the European Parliament only have to focus on the essential issues and not on technical implementing details.

Level 1, step 1 and step 2:

The level 1 principles should be incorporated in new types of Directives or Regulations in the field of securities which are to be decided by normal EU legislative procedures (i.e. proposal by the Commission to the Council of Ministers/European Parliament for co-decision). The European Commission should consult, beforehand, with market participants, end-users (issuers and consumers), Member States and their regulators on any level 1 legislative proposal. Furthermore, the European Commission should inform the European Parliament, the Member States and their regulators on an informal basis of forthcoming proposals.

Level 1, step 3:

The nature and the extent of the technical implementing measures that should be taken at level 2 have to be specified in the EU directives and regulations. This means that the European Commission has to seek understanding with the Council of Ministers and the European Parliament on the scope of level 2 implementing measures.

With respect to level 2, the Committee proposed a working method for CESR, the European Commission and the ESC to define, propose and decide on the technical implementing measures of level 1 directives and regulations.

Level 2, step 1:

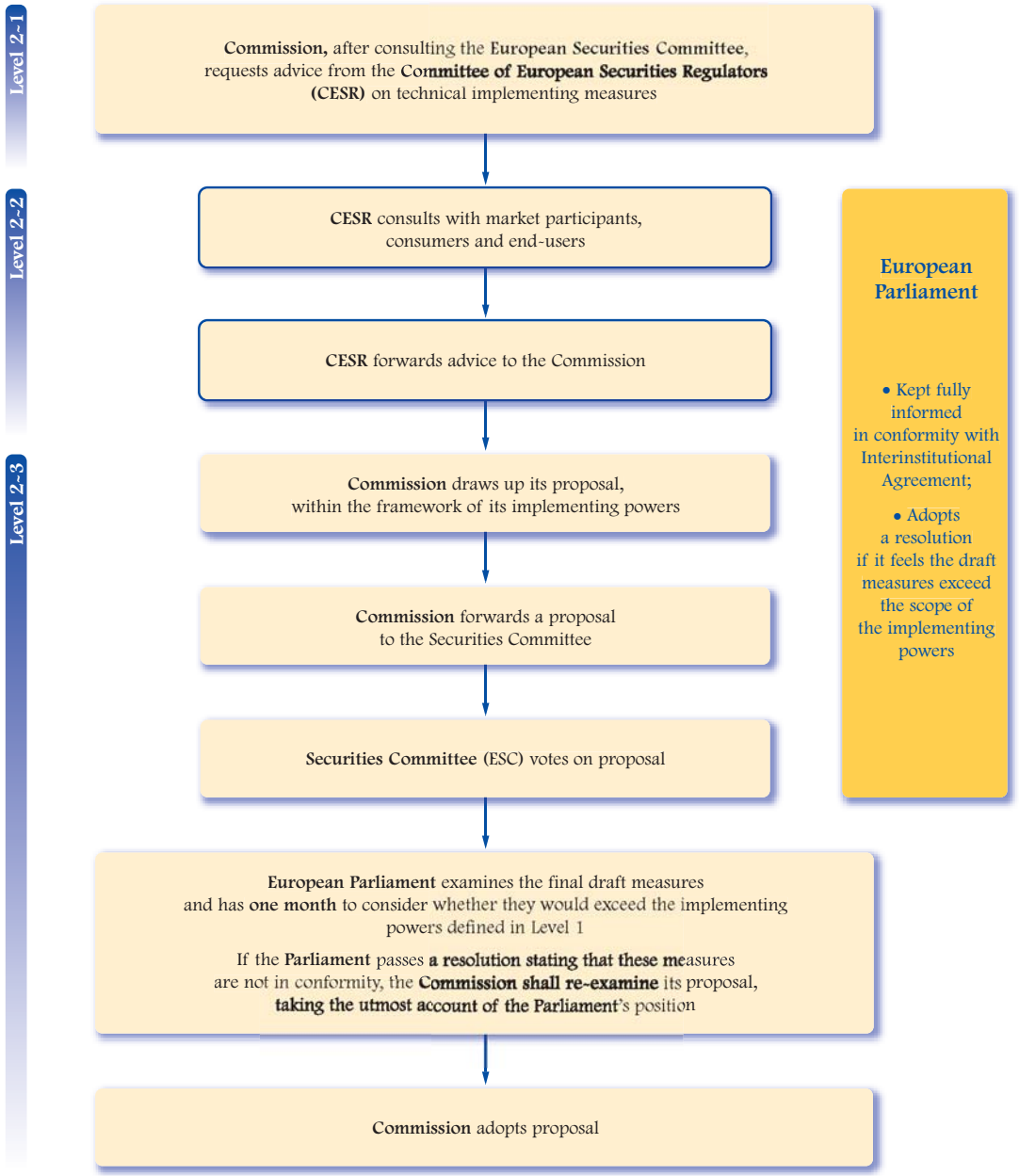
The European Commission, after consultation with the ESC, asks CESR to draw up a technical advice for the implementing measures on the basis of a clear mandate of the European Commission.

Level 2, step 2:

CESR will publish any mandate received from the European Commission to provide interested parties to make submissions. In addition, CESR will consult with the market participants, consumers and end-users on the basis of a draft advice at a sufficiently early stage to be able to take the responses into account. CESR may also establish consultative working groups where appropriate. After the consultation procedure, CESR draws up the final advice and sends it to the European Commission.

Level 2, step 3:

The European Commission presents a proposal for technical implementing measures to the ESC taking into account the technical advice of CESR. The European Commission ensures that the European Parliament is fully informed on all these proposals in order to check whether the proposal is in conformity with the scope of the implementing powers defined by co-decision in level. After the ESC has approved of the proposal of the European Commission, the technical implementing measures will be formally adopted by the European Commission.



Level 3 concerns a strengthened co-operation between national regulators to ensure consistent and equivalent transposition and implementation of level 1 and level 2 legislation. This requires an active role of CESR in the field of common and uniform implementation of EU legislation. CESR should fulfill this role by producing administrative guidelines, interpretation recommendations, common standards, peer reviews and comparisons of regulatory practice to improve enforcement of the legislation concerned.

Strengthened enforcement of the Community rules is identified by the Committee as **level 4**. This is primarily the responsibility of the European Commission but Member States, regulators and the market participants have an important role in supplying information to the European Commission about any potential infringement of Community rules.

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