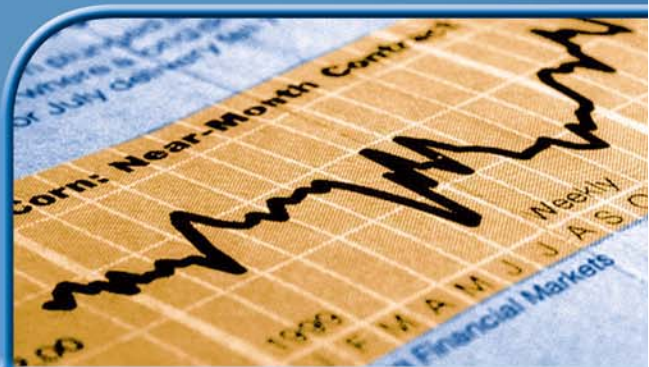
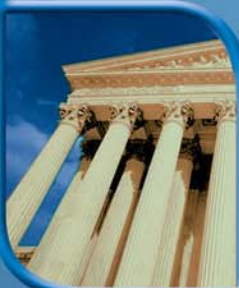


The Committee of European Securities Regulators



ANNUAL REPORT 2006

ANNUAL REPORT OF
THE COMMITTEE OF EUROPEAN SECURITIES
REGULATORS (CESR)
TO
THE EUROPEAN COMMISSION
AND TO
THE EUROPEAN PARLIAMENT
THE ECOFIN COUNCIL

2006

CESR's Members



Along with my colleague, Carlos Tavares, Vice-Chair of CESR, I am pleased to report last year's activities of the Committee.

In 2006 CESR celebrated its 5th anniversary. Since its foundation, as the Forum of European Securities Regulators (FESCO), the number of its Members has increased from 15 (plus Iceland and Norway) to 27. The secretariat now consists of a highly motivated, multinational staff of 20.

Since its creation, CESR has kept up the pace. It is widely recognised as the central contact point on securities markets regulatory issues. Through its consultations and public statements, it has strongly contributed to making the regulatory process in Europe more visible, more transparent and closer to the regulated activities. Better regulation is strongly pursued.

The first phase of its existence mainly consisted of contributing to the regulatory initiatives of the Commission, advising on the Level 2 implementing measures. Considerable efforts were made by all CESR Members and their staff to propose well thought through advice for regulations, while meeting the strict deadlines set by the Commission. Its opinions are considered authoritative and mentioned in later interpretations of Directive provisions.

Now, CESR has entered into a new phase.

2007 will be the year of the Review of the Lamfalussy process. Fundamental questions about the middle to long term development of the supervisory mechanism will have to be dealt with in particular, including efficient decision making, measures to strengthen the convergence efforts, and developing operational initiatives.

Institutional matters may need to be addressed, such as the legal status of the Committee within the European institutional framework, and the Members' relationship with their national mandate.

The Level 3 convergence exercise will be pursued unrelentingly. Several of the recommendations of the ECOFIN Council "Francq Report" have already been introduced: the peer review panel and the mediation protocol are in force while work has started on delegation of supervisory tasks. Operational co-operation, based on networking among the Members, results in exchanging information and experiences on common subjects while databases (e.g. on market abuse cases, or the application of IFRS) contribute to the creation of a common body of precedents.

The Committee and its Members remain firmly committed to undertake these efforts with a view of making the markets in Europe better integrated, more efficient, thereby delivering a significant contribution to our populations' overall welfare.

Last but not least, on behalf of all the Members of CESR, I would like to thank Arthur Docters Van Leeuwen and Kaarlo Jännäri, former Chair and Vice-Chair of CESR, for their outstanding contribution to the establishment of CESR and the Single Market for financial services. I would also thank Manuel Conthe, Marios Clerides, Virgilijus Polderys, Jaroslaw Kozlowski, former CESR Members for their significant contribution to the work of CESR, and Alexander Schaub former Director-General, for Internal Market and Services, European Commission, and welcome and look forward to working with Georgios Charalambous, Anneli Tuominen, Vilija Naudsėdaitė, Stanislav Kluza and Jörgen Holmquist, present Director -General, for Internal Market and Services, European Commission.



A handwritten signature in black ink, which appears to be 'E. Wymeersch'. The signature is fluid and cursive, written on a white background.

Eddy WYMEERSCH

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THIS REPORT COVERS THE WORK OF CESR FOR THE PERIOD JANUARY 2006 TO END OF JANUARY 2007

The Market Participants Consultative Panel (MPCP) met twice in 2006, on 14 June and on 18 October, and at both meetings the discussions were facilitated by CESR's Chairman, Arthur Docters van Leeuwen. The meeting on 18 October was a joint meeting with CESR Members.

The following sections set out the main topics which were discussed at the two meetings.

Opening remarks

In his opening remarks the Chairman updated the members of the Panel on the developments in the Transatlantic Dialogue with particular regard to the work programme with the SEC. With regard to the SEC, two issues were flagged: the self-contained discussion about International Financial Reporting Standards (IFRS) and the proposal on de-registration. On the postponement of the US GAAP/IFRS convergence timetable, a formal decision is expected by the EU Commission this summer. CESR will prepare a preliminary report for the EU Commission on the progress in the implementation of the IFRS before the end of 2006. A final report is envisaged for 2007.

On de-registration, it was noted that the SEC-proposal of December 2005 would - in CESR's view - not enlighten the reporting burden for companies which want to de-register, as much as hoped for.

Furthermore, the Chairman of CESR informed members of the Panel about the implications of a possible (Transatlantic) consolidation of stock exchanges. Whatever the parties involved would be, the benchmark would remain: the impact of such a consolidation on fair and orderly organised markets. The most involved regulators currently identify and analyse the relevant issues (i.e. scope of activities, cascade effects and application of other legislation). The importance of the competition-issue was underlined.

Finally, the Chairman underlined the major milestone achieved in the dossier of supervisory convergence and the future of supervision of EU financial markets by referring to the conclusions of the ECOFIN Council on these matters in early May.

The role of CESR in protecting individual retail investors

Based on experience in the UK, and in particular the FSA-work on financial capability, John Howard presented the most relevant issues retail investors are dealing with when shopping for financial services. While congratulating CESR on its continuous efforts to improve consumer representation (i.e. the Retail Investors Conference in Valencia, Spain on 28 November 2005, followed by a number of hearings with retail investor associations on MiFID and the Transparency Directive etc), it was also noted that consumer organisations clearly have a lack of resources to contribute to the process. Efforts should be done to enhance the level of representation of the retail investors' voice in Europe. To overcome some of these difficulties, John Howard suggested that consultations should be conducted in the various languages and in a clear format.

According to John Howard, the relevant issues for retail investors vary from: qualification of products, status of advisors, execution-only, pre-contract documentation, suitability, and the handling of complaints. Particular attention should be paid to the phase of financial promotion, and particularly that taking place via electronic means and cross-border. On the latter issue John Howard argued for a role of CESR to streamline national systems, as current ombudsman schemes and compensation schemes vary enormously across Member States. The more integrated financial markets and harmonised rules across Europe are, the less risk for consumers would remain. With regard to the issue of suitability, risk ratings of financial products would help and a plea was made for a strong role for CESR in this area. Additionally, reference was made to the fact that recently - for the first time in the UK - traditional financial advertising was outstripped by internet-advertising which may also provide challenges for regulators.

It was concluded that boosting retail investor confidence in the area of protecting retail investors, could be achieved by creating an understandable, consistent approach which is

easy to use. Criteria for adequate qualification of investors and correlation to categories of products should be developed; self regulatory initiatives may be pursued. Furthermore, information given to retail investors should be targeted, simple and timely.

In the subsequent discussion, some members of the Panel do expect positive impacts on the position of retail investors by the entering into force of the MiFID at the end of 2007; others considered that it is too early to assess the impact of MiFID. Other MPCP members mentioned the importance of consumer education, even though it was considered to be only a partial solution. Members called for a mapping by CESR on the various national educational efforts. National education systems should address problems of education on key economic principles.

It was also pointed out that a “one size fits all approach” would be impossible to be achieved and that it could possibly drive out risky products and innovation. The CESR Chairman noted that education can only be a partial solution and will not solve everything. The Chairman concluded this session with the suggestion to table the issue of consumer education for policy discussion at the next Away Day of the CESR Members, particularly in the light of the new countries’ experiences and cross-border evolutions. This point will be re-discussed by the Panel in one year to monitor developments.

Consistency across financial sectors

Dominique Hoenn introduced the discussion starting from the issues listed on the joint working programme of CESR, CEBS and CEIOPS. In particular, he mentioned the following issues which are deemed relevant across the various financial sectors:

Financial Conglomerates: in banking/insurance: securitisation and the operational risk not taken into account in the insurance sector;

Substitute products: same rules should be introduced on eligibility of products. A concrete case was made where a re-structured product was admitted to trading in one ju-

risdiction after being barred in another jurisdiction for sale to retail investors;

Reporting requirements: provision of statistical data by financial firms without knowing for what specific usage/purpose;

Internal Governance: what is significant here is what kind of decisions should be taken and at what level (managing board level or supervisory board level?);

Crisis management: two types of crises can be distinguished; crisis at a specific institution and a market crisis.

The highest priority however, should be given to (different) capital requirements for substitute products. Distortion of competition should be avoided. He called for the creation of a group of wise men to advise on a general prudential supervisory framework.

In the following discussion, members of the Panel strongly supported the co-operation between the 3L3 Committees. Level playing field and consistency across sectors were considered important objectives to be achieved, also in order to protect retail investors. Compliance and monitoring requirements and hedge funds were identified as issues for further work. Lars-Erik Forsgardh suggested the issue of taxation of shareholders to create awareness among Member States about the negative effects of taxation.

In summarising this session, the Chairman of CESR acknowledged the issue of capital requirements, but noted that this does fall within CESR’s remit. Concerns will be conveyed to the competent authorities and the European Commission. On substitute products, the Chairman underlined the increased awareness by the EU institutions about cross-sectoral effects of rules and regulations. On reporting requirements, it was emphasised that not everything is known to CESR with regard to statistical output. For this reason, CESR needs to conduct surveys and gather evidence of problems signalled by market participants. He nevertheless noted a need for more pressure by the industry and called upon the industry to identify (and report) any idiosyncratic requirements. Finally, the Chairman proposed to table the

Market Participants Consultative Panel

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issue of hedge funds for the joint meeting of MPCP and CESR, mid-October 2006.

The future regulation of investment management in Europe

Following a presentation by Jonas Romlin, the members of the Panel had a policy discussion on the issues arising from the Expert Groups' reports on investment management with particular regard to hedge funds activity. This discussion will help CESR provide its input to the European Commission for the White Paper which was published in November 2006.

In his introductory remarks Jonas Romlin noted that the asset management industry is affected by a highly sophisticated range of products. There is an increasing focus on absolute return and particularly the use of instruments tracking benchmarks, including products that are accessible to retail investors, such as exchange traded funds (ETFs); this widens the gap between alpha and beta. There is also an increasing importance of risk management and alternative investments. From the perspective of end investors we can perceive an increasing attention to costs. As regards hedge funds, he mentioned that classification of these instruments is still unclear: ranging from new classes of instruments, new strategies or new business models. There is an extended use of derivatives either to take risks or to hedge risks. Finally Jonas Romlin mentioned that it is difficult to build index tracking funds.

In the following discussions members of the Panel noted that hedge funds do not give rise to investor protection concerns provided that they are targeted at professional and sophisticated investors (including pension funds and other institutional investors). The proposal to establish a common European private placement regime was supported. Competitive arbitrage between hedge funds and mutual funds was also mentioned.

More information about their activities (such as the degree of leverage) should be given to the market to assess potential market impact and systemic risks. As regards the current level of leverage in the market, it was not felt

to be excessive. Members of the Panel also considered that categorisation of hedge funds would be an useful exercise for CESR. Risks of potential market abuses by hedge funds should be monitored particularly when hedge funds are very closely related to issuers. It was also mentioned that the lack of standardisation of certain aspects in the settlement process (in the absence of depositories and clearing houses) might pose some risks.

As regards the debate on the possible modernisation of the UCITS Directive, it was considered that mergers between funds do not fall under the regulatory questions; a basic framework for information concerning mergers should be established, to which national specific requirements should be added. Key priorities have been identified in measures to enhance industry's efficiency (such as cross-border mergers, portfolio of management companies and pooling) and harmonisation of a private placement regime.

As regards supervision of cross-border asset management, some members of the Panel favoured the passport of the management company, whilst for depositories it was felt to be more difficult.

Evaluation of implementation of the Market Abuse Directive

Following a presentation by Rudiger von Rosen, the members of the Panel had a discussion on aspects of implementation of the Market Abuse Directive. This discussion will provide input into the evaluation of the supervisory functioning of the MAD that CESR is currently conducting.

In his introduction Rudiger von Rosen supported the CESR initiative to evaluate the functioning of MAD. He mentioned in particular three critical aspects: a) directors' dealings, b) insiders' list and c) costs. As regards the first point, he noted that the threshold to notify directors' dealings is too low and it generates too much information that might become unnecessary. In relation to insiders' lists he mentioned that the requirements should be less bureaucratic and follow the normal behaviour of companies; in particular he mentioned that too many

persons on the list can render the list unhelpful. He also called for equivalent implementation across Europe.

In the discussion that followed, members of the Panel identified further key issues: the fact that the market abuse regime under MAD does not apply to unregulated markets, the treatment of 'contracts for difference' or commodities contracts. Members of the Panel considered that this regime is essential for the confidence in the market and that enforcement actions and publicity of these actions are important aspects of the regime. On directors' dealings, some members of the Panel considered that the rule works effectively in many jurisdictions and it appears to be a useful source for journalists. Others raised the point that the scope of the obligation is too wide, also covering related parties. There was no call to change the legislation but rather, to find practical solutions to avoid excessive burden; guidance may be developed when necessary.

Clearing and Settlement

Following a presentation by Jeffrey Tessler, the members of the Panel were invited to comment on the recent way forward announced by Commissioner McCreevy and have a policy discussion on the role that CESR could play.

In his introduction Jeffrey Tessler started by comparing the costs of cross-border equities transactions in Europe and in the US. He also mentioned how the project launched by the European Central Bank on Target 2 Securities might affect the system. Finally he noted the difference between the activities of Central Securities Depositories (CSDs) and International Central Securities Depositories (ICSDs) and the impact of the initiative of the Commission on the industry code of conduct.

In the following discussion members of the Panel supported the clarifications about the different activities performed by CSDs and banks. However, in relation to the various initiatives currently undertaken by the Commission and the ECB, it was felt that there is not a clear picture yet about how these initiatives will evolve. Supervision of Target 2 securities raised some questions. The approach of the code of conduct was supported, with particular regard to the transparency of prices.

CESR Work Programme

The Chairman introduced the work programme of CESR by explaining the shift in emphasis from rule-making (as an advisory body to the Commission) to operational matters. In this context, he also mentioned the criteria developed by CESR's Priority Task Force for the prioritisation of work. Members were invited to suggest any additional areas of supervisory work which are not covered in the current work programme. As regards the future Level 3 work under MiFID, members of the Panel mentioned the need to avoid gold-plating and the fact that Level 3 measures should not represent another layer of regulation. In response to this suggestion, the Chairman of CESR underlined the implicit role of avoidance of gold-plating in the current and future MiFID-work and the extension of the role of the Review Panel. Some members also underlined that a flexible approach to best execution should be envisaged for inter-professional business. Some members of the Panel invited CESR to organise training on MiFID regulation.

The detailed summaries of the discussions are available on CESR's website www.cesr.eu, in the section Market Participants Consultative Panel.

Market Participants Consultative Panel

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**In the course of 2006, five members of the Panel were chosen to be renewed.
The current list of Members of the Market Participants Consultative Group is:**

Mr John Howard, Chairman, Financial Services Consumer Panel

Dott Salvatore Bragantini, Vice-president, IW Bank

Dr Rolf E Breuer, Former Chairman of the Supervisory Board, Deutsche Bank AG

Mr Donald Brydon, Chairman London Metal Exchange and Director AXA Investment Managers

Professor Jarmo Leppiniemi, Representative of retail investors

Mr Peter Paul F. de Vries, Director, Association of Shareholders, Vice-President, Euroshareholders

Mr Jeffrey Tessler, CEO of Clearstream International S.A

Mr Dominique Hoenn, Deputy General Manager of BNP Paribas, Vice-Chair of the Supervisory Board of Euronext

Dr Buhl, Joint CEO of Wiener Börse AG and Member of Board of Directors of Budapest Stock Exchange

Mr Julio Lage Gonzalez, International, Institutional relations, innovation and strategy areas, CAIXA

Mr Jonas Romlin, Head of Derivatives, SEB Asset Management

Dr Ruediger von Rosen, Managing Director of Deutsches Aktieninstitut

Dr Zoltan Speder, Vice-President and CEO of OTP Bank RT

Mr Theodoros Philippou, General Manager of the Institute of Certified Accountants in Cyprus

Mr Tom Healy, Chief Executive of the Irish Stock Exchange

Ms Andrea Corcoran, (Observer), Managing Director, Promontory Financial Group LLC"

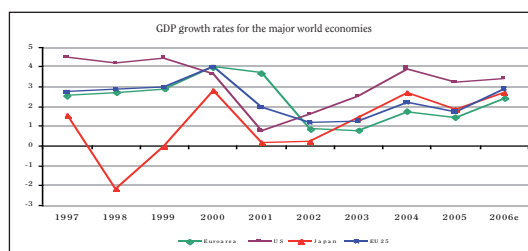
Salvatore Bragantini and Peter Paul F. de Vries saw their appointments renewed in 2006, and four new members of the Panel were appointed: Jarmo Leppiniemi, Jeffrey Tessler, Michael Buhl, and Tom Healy.

This chapter gives a brief overview of major economic trends and risks in 2006, which can be interpreted as having had a significant impact on the performance of European securities markets.

During 2006, the global financial markets were characterised by ample liquidity, low volatility, which remained at its recent historic lows, and increasing investor risk appetite. The markets were tested in May/June, when concerns over the US economic outlook and increasing inflationary pressures in the major economies resulted in a sudden reversal of investor sentiment and a sell-off of higher-risk assets, such as emerging-market debt and commodities. However, financial markets recovered relatively quickly and volatility across markets returned back to its recent historic lows. While the global economic and financial conditions remained benign and are expected to remain so, geopolitical and event risk could still pose challenges for the European economies.

Output growth

The performance of the global economy has remained strong, with most regions growing at, or above, expectations throughout 2006. The expansion proved particularly robust in emerging Asia and Latin America. However, the US economy slowed considerably over the course of the year due to a weaker domestic housing market and high energy prices. Strong corporate balance sheets and tight labour markets were able to partly offset the impact of the housing slowdown, but with the US economy looking somewhat fragile towards the end of the year, this also dampened global growth forecasts for 2007. The peak of the global economic expansion during the present cycle may already have passed, with the IMF expecting global GDP growth to moderate to 4.9% in 2007 from 5.1% in 2006.



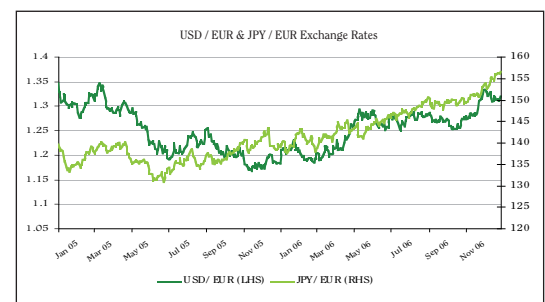
Source: DataStream, IMF, Oxford Economic Forecasting UK Weekly Brief

Euro area economic growth accelerated to 2.7% in 2006 from 1.4% in 2005, driven by a recovery in domestic demand on the back of improving labour markets and strong busi-

ness confidence. The pace of the economic upturn in 2006 exceeded investor expectations, and was considerably more broad-based than in recent years, with the German economy, in particular, showing surprising strength. The rest of Europe, particularly Eastern Europe, also benefited from the increase in demand in the Euro area and considerable Foreign Direct Investment from Germany. While some of the growth momentum may carry over to 2007, the rate of economic growth in the Euro area is expected to moderate as higher interest rates, the stronger exchange rate, fiscal tightening (notably in Germany), weaker industrial output and the slower-growing US economy begin to weigh upon the economies of the region. Furthermore, the overall global economic outlook will also be reliant on the performance of the Asian economies.

Exchange rates

On foreign exchange markets, monetary tightening by the European Central Bank (ECB) contributed to a 4% appreciation of the trade-weighted euro exchange rate over the course of 2006. In December 2006 the euro reached a two-year high against the dollar, having appreciated by 12% over the year. The pause in the US monetary-tightening cycle removed some support from the US dollar, with the dollar weakness further compounded by investor concerns over the continuance of the external financing of the US current account deficit, which remains at record highs of around 6.6% of GDP.



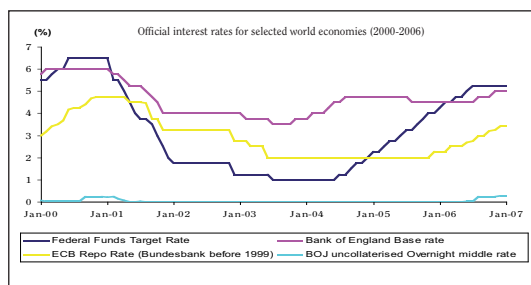
Source: DataStream

Over the same period, the euro appreciated by 12% against the Japanese yen. This occurred in spite of the Japanese economy outperforming expectations in 2006. The

weakness of the yen can be partially explained by the widening interest rate differential between the two regions and the continuing popularity of the yen carry trade.

Inflation and interest rates

The ECB continued to gradually raise interest rates during 2006 in response to increasing inflationary pressures. Official interest rates reached 3.5% in December 2006, representing an increase of 150bp over the course of the year. Improvements in labour markets in the Euro area and the long-term convergence process across the accession countries supported demand for credit, which remained strong despite the tighter financial conditions. Inflation remained contained in 2006, reaching 2.2% in both the Euro area and the European Union. The ECB has stated that it still views monetary policy as accommodative and has cited further tightening will be necessary to maintain long-term price stability.



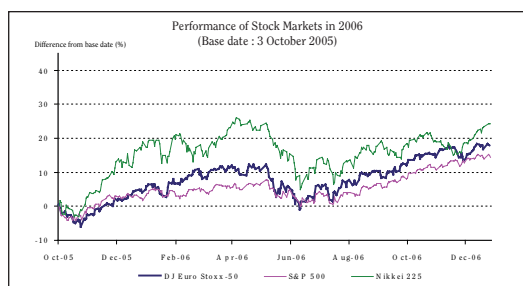
Source: ECB Statistics

A strong global economy, high energy prices and falling levels of spare capacity have also contributed to the build up of inflationary pressures in many other countries. The central banks of the US and UK continued to withdraw liquidity from the markets and normalise interest rates during 2006. Many emerging-market central banks also tightened monetary policy during 2006 to deter exchange-rate depreciation. The Bank of Japan ended five years of its zero interest-rate policy by raising rates to 0.25% in July 2006, but the weaker yen more than offset the restrictive impact of higher interest rates on monetary conditions in the country. The pace of interest-rate tightening slowed towards the end of 2006 as many central banks judged rates to be approaching their neutral

levels. However, while inflationary pressures across the major economies appeared to be moderating, they remain at elevated levels which could increase the likelihood of further rises in interest rates in 2007.

Equity Markets

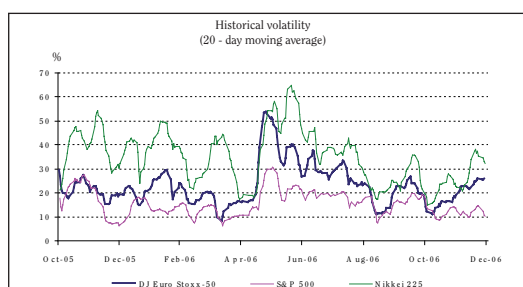
Global equity markets enjoyed strong support for most of 2006. Most markets have shown a more upbeat performance, continuing the overall upward trend that prevailed throughout 2005. During 2006 oil and commodity prices continued to rise. This sparked off the initial concerns about increasing inflation, higher interest rates and in some cases slowing growth prospects leading to a period of volatility in May and June 2006.



Source: Naftemporiki

As a result of the corrections experienced in that period, some major equity markets dropped back to the levels that they had reached in the last quarter of 2005, which for some of them implied losses of up to around 20 percent from their recent peaks. Those losses were particularly steep in markets where strong gains had been recorded previously, as in Japan or the Euro area.

In the course of these downward adjustments, volatility of major indices increased substantially and continued to rise even after markets had started to regain some strength.



Source: HCMC

Although equity markets suffered during the global May-June correction, they soon resumed their upward path and by early November they were slightly above (with the exception of Japan) the levels recorded before the downturn. Such developments have been supported by positive earnings reports and a favourable growth outlook for the Euro area as well as a drop in oil prices, which relieved some concerns among market participants regarding upward pressure on inflation.

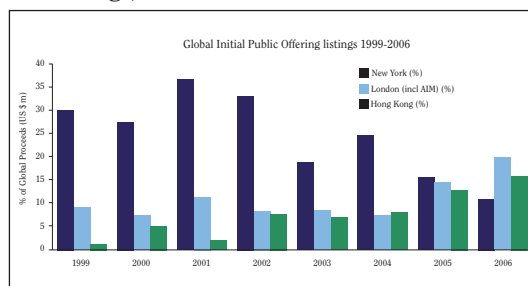
Initial Public Offerings (IPOs)

In Europe, the main exchanges saw a rise in the total capital raised through initial public offerings in 2006, despite large public-to-private deals such as VNU, the Dutch-listed media group.

Europe and Asia eclipsed North America in the value of IPOs thanks to activity in emerging markets. Six of the top 20 IPOs were from emerging markets.

An aspect highlighted in 2006 is that all over the world, IPOs are getting bigger. The record number of billion dollar flotation — 42 in total — pushed the funds raised by means of IPOs to \$257.1bn, outperforming the previous high of slightly more than \$200bn in 2000. The year's two biggest IPOs were Industrial & Commercial Bank of China (ICB) which raised \$21.9bn and Bank of China, which raised \$11.2bn. Rosneft, Russia's state-backed oil group was third raising \$10.7bn.

Measured by IPO proceeds, the London Stock Exchange and Hong Kong Stock Exchange both surpassed the New York Stock Exchange, the perennial leader for new listings, for the first time ever in 2006.



Source: Thomson Financial

According to data from Thomson Financial, offerings in the Financial, Energy and Power sectors accounted for 45.4% of total IPO volume in 2006, compared to 32.5% in 2005.

However, there were also further signs of blurring between the public and the private equity markets as several private equity firms sought new capital by listing shares in their own funds on stock exchanges.

Finally, de-listings also continued. The decline in the number of listed companies can be attributed to a number of factors, including the loss of appeal of multiple listings, the de-listings by smaller companies, the restructuring of international companies, the cross-border merger activity and the activity of private equity funds.

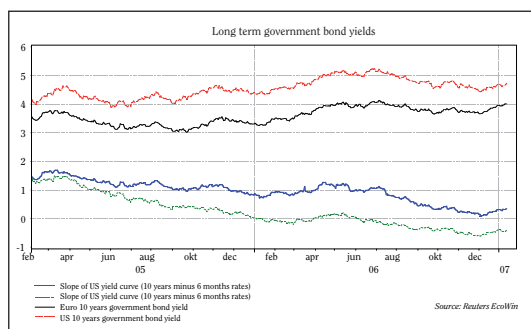
Bond Markets

Bond markets have been fairly stable in the Euro area during the year, with generally low volatility, reflecting the positive macro-economic development. Nevertheless, during the turmoil on the equity markets in May and June, there were some "flight to safety" effects, meaning that demand on bonds led to somewhat falling yields during these months. These effects were however quite small.

The fall in the second half of 2006 in bond yields can mainly be explained by lower inflation expectations, particularly in the US. The increase in short term interest rates during the year has led to quite a pronounced flattening of the yield curve. In the US, the yield curve has even become downward sloping. With the strong macroeconomic development, bond yields were expected to rise further, but there could have been demand factors, such as large investments by pension funds and insurance companies, that have held yields down. The supply of bonds with very long maturities seems not to have grown enough to support the high demand.

Government bond yields generally increased during the first half of 2006, while falling back during the second half of the year. The growth rate of the amounts outstanding of long-term government bonds was fairly stable, with growth rates varying around 5%

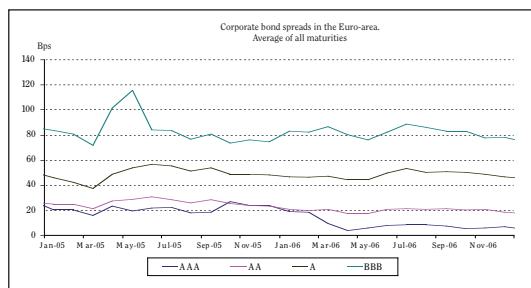
annually during the last 10 years. The growth rate dropped to about 3% in 2006,



reflecting a somewhat stronger fiscal position of governments in the Euro area.

Financial institutions have had a higher volume of issuance. Outstanding amounts of long term-bonds have grown about 10% for monetary financial institutions and almost 30% for non-monetary financial corporations.

The corporate bond markets in the Euro area have also been stable during the year. There was a slight increase in spreads after the period of volatility on stock markets in May and June, but with small effects. Non-investment grade bonds have shown declining spreads throughout the year. In general, corporate sector indebtedness has increased. The declines in corporate spreads thus suggest that the search for yield by investors has continued. Investors seem to have a positive outlook towards the European corporate sector in general.



Source: Datastream

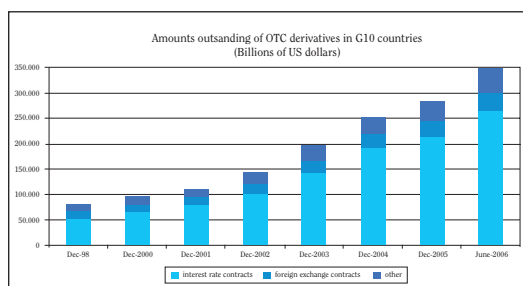
Gross issuance of corporate bonds increased during the first half of 2006. It was particularly high yield issuers (single A and below) that showed significantly growing volumes. However, volumes are still quite far from the high volumes of the last boom of the econ-

omy around the millennium shift. It is also the case that European corporate bond markets have still not reached the level of development that exists in the US.

Derivatives Markets

The volume outstanding of derivatives went up sharply in 2006. This increase of derivatives markets activity confirms their continuing growth in recent years. Interest rate products account for the major part of the notional amounts of both over-the-counter (OTC) and exchange traded derivatives. On the other hand, currency derivatives are still a relatively small segment of the organised derivatives market.

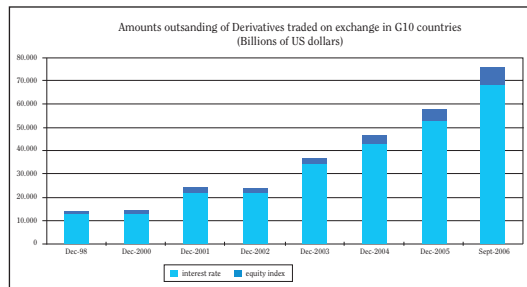
Notional amounts of all types of OTC derivatives in G10 countries increased by 23% to \$350 trillion in the first half of 2006.



Source: BIS Quarterly Review, December 2006.

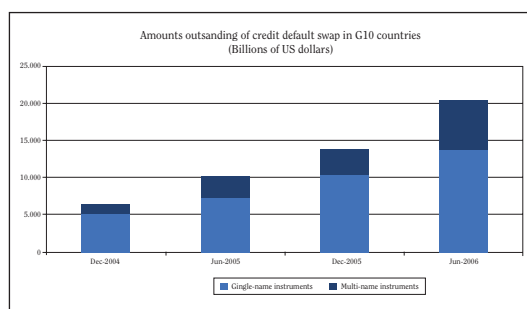
Growth in the market for OTC derivatives accelerated after more moderate rates of increase in the previous year (13% between December 2004 and December 2005). The increase was particularly strong in the market for OTC interest rate derivatives, where the volume outstanding rose by 24% reaching \$262 trillion. Moreover, a robust activity was recorded also in the foreign exchange market segment, where the notional amount grew by 21% to \$38 trillion. The dollar was the most important vehicle currency, given that 83% of all contracts had one leg denominated in US dollar, compared to 40% for the euro and 25% for the Japanese yen. Lastly, both commodity contracts and equity derivatives, which are included in the category of derivatives classified as "other" 1, grew at a slower pace (17% and 18% respectively).

The volume outstanding of derivative financial instruments traded on exchange reached \$75 trillion in September 2006, 31% higher than nine months before.



Source: BIS Quarterly Review, December 2006².

Notional amounts of interest rate contracts increased by a solid 30% to \$68 trillion. The volume outstanding of futures and options on stock indices grew sharply by 37% to \$7 trillion, while positions in foreign exchange contracts expanded at a slower pace (20% to \$208 billion). From June to September notional amounts of derivative financial instruments slightly decreased by 10% mainly because of seasonal factors which influenced interest rate contract dynamic. Credit default swaps grew at a brisk pace in the first half of 2006.



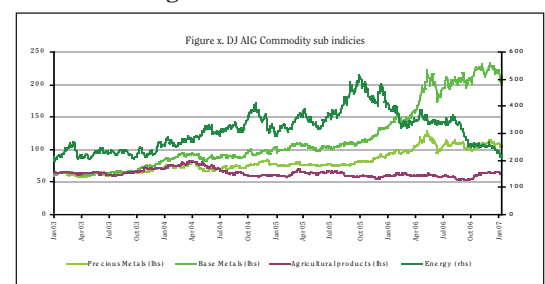
Source: BIS Quarterly Review, December 2006.

From December 2005 to June 2006 notional amounts increased sharply by 46% to \$20 trillion. During the first half of 2006 credit default swaps with maturities up to one year and over five years increased by more than 50%, while contracts with maturities between 1 year and five years grew by 23%. At

the end of June single-name contracts represented the major part of credit default swaps (the volume outstanding was 68% of total notional amounts) and most single name contracts were rated investment grade (67% of the volume outstanding). However, notional amounts of multi-name contracts increased at a faster pace than single-name contracts (86% compared to 33% in the first half of 2006).

Commodity Markets

Commodity markets had a mixed year in 2006. Non-energy commodities continued their exceptionally strong performance and many reached record prices in the first half of the year, while energy commodities underperformed many other financial assets in 2006. Like other financial markets, commodity markets were shaken by the May and June sell-off, which saw prices fall across the different commodity classes. However, most commodity prices recovered quickly after the turbulence in the international financial markets calmed and continued to make strong gains towards the end of the year. Commodity price volatility increased markedly during the May and June turbulence but fell again in the autumn of 2006.



Source: Datastream

High historical returns attracted considerable interest in commodity markets in 2006. This was demonstrated in both increasing participation from hedge funds and other investment vehicles in the market as well as the introduction of new products that would allow a wider variety of investors access to commodity markets. Newer commodity

¹ The category "other" includes equity-linked contracts, commodity contracts and positions reported by non-regular reporting institutions.

² Currency derivatives are not reported because in all the years they represent less than 1% of the total notional amount.

markets, such as markets for weather derivatives and carbon emissions continued to expand in 2006. While many commodities have been traditionally traded mainly for commercial purposes, the use of commodity derivatives as financial instruments has increased. This means that in addition to physical demand and supply pressures on prices, investor sentiment and speculative activity in futures markets is exerting increasing influence on prices. This has been particularly evident in energy markets, where speculative inflows of money and investor demand for innovative products that allow for access to the markets without the need to hold the underlying commodity have increased volatility. The risks in commodity markets were illustrated by the \$6 billion losses and the collapse of Amaranth (a hedge fund that had made extensive bets on natural gas swaps) in September 2006.

Oil and Gas

Oil prices made gains in the first half of 2006, with benchmark crude West Texas Intermediate reaching a nominal record of \$78.4/bbl in July due to heightened geopolitical pressures in the Middle East and supply disruptions around the world. This was relatively short-lived and from August onwards, oil prices weakened towards the end of the year. Natural gas prices appeared to diverge from oil prices and front-month natural gas prices fell by 44% over the year. This was largely due to the commercial and industrial substitution away from natural gas after the record prices seen in 2005 after the US hurricane season. Higher inventories and unexpectedly warm winter weather also reduced the demand for natural gas. The weakness in oil prices was largely the result of moderating concerns over geopolitical risk in key oil-producing countries, higher inventories and OPEC's decision to not to go ahead with planned production cuts. Despite the considerable weakening in oil prices, benchmark crude continues to trade roughly double the price seen in 2003.

Industrial and Precious Metals

Industrial metals prices grew by 64.3% in 2006 on the back of growing demand for raw materials, particularly from China and the rest of non-Japan Asia as part of their industrialisation process. Frequent strikes in several large mines around the world and considerable problems with ageing infrastructure resulted in supply disruptions, which added further increases in the prices. However, supply pressures have now moderated as many pending labour contracts have been settled, reducing the risk of strikes and allowing inventories to build up from their record lows.

The prices of precious metals increased by 21.2% in 2006. Gold has traditionally had a negative correlation with the US dollar and has been viewed as an effective inflation-hedge and a medium of exchange in times of geopolitical or market turbulence. This relationship appeared to re-establish itself in 2006 and gold prices made gains when the dollar depreciated. Growing demand for precious metals exchange-traded funds (ETFs) also contributed to investor interest in gold in 2006. Additional demand for gold was created by a desire by some central banks to increase their gold reserves and shift away from US treasuries. Silver prices are closely correlated with gold prices and also made dramatic gains in 2006.

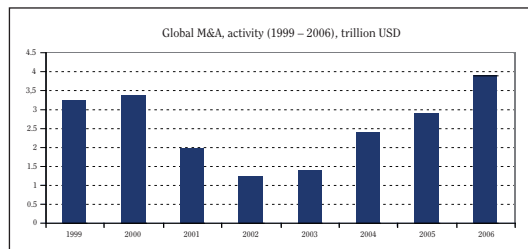
Agricultural commodities

Gains in the agricultural commodities sector were highly unevenly distributed. High energy prices and increasing demand for 'green energy' made it economical to refine several agricultural crops to ethanol. Ethanol-related demand was largely responsible for the 40% gain in corn prices in 2006. Drought and crop losses in major wheat-producing countries pushed up wheat prices (up 20%) over the year, which increased demand for corn as an alternative livestock feed and contributing to the high corn prices. While grains generally performed extremely well, weakness in sugar prices pulled down the gains in Agricultural sub-indices over the year.

Corporate Financing (M&A, Private Equity)

Mergers & Acquisitions

Major merger deals have been a key catalyst fuelling recent stock market gains. At the end of 2006, the global M&A activity reached \$3,8 trillion, being the hottest year for mergers and acquisition since 2000, the year before the dotcom bubble burst, when it topped at \$3,4 trillion. The number of deals announced during the year reached 36,958 a 37.9% increase from 2005.



Source: Dealogic. Numbers are in \$trillion.

On the one hand the European markets have been opened up by the authorities easing mega-mergers to be completed, on the other hand some countries adopted political measures in order to protect companies being identified as targets for mergers and/or acquisitions mainly those of strategic impor-

Some of the most significant offers announced in 2006

Target (country, sector)	Acquirer (country, sector)	Value (billion USD)
Bellsouth (America, telecommunications)	AT&T (America, telecommunications)	89,4
Endesa (Spain, public utilities)	E.On (Germany, public utilities)	71,3
Arcelor (Pan-European, steel industry)	Mittal (India, steel industry)	43,6
Gaz de France (France, public utilities)	Suez (Belgium-France, public utilities)	40,9
SanPaolo IMI (Italy, bank sector)	Banca Intesa (Italy, bank sector)	37,6
Equity Office (America, real estate handling)	Blackstone Group (America, private equity)	36
America Telecom (Mexico, telecommunications)	America Móvil (Mexico, telecommunications)	35,2
HCA (America, hospital operator)	Bain Capital (America, private equity)	32,1
BAA (Great Britain, airport operator)	Grupo Ferrovial (Spain, real estate)	30,2
Autostrade (Italy, motorway operator)	Abertis (Spain, motorway operator)	28,2

Source: Thomson Financial

tance (e.g.: in the utilities sectors). The number of companies launching hostile bids rose dramatically across the globe up from 94 hostile bids in 2005 to over 355 in 2006, exceeding the previous record of 272 hostile bids in 1999.

Besides the growing portion of Europe within global M&A transactions (in 2006 M&A transaction registered in Europe amounted to \$1.53 trillion, in America for \$1.44 trillion and in Japan for \$0.38 trillion), there are other features that distinguishes the present growth from that of the year 2000.

Firstly, elite private investors buying up companies at a record pace is a new phenomenon. Historically the largest takeovers were realised by publicly traded companies, but this year among the biggest deals were that of numerous private-equity firms. These are generally close-ended investment firms that collect money from pension funds, college endowments, wealthy individuals and other investors that are expecting double-digit returns on their investment.

Secondly, the present M&A boom can not be tied only to a single sector, as was the case in the year 2000 with the telecoms sector. Now the leading sectors are finance, real estate, utilities and healthcare.

Finally, current deals are being paid for decisively in cash or funded with debt, as opposed to transactions using overvalued stocks of low profit "new economy" companies. According to Dealogic the cash transaction's portion is significantly bigger than that of combined cash and stock deals, which may increase the chance of successful mergers, as in the case of banks willing to lend money to cash acquisitions. They usually closely examine the proposed benefits of the deal before remitting any cash for the transaction.

Private Equity

Private Equity provides capital or management expertise to companies in order to create value and subsequently, with a clear view to an exit, generate capital gains after a medium to long term holding period. The market for Private Equity is characterised by a huge dynamism that is closely linked to

global economic developments, in which periods of strong growth and shrinkage take turns. In the United States, the Private Equity market traditionally consists mainly of venture capital; while in Europe the Private Equity market is dominated by buy-outs and is rather strongly influenced by international (especially US) investors.

2006 was a year with marked heights and records for private equity. Interest rates continued to be low by historical standards, rendering financing by leverage very attractive. In addition, banks were very willing to finance private equity projects. The days of low interest rates seemed to be drawing to a close however, and private equity firms were facing increasing debt levels. Therefore firms also sought to raise public money. Kohlberg Kravis Roberts (KKR) was the first private equity firm to go public, with a \$5 billion fund flotation in 2006.

Recent Private Equity Listings

Company	Value	Date	Stock Exchange
KKR (Private Equity Investors, PEI)	\$ 5 billion	May 3, 2006	Amsterdam
Apollo Group (AP Alternative Assets)	€ 2 billion	August 8, 2006	Amsterdam
Partners Group Global Opportunities Ltd.	€ 350 million	Sept. 30, 2006	London
Doughty Hanson	Expected € 1 billion Listing did not occur	Sept. 11, 2006	Amsterdam
CVC and Alpinvest (Wavin)	Expected € 515 million Received € 371 million	October 12, 2006	Amsterdam

Source: AFM

2006 saw many big takeovers, made possible by higher leverage, larger fund raising and more 'club deals'. The value of worldwide public companies going private peaked in 2006 at \$150 billion. KKR beat its own record and set a new standard for private equity deals by joining a consortium to pur-

chase HCA, one of America's largest hospital operators. This deal had a total value of \$32,1 billion. European sectors in which private equity showed interest were especially telecoms, technology and media. In telecoms, private equity was involved in about 40% of the deals in recent years.

In early 2006, the Danish phone company TDC was acquired by a private equity consortium for €12 billion. The Spanish broadcaster Univision was acquired by a consortium for €11 billion. The biggest private equity buyout also took place in the media sector. The Dutch media firm VNU was acquired for €8.6 billion by Alpinvest, the Carlyle Group and KKR are taken private. In the technology sector, Philips Semiconductors was acquired by a private equity consortium for €8 billion. Private equity firms were also turning attention to Germany and Sweden. In Germany, an attempt by Bain Capital to acquire the German car parts supplier Continental failed.

All in all, private equity adds a dynamic element to the economy and it is a vital component of financial markets, capable of inducing changes and structural improvements that are beneficial to companies and society as a whole. However, following its more prominent presence on financial markets, concerns about the possible risks have also been voiced in 2006. Private equity is, by nature, less transparent than other forms of equity and this is a cause of concern from a regulatory perspective. The prudential risk caused by the current high leverage also calls for continued watchfulness.

Asset Management

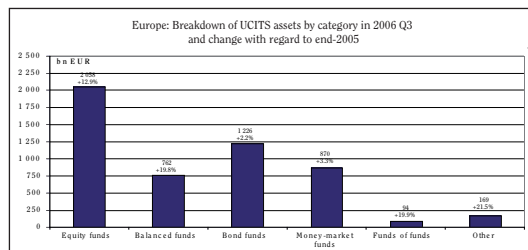
Europe has one of the most developed fund management industries in the world and estimates put total European assets under management (AUM) for September 2006 at more than €7 trillion³. This number represents around 14.4%⁴ of the world's funds under management, a total that includes the investment fund industry, as well as assets

³ €7,266bn according to EFAMA, Trends in European investment funds, 2006Q3, namely €5,727bn for UCITS investment funds and €1,539bn for non-UCITS investment funds.

⁴ Based on AUM estimates from EFAMA and IFSL.

managed by insurance companies and pension funds. While retail assets continue to grow, discretionary mandates on behalf of pension funds, insurance companies, charities and endowments, have been more challenging. Indications are that traditional managers are facing increased competition from alternative providers such as hedge fund managers and private equity managers on the one hand, and from passive products charging relatively low fees such as index trackers on the other hand.

Some investors have recovered their confidence in the equity markets, along the traditional pattern according to which net retail sales tend to follow market trends. Accordingly, sales in France exceeded €56bn last year, and €28bn in the UK. But as markets pass their pre-dotcom bubble peaks, memories of the market downturn of the period 2000-2003 remain and retail investors have been sensitive to the market downturn in the second quarter of the year, prompting increased sales in some markets.



Source: EFAMA

Some European countries, such as Germany and Italy, have shown a trend of net redemptions in domestic fund sales. Those net redemptions happened at a time when local equity markets were strongly rising, as shown by the gains of stock market indices. A possible explanation for this could be the growth

of cross-border funds such as those classified as “international funds” by FERI-FMI⁵. Roughly 31.2% of funds fall into this category and their growth continues to be strong⁶. The majority of these cross-border funds are being domiciled in Luxembourg and Ireland and the €250bn of net sales of UCITS recorded in the first three quarters of 2006 can, to a large extent, be ascribed to them, as well as to France and the United Kingdom⁷.

A number of country specificities remain in the European investment fund market, notably with regard to administrative and tax treatments, and to the retail market distribution of investment funds⁸. As a trend, the “open architecture” distribution model seems however to be slowly gaining ground in Europe⁹. The demand side of the market, also shows a number of country differences: formula-based funds, for example, remain largely specific to some countries, as well as money-market funds (for which a significant market has only developed in France), or tracker funds which are mainly marketed on a few exchanges. This is also true with regard to the importance of invested amounts.

Hedge funds

The significant growth in assets under management (AUM) by hedge funds recorded in 2006 came mainly on the back of inflows close to the previous record seen in 2004, as asset growth due to performance remained subdued. The 14% growth in 2006 of the widely used CSFB Tremont index improved on the gains of 8% made in 2005. It is the best annual result since 2003 for hedge funds, but does not compare favourably to the +16.3% and +17.8% of the DJIA and DJ STOXX indices.

⁵ Such funds are mainly distributed in countries other than that in which they are registered.

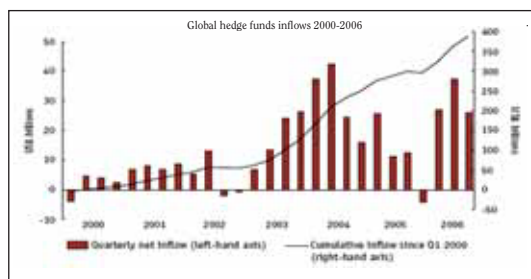
⁶ FERI-FMI, estimated net flows Jan-Nov 2006, Total Net Sales ex-Liquidity

⁷ Actually, since a number of countries recorded negative net sales, these four countries recorded more than €250bn of net sales.

⁸ The recent European Commission White Paper on investment funds indicates that differences in cost levels across European countries relate mainly to the costs of distribution and that this cost varies between a low of 46% in France to a high of 75% in Italy measured as a proportion of the management fee being used to meet distribution costs.

⁹ Source: McKinsey.

¹⁰ For 2006Q3, HFR estimates assets managed by hedge funds worldwide at USD1,336.5bn, which includes USD499.6bn of funds of hedge funds. Comparable figures for end-2005 were USD1,105.4bn and USD394.6bn.



Source: CSFB/Tremont

An important source of asset growth came from funds of hedge funds, which now account for a significant part of hedge funds' AUM¹⁰.

Institutions are said to be the new source of assets for hedge fund managers. In particular pension funds are increasingly moving to "alpha"-generating strategies¹¹ such as hedge funds. Indications are that overall pension fund allocation to this type of fund is increasing. In 2006, 13% of European pension funds invested in hedge funds¹². In addition, it appears that pension fund trustees are allocating a greater proportion of their assets to other alternative strategies including property and private equity.

European hedge fund managers are estimated to have accounted for roughly 26% of global hedge fund assets in 2005 (US: ~62%, others: ~2%)¹³. In Europe, London has become the leading centre of European hedge fund management, with nearly 80% of European assets managed from the UK's capital and AUM growing strongly.

Hedge funds are increasingly active in various asset markets, especially those with higher risk potentials. According to a study by Greenwich Associates, in September 2006, the share of hedge funds in the daily trade volume in credit derivatives was 58%, in high yield bonds 25%, and in non-performing loan trades 47%¹⁴.

Amaranth Advisors LLC, a multi-strategy hedge fund lost an estimated \$6.4 billion on initial AUM of \$9.2 billion in September 2006. The majority of the losses came from the energy trading on natural gas swaps. The fund was significantly leveraged and ran into trouble when it found itself on the wrong side of the natural gas market and was forced to unwind most of its unrelated positions to satisfy its margin calls. Amaranth was unwound in an orderly fashion with minimal systemic impact, but has also raised questions around governance controls and risk management.

The concerns over risks posed by hedge fund activities have led the G7 to address "hedge funds transparency" on top of their agenda in the first half of 2007. The Financial Stability Forum will present an update to its 2000 report on hedge funds to an International Monetary Fund meeting in April 2007 following a request from the G7. The report would focus on "stress-testing" and looking at how market turbulence could affect banks and other financial institutions dealing with hedge funds.

¹¹ 'Alpha' is the return of an asset manager over-and-above its relevant market, or 'Beta'.

¹² European Asset Allocation Report 2006, Mercer Investment Consulting, September 2006.

¹³ Eurohedge, September 2006 – the estimation is for mid 2005 and it is the latest published at the time of writing.

¹⁴ "For hedge funds, fixed-income trading volumes soar, while costs take on new importance", Greenwich Associates 2006.

5.1 ♦ Transparency

MANDATE

Mandate of the Transparency Expert Group

In July 2005, CESR received from the European Commission a mandate for technical advice on implementing measures concerning the storage and filing of regulated information.

The mandate contained three elements and invited CESR to provide:

a. By June 2006, an opinion for possible implementing measures on two preliminary issues relating to the architecture for the EU storage network: (a) the agreement on interoperability of the national Officially Appointed Mechanisms i.e. how an agreement on technical requirements could allow technical interoperability of the national OAMs and (b) the cost and funding implications for the Member States arising out of the creation of the EU network.

b. By June 2006, technical advice on the role of the OAM for the central storage mechanism and on the role of the competent authority. More particularly, CESR was invited to determine the minimum quality standards the OAM will have to comply with, such as standards of security, of certainty as to the information source (authenticity), of time recording and of easy access by end users. In respect to the role of the competent authorities, CESR is invited to examine the power of the competent authorities in supervising the OAMs as well as their role in adapting the standards in case of technical developments.

Moreover, the same technical advice invited CESR to explore the issue of filing of regulated information with the competent authorities. More specifically to determine minimum quality standards to be complied with by the competent authorities, in particular in relation to security, certainty as to the information source and of time recording, and to determine whether the procedure of filing with the competent authority can be aligned with the procedure of filing with the OAM in order to avoid duplicate submission of the same information.

c. By April 2006, an interim report regarding the cost of setting up and operating an OAM that would meet the prescribed quality standards.

CESR's advice was prepared by an expert group chaired by Carlos Tavares, Chairman of the Portuguese CMVM, and supported by a permanent member of the secretariat, Mina Filippa. From October 2006, a remote member of the secretariat, Anita Farkas, has been appointed CESR rapporteur on Transparency.

**Chair's message**

Carlos Tavares, Chairman of the CMVM, Portugal

"The availability of regulated information is critical for investor protection as well as for the proper operation of the market and market efficiency. Information is indeed a key component for the evaluation of investment opportunities in financial markets. The idea is that all regulated information on listed companies should be accessed at affordable cost by all investors through one or more officially appointed central databases in each country.

By interlinking these national repositories of regulated information, this information should also become accessible to all EU investors irrespective of where they are situated.

During 2006, CESR has advised the European Commission on the minimum quality standards of the national storage systems and on possible ways to create a viable and user friendly storage system at an EU level, taking into consideration at the same time, the cost implications of such a structure. I think the EU network of national storage systems would be a key tool in the integration of EU financial markets, fostering investor confidence. CESR should therefore endeavour to facilitate the implementation of this EU network and has already taken steps in this respect. Looking ahead, another key task for CESR in the area of transparency will be to promote consistency in the application of the level one and two Directives.

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A- CESR's final advice and opinion on the storage and filing of regulated information

On 6 July 2006, CESR delivered its final advice and its opinion on the storage and filing of regulated information, covering the minimum quality standards of the national storage systems and its opinion on establishing the interoperability amongst national storage systems (European Union network) (Ref. CESR/06-292). The information affected by the Transparency Directive and these implementing measures includes price sensitive information, regular financial reports, notifications for major holdings and, according to the Commission's Mandate, prospectuses. The issue of how such information is stored is crucial for the development of EU financial markets. For the first time, there is a requirement to ensure that EU investors have easy access to information about all EU issuers on a pan-EU basis, irrespective of where they are located. This will enable investors to better evaluate investment opportunities and make informed assessments of an issuer's business performance and assets. The storage system is intended to become a key tool in the integration of EU financial markets, fostering investor confidence.

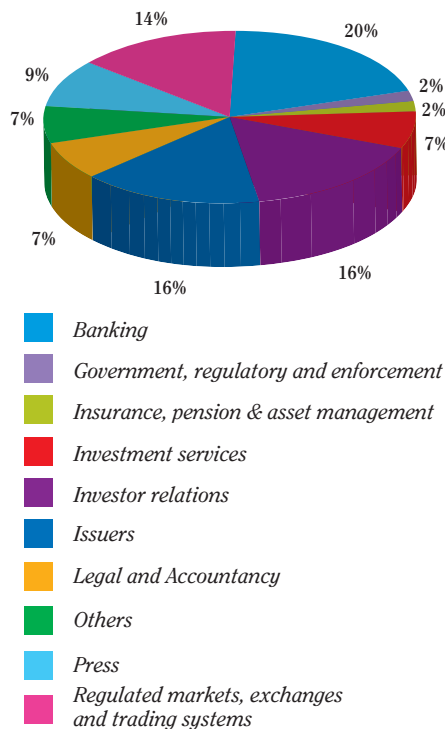
In accordance with the relevant mandate, CESR provided its advice and its opinion in relation to both the development of the national storage mechanisms and the creation of an EU network of these national mechanisms.

The content of CESR's final advice and opinion reflected comments received during the consultation on CESR's draft technical advice on the storage and filing of the regulated information. The responses to this consultation had been largely supportive of the CESR approach. Moreover, it reflected comments that CESR received during the Investors' Hearing that it organised in March 2006 (Ref. CESR/06-092), as well as the comments of the Consultative Working Group on Transparency. CESR modified its advice in response to comments received as a result of the consultation and the investor hearing. A Feedback Statement describes fully how

CESR has adapted its advice in response to these comments (Ref. CESR/06-293).

Transparency Directive – storage of regulated information and filing of regulated information (Ref. CESR/06-025) and (Ref. CESR/06-092)

Total number of responses: 35



The CESR paper on storage encompasses CESR's advice and CESR's preliminary opinion and more particularly it contained four parts, the main issues of which are analysed below:

CESR's final advice on the minimum quality standards of the national storage systems

The first part of the advice related to the national storage mechanisms called Officially Appointed Mechanisms (the "OAM"). CESR sets out some minimum 'quality standards' that such mechanisms would need to meet. The main standards proposed were:

- assurance of adequate security of the IT systems such as, an effective validation procedure, availability of the stored information, acceptance of waivers and recovery and back-up systems;

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- certainty as to the information source and authenticity of origin of the information stored (authentication procedures);
- easy access by end-users, this includes for example ensuring the search functions can operate in different languages.

CESR's opinion on establishing the interoperability amongst national storage systems (EU network)

The second part of the mandate dealt with the architecture of the EU network of national storage systems (national OAMs).

CESR also considered how a network model could be implemented. To this end, CESR describes three alternative approaches. The first and preferred approach was based on the development of a binding provision, by which the model of network would be defined and an oversight responsibility would be assigned, Member States would ensure that the OAMs to be appointed, abide by an interoperability agreement and that co-ordination was ensured. This structure will be complemented with an interoperability agreement to be drafted by the competent authorities and to be followed by the OAMs. According to the second approach, interoperability could be achieved with stand alone agreements among Member States alone and the third possible approach proposed that interoperability could be achieved with stand alone agreements between the OAMs themselves.

CESR presented four possible network models as a basis for its work on developing a system which could link the national OAMS. These models ranged from the most centralised of systems to the least centralised and could be summarised as follows:

- **Model A: A Central Access Point (CAP)** which is based on a central application server, which collects the search requests coming from a web page available to the users and dispatches these requests to the OAM(s) of each Member State;
- **Model B : A De-centralised system** under which an application server is located in each OAM;
- **Model C: A Central list of issuers** which would operate as if there is a central server

hosting an application, containing a complete list of issuers and the links to each OAM holding information on that issuer; and,

- **Model D: Basic Access Model** which would require every national competent authority to publish on its website a list of hyperlinks to every OAM in the EU.

Although CESR had not been mandated to opt for a preferred network model, CESR decided to express a preference for Model C, which was also the one that gathered most support from consultees who provided views on this issue. It is also the model that, in accordance with preliminary cost estimates, has proved to have adequate functionalities with lower costs.

CESR also presented the possible content of the interoperability agreements, which will cover government and technical issues. For the more advanced network models, the technical issues would be common reference data items, common interface and communication standards as well as common search keys.

CESR's final advice on the technical issues in relation to the role of the competent authority and on the standards of filing of the regulated information with the competent authority

Finally, CESR's paper also addressed a number of technical issues regarding the role of the national competent authority. In addition, CESR's technical advice on the filing standards of the regulated information with the competent authority proposed standards in relation to security and certainty as to the information source and in relation to time recording, and examined possible ways of aligning the filing with the storage procedures.

B- CESR's paper on Costs of the national OAMs and of the EU network

In May 2006, in response to the Commission's mandate on storage and filing of regulated information, CESR presented a preliminary report in relation to both the costs of setting up and operating national OAMs and costs in relation to networking all national OAMs. These cost estimates are in-

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tended to provide an indication of the order of magnitude of such projects. These are subject to certain assumptions further explained in the paper and were based on the standards for OAMs analysed in the final advice on storage.

In relation to the national storage mechanism (OAM), the paper on cost issues contained:

- a. The specific minimum quality standards to be complied with by the national OAMs have been the basis for the cost evaluation. These included security standards, standards of certainty as to the information source, standards of time recording and standards of easy access by end-users. It should be noted that the cost estimates provided in the paper were based on the standards for OAMs.
- b. The assumptions and caveats of the cost estimates in relation to the OAMs: One important assumption noted was that the OAMs will have to be set up from scratch. Therefore, the existing storage mechanisms have not been taken into account for the purposes of the evaluation.
- c. The actual cost estimates for the setting up and operating a national OAM was presented in the form of a table.

In relation to the EU network, the paper on cost issues contained:

- a. The four possible network models (Models A to D) contained in CESR's advice that are used as the basis for the cost evaluation.
- b. The assumptions and caveats of the cost estimates in relation to the network of national OAMs
- c. The actual cost estimates consisting of a summary cost estimate for all models.

C- Adoption of the Level 2 measures of the Transparency Directive on dissemination, notification of major holdings, equivalence of reporting duties, interim financial information and election of home Member State

In June 2005, CESR submitted to the Commission its final Technical Advice on dissemination

of regulated information, notification of major holdings of voting rights, equivalence of reporting duties, interim financial information and procedural arrangements for election of home Member State (Ref. CESR/05-407).

On the basis of the various elements of CESR's advice, the Commission presented its document for the Level 2 Directive on the implementing measures which was voted in the meeting of the European Securities Commission (ESC) on 17 November 2006 and was passed by unanimity. CESR has actively participated as an observer in these discussions and contributed to the discussion in the light of its advice.

D- Developments on storage of regulated information

In November 2006, the Commission started the discussions with the Member States at the ESC on the minimum quality standards of the national storage mechanisms and on the EU network that would connect them. CESR has actively participated in such discussions, underlying that the impossibility of achieving the final network in the short term might make necessary the establishment of an interim solution. During CESR's Chair's meeting of January 2006, CESR discussed the possibility of setting up an initial low scale European network among national storage mechanisms consisting of a common website with the list of EU issuers which would include hyperlinks from each issuer to its relevant storage mechanism. This website could be provisionally hosted by CESR on a voluntary basis.

A precondition for this provisional system to work is to make sure that the national storage mechanisms agree to provide CESR with the lists of issuers and, more importantly, to update them on a regular basis.

At this stage, CESR needs clear formal support from the Commission and from Member States in order to remain constantly involved and committed to this process of developing a European network of national repositories of financial regulated information. The DG Internal Market of the Euro-

NEXT STEPS

CESR will continue to follow the Commission's activity on the issues of storage and filing of regulated information.

Additionally, when more Member States implement the Transparency Directive, CESR will consider whether Level 3 work should be undertaken by the Transparency Expert Group and identify the areas where this possible work might need to be developed.

5.1 ♦ Transparency

pean Commission has expressed its preliminary support for the interim solution described above.

E- First Implementation Forum

CESR organised on 1 December 2006 an Implementation Forum of the Transparency Directive. The aim of that meeting was to gather information at this stage of the state of the implementation process in the Member States and also about some of the choices made or to be made by national legislators. Additionally, this exchange of information contributes to a consistent transposition of

the TD. Participants found the meeting very useful and agreed to consider the possibility of organising another one in the future, in order to share and to examine the experience gained on the implementation of the TD.

Also, Members concurred on the need of future work at Level 3, as agreed by the former Transparency Expert Group. This work will be considered when the process of transposition is more advanced, around the second quarter of 2007, if agreed by CESR Members.

Statistics of the meetings

The Transparency Expert Group met four times during 2006.

6.1 ♦ Policy

Second progress report to the Financial Services Committee

Following the ECOFIN endorsement on 5 May 2006 of the FSC report on supervisory convergence (the so called Thierry Francq report), CESR provided the FSC with its second supervisory convergence report in which the following three specific obstacles to supervisory convergence were highlighted: (a) those areas where there is still a continued lack of clarity regarding the supervisory authorities for the purposes of the Transparency Directive; (b) the delay regarding the decisions about third country GAAP in particular US GAAP ; and (c) the lack of harmonisation in the supervisory powers relating to the breaches of the market integrity rules.

NEXT STEPS

In 2007, CESR will continue to report to the FSC on the development regarding supervisory convergence, and will submit a package of contributions for the FSC's discussions regarding the Lamfalussy review.

Increasing active dialogue and assisting the cross-border retail investor

Following CESR's consumer workshop which gathered investor associations and CESR experts on investor education in Valencia in November 2005, CESR has started work on developing a common portal of information for the cross-border investor.

The facilitation and sharing of best practices and experiences between Members, is key to providing investors with a harmonised level of protection and information throughout Europe. As such, CESR has established a network of contacts in this area that Members can draw on, to gain or share information on good practice.

In addition, CESR has sought to increase the voice of retail investors in its development of advice. To this end CESR has reviewed how expert groups engage retail investors during the preparation of advice and has sought to enhance CESR's consultation practices in a tangible manner to gain more input from re-

tail investors. This new practice was tested in relation to the development of CESR's advice on Transparency, and in particular in relation to Storage of Financial Information which CESR thought would be an area of particular interest and impact on retail investors. As such, CESR held a specific hearing for investors in March 2006, and developed tailored questions for retail investors on this issue. CESR Members were asked to contact their national consumer association to establish if translations were needed and to explain the background and technical aspects of the paper. In addition, CESR sought in the Feedback Statement (Ref: CESR/06-293) to provide a particular response to the issues raised by retail investors and illustrated how the expert group had amended its advice to reflect the valuable input it had received. The hearing also provided an opportunity for CESR to update retail investor associations on the progress made in relation to MiFID. The practice of tailored consultations of this kind will continue, particularly where the issue has a clear impact on retail investors.

In addition, in response to comments made in Valencia, which suggested that retail investor associations did not feel CESR had a role to provide education but that information would be useful, a small taskforce of CESR Members has been set up to prepare draft proposals on information to be made available to retail investors via a link from national securities supervisors' websites to a page on CESR's website, developed particularly with retail investors in mind. CESR has also agreed to hold at least one larger meeting with retail investors on a regular basis (every year or year and half).

Following the steps taken by CESR to increase the place of retail investor associations in its work, the percentage of responses from retail investor associations in the total number of responses to consultations has increased from 1,7% in 2005 to 3,1% in 2006. This remains a low percentage, but CESR will pursue its efforts to increase this in future consultations.

6.1 ♦ Policy

NEXT STEPS

In order to ensure that meetings with the retail investors are very much focused on providing input into streams of CESR's work, the next meeting will be held in February 2007.

On this occasion, CESR will seek to gain input from retail investors on CESR's Level 3 work on MiFID; CESR's work to review a simplified prospectus for UCITS; a review of the prospectus regime and how it is functioning since the new Prospectus Directive was introduced.

Finally, CESR will seek to explain and discuss how CESR Members go about enforcing rules and the work of CESR-Pol.

Developing supervisory convergence through movement of staff and joint training

As CESR has grown to 29 Members, the need has been felt to strengthen the network amongst the staff of CESR's Members, both through training and greater movement of staff amongst the supervisors. This practice has been encouraged by the ECOFIN Council Conclusions of 5 May 2006, which in order to further converge practices amongst supervisors requested that the three Level 3 Committees report regularly on the progress made to put in place, and to maintain, joint training and approaches to assist the movement of staff.

Movement of Staff

CESR has established a taskforce of human resources (HR) experts to develop the essential elements of the framework regarding how to facilitate movement of staff between CESR Members.

Movement of staff could generally fall under three main categories:

- 1) 'Permanent moves': staff who apply to another CESR Member and take either a permanent or on a 'time limited' contract;
- 2) 'Secondments': which involves staff who undertake a specific role in another authority for no less than 6 months and up to 4 years;
- 3) 'Short study visits': this will involve a staff member of one CESR Member visiting an-

other CESR Member for a short period to learn specific skills, and would not last more than 3 months, mostly lasting 1 week.

CESR's website has a Members' area where a section will be developed with information on vacancies and CESR Members. This HR section will aim to bring about greater transparency regarding the existing opportunities available for the staff of the Members throughout the CESR network. Staff will be able to find information regarding job vacancies currently being advertised by each member authority, core information regarding the basis on which each CESR Member can employ non nationals, along with information on the structure of the authority, and basic information on cost of living and tax issues. The HR taskforce met twice in 2006.

NEXT STEPS

Further meetings will be held in order to finalise the framework to be presented to the ECOFIN in June 2007. A meeting with the extended HR network, consisting of all CESR Members, will take place in order to present the work of the task force.

The Development of Joint Training

The three Level 3 Committees (CESR, CEBS, CEIOPS) have decided to establish a Joint Steering Committee on training, which will apply a step-by-step procedure to outline all potential options of a possible European cross-sector training framework. The Steering Committee will be composed of Members of the three committees, each committee designating two representatives.

Step 1: a comprehensive mapping of the potential demand for a primarily cross-sectoral training framework within the regulators of the three sectors, so as to prepare policy discussion and decisions of the possible options for the articulation of cross-sector and national and EU training possibilities as well as the governance structure, logistics and the financial parameters of the platform;

6.1 ♦ Policy

Step 2 : the identification of all existing supply in terms of training programmes at the national or the international level, and with active involvement of academics (proposed partnerships) to cover all the needs,

Step 3: the first test seminars to be launched and the structure and contents of the medium-term programme to be set up,

Step 4: the logistics and the budgetary aspects of the framework.

NEXT STEPS

By the first half of 2008, the Steering Committee will deliver a report and a proposed way forward to be approved by the three Committees, including a precise framework.

6.2 ♦ Monitoring

6.2.1 – Review Panel

MANDATE

Mandate of the Review Panel

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 co-operation between national supervisory authorities, carrying out peer reviews and promoting best practice.’

To fulfil this important task, CESR established the Review Panel in March 2003. The Panel, chaired by the Vice-Chair of CESR, Kaarlo Jännäri, and subsequently by Carlos Tavares, 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 CESR standards and guidelines into national rules and of EU legislation where requested by the European Commission.

Its recent work includes a survey conducted at the request of the European Commission, regarding implementation of the European Commission’s recommendations on UCITS, a review of the CESR Standard Number 1 on financial information, a mapping exercise of the supervisory powers under the Market Abuse and the Prospectus Directives as well as the creation of the Protocol and the updating of the Methodology of the Review Panel.



Chair’s message

Carlos Tavares, Chairman of the CMVM, Portugal, and Vice-Chairman of CESR

“It has been another busy year for the Review Panel, whose importance in CESR’s work becomes more apparent as the transition from Level 2 to Level 3 work continues.”

The creation of the Protocol cements this important role and represents the commitment that CESR has to facilitating supervisory convergence. As the new Chair of the Review Panel I look forward to carrying on the solid and important work that my predecessor Kaarlo Jännäri has done.”

During the course of the last year, the Review Panel met 5 times and completed its work on four important areas: the review of the CESR Standard Number 1, the review of the implementation of CESR’s guidelines on the transitional provisions amending the UCITS Directive, the mapping exercise on the supervisory powers of the authorities arising out of the Market Abuse and the Prospectus Directives and the Protocol and Methodology of the Review Panel. Moreover, the Review Panel started working on the monitoring of the implementation of CESR’s guidelines to simplify the notification procedure of UCITS.

1. Review of the Standard Number 1 on Financial Information

CESR agreed that the Review Panel should start a review of the implementation of the CESR Standard No.1 on Financial Information (Ref. CESR/03-073) in CESR Members’ jurisdictions before the summer of 2005. In its meeting of 14 April 2005, the Review Panel set up an ad-hoc group, co-ordinated by Mr Didier Niclaes from the Belgian CBFA, which developed the additional assessment criteria to be used in the exercise.

On 10 May 2006, CESR published a summary of the self-assessments regarding the

6.2 ♦ Monitoring

implementation of Standard No. 1 on financial information (Ref. CESR/06-185). The final report on the review (Ref. CESR/06-181) was published on 2 August 2006, and sets out a full and comprehensive review of CESR Members' implementation of Standard No. 1 by the Review Panel. The review reflects some changes in the conclusions drawn by CESR Members within the framework of their self-assessments.

2. Review of the implementation of CESR's guidelines on the transitional provisions of the amending UCITS Directive

On 23 May 2006 CESR published the results of an assessment of its Members' implementation of a number of CESR's guidelines on the transitional provisions of the amending UCITS Directives (the "UCITS Guidelines"). The 'UCITS Guidelines' (Ref. CESR/04-434b) published in February 2005, were developed to converge the different administrative practices that Member States had developed due to ambiguities contained in the UCITS III legislative texts. The review by Members began in June 2005 and the review took place in three separate phases in accordance with the different deadlines set out in the UCITS Guidelines themselves.

The first part of the assessment is a summary report which aims to facilitate readers in understanding how Members have implemented the UCITS Guidelines (Ref. CESR/06-182). The second part of the information includes the Members own self-assessment of their implementation of the UCITS Guidelines which can be viewed 'country by country' or 'measure by measure' on CESR's website by accessing the database 'Review Panel Assessments'. How the CESR Members' have (or have not) implemented the relevant guideline is set out in the details of the self assessment.

The results of the review based on the self-assessments of Members, are very encouraging, in that:

- In relation to the first phase of the review regarding the transitional guideline concerning the availability of a simplified prospectus, the assessments show that this has been implemented in almost all Member jurisdictions, with very few exceptions;

- In relation to the second phase of the review which focused on the treatment of UCITS I funds of single fund structures authorised between 13 February 2002 & 13 February 2004, and UCITS I umbrella funds, the transitional guidelines have been implemented in all Member jurisdictions;
- In relation to the third phase of the review regarding Grandfathered UCITS I management companies managing "pass portable" UCITS III funds, the transitional guidelines have been implemented in all Member jurisdictions.

The Review Panel notes that it is necessary to exercise caution in drawing conclusions from this review as many Members have not implemented the guidelines by issuing any specific regulatory measures. Rather, in many cases, implementation has taken place through the application of daily supervisory practices, the effectiveness of which is not something that can be verified objectively by the Review Panel.

For this reason, the Review Panel has recommended that the home Member State authorities make sure that the practical implementation at the actual fund level is effective, and has drawn to the attention of CESR's Investment Management Expert Group the need to follow up on the efficacy of the fund level implementation of the transitional guidelines.

3. Mapping exercise of the supervisory powers under the Market Abuse and the Prospectus Directives

In 2006, the Review Panel was mandated by CESR to conduct a mapping exercise on the supervisory powers that CESR authorities are vested with in accordance with the Market Abuse Directive, the Prospectus Directive and their respective implementing measures.

Within the context of this exercise, the Review Panel prepared the following documents that were approved by CESR:

- Two reports (one for the Market Abuse Directive and one for the Prospectus Directive).
- Two executive summaries (one for the Market Abuse and one for the Prospectus report).

6.2 ♦ Monitoring

- Two excel files setting out in the form of tick boxes the supervisory powers of the competent authorities (one for the power arising out of the Market Abuse Directive and one for the powers arising out of the Prospectus Directive).

These reports will be published during the course of 2007 and will contain the following sections:

a. Supervisory powers granted to the authorities

This section sets out what the powers of CESR authorities are in relation to the provisions of the Market Abuse and the Prospectus Directives and their respective implementing measures.

This section also describes how the powers are exercised by the authorities i.e. directly, in collaboration with other agencies, institutions etc, with application to judicial authorities or whether these powers have delegated these powers in accordance with the provisions of the EU law. Moreover, this part of the reports includes information on how CESR authorities have implemented specific provisions of the Directives in the everyday execution of their tasks.

b. Issues of interest

This section includes a series of issues deemed to be of special interest concerning the application of the Directives' provisions in practice.

Finally, the reports include a section regarding the progress that has been made since the last mapping exercise conducted by CESR in 2004 that was set out as an annex to the Himalaya report (Ref. CESR/04 527b).

CESR will review the expansion of this exercise to other Lamfalussy Directives and the UCITS Directive.

4. The Protocol and the Methodology of the Review Panel

In accordance with the ratification of CESR Priority Task Force recommendations and the agreement to further reinforce and upgrade the role of the Review panel, a Protocol on the Review Panel was prepared and approved by CESR Chairs. This Protocol is attached to CESR Charter and forms an integral part of it. It sets out the principles of the Review Panel and more specifically its role, the purpose of its work, its tools and working procedures as well as the commitments of CESR authorities to actively ensure that the Review Panel fulfils its role.

The Methodology of the Review Panel was updated to be aligned to the Protocol and to reflect the experience gained by the Review Panel during its first few years. The Methodology covers the self assessments and peer reviews to be undertaken by the Review Panel. It does not cover other tools to be used by the Review Panel such as mapping, surveys and selective reviews for which the Review Panel will create methodologies in the future.

5. Simplification of notification procedures for UCITS

Following the publication in June of the CESR's guidelines to simplify the notification procedure of UCITS (Ref: CESR/06-120b) and the agreement that monitoring of the implementation of these guidelines would happen within a year, the Review Panel sent a questionnaire to the members of the investment management group in order to get a quick overview of what is the current state of implementation of the guidelines in the different jurisdictions.

Statistics of the meetings

The Review Panel met five times during 2006.

NEXT STEPS

Report to the Financial Services' Committee

The Review Panel will prepare a separate report to be submitted to the Financial Services' Committee (FSC) on the results of the mapping exercise of supervisory powers under the Market Abuse Directive, the Prospectus Directive and their respective implementing measures. This report will form part of CESR's package of contributions to the Lamfalussy review.

Review of existing Standards, Recommendations and Guidelines

There are in total 16 Standards, Recommendations and Guidelines some of them stemming back to 1999, the majority of which fall under the competence of MiFID. During the course of the next year, the Review Panel will commence a mapping exercise of all these existing CESR Standards, Recommendations and Guidelines against the FSAP measures that either have already or will in the coming year be implemented.

Simplification of notification procedures for UCITS

A full review of the implementation of these guidelines will commence in the first quarter of 2007.

6.2 ♦ Monitoring

6.2.2– Credit Rating Agencies – Code of conduct

MANDATE

Mandate of the Credit Rating Agencies Task Force

The European Commission published on 27 July 2004 a call to CESR for technical advice on possible measures concerning credit rating agencies that was submitted by 1 April 2005.

The work in this area was carried forward by a task force led by Ingrid Bonde, Director General of Finansinspektionen, Sweden, and assisted by a member of the secretariat, Javier Ruiz del Pozo.

On 17 May 2006, CESR received a letter from the European Commission formally requesting CESR to report on credit rating agencies' compliance with the IOSCO Code by the end of 2006.



Chair's message

Ingrid Bonde, Director General of Finansinspektionen, Sweden

"The voluntary framework of co-operation between CESR and Credit Rating Agencies has proved a successful way to move forward in an environment where there is an absence of regulation. The extensive dialogue with CRAs and with market participants that CESR undertook before producing its report to the European Commission has had a very positive effect in assessing the real level of day- to-day compliance of the CRAs with the provisions of the IOSCO Code. This work has proved to be satisfactory and CESR has concluded that the codes of the four CRAs comply to a large extent with the IOSCO Code. However, as there is still room for improvement, we intend to monitor closely the CRAs efforts to improve on those areas where a higher level of compliance or clarity would be desirable. In addition, we look forward to assess the impact of the new US legislation and the SEC implementing rules on the rating business in the European Union."

Background

On 30 March 2005, at the request of the European Commission, CESR delivered its advice (Ref. CESR/05-139b) regarding the potential options to regulate credit rating agencies (CRAs). In its advice, CESR proposed not to regulate the credit rating agencies industry at an EU level for the time being, and instead proposed that a pragmatic approach should be adopted to keep under review how CRAs would implement the standards set out in the IOSCO Code of Conduct. CESR therefore developed this strategy on the basis of voluntary participation from CRAs. Moody's, Standard and Poors', Fitch Ratings and Dominion Bond Rating Service Limited are the CRAs that have currently chosen to adhere to the voluntary framework.

In summary, this framework includes three elements: (i) an annual letter from each CRA to be sent to CESR, and made public, outlining how it had complied with the IOSCO Code and indicating any deviations from the Code; (ii) an annual meeting between CESR and the CRAs to discuss any issues related to implementation of the IOSCO Code; and (iii) CRAs would provide an explanation to the national CESR Member where any substantial incident occurs with a particular issuer in its market.

In January 2006, the European Commission published a Communication setting out its approach to credit rating agencies. In line with the advice provided by CESR, the Commission concluded that at that moment no new legislative proposals were needed. The European Commission considered that the

6.2 ♦ Monitoring

existing financial services directives, combined with self-regulation by the CRAs on the basis of the IOSCO Code, would provide an answer to all the major issues of concern in relation to CRAs. However, the Communication concluded that there was a need for the Commission to monitor the global development of the rating business and for CESR to monitor compliance with the IOSCO Code and to report back to the Commission on an annual basis.

On 17 May 2006, CESR received a letter from the European Commission formally requesting CESR to report on credit rating agencies' compliance with the IOSCO Code by the end of 2006. In its formal letter the Commission requested CESR not only to carry out the theoretical work of comparing codes, but also to assess the level of day-to-day application of the IOSCO Code in practice.

Process

CESR set up a task force responsible for following the steps outlined in CESR's voluntary framework and for developing the report to the Commission. The task force, which is the same as the one that prepared the advice to the Commission, has been chaired by Ingrid Bonde, Director General of the Swedish Finansinspektionen and supported by Raquel García Alcubilla 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.

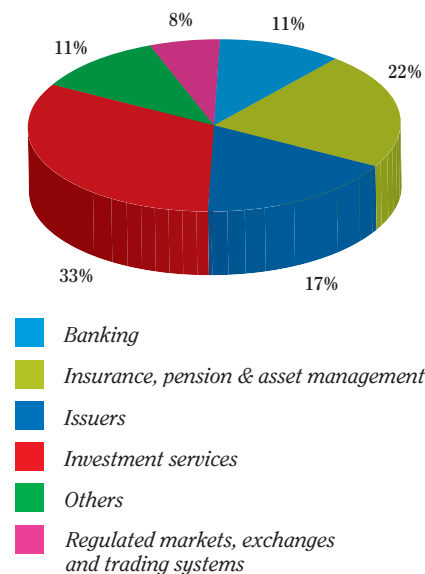
In June 2006, the task force held a meeting with the CRAs to discuss further how the codes were being applied in practice. Separate meetings were held with each CRA and the members of the CESR task force had the opportunity to ask a number of questions to the CRAs' representatives. Prior to the meeting, CESR wrote a letter to each CRA setting out the questions that were to be raised on the meeting and asking for a written response.

In July 2006, following the steps outlined in the voluntary framework, CESR published on its website the annual letters of disclosure from the CRAs on their compliance with the

IOSCO Code, together with a public statement with an update on CESR's dialogue with CRAs.

In addition, in July 2006 CESR published on its website an open survey (Ref. CESR/06-312) addressed to all market participants with the purpose of gathering their experience on the day-to-day application of the CRAs codes in practice. The period for comment ended on 15 September and CESR received 18 responses that can be viewed on its website.

Questionnaire on day-to-day application of the IOSCO Code by the Credit Rating Agencies (Ref. CESR/03-312)
Total number of responses: 18



CESR's report

In January 2007, CESR published its first report to the European Commission on the compliance of the CRAs with the IOSCO Code (Ref. CESR/06-545).

The report provides a clear analysis of the codes of the four CRAs that have chosen to adhere to the voluntary framework in relation to the IOSCO Code. It includes in a column format a comparison of the provisions of the IOSCO Code with the corresponding ones in the CRAs codes, indicating in the table those measures where the CRAs have chosen to explain rather than comply, and including the CRAs' explanations. The table

6.2 ♦ Monitoring

also provides for certain provisions some indications of how the measures are being applied in practice.

In addition to the indications provided by CRAs on the practical application of the provisions included in the table, section III of CESR's report deals more specifically with the practical aspects of the day-to-day application of the CRAs codes by including a summary of the responses received to the questionnaire prepared by CESR.

CESR's conclusions are explained in the last section of the report. CESR considers that the CRAs codes comply to a large extent with the IOSCO Code. There are, however, some areas or provisions where the CRAs codes do not comply. Some of these are of minor importance, because the CRAs achieve the desired outcome that the IOSCO Code aims at, without formally having provisions in their codes that mirror the IOSCO Code. Nevertheless, there are some areas, highlighted in the last section of the report and mostly coincident with those pointed out by market participants, where the deviations are of greater importance. Some of them are common to all four CRAs, and some of them are specific to individual CRAs. In particular, the area where all the CRAs seem to have difficulties in complying with the IOSCO Code, relates to the separation between the rating services and the ancillary services provided by the CRAs and the disclosure of unsolicited ratings.

While preparing its report, CESR closely coordinated with fellow regulators, especially with IOSCO, as it was also reviewing the im-

plementation by the CRAs of the IOSCO Code. IOSCO set up a taskforce to examine the codes of conduct released by CRAs of all sizes and jurisdictions in response to the IOSCO Code and to determine whether any trends exist with regard to non-compliance or consistent variations in interpretation by CRAs of what constitutes compliance.

IOSCO will publish a consultation paper with its initial review in February 2007. IOSCO's main findings about the codes of the four CRAs which are the object of CESR's report are basically consistent with CESR's work.

NEXT STEPS

CESR will continue its work during 2007 following the voluntary framework of co-operation with CRAs. In its next report, CESR will look particularly into those issues identified in the 2006 report as areas where there is still room for improvement to see whether there have been any positive actions undertaken by the CRAs.

Moreover, CESR also intends to assess in its next report the impact of the new US legislation and the SEC implementing rules on the rating business in the European Union.

In addition, CESR will continue its cooperation with IOSCO, in particular in relation to those aspects mentioned in section IV of the report, which highlight areas where there might be scope for clarification of the IOSCO Code.

Statistics of the meetings

The Credit Rating Agencies task force met three times during 2006.

6.3 ♦ Operational

6.3.1 – CESR-Fin

MANDATE

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 is compulsory for all European listed companies, as of 2005. This allows CESR to participate pro-actively through an engaged dialogue with all the key policy makers involved throughout the European endorsement process, during the formation and implementation of the international accounting standards (IAS/IFRS).

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 Paul Koster, Member of the Board of the Dutch AFM, and supported by Javier Ruiz del Pozo, Director of Financial Information at the CESR secretariat, and Marion Bougel-Bomtemps, Senior Officer.

**Chair's message**

Paul Koster, Board Member at the Financial Market Authority (AFM), The Netherlands

“Since January 2005, International Accounting Standards (IAS/IFRS) have been adopted for all EU listed groups. CESR was closely associated to the process that led to the introduction of the standards in the EU, notably through its monitoring work on the development and adoption of the EU standards, or with the publication of additional recommendations accompanying the transition to IFRS. After the second year of IFRS accounts,

CESR-Fin's main priority is to contribute to the consistent application of the standards. CESR-Fin has already taken the initiative to help with the development of robust and co-ordinated enforcement across the EU by establishing a framework for discussion and information sharing among European enforcement agencies (European Enforcers Co-ordination Sessions –EECS). In 2006 we have increased the number of meetings of the EECS and also we have seen a growing use of the enforcement database created by CESR-Fin. I also think that the forthcoming publication of the enforcement decisions included in the database will produce further benefits for harmonisation. Issuers, auditors and non EU enforcers will see which accounting treatments adopted by issuers are considered by EU enforcers as being within or outside the legal framework.

Discussion and analysis of enforcement decisions is the main CESR-Fin task, but the enforcers' sessions also enable us to identify issues which are not covered by the standards or which may be affected by conflicting interpretations. The referral of these issues to the IASB or IFRIC, if needed, will further contribute to a proper implementation of IFRS in the EU.

Nevertheless our work to promote consistent application does not stop at the EU's borders. As consistent application is a key condition for the lifting of the SEC's reconciliation requirement of IFRS accounts to US GAAP, we have established in 2006 a regular dialogue with the SEC. I hope our periodic exchanges of information with the SEC will contribute to achieve that goal and will help us to avoid conflicting regulatory decisions.”

6.3 ♦ Operational

In 2006, CESR-Fin revised its structure (Ref. CESR/06-117b), in order to be even more operational and ensure it is more efficient in dealing with the new practical challenges faced by securities regulators in the area of financial reporting.

These new challenges included above all, the reinforcement of the co-operation among EU national enforcers in the field of enforcement of compliance with IFRS (through the EECS). Furthermore, in considering its new structure, CESR-Fin took into particular consideration the need to work on the global acceptance of IFRS financial statements prepared by EU issuers subject to supervision in Europe and outside Europe. CESR-Fin was also encouraged to deepen the relationship with securities regulators in major third countries on financial reporting matters.

In 2006, CESR-Fin devoted a large part of its attention to four main projects:

- The development of the European Enforcers Co-ordination Sessions and the development of the database of enforcement decisions;
- The report on the first experience with the enforcement of compliance with the IFRS standards;
- The CESR-SEC dialogue and co-operation; and
- The work necessary as a result of the European Commission's new transitional measures on the use of third country issuers of information prepared under local or internationally accepted accounting standards, published on 5 December 2006. CESR-Fin has produced guidance for its members in order to ensure a consistent approach towards third countries' convergence programmes to IFRS during the new transitional period.

Besides those major projects, CESR-Fin also continued to follow the EU endorsement of standards/interpretations published by the International Accounting Standards Boards (IASB) and the International Financial Reporting Interpretations Committee (IFRIC), as well as regulatory developments concerning auditors' work. This entailed the maintenance of structures within CESR-Fin for

the oversight of the standard setting processes in the area of financial reporting and to maintain or develop a closer relationship with relevant EU and international third parties such as the Accounting Regulatory Committee (ARC), Audit Regulatory Committee AuRC, the European Financial Reporting Advisory Group (EFRAG), the International Accounting Standards Board (IASB), the EU Accounting Roundtable, or the International Auditing and Assurance Standards Board (IAASB).

In addition, recent developments demonstrated the need for close co-operation between securities regulators and audit regulators. CESR had a strong interest in being closely associated with the European audit regulators represented in the European Group of Auditors Oversight Bodies (EGAOB) as well as with the recently established International Forum of Independent Audit Regulators (IFIAR).

The European Enforcers Co-ordination Sessions (EECS)

The core business of CESR-Fin is to promote convergence on the application of IAS/IFRS in the European Union.

Since 2006, the CESR database of enforcement decisions has been up and running. In parallel, the European Enforcers Co-ordination Sessions (EECS), which includes CESR and non-CESR members who have competences in the enforcement of compliance with IFRS, held 8 meetings devoted to discussion of the decisions sent to the database, as well as emerging practical and technical issues or cases that members encounter or are made aware of in the process of the surveillance of financial information. The group also held two joint sessions with representatives of the IFRIC/IASB.

The EECS also started working to put into place the necessary arrangements to start publishing the enforcement decisions that were discussed in EECS, on the basis of guidelines for publication which CESR Members agreed on in January 2007. It was decided that all the decisions included in the database will be published, unless:

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- A similar decision has already been published by CESR, and publication of a new one would not add any substantial value to the fostering of consistent application;
- The decision deals with a simple accounting issue that, even having been considered a material infringement, does not in itself have any accounting merit;
- A particular EU National Enforcer, on a grounded and justified basis, believes that the decision should not be published;
- There is no consensus in the EECS to support the submitted decision.

Publication of enforcement decisions will inform market participants about which accounting treatments, as adopted by issuers, EU National Enforcers consider as complying or not complying with the IFRS. This means that the treatment adopted by the issuer is considered as being within or outside the accepted range of possible treatments allowed by the standards. Such publication, along with the rationale behind these decisions will contribute to a consistent application of IFRS in the European Union. Finally, it may also facilitate wider consensus on IFRS matters by fostering public discussion and exchange of views with other interested parties, namely issuers and auditors, on publicly disclosed enforcement decisions, which will help diminish the risk of divergent and unacceptable financial reporting treatments. The publication should take place around the first quarter of 2007.

CESR's report on the first experience with the enforcement of compliance with the IFRS standards

In March 2006, CESR-Fin started working on a report on the first experience with the enforcement of compliance with the IFRS standards. CESR hopes that this report will further promote the co-ordination of the enforcement activities of its Members and will facilitate the understanding of the enforcement of IFRS financial statements in the EU, especially in the context of the dialogue with the US SEC and other third country enforcers.

The main objective of the report is to provide information about the activities of CESR-Fin and its members in relation to the enforcement of compliance with IFRS. Whilst the report will focus on the application and enforcement of IFRS, it is important to bear in mind that implementation of enforcement mechanisms is still in progress in many jurisdictions and that enforcement of financial information is not a one-shot activity, but a continuous process (sometimes spanned over several months or even years) requiring effective professional judgment. CESR-Fin expects to publish the report around mid 2007.

CESR – SEC co-operation

CESR and the US Securities and Exchanges Commission (SEC) published on 2 August 2006 a joint work plan (Ref. CESR/06-434) whose main focus is the application by internationally active companies of US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) in the European Union and the United States, respectively.

The co-operation between CESR and the SEC on the application of US GAAP and IFRS in the European Union and the United States should promote:

- The development of high quality accounting standards;
- The high quality and consistent application of IFRS around the world;
- Full consideration of international counterparts' positions regarding application and enforcement; and
- The avoidance of conflicting regulatory decisions on the application of IFRS and US GAAP.

As part of its regular review of corporate filings, the staff of the SEC regularly reviews issuers' implementation of IFRS in the United States. CESR Members will also continue to review US GAAP implementation by US issuers in the EU. Under the work plan, these reviews might give rise to two types of communication:

- Policy contacts: CESR and the staff of the SEC will share information about areas of IFRS and US GAAP that raise questions in

6.3 ♦ Operational

terms of high-quality and consistent application.

- Individual case contacts: Where appropriate, CESR Members and the staff of the SEC will consult on issuer specific matters regarding the application of US GAAP and IFRS in order to facilitate a solution that contributes to the consistent application of US GAAP or IFRS by companies that are both listed in the EU and registered with the SEC. This dialogue should avoid conflicting regulatory decisions. Protocols for the sharing of this confidential information between CESR Members and the staff of the SEC will be established.

The implementation of this work plan started in 2006. The discussions took place principally in two meetings, Washington on 25 October 2006 and Paris on 4 December 2006. These meetings were devoted to reaching a common understanding of the commitments of both parties under the work plan, especially the interpretation of the events that trigger communication on individual cases between the SEC and CESR Members. The SEC and CESR are also discussing the standard protocol that the SEC and the individual CESR Members would sign in order to permit the exchange of confidential information. Finally, the SEC and CESR-Fin exchanged views on recurring accounting issues arising from IFRS enforcement and policy developments in the EU and in the US.

Equivalence of third country GAAP

The Commission's measures on the use by third country issuers of information prepared under local or internationally accepted accounting standards were published on 5 December 2006. This can be found in the Commission's Regulation 1787/2006 of 4 December amending Commission Regulation 809/2004 on prospectuses and Commission

Decision 2006/891/EC of 4 December 2006 on the use by third country issuers of securities of information prepared under internationally accepted accounting standards.

These measures envisage a different treatment of such issuers before and after January 2009:

- Transitional period until January 2009: During this phase, accounting frameworks other than IFRS, Canadian, Japanese or US GAAP may be used subject to certain conditions¹⁵. The decision to accept other accounting frameworks is the responsibility of the competent authority, although recitals in the two measures state that "To ensure consistency within the Community, CESR should co-ordinate the competent authorities' assessment as to whether those conditions are satisfied in respect of individual third country GAAPs".
- After the transitional period, a third country's GAAP will be acceptable only if it was determined equivalent to IFRS by the European Commission pursuant to their definition of equivalence which they will establish by 1 January 2008. The Commission will consult CESR on the appropriateness of the definition of "equivalence", the "equivalence mechanism" and the actual determination of the equivalence.

In September 2006, CESR-Fin started its work in relation to the above mentioned measures:

To provide a list of GAAPs used by third country issuers in the EU;

To provide guidance on how individual competent authorities might decide during the transitional period on a consistent basis which third country GAAPs might satisfy the transitional requirements; and

When requested by the EC, to assist them in developing a definition of equivalence, a mechanism for its determination and the actual determination of equivalence.

¹⁵ According to Article 35.5A (c) of the Prospectus Regulation (and the similar provision in the Transparency Decision) these conditions are:

(i) The third country authority responsible for the national accounting standards in question has made a public commitment, before the start of the financial year in which the prospectus is filed, to converge those standards with IFRS;

(ii) That authority has established a work programme which demonstrates its intention to progress towards convergence before 31 December 2008; and

(iii) The issuer provides evidence that satisfies the competent authority that the conditions in (i) and (ii) are met.

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Statistics of the meetings

CESR-Fin met four times in 2006.

The EECS met eight times in 2006, and held two joint meetings with representatives of the IFRIC/IASB.

NEXT STEPS

On 22 February 2007, CESR received the first request for advice from the European Commission on third country GAAP.

The Commission has to report to the European Securities Committee and the European Parliament before 1 April 2007 on the timetable envisaged by national accounting authorities of Canada, Japan and the United States for the convergence. To this end, the Commission requests updates on the convergence programmes in US, Japan and Canada as well as a list of the GAAP currently being used on EU markets and a definition of equivalence. The deadline for submission to the Commission is 1 March 2007.

Also, CESR will have to advise by 1 May 2007 on a suitable mechanism for determining the equivalence of a third country GAAP. This advice will not be an assessment of which GAAP are equivalent, but of the mechanism, or procedure, for making that assessment.

Finally, CESR expects that the first publication of enforcement decisions would take place normally at the end of the first quarter of 2007.

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6.3.2 – CESR-Pol

MANDATE

Mandate of CESR-Pol

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 flow internally (in an authority) 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 multi-lateral Memorandum of Understanding on the Exchange of Information and Surveillance of Securities Activities (MoU) in January 1999.

CESR-Pol was mandated to promote closer co-operation and to ensure the consistent and effective application of EU key Directives, particularly the Market Abuse Directive (MAD). To this end, CESR-Pol is also entrusted by CESR Chairs (Ref. CESR/04-010c) to conduct Level 3 work in the area of the MAD.

As a result of the MAD work, CESR-Pol strives towards more operationality. It established a permanent sub-group, the Surveillance & Intelligence Group (S&I Group), which provides experts in the investigation and enforcement of market abuse with a forum for sharing their experiences on the basis of individual cases, and exchanging valuable information on methods and procedures used in day-to-day supervision. In addition, CESR-Pol has the capacity to create, on an ad-hoc basis, Urgent Issues Groups. These groups are established when necessary, and allow the respective CESR-Pol members to co-ordinate and jointly conduct investigations in urgent cases.

Kurt Pribil, Chief Executive Officer of the Austrian Financial Market Authority (FMA) was appointed Chairman of CESR-Pol in September 2003. The group's work is supported by a member of the CESR secretariat, Angie Reeh-Schild.



Chair's message

Kurt Pribil, Chief Executive Officer of the Financial Market Authority (FMA), Austria

CESR-Pol is very often dubbed as "the heart" - or less emotionally "the centre" - of the co-operation taking place among European regulators as we CESR Members are mandated by virtually all European Directives of the Financial Services Action Plan (FSAP) to co-ordinate our efforts and to co-operate closely. Our overall goal is to achieve a level playing field for investment services and the requirements which apply to them across Europe to ensure sound and fair markets. It is clear to us that common objectives envisaged by the FSAP can only be achieved by close collaboration of the regulators within the European Economic Area (EEA) which should be built on trust and effective assistance and the active exchange of information. Having said this, I very much appreciate the high level of team spirit and co-operation that takes place within CESR-Pol. It is pleasing to see how full and frank exchanges of expertise and the sharing of information is, in particular, the full discussions of findings of investigations, that are also of concern to other members, all of which have helped CESR-Pol achieve a greater operational focus.

With the establishment of the S&I group and the intensive use of the newly invented instruments such as the Urgent Issues Group, and through in-depth discussions of cases at the plenary, CESR-Pol has become very operational in character. I believe we have made progress being in a good position to detect and deter market abuse across European borders and we will continue to pursue this direction.

6.3 ♦ Operational

One of CESR-Pol's key priorities also in 2006 has been to achieve greater convergence in the application of the Market Abuse Directive at Level 3 of the Lamfalussy process and to foster greater co-operation in fighting market abuse.

The Market Abuse Directive: Public guidance

CESR-Pol's ad hoc MAD Level 3 drafting group prepared a 2nd set of guidance on the operation of the Market Abuse Directive (Ref. CESR/06-562) which was launched for public consultation on 2 November 2006. Following the first two years of experience gained under the new market abuse regime, CESR-Pol was of the view that this was the right time to provide further guidance to market participants regarding common understandings developed amongst supervisors with the intention of achieving a convergent application of the legal requirements on a day-to-day basis.

CESR-Pol has therefore developed in relation to Articles 1-6 of the Directive, a draft common understanding amongst CESR Members, regarding treatment of the following aspects of the Directive and associated issues concerning market abuse:

- What constitutes inside information?: The guidance in this context gives further clarification on: 'information of a precise nature' as a term set out in the Directive; further guidance on information on making information public; amplifies what is meant by the concept 'information likely to have a significant price effect'; a non exhaustive list of purely indicative types of event or information which may constitute inside information. This guidance was developed by drawing on the advice which CESR provided to the Commission for the Level 2 MAD implementing measures;
- When is it legitimate to delay the disclosure of inside information?: CESR-Pol provided a few indicative examples of the two circumstances mentioned in Article 3 (1) where it provides for the legitimate delay of disclosure of insider information. For example, the guidance provides indicative examples in relation to: confidentiality constraints relating to competitive situations; product development; selling of major holdings in

another issuer; impending developments that could be jeopardised by disclosure;

- When are client orders inside information?: Criteria have been drawn up which can be used in judging when the tests are met. In addition, CESR-Pol produced indicators to assist CESR Members in determining whether trading ahead of a client order has taken place;
- Insider lists in multiple jurisdictions: CESR-Pol members have recommended that a mutual recognition system shall be put in place (i.e. a competent authority would accept an insider list maintained in accordance with the rules of another CESR member).

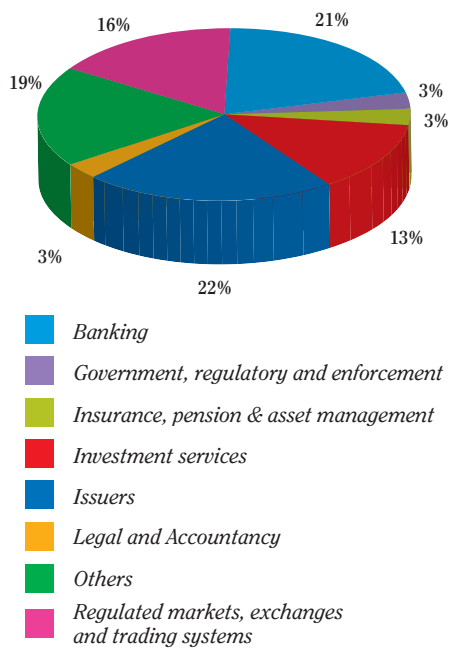
The draft guidance had been discussed in depth with the European Commission which had been present during CESR-Pol's meeting in Bratislava in October 2006. The Commission expressed appreciation for CESR-Pol's draft guidance and contributed a few comments which were generally incorporated. CESR Chairs approved the draft guidance in October 2006 and the guidance is currently being finalised following the conclusion of the consultation process.

Call for evidence

The work on MAD Level 3 guidance was intended to compliment the Call for Evidence on the evaluation of the supervisory functioning of the EU market abuse regime (Ref. CESR/06-078) which was sent out in June 2006 with a time span for responses until 31 October 2006. The first one and a half year existence of the MAD had been considered as an excellent opportunity to consult with the public to hear views and experiences, benefits and eventually problems, with the new market abuse regime in Europe. Any recommendations on what issues further guidance would be needed and proposals to overcome any obstacles to efficient functioning of the markets in accordance with the legal environment were welcomed. The goal of this exercise was to maintain a general overview of the operation of the Directive and, if necessary, alerting CESR to the need to suggest changes to the Directive or the Level 2 implementing measures or existing CESR standards or even supervisory practices.

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Call for evidence – Evaluation of the supervisory functioning of the EU market abuse regime (Ref. CESR/06-078)
Total number of responses: 32



As part of the Call for Evidence on the functioning of MAD, CESR organised a public hearing on 17 October 2006, at CESR's premises in Paris. At the hearing, market participants indicated that they had not only found the first set of CESR guidance issued in May 2005 (Ref. CESR/04-505b) helpful, but also requested further guidance.

30 market participants responded in writing to the Call for Evidence. Many contributions emphasised the burdensome nature of obligations and elaborated on different implementation as well as different application of the MAD provisions. Overall, further clarification was requested from CESR on issues which came to light only during the day-to-day application of the provisions implementing MAD.

In deciding what to follow up from the Call for Evidence, future work will be split into two strands: first, the work on Level 3 where CESR can take action itself; and second, considerations concerning Level 1 and Level 2 which lays in the responsibility of the Commission, the Member States, and the Euro-

pean Parliament. Taking into account the importance of the MAD regime, CESR-Pol is of the opinion that the discussion should not be structured along responsibility lines but rather deserves joining forces of all European institutions involved in the Lamfalussy procedure. Thus CESR-Pol will consider the suggestions for changes and where a review of the provisions of the Directive or regulations seem to be necessary CESR will suggest to the Commission to examine the issues in question.

Members of CESR-Pol are currently prioritising the issues flagged by market participants to give the MAD Level 3 drafting group basic ideas to continue its work. CESR-Pol will produce a work programme to be posted on CESR's website to provide the industry feedback.

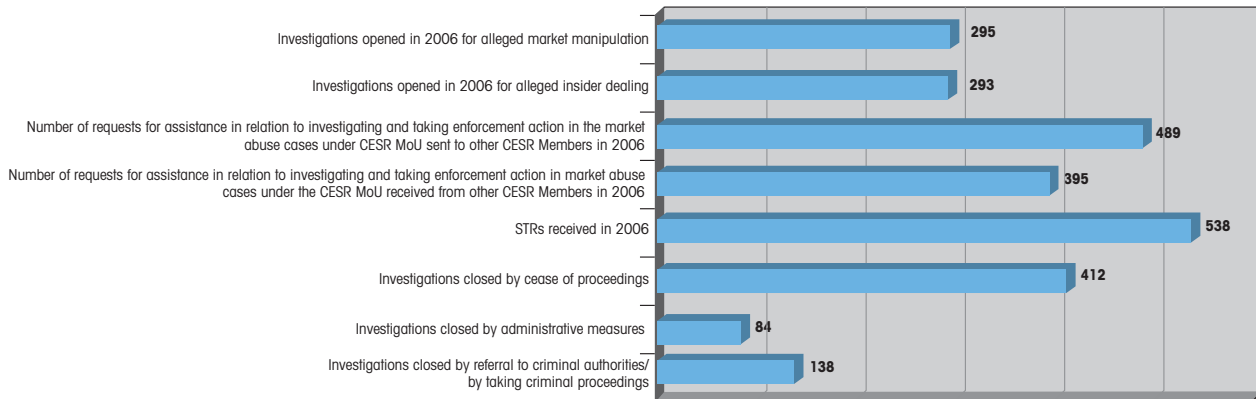
Database for market abuse enforcement cases:

In June 2006, CESR-Pol started a project to establish a database for market abuse enforcement cases. This project is intended to fulfil the mandate to undertake Level 3 work on the MAD and to develop a common understanding among CESR Members of what constitutes market abuse.

The database will allow the central recording of enforcement decisions made/sanctions imposed by CESR Members (and possibly non-CESR members) in respect of breaches of the MAD with a view to assist regulators in applying the provisions of MAD in a consistent and co-ordinated manner. The decision to record the case in the database will be taken by the CESR Member who conducted the investigation. For confidentiality concerns only CESR Members and specifically nominated staff of the CESR secretariat will be granted access to the database.

The target date for the launch of the database is the end of 2007, provided the legal and technical requirements are fulfilled. It must be noted that CESR-Pol puts emphasis on high quality and proper functionality of the MAD database rather than on meeting the deadline by any means.

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CESR-Pol Enforcement Statistics**Surveillance & Intelligence Group**

The work of the Sub-group of CESR-Pol, the Surveillance & Intelligence Group (S&I group), which was established in November 2005, has successfully contributed to the operational approach of CESR-Pol aiming at achieving a convergent application of the MAD. The S&I group was set up to foster simultaneous and comprehensive intelligence sharing and discussion of practical issues of concern arising in relation to day-to-day supervision of firms and markets.

The report of the Chair of the S&I group, Regina Schierhorn (BaFin), on the current work is a standing item on the agenda of CESR-Pol's meetings. In 2006, the S&I group conducted several surveys among its members to get a better picture of the legal and practical situation in the jurisdictions involved, on issues of common concerns such as: the management of trading halts; suspicious transaction reports; shareholder activism; algorithmic trading and access to phone records.

At its December 2006 meeting in Paris, CESR-Pol approved the S&I group work programme for 2007. The established approach to prepare presentations on certain issues, which serve as a basis for an intense exchange of practical experiences, has proven to be successful and will be pursued further. Key elements of the work programme are:

- Experiences with types of market abuse and possible consequences, i.e. insider

dealing rings and market abuse in shares with low liquidity was given high priority;

- Sharing information on working methods, e.g. on new investigation techniques or information sources;
- Issues of common concern, i.e. the handling of disclosure duties of market participants in order to profit from the safe harbours provided by EU-Regulation 2273/2003 will be dealt with;
- Discussion of cross-border cases in order to alert other members of important developments in the markets; and
- Information on public guidance/guidelines issued in Member States (standing point on the agenda, for information purpose only).

Urgent Issues Groups

CESR-Pol had established the framework for Urgent Issues Groups, a mechanism designed in the course of MAD Level 3 work to achieve more operational functionality. Urgent Issues Groups are convened on an ad hoc basis when necessary, and allowing the respective CESR-Pol members which are concerned by alleged unlawful cross-border activities to co-ordinate and jointly conduct investigations in urgent cases. So far, four ad hoc Urgent Issues Groups have been established, and they have been working very efficiently and successfully.

Amendment to the Terms of Reference

In May 2006 a revised version of the Terms of Reference (Ref. CESR/06-114) was approved

6.3 ♦ Operational

at the CESR meeting in Paris. The original basis for the organisational structure and the operation of CESR-Pol which had been laid out in the Terms of Reference (Ref. CESR/02-070b) of June 2002 needed an adjustment to incorporate the structural changes of CESR-Pol such as the establishment of the S&I group and Urgent Issues Groups following the change of the legal environment within Europe as well as the enhanced co-operation among CESR-Pol members.

Co-ordination with other supervisory institutions

Dialogue with IOSCO Standing Committee

CESR-Pol as well as IOSCO SC 4 has conducted intensive work in the field of how to proceed with jurisdictions which are unable and/or unwilling to co-operate with foreign regulators. CESR-Pol provided input to IOSCO Standing Committee 4's work by submitting names of jurisdictions where the legal and factual situation regarding co-operation and exchange of sensitive information gave reason for concerns. A survey was conducted among CESR-Pol members to get an updated picture of the main jurisdictions with which there have been issues concerning co-operation.

Co-operation with the CFTC:

Following personal discussions between the Chairman of the US Commodity Futures Trading Commissions (CFTC), Reuben Jeffrey III, and the Chairman of CESR-Pol it was agreed to intensify the communication between the CFTC and CESR-Pol. On invitation of CESR-Pol Phyllis Cela, Director of the Enforcement Division of the CFTC, attended the meeting of CESR-Pol in Vienna in July 2006 during which meeting there were frank discussions and exchanges of views on enforcement matters and regulatory co-operation. It is envisaged that CESR-Pol will continue its dialogue with the CFTC and in particular, will meet to share experiences regarding the en-

forcement of combined futures/cash transactions on bond markets in the future.

Dialogue with Liechtenstein:

CESR-Pol has held close contacts with the regulator of Liechtenstein, the Finanzmarktaufsicht (FMA) Liechtenstein, in order to support its efforts to extend its ability to exchange confidential information for law enforcement purposes, including investigations or administrative, civil or criminal proceedings, with European regulators. The new law implementing the MAD came into force in Liechtenstein on 1 February 2007. Former impediments in the law which hindered co-operation such as the requirement of dual criminality and the 'principle of the long hand' were eliminated, and this aligns the regime more closely with international standards. However, despite strong efforts of the FMA Liechtenstein, for constitutional reasons the right of appeal available to the person whose information and documents are the subject of a request for assistance by a foreign regulator has not been abolished. However, the length of time for this procedure has been shortened. The draft law was discussed at the CESR-Pol meeting in Paris in December 2006. Members expressed concerns that the new law may not be considered sufficient to meet European standards for full co-operation and could not remove the obstacle to Liechtenstein's ability to sign the CESR Memorandum of Understanding (MoU). However, CESR-Pol would be willing to provide the FMA Liechtenstein any further assistance where requested to finally achieve a level playing field concerning co-operation with CESR Members.

Statistics of meetings in 2006

CESR-Pol convened four times and its subgroup, the Surveillance & Intelligence group, met three times during 2006 as well as working on a virtual basis. In addition to this, the Urgent Issues Groups and drafting groups met separately.

6.3 ♦ Operational

NEXT
STEPS

The consultation period of the 2nd set of guidance on the operation of MAD will end on 2 February 2007. Any comments by market participants will be considered seriously to ensure that the guidance is as helpful as possible to market participants and issuers, in complying with their obligations under the MAD regime.

CESR-Pol members are currently prioritising the issues flagged in the 'Call for Evidence' to give the MAD Level 3 drafting group, basic ideas to continue its work. CESR-Pol will produce a work programme to be posted on CESR's website to provide the industry feedback.

Concerning the MAD Database for enforcement cases, the target date for the operation of such a database will be the end of 2007, subject to legal and technical prerequisites being met. More technical work has been undertaken in the preparation of a detailed Users' Manual and test cases will be produced to make sure that the database functions properly when going 'live'.

CESR-Pol will collaborate with the MiFID Expert Group on the convergent implementation of the MiFID in relation to the co-operation arrangements among EU regulators established within the Directive.

As a key aspect of CESR-Pol's activities, CESR-Pol will continue to build on the close co-operation established amongst CESR Members on enforcement cases. In this context, Urgent Issues Groups will continue to be convened as and when necessary.

CESR-Pol's subgroup on Surveillance & Intelligence (S&I group) will continue to act as a platform for the exchange of intelligence and expertise in day-to-day supervision on the basis of concrete cases and will provide the CESR-Pol plenary with the results of its deliberations.

Externally, CESR-Pol will also continue to establish and intensify bilateral contacts with non-CESR members who lack the ability and/or willingness to collaborate. CESR-Pol will also maintain close contact with other bodies that are affected by similar issues pertaining to co-operation difficulties with a view to exchanging views and experiences on managing relationships with unco-operative jurisdictions.

It is envisaged that CESR-Pol organise a meeting with the US CFTC to share experiences regarding the enforcement of combined futures/cash transactions on bond markets.

6.4 ♦ Expert groups

6.4.1 – CESR-Tech

MANDATE

Mandate of the CESR-Tech

CESR established CESR-Tech in May 2006 in order to strengthen its information technology governance structure. This working group will enable CESR to work on IT related issues quickly, efficiently and in a manner that allows for necessary IT project management to be used for IT projects that CESR undertakes in conjunction with its Members. CESR-Tech is chaired by Hector Sants, Managing Director, Wholesale and Institutional Markets at the UK FSA, and a member of the secretariat, Ari Voipio, IT Project Manager, who also acts as the rapporteur.

CESR-Tech is established to deal with any form of pan-EU IT project stemming from EU legislation (either current, or future) and any other area where CESR Members consider it necessary or useful to work together on IT issues.

CESR-Tech is composed of senior CESR representatives who have experience, knowledge and expertise in IT project management, financial markets, and supervisory related issues.

The main tasks of CESR-Tech are:

- Allocation and use of IT budget on a 'project by project' basis;
- Operational issues related to the management and running of IT projects;
- Technical issues that arise during the course of specific projects;
- Setting up of an operational working method necessary to achieve its objectives.



Chair's message

Hector Sants, Chief Executive Officer of the FSA, UK

The more operational nature of CESR is well demonstrated in the area of IT. CESR as an organisation faces new challenges as the operator of new Europe-wide IT systems. This new role has been and still is, a learning process for CESR. We have been forced to find new ways to co-operate and make decisions and to share responsibilities. While this has been challenging at times, it has already also proven to be rewarding as well.

As the chairman of CESR-Tech, I look confidently towards the future as we go forward and finalise the arrangements for the exchange of transaction reporting. The new TREM system will set a standard for future co-operation that I hope will bring benefits to the investors, the financial industry and the regulators all alike.

The first major IT project for CESR-Tech deals with the exchange of transaction reports between CESR Members in accordance with Article 25 of the MiFID. This project started in June 2006 and the exchange mechanism will be up and running in Autumn of 2007. Other activities included drafting CESR's IT budget for 2007, as well as the sign-off of various internal guidelines for the group and for projects working under its supervision.

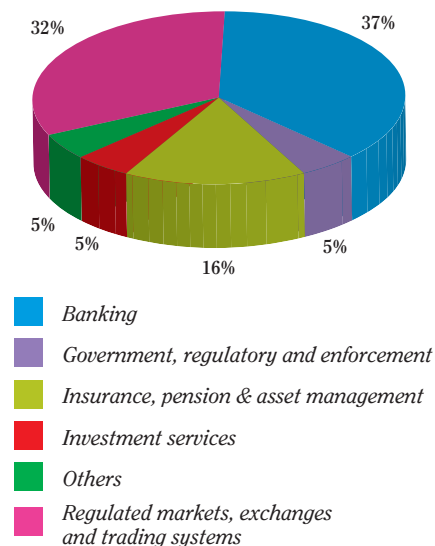
The Transaction Reporting Exchange Mechanism or the 'TREM' Project made good progress in 2006, despite the tight timetable and a number of difficult issues to solve. The project team working under the supervision of the group specified the content of the reports to be exchanged between competent authorities, started the setup of a hub to be used in the exchange and worked on various practical aspects of the exchange mechanism.

6.4 ♦ Expert groups

CESR-Tech launched in December a consultation on coding standards (Ref. CESR/06-648b) to be used in the exchange between CESR Members. The TREM system will be used only by CESR Members. It was, however, felt useful to consult the industry on this aspect of the system since the choices for TREM influence the choices made and to be made by CESR Members with respect to the coding standards in national transaction reporting.

Consultation on the use of reference data standard codes in transaction reporting (ref. CESR/06-648b)

Total number of responses: 19



The responses from the industry confirmed the concept proposed but also flagged a number of practical challenges in the use of the proposed coding standards. Many instruments lack ISIN codes, which CESR proposed to use for the identification of financial instruments and the use of CFI code for the identification of the type of an instrument is still gathering pace. Many investment firms need to acquire BIC codes and there is also a

need to extend the coverage of MIC codes for the identification of regulated markets and multilateral trading facilities. The implementation approach adopted will therefore have to take account of these practical issues.

The main challenge to the project is the issue of instrument reference data. Each CESR Member potentially needs to identify and route to other CESR Members transaction reports on trades in any instrument admitted to trading in Europe. The default solution in the MiFID Level 2 Regulation Article 11 for the sourcing of instrument reference data from the regulated markets and individual CESR Members proved to be impossible to deploy in the available timeframe, and CESR therefore started to explore alternative interim solutions. The group also started a dialogue with FESE, the Federation of European Securities Exchanges, in order to co-operate and establish a longer term solution.

The TREM project started to train CESR Members for the use of the new system. An executive briefing was held in November in Paris. The purpose of the meeting was to brief CESR Members on the practical steps they need to take in order to connect their national transaction reporting systems to TREM.

CESR-Tech prepared a report to the EU Commission on the arrangements for the exchange of transaction reporting between CESR Members. The report was submitted at the end of January. It explains the overall architecture of TREM. The report details the remaining main challenges in the project and explains the steps CESR planned to undertake in order to face them.

Statistics of meetings

CESR-Tech met six times during the course of 2006 and there were a number of additional meetings. The TREM project held several meetings in various compositions throughout the year.

6.4 ♦ Expert groups

NEXT STEPS

The TREM project will continue in 2007. The project will finalise the specifications of TREM, set up the hub for the exchange of information, identify a solution for instrument reference data and continue training CESR Members in TREM. The group will liaise with the industry in order to promote the use of standard codes and co-operate with the MiFID expert group on technical issues related to transaction reporting. TREM will be active by the end of 2007.



6.4.2 – Clearing and Settlement

MANDATE

Mandate of the CESR/ESCB joint working group

After the publication of the CESR/ESCB “Standards for Securities Clearing and Settlement Systems in the EU” in October 2004, the Joint Working Group received the mandate from CESR/ESCB to continue its work on the development of an assessment methodology, further work in the area of central counterparties and the elaboration of a number of open issues, as announced in the introduction of the aforementioned Standards.

In view of the position of the EU institutions in this area, the announcement by the European Commission in July of 2006 not to propose any specific EU-legislation in this area and the development of a Code of Conduct by the relevant parties in the industry (covering issues such as price transparency, access and interoperability), the activities of CESR/ESCB in this area were put on hold during 2006. After the adoption of the Code of Conduct in November 2006, which will gradually be implemented by 2008, CESR joined the Monitoring Group established by the European Commission, to review compliance with the Code of Conduct by the signatories.

NEXT STEPS

CESR will remain in close contact with the European Commission in order to keep up to date with the on-going regulatory initiatives in the area of clearing & settlement. In this context, following indications by the EU institutions, CESR has to consider if and how to resume its work on the CESR/ESCB Standards for Securities Clearing and Settlement.

6.4 ♦ Expert groups

6.4.3 – ECONET

MANDATE

Mandate of the ECONET

ECONET was established in June 2006 in order to facilitate the ability of CESR to meet an increasing number of reporting commitments to European bodies that require the input of financial economists, and to evaluate and, as appropriate, develop CESR's approach to the use of impact analysis. This group is chaired by Alexis Pilavios, Chairman of the Hellenic Capital Markets Commission, and assisted by a member of the secretariat, Alexandra Berketi.

The objectives of ECONET are to:

enhance CESR's capability to undertake economic analysis of market trends and key risks in the securities markets that are, or may become, of particular significance for its Members;

review existing impact analysis methodologies regarding financial regulation and supervision, evaluate the feasibility of developing such a methodology for use in CESR's work, and if considered useful and necessary to develop practical impact analysis principles for use on a case by case basis by CESR.

**Chair's message**

Alexis Pilavios, Chairman of the Capital Markets Commission, Greece

For a number of years an ad hoc CESR group of economists has met on a non regular basis, primarily for discussing inputs for the purpose of reporting economic trends in the Securities Markets to the Financial Stability Table of the Economic and Financial Committee. In line with the recommendations of the Priorities Task Force and in recognition of CESR's move to Level 3 work, it was considered necessary to change this group into a more structural one.

Following these recommendations, ECONET, which I have the pleasure to chair, was established in June 2006. Since then, the members of the group have dedicated a significant amount of work to facilitate the ability of CESR to meet its increasing number of reporting commitments to EU institutions that require input by financial economists on market trends, risks and stability issues and to align CESR with the European Union's commitment to a better regulation agenda that included impact assessments.

ECONET's report on "Financial stability issues related to key financial market infrastructures in the Credit Derivatives market and other EU wholesale markets" was delivered as part of CESR's contribution to the September 2006 Financial Stability Table meeting of the European Financial Committee.

A subgroup on Impact Assessment (IA) was set up in July 2006. The subgroup consists of members of ECONET that are experts in the field of IA in their national authorities.

CEBS and CEIOPS nominated representatives to the ECONET who participated in

both the ECONET and the IA subgroup meetings.

Following its mandate, one of the tasks that ECONET undertook in 2006 was to review existing IA methodologies regarding financial regulation and supervision. ECONET conducted a survey of all CESR Members that apply impact assessment in the area of financial regulation. The results showed that one in three CESR Members had formally adopted IA in their decision making process and that there was a high degree of commonality in the IA methodologies used by these Members.

6.4 ♦ Expert groups

A second study ECONET conducted was to evaluate the feasibility of developing an IA methodology for use in CESR's work and to develop a number of issues linked to its possible use. The results of this study showed among other things that it was feasible to develop an IA methodology for CESR's work, that there were in principle valuable roles that IA can play and that IA could be structured as a practical and economical tool focussed on questions that are important to the work done by CESR.

Following this outcome, ECONET was mandated in October 2006 by the CESR Chairs to develop practical IA guidelines. The Draft Guidelines were submitted in January 2007 to CESR Chairs. It was agreed to test the approach on the next CESR request for advice in order to refine and finalise them.

During 2006 ECONET discussed thoroughly with the CEBS and CEIOPS the possibilities of a common 3L3 approach to IA. CEBS and CEIOPS followed closely ECONET's work in this area and as a result, the Draft Guidelines are applicable to all EU Level 3 Committees. Finally, ECONET was mandated and conducted preliminary research on the different hedge fund classification systems currently adopted by the industry, and have drafted Chapter 4 of this annual report.

Statistics of the meetings:

ECONET has met four times since its establishment in June 2006. ECONET's subgroup on Impact Assessment (IA) has met six times since its establishment in July 2006.

NEXT STEPS

Reporting to European financial institutions:

ECONET is expected to submit two reports to the Financial Stability Table (FST) of the European Financial Committee on topics mandated by the FST. These reports will mainly deal with current market developments and risks in the securities markets with a particular emphasis on the risks involved in the hedge fund industry and in the structural developments in the markets. The reports are expected to be delivered in March and August 2007 respectively.

ECONET's work on Impact Assessment:

ECONET will apply its draft IA methodology on the next CESR request for advice in order to refine and finalise it. CESR, CEBS and CEIOPS will launch a consultation on the methodology itself.

Contribution to the Review of the Lamfalussy framework:

ECONET will prepare a fact book on the European Market's structure based on information received by CESR Members.

Hedge Fund Research:

ECONET will continue exploring the possibility of assigning specific risk factors to hedge funds investment strategies.

6.4 ♦ Expert groups

6.4.4 – Investment Management

MANDATE

Mandate of the Investment Management Expert Group

The work is carried forward by an Expert Group chaired by Lamberto Cardia, Chairman of the Italian securities regulator, the Commissione Nazionale per le Società e la Borsa (CONSOB). The Group is assisted by Carlo Comporti, deputy to the Secretary General, as interim rapporteur within the CESR secretariat.

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 a consultation on “The role of CESR in the regulation and supervision of UCITS and asset management in the EU”, 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.

**Chair’s message**

Lamberto Cardia, Chairman of the CONSOB, Italy

“After an intense activity in improving the functioning of the current UCITS Directive, from the perspective of both eligible assets and the simplification of the notification procedure, the Expert Group is now entering into an even more challenging phase, in parallel with the proposal for legislative changes anticipated by the Commission. In particular, the Group, under a specific request from the Commission, will develop a new regime for the key information to be given to investors to replace the current simplified prospectus.

The Group will also start conducting operational sessions to improve the mutual understanding of day-to-day supervision with a view to achieving progressive convergence in this area, for which an Operational Task Force will take the necessary preparatory steps for the establishment of a permanent forum where this important activity will be conducted.

I am sure that with these two initiatives the Expert Group will continue to provide important input to the fostering the functioning of the internal market for asset management in the interests of both the investors and the industry”.

CESR contribution to the Commission White Paper

The Expert Group on Investment Management prepared CESR’s contribution to the Commission White Paper as well as a reaction to the European Commission’s industry reports (Ref. CESR/06-461d).

Eligible assets under the UCITS Directive

CESR delivered its final advice on the clarifications of definitions concerning the eligible assets for UCITS on 26 January 2006 to the European Commission after two rounds of consultation (Ref. CESR/06-005), together

with a feedback statement (Ref. CESR/06-013). The advice aims at providing fund managers and competent authorities with more certainty as to whether certain financial products are an eligible asset for UCITS. The advice seeks to provide the necessary product innovation within UCITS whilst ensuring a high and consistent level of investor protection across the EU.

When publishing CESR’s advice to the European Commission on clarification of the definition concerning eligible assets for investments by UCITS, CESR concluded that it looked to consider further whether derivatives of hedge fund indices can be deemed

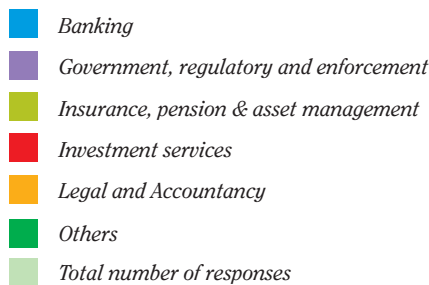
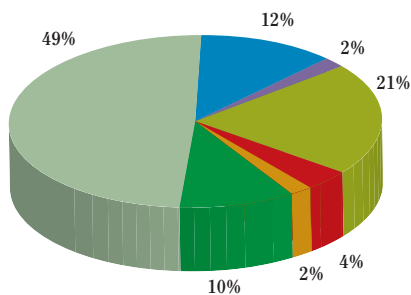
6.4 ♦ Expert groups

as eligible investments for UCITS. The reason was that the impact of such derivatives raised questions about the risk profile of the UCITS, and the ability of retail investors to assess this impact.

CESR published an Issues Paper CESR/06-530 on this topic in October 2006. Through the publication of this paper, CESR requested additional input into the debate on eligible assets under the UCITS Directive in relation to the inclusion of hedge fund indices. Through this Issues Paper CESR indicates its desire to ensure that the full breadth of views and opinions that market participants and retail investors hold on this issue are fully heard before reaching any formal conclusion.

CESR Issues Paper – Can hedge fund indices be classified as financial indices for the purpose of UCITS? (Ref. CESR/06-530)

Total number of responses: 26



The decision to explore more thoroughly the issues arising from the potential inclusion of hedge fund indices in UCITS, should be seen in the wider context of CESR's final advice to the European Commission on eligible assets, which set out in detail its views on the criteria that should be met by a financial index in order for it to be an eligible investment. In developing the advice and the two rounds of consultation CESR analysed many of the

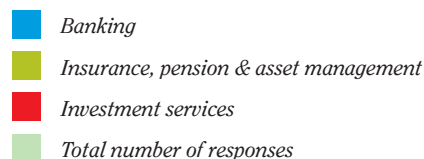
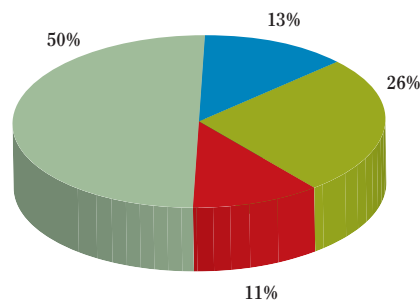
comments received, which suggested that hedge fund indices should also be considered by CESR as an eligible underlying asset for derivatives. However, given the complexities of hedge fund indices and the fact that they are still developing, CESR concluded that further work was necessary.

Guidelines to simplify the notification procedure of UCITS

In order to simplify access by investors to investment funds created under the UCITS Directive in the EU Single Market, CESR issued on 29 June 2006, guidelines to facilitate the cross border notification of UCITS (Ref. CESR/06-120b), together with a feedback statement (Ref. CESR/06-301).

Second consultation regarding CESR's guidelines for supervisors regarding the notification procedure according to Section VIII of UCITS (Ref. CESR/06-120)

Total number of responses: 23



Within the boundaries of the existing legal framework of the *acquis communautaire* of the UCITS Directive, the guidelines have tried to address several of the requests for simplification of the cross border notification process, proposed by market participants.

The following key issues were included in the final text of the guidelines:

- UCITS can submit the notification letter in a language common in the sphere of in-

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ternational finance to the Host competent Authority where this is not contrary to the domestic legislation or regulations;

- Once a complete notification has been filed, the notification procedure should possibly be reduced as an average to a shorter period than the maximum two months allowed. The Host Member State Authority shall inform the UCITS about the incompleteness and missing information and documents as soon as possible and in any case, within one month from the date of the receipt of the incomplete notification;
- In order to simplify practices and reduce costs, Competent Authorities will rely on self-certification of copies of original attestations by the notifying UCITS, the origi-

nal attestation should include an English version to be provided by the UCITS.

Regarding new sub-funds, which are added to the umbrella fund with the intention to be marketed in the Host Member State, where the marketing arrangements are already familiar to the Host country Competent Authority, CESR has agreed that the necessary time for the Host Authority to check should be significantly less than the two-month period. To simplify the processing by the Host Competent Authority of the notification of umbrella funds with a large number of sub-funds to be marketed, CESR recommends that umbrella funds with a large number of sub-funds should have one full prospectus.

NEXT STEPS

Following its Green Paper on the enhancement of the EU framework for investment funds, the European Commission adopted its White Paper in November 2006, containing actions for future developments in the area of investment management. Following this document CESR adopted a revised Work Programme of the Expert Group that includes two new projects: the establishment of an Operational Task Force and the work in the area of Simplified Prospectus under a request from the Commission.

Finally, the Expert Group on Investment Management will finalise its views on hedge fund indices.

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6.4.5 – Mediation Task Force

MANDATE

Mandate of the Mediation Task Force

CESR established a Task Force on Mediation, which was chaired by Manuel Conthe, Chairman of the Spanish Securities Commission (Comisión Nacional del Mercado de Valores) and with the mandate to develop a proposal for a general CESR mediation mechanism. The Task Force was composed of members from eleven CESR Members, and the European Commission also participated. The work was supported by Geraldine Levy, Director at the CESR secretariat.

The objective of such a mediation mechanism is to facilitate the rapid, effective and balanced solution to disputes between CESR Members, in order to facilitate convergence at Level 3 and the fair implementation and application of CESR measures and EU law. The mechanism proposed had to ensure that the competence of the Commission was fully respected, and that it did not interfere with the respective roles of the Commission and the European Court of Justice in the interpretation and enforcement of EU law.



Chair's message

Manuel Conthe, Former Chairman of the CNMV, Spain

“An important step in achieving supervisory convergence and building an effective network was successfully taken when the mechanism was finalised and adopted by CESR in the summer of 2006.

The mechanism has been up and running since September 2006, and we have a sound and robust list of mediation experts ready and waiting for the first case. Although there have been no mediation cases to date, I am confident that when used it will be a successful tool through which conflicts between CESR Members can be resolved in a constructive and efficient manner.

I am delighted that the task force's hard work has also paid off in terms of the use of the mechanism as the basis for the creation of similar mechanisms by CESR's sister Lamfalussy Committees CEBS and CEIOPS.”

During the course of 2006 and in line with the ECOFIN conclusions, CESR finalised and put in place its mediation mechanism which is set out in the form of a Protocol that is attached to the CESR Charter. The general mechanism is based on, and incorporates, the specific mediation mechanism which CESR-Pol developed for market abuse enforcement cases as stipulated in Article 16 (4) of the Market Abuse Directive in March 2005.

The finalisation of the mechanism follows a consultation paper that was published in the autumn of 2005 (Ref. CESR/05-483c), an open hearing and a meeting with mediation experts. The mediation Protocol and Feedback Statement (Ref. CESR/06-287b) was

published in August, and the mediation task force was disbanded following completion of its work. The last step in the process was putting together a list of mediation experts from which the gatekeepers will select panelists/mediators as and when the need to do so arises. The mechanism will enable the network of regulators to deal with potential disputes in an efficient, fair and confidential manner.

Key features of the mechanism are set out in the Protocol on CESR's mediation mechanism (Ref. CESR/06-286b), and include:

- a “comply or explain“ approach by Members to both a request for mediation and its outcome;

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- market participants' ability to bring issues for mediation to the attention of the relevant competent authority;
 - a flexible approach to dispute resolution through the use of either an evaluative or facilitative procedure depending on the preferences of the parties;
 - confidentiality;
 - rapidness and efficiency of the procedure.
- The mechanism includes a number of procedures through which:
- the appropriateness of an issue for mediation can be assessed;
 - potential disagreements of the parties to either the initial assessment of the suitability of the case for mediation or its outcome can be dealt with in a speedy, fair and efficient manner;
 - conflicts of interests of gatekeepers, panel members and mediators are dealt with;
 - the European Commission is consulted for their views on conflicts of interpretation of EU legislation;
- publication of outcomes in the form of reports and summaries to enhance supervisory convergence or provide guidance to authorities or market participants has been introduced.
- Strict timeframes have been introduced into all aspects of the procedure to ensure that cases do not take any longer than six months maximum to resolve, but can also be completed within six weeks. It is anticipated that a case will normally take around 3-4 months depending on its complexity and the number of embedded appeal procedures that get used.

NEXT STEPS

In accordance with Article 12 of the Mediation Protocol, publication of reports or summaries on an anonymous basis of mediated outcomes will be made public if, such publication is considered by CESR to encourage supervisory convergence or provide guidance to authorities or markets participants. There were no mediation cases during the course of 2006.

6.4 ♦ Expert groups

6.4.6 – MiFID

MANDATE

Mandate for the MiFID Level 3 Expert Group

In the light of the changing emphasis of CESR's work on MiFID, which is now focused on ensuring a seamless application of the rules across Europe by its Members, CESR has decided to dissolve the previous three Expert Groups and the MiFID Steering Group which prepared and submitted its Level 2 technical advice on implementing measures.

In its place, CESR has established a new single 'MiFID Level 3 Expert Group' that will undertake work to deliver supervisory convergence in the day-to-day application of the legislation (i.e. Level 3). This group has been chaired during the course of 2006 by Arthur Philippe, Director and member of the Management Board at the Commission de Surveillance du Secteur Financier, Luxembourg's securities supervisor. The secretariat's rapporteur for this group is Carlo Comporti, Deputy to the Secretary General at CESR and Director of Markets and Intermediaries.

There are two working sub-groups reporting to the MiFID Level 3 Expert Group:

- the 'Intermediaries Sub-group', has been chaired by Antonio Carrascosa, Director General at the Comisión Nacional del Mercado de Valores (CNMV), Spain's securities supervisor. The rapporteur of the 'Intermediaries Sub-group' is Diego Escanero, Senior Officer at the CESR secretariat;
- the 'Markets Sub-group', chaired by Hans Wolters, Head of Policy at the Autoriteit Financiële Markten, Holland's securities supervisor. The rapporteur of the 'Markets Sub-group' is Jari Virta, Senior Officer at CESR secretariat.

CESR has also formed a MiFID Consultative Working Group which draws together technical experts from the markets and industry practitioners with expertise in the various sectors covered by MiFID to provide advice on the technical practicalities of the guidance developed under the work programme. A list of its members is available on CESR's web page.

Finally, a number of MiFID Implementation fora have been organised to enable the exchange of information between Members on the practical implementation of MiFID across Europe to take place.

To date CESR has held three meetings of the MiFID Level 3 Expert Group, six meetings of the Intermediaries Sub-group and 5 meetings of the Markets Sub-group.



Chair's message

Arthur Philippe, Director and member of the Management Board at the Commission de Surveillance du Secteur Financier, Luxembourg, Chair of the Expert Group in 2006

"MiFID represents a big challenge for all actors: industry, investors and regulators. The MiFID Expert Group will take the necessary steps to facilitate the smooth implementation of the new measures by November 2007. Continuous and open dialogue with market participants is instrumental in achieving good results; for this reason we have strengthened the ways of conducting

this dialogue through a newly established Consultative Working Group, a more structured dialogue with representatives of retail investors and open consultations.

The MiFID Expert Group will facilitate achieving common views on the way in which the rules will be implemented; in so doing I am confident it will represent and meet the high expectations that are put on CESR to develop convergence of regulatory responses across Europe."

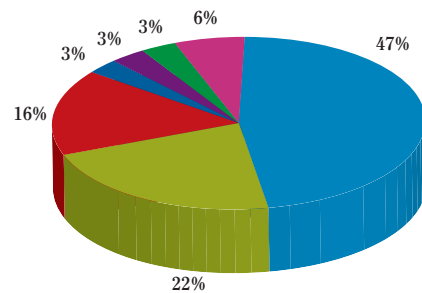
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Following the European Securities Committee and EU Parliament approval of the draft Level 2 implementing measures, CESR has shifted its attention to ensuring that day-to-day application of the MiFID, which was to be transposed by Member States by January 2007 and will apply by November 2007, takes place in a convergent manner amongst supervisors across Europe.

The first step in this process was a consultation issued on 6 July 2006 (Ref. CESR/ 06-413) which proposed the details of CESR's work programme for a new MiFID 'Level 3' Expert Group. A revised version of the work programme, focussing on the activity of the Group up to November 2007 was then approved at the CESR meeting in Paris on 19 October 2006, taking into account both the results of public consultation and input from the MiFID Consultative Working Group.

CESR's Work Programme on MiFID Level 3 work (Ref. CESR/06-413)

Total number of responses: 32



The work programme concentrates on key issues that need to be addressed before the application of the new measures. It concentrates on the operational aspects that arise as a consequence of the provisions of the Directive and its implementing measures, and in identifying practical solutions to address

the regulatory changes. It also includes areas of work that will originate from the Commission as contribution to the reviews under Article 65 of MiFID. Finally, it includes areas of joint work conducted with the other Level 3 Committees (CEBS and CEIOPS) on outsourcing and internal governance.

More specifically, CESR has identified four categories of 'Level 3' work under MiFID, on which it would be helpful for supervisors to ensure convergence in their practices. These include:

- Technical issues of operational importance where consistent implementation of the Level 1 and Level 2 legislative texts need to be achieved before their implementation in order to provide market participants with pan-European strategies with greater certainty. These issues broadly relate to the functioning of the passport of investment firms and regulated markets. Areas of work include, for example, calculations relating to market transparency (such as the definition of liquid shares and "block sizes") and publication and consolidation of market transparency information;
- Other issues of a technical and operational nature, aimed at ensuring a convergent implementation of MiFID, which do not all necessarily need to be tackled before the date of implementation of the new legislative framework. Amongst such issues, priority is given in the work programme to 'best execution' where for example, it may be considered useful to develop a convergent view amongst supervisors on, the best execution requirement for non-equity markets in particular and, clarifying interpretations of the execution performance which is also identified;
- Work to foster greater cross-sector convergence is also proposed and will be conducted with CEBS and CEIOPS. Examples of such work include outsourcing and a review of internal governance of intermediaries to ensure there is no unnecessary duplication;
- A number of reports or reviews are also anticipated in the MiFID legislative texts, for example, a review of the possible extension

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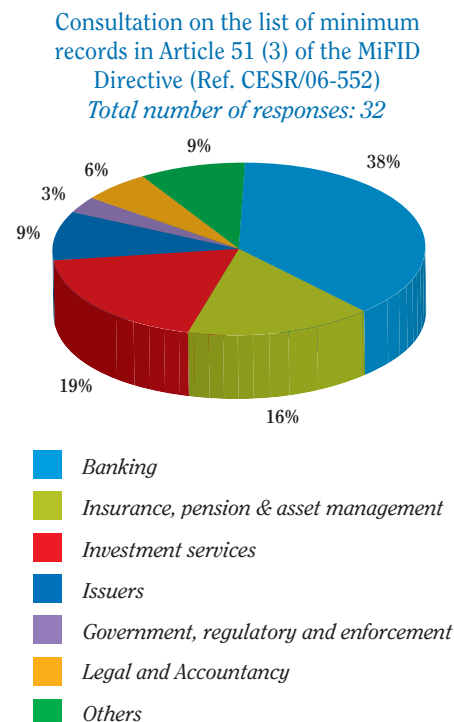
of the pre- and post-trade transparency regime to transactions in classes of financial instruments other than shares.

6.4.6.1. Intermediaries

Work that has been undertaken to date has focussed on the following issues:

Record Keeping

On 20 October 2006, CESR published for consultation a draft recommendation of a list of minimum records that competent authorities are required to develop in accordance with Article 51(3) of the Level 2 Implementing Directive. The objective was to achieve consistency in the list. The consultation period closed on 27 November 2006. In January 2007, CESR approved a final recommendation (Ref. CESR/06-552c) to its Members which sets out the content of the list of minimum records together with a feedback statement offering some explanations on CESR's final approach to some of the most significant issues raised in the consultation (Ref. CESR/07-085).



Passporting

Passporting was identified as one of the key priorities of the work programme, to allow for both the smooth functioning of the rights set forth under the Directive, and a smooth transition from the current Investment Services Directive to the new MiFID regime. CESR published a public consultation paper on 15 December 2006. The consultation period closes on 9 February 2007. The paper sets out a number of practical proposals and questions for a common approach on the notification procedures under Articles 31 and 32 of MiFID as well as proposals on the future collaboration between home and host authorities that will be necessary in order to ensure that supervision of cross-border activities under the Directive is clear, efficient and effective. Taking into account the proposals in the consultation paper, together with stakeholder responses, CESR intends to issue recommendations to its Members that will set out a common approach to practical and operational aspects related to the functioning of the passport of investment firms.

Inducements

CESR published a public consultation paper on the 22 December 2006. The consultation period closes on the 09 February 2007. Taking into account the proposals in the consultation paper, together with stakeholder responses, CESR intends to issue guidelines that will set out a common approach to the inducements regime under MiFID.

Best Execution

CESR approved the publication of a public consultation paper on best execution on 31 January 2007. The paper sets out a number of practical proposals and questions for a common approach with respect to the practical aspects of the best execution requirements under MiFID. Taking into account these proposals, together with stakeholder responses, CESR intends to issue recommendations to its Members.

As regards the work conducted jointly with CEBS and CEIOPS, it is worth mentioning outsourcing and internal governance.

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Outsourcing

This work was finalised by the publication of the CEBS guidelines on outsourcing on 14 December 2006, these guidelines apply only to credit institutions. A joint report was prepared to map different requirements across the sectors and to promote further convergence. The objective was to foster convergence in the application of different requirements across the sectors.

CEBS and CESR have worked closely together to ensure that the proposed guidelines are consistent with the regulatory framework defined by the MiFID and its application to credit institutions. There will not be further work undertaken by CESR in this area until after MiFID's implementation date.

Internal Governance

The work within the context of mapping the requirements included in various Community laws, including, in particular, the Capital Requirement Directive and the MiFID, has progressed during 2006.

6.4.6.2. Markets

The work of the Markets sub-group covered three areas: (i) work facilitating the operation of MiFID market transparency regime; (ii) some (non-technical) aspects on transaction reporting; and (iii) work relating to the Commission's forthcoming report on the possible extension of market transparency to financial instruments other than shares.

Market data consolidation

Based on public consultation CESR approved in January 2007, Level 3 Guidelines and Recommendations on Publication and Consolidation of market data (Ref. CESR/07-043)

Transaction reporting

In the context of the overall CESR work on transaction reporting the Expert Group acts in full co-ordination with CESR-Tech and its TREM project. There are three layers of work that have been identified and allocated according to the following criteria:

- who should report and to whom; this question relates to the scope and is addressed

in a consultation paper approved in January 2007;

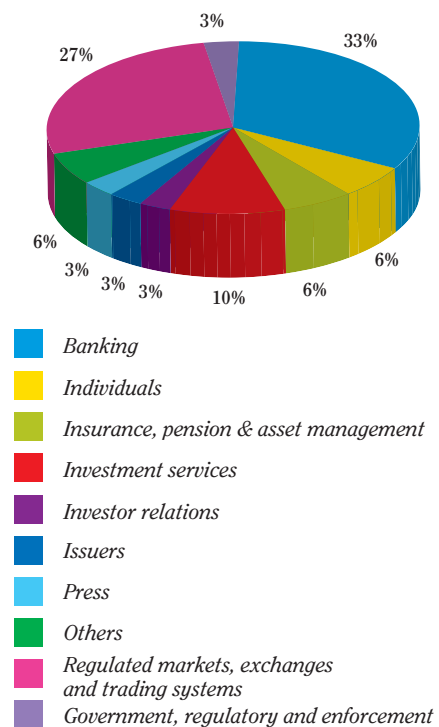
- what should be reported; this refers to the national systems of transaction reporting;
- how reports should be exchanged between competent authorities; this refers to the TREM project details of which are set out in Section 6.4.1 of Chapter 6.4 of this annual report.

On transaction reporting the sub-group has addressed some non-technical issues which have been evaluated as crucial for the smooth operation of the reporting system. A consultation paper was approved in January 2007 (Ref. CESR/07-047).

Non-equities transparency

Call for evidence on the consolidation of market transparency data
(ref. CESR/06-134)

Total number of responses: 31



Based on Article 65 of the MiFID, the Commission shall submit reports to the European Parliament and the Council on the possible extension of the scope of the MiFID's pre and post-trade transparency re-

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quirements, to financial instruments other than shares. As part of its preparation for the report, the Commission has asked CESR for advice. The first part, including some factual information on the operation of bond markets was delivered in the autumn of 2006. Based on an additional request CESR has started broader work. A call for evidence will be published in February 2007 (Ref. CESR/07-108).

6.4.6.3. Implementation fora

The MiFID Level 3 Expert Group has organised three sessions of the implementation fora, to share experiences on the practical implementation of the MiFID. The meetings have been devoted to discussing:

- initiatives undertaken by CESR members at national level to approach implementation of the MiFID;
- sharing of information about the parts in the Directive where there are discretions or options for Member States or Competent Authorities;

- sharing of information about powers and resources of Competent Authorities and possible use of delegation by Competent Authorities, where allowed by the Directive;
- internal questionnaire on transaction reporting;
- sharing of information about the implementation of Article 4 of the Level 2 Directive;
- sharing of information about programmes of internal and external training and education and other communication programmes.

The next meeting will take place in 2007, when the transposition and implementation of the MiFID will be at a more advanced stage.

Statistics of meetings

In 2006, CESR has held three meetings of the MiFID Level 3 Expert Group, six meetings of the Intermediaries Sub-group and five meetings of the Markets Sub-group.

NEXT STEPS

The MiFID 'Level 3' Expert Group aims to facilitate a smooth and consistent implementation of the new regime. In addition to the proposed work programme which is developed for this purpose, the MiFID Expert Group will also foster supervisory convergence by providing a close network of colleagues which will enable Members to seek each other's advice and share their experience in respect to operational issues arising out of the implementation of MiFID, where it is necessary to address certain issues at a European level.

With a view to encouraging consumers to participate in its work, on 12 February 2007 CESR will host a Consumer Day where representatives of national and European consumer associations are invited to share their views on the Inducements and Passporting consultation papers.

The Intermediaries sub-group will continue its work on passporting (with the objective of developing a protocol for co-operation between competent authorities particularly for supervision of EU branches), inducements, and best-execution.

The Markets sub-group will continue its work on transaction reporting and evaluate the comments received during the public consultation. The sub-group will also prepare an internal guide for CESR Members on the calculation and publication of MiFID market transparency data. Finally, the sub-group will prepare the response to the mandate from the Commission on bond market transparency. This work will include a public consultation in spring and a final response to the Commission by the end of June.

6.4 ♦ Expert groups

6.4.7 – Prospectus

MANDATE

Mandate of the Prospectus Contact Group

To ratify the work conducted during 2005 by CESR prospectus experts, the Committee set up on 19 January 2006 a Prospectus Contact Group and issued the mandate this group will follow. The Prospectus Directive and the Commission's Regulation on prospectuses became effective on 1 July 2005. Regulators and market participants are facing many application and operational issues arising from the implementation of this new legal framework. This is compounded by the fact that the Prospectus Directive is a maximum harmonisation Directive and that the scope for interaction between competent authorities has increased because of the passport. It is therefore essential to have convergent application amongst the competent authorities. CESR considers that in order to achieve such convergence it is necessary to hold practical and operational meetings of prospectus contact experts to discuss specific implementation and application issues and, to the extent possible, agree common solutions. A Prospectus Contact Group was therefore set up to fulfil this objective.

**Chair's message**

G rard Rameix, Secretary General of the AMF, France

“CESR has been very active in the area of Prospectus over the last four years by providing advice to the European Commission on the implementing measures of the Prospectus Directive and producing Level 3 recommendations for the consistent application of the Prospectus legislation.

After completion of these tasks, there has been a strong call from market participants for the establishment within CESR of a method of exchanging views on implementation problems and ideas, and the development and sharing of daily operational and supervisory best practices between Members.

To cater for these demands, CESR has continued its work through the Prospectus Contact Group that has concentrated the efforts of competent authorities to ensure supervisory convergence in the application of the new legal framework on Prospectuses that became effective on 1 July 2005. This group has focused on the simplification of procedural aspects for the correct functioning of the passport, but has also made an important effort to reach and publish common approaches on the practical aspects put forward by market participants and regulators.

The positive response from market participants to the Q&A on prospectus that we have published and the demands for a continuous update of this guide, highlights the relevance of CESR's work to effectively reduce divergent practices in Member States and foster a proper and consistent implementation of the European legislation on Prospectus.

To add to this work, the Prospectus Contact Group has undertaken the challenging task of producing a report on the evaluation of the practical functioning of the Prospectus Directive and Regulation. In this report we will identify obstacles and divergent practices that pose a risk for the proper functioning of the single market and, where needed, propose solutions.”

6.4 ♦ Expert groups

Background

CESR has been very active in the area of prospectus over the last four years, providing the European Commission (Commission) with technical advice on the implementing measures of the Prospectus Directive. CESR completed this initial work in 2003 and continued its activity in this area during 2004 to ensure the consistent application of the Prospectus legislation. To this end, the CESR expert group prepared a set of recommendations (Ref. CESR/05-054b) which gave guidance on how to produce a prospectus. In addition, in 2005, CESR delivered its advice to the Commission on how to deal with those circumstances where the historical financial information to be included in the prospectus might not sufficiently reflect the issuer's whole business throughout the required period ("complex financial histories"). In a parallel manner, CESR Members have been co-ordinating procedures to assist a seamless operation of the passport and to deliver supervisory convergence. These have contributed to the smooth functioning of the passport since 1 July 2005.

The Prospectus Directive and the Commission's Regulation on prospectuses became effective on 1 July 2005. During the course of the 2005 and 2006, regulators and market participants have responded to practical application and operational issues arising from the implementation of this Community framework into national law. The need for a 'common approach' is compounded by the fact that the Prospectus Directive is a maximum harmonisation Directive and that the scope for interaction between competent authorities has increased because of the passport that it provides for issuers. It is therefore essential for CESR Members to achieve convergence in their approaches.

Publication of Q&A on prospectuses

To this end, prospectus experts from CESR Members have been holding practical and operational meetings to discuss specific implementation and application issues and, to the extent necessary, agree on common so-

lutions. This Expert Group is chaired by Gérard Rameix, Secretary General of the French Autorités des Marchés Financiers and supported by Javier Ruiz del Pozo, Director of Financial Information at the CESR secretariat, and Raquel García Alcubilla, Senior Officer. The European Commission also participates at the meetings of the group as an observer.

The work of this group materialised in July 2006, when CESR published a guide for market participants (Ref. CESR/06-296d).

This 'Q and A' guide that CESR Members developed, establishes a convergent response from all EU securities supervisors to commonly asked questions on the day-to-day application of the EU legislation regarding the preparation of prospectuses. It focuses on responses to queries that are likely to have an EU-wide impact on market participants or end users, and therefore on the smooth functioning of the Single Market. Some of the agreements aim at facilitating the correct functioning of cross-border offers (for example, information from the issuers to host competent authorities or passport of the supplements). The rest are responses to questions on the application of the legislation that have been arising frequently in most Member States (for example, how to treat employee share option schemes, free offers or interpretation on the historical financial information to include in the prospectus).

CESR does not intend to issue new standards, guidelines or recommendations on prospectuses. Rather, the purpose of this publication is to provide quick answers to the questions market participants channel to the relevant CESR Members and/or to CESR secretariat. The common approaches reached are not set in stone. The Group operates in a way that will enable it to react efficiently if any aspects of the published 'common positions' needs to be modified or adapted for greater clarity.

The European Commission Services have provided very useful input on some of the questions discussed in the paper. However, these views do not bind the European Com-

6.4 ♦ Expert groups

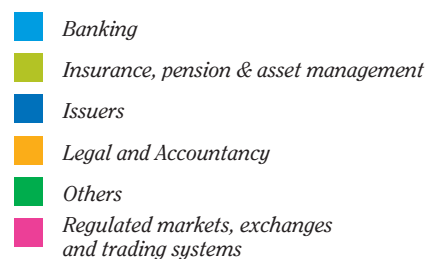
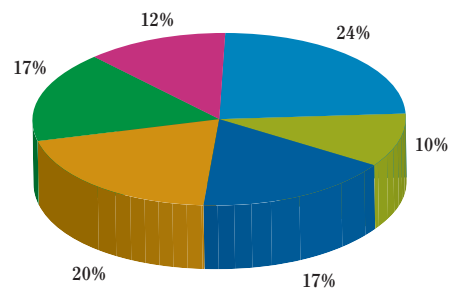
mission as an institution, which will be entitled to take a different position.

Report on the evaluation of the practical functioning of the Prospectus Directive and Regulation

In addition to this effort to achieve and publish common approaches, the Prospectus Contact Group has been working on a report that seeks to identify any practical day-to-day difficulties encountered with the passport and other relevant provisions of the Prospectus Directive. The objective of the report is to identify obstacles to the fluid functioning of the passport and divergent practices in Member States that pose a risk for the proper functioning of the single market.

To seek input from market participants, CESR published a call for evidence (Ref. CESR/06-515) in November 2006 and received around 40 responses. Those that are

Call for evidence on the supervisory functioning of the Prospectus Directive and Regulation (Ref. CESR/06-515)
Total number of responses: 41



public can be viewed on CESR's website. In addition, an open hearing was held in January 2007.

CESR's report will analyse the responses received from market participants and will include proposed solutions to the issues where action is needed.

NEXT STEPS

The CESR group will continue to meet regularly to discuss the questions that might be raised by market participants. (CESR has set up a specific email address to receive these questions: prospectus@cesr.eu). The pace of the future publications will depend on the amount of new questions identified and how long it takes to analyse the issues and to develop common positions.

CESR intends to publish its report on the supervisory functioning of the Prospectus Directive and Regulation around June 2007.

In addition, now that the Prospectus Regulation has been amended to include an additional provision to deal with issuers having a complex financial history, CESR will assess what Level 3 work is needed in respect of the requirements relating to complex financial histories.

The Prospectus Contact Group is chaired by Gérard Rameix, Secretary General of the AFM, France, and supported by Raquel Garcia, senior officer at the CESR secretariat.

Statistics of the meetings

The Prospectus Contact Group met three times during 2006 (and once in January 2007).

6.5 ♦ Supervisory Convergence beyond CESR

6.5.1 – Contacts with other Level 3 Committees



In 2006 the Committee of European Securities Regulators (CESR), the Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) had agreed on a joint Work Programme, which was published in February 2006 and built on the Joint Protocol signed by the three Committees on 24 November 2005.

The objectives of the co-operation between the three Committees are set out in the Joint Protocol and include (i) sharing information in order to ensure compatible sector approaches are developed; (ii) exchanging experiences which can facilitate supervisors' ability to co-operate; (iii) producing joint work or reports to relevant EU institutions and committees; (iv) reducing supervisory burdens and streamlining processes; and (v) ensuring the basic functioning of the three Committees develops along parallel lines.

In light of the need for convergence across sectors wherever possible and appropriate, and given the increasing importance of market integration and cross-sector business activities within the EU, the objective of the Work Programme is to make supervisory co-operation transparent across financial sectors and to enhance the consistency between the sectors so that work done in one financial sector is coherent with the work developed in the others.

The Committees have established liaisons for the daily contacts that take place between the Committees, as well as specific contact persons for each of the different work streams set out in the 3L3 Work Programme.

The secretariats and chairs of the Committees meet on a regular basis. During the course of 2006 there were three 3L3 secretariats and three 3L3 chairs meetings.

The work done under the 3L3 Work Programme 2006 can be divided into four sections as (A) joint work, (B) consistency projects, (C) reports to EU institutions and (D) information exchange:

A – Joint work

1. *Financial conglomerates*

The work on financial conglomerates is led by CEBS and CEIOPS, with CESR participating as an observer. Preparations were started by the Committees in late 2005 to form an Interim Working Committee on Financial Conglomerates (IWCFC), which came into being in early 2006. It was chaired by Prof. Arnold Schilder (CEBS Member) and Vice-Chaired by Michel Flamée (CEIOPS Member). The decision to set up this Committee involved the EU supervisors in banking and insurance in the three Level 3 Committees, the European Commission and the finance ministries in the European Financial Conglomerates Committee (EFCC). The EFCC needs expert input on financial conglomerates issues to feed its discussions for example when reviewing the Financial Conglomerates Directive (FCD). The European Commission confirmed in a letter to the IWCFC Chair in November 2006 its expectations of the IWCFC to address the unique challenges posed by conglomerates.

The Committee's work focuses on the consistent implementation of the FCD, looking at the convergence of national supervisory practices on issues such as the assessment of capital requirements, and tackling issues related to the identification, co-operation and co-ordination requirements.

The IWCFC met on three occasions in 2006, with a first meeting in May 2006. Most of the Committee's work in 2006 has led to exchanging information arising from the way

6.5 ♦ Supervisory Convergence beyond CESR

the FCD has been implemented in the different Member States. In addition the Committee has been working on two draft Calls for Advice from the European Commission and the EFCC. These cover an investigation into the eligibility of capital in the different sectors, and a joint exercise on the arrangements for supervision in the USA and Switzerland.

The work of the Committee resulted in January 2007 in the publication of IWCFC's report on eligibility of capital instruments. The report analyses the main similarities and differences of the characteristics of regulatory capital for a bank, an investment firm and an insurance entity. The IWCFC found that most eligible capital instruments - although named differently - are in fact common in the banking and insurance sectors and share the same core characteristics. However there are important differences as well, which can be explained by the differences in the nature of business of each sector, or by differences in the calculation of eligible capital elements and the way they are taken into account at group level.

The IWCFC has a full Work Programme for 2007. In 2007 it will analyse the impact and consequences that any differences in the sector rules on eligible capital elements might have for the supervision of financial conglomerates. In 2008 it plans to deliver answers in the form of a roadmap on that issue. By end 2007 the Committee will also provide the European Commission with some technical analysis on the arrangements for consolidated supervision of financial conglomerates in the US and in Switzerland. Thirdly, the Committee will work on the identification of conglomerates and the use of the waiver provided by Article 3.3 of the FCD. Fourthly, the Committee will work on co-operation arrangements between authorities involved in the supervision of each financial conglomerate. Finally, the IWCFC will start to work in detail on the key risks for conglomerates, such as concentration risk and intra-group transactions. Throughout, it will continue its dialogues already opened with the industry, such as presentations and case studies.

2. Joint definitions of standards, guidelines and recommendations

The three Committees aimed at aligning the common application of the terms used to describe Level 3 measures, namely "standards, guidelines and recommendations" in each of the Committees. During the course of this work, it became apparent that due to the legal limitations inherent in the use of Level 3 measures and the varying historical traditions of how these terms have been applied in each of the respective Committees, the terms are actually interchangeable in and across the sectors. As such, the Committees have agreed that an attempt to harmonise the use of the terms would not have added value, though a description of their use and expected effect would. The results of this work are attached as annex [XX] to this annual report.

B – Consistency projects to reduce supervisory burdens and streamlining processes.

1. Outsourcing

The joint work that the Committees undertook to ensure that to the greatest extent possible there would be consistency and alignment between the outsourcing rules set out in the MiFID Level 2 measures, and the CEBS Level 3 guidelines on outsourcing, has been completed following the adoption of the MiFID regulation in August 2006 and CEBS publication of its guidelines in December, including a table of the mapping of the compatibility of the sector work.

2. Supervisory co-operation

The secretariats of the three Committees have been working on a comprehensive report comparing the regulatory approaches and co-operative arrangements in place between the various supervisors. This will help share information on methods and practices across the sectors. The report is due to be finalised during the first half of 2007.

3. Reporting requirements

The three Committees issued a questionnaire to a number of conglomerates in the

6.5 ♦ Supervisory Convergence beyond CESR

EU with the objective of identifying possible inconsistencies between sectors in the application of reporting requirements in the EU. The responses to the questionnaire are being analysed and the results will be presented in the first half of 2007. As a first impression, it is noted by the respondents that overlap on a cross sector basis is not the main issue when looking at reporting requirements.

4. Internal governance

During the course of 2006, the 3L3 Committees have been examining the internal governance rules that exist within the three sectors. The analysis is being debated by the members of the three Committees, both regarding the similarities and the differences in sector requirements and guidelines. It is anticipated that during the second half of 2007, the three Committees will decide what further work in this area should be done.

5. Substitute products

Following from developments in the area of MiFID, the Committees have increased their co-operation on the issue of substitute products, i.e. products which have essentially the same characteristics for clients, but are issued by institutions regulated in different sectors. There can be 'conduct of business' concerns as well as different burdens if there is no level playing field regarding the requirements to provide e.g. information to clients. This work will continue into 2007, based on a cross sector survey amongst supervisors on the approach to substitute products at a domestic level, and on the issues supervisors should look into at an EU level.

C – Reports to the European Institutions

Financial market trends and cross sector risks

As set out in other sections of this report the three Committees have contributed to the work of the Economic and Financial Committee's Financial Stability Table (EFC/FST) through the meetings this Committee held in April and September.

For the April 2006 EFC/FST meeting, the three Committees prepared a cross-sector report on cross-sector aspects regarding the functioning of bond markets in the European Market. The report, which was very well received, dealt with the bond markets primary and secondary markets and raised a number of points highlighted by market participants who had participated in the wholesale day arranged by CESR in February 2006.

For the September 2006 Financial Stability Table the three Committees provided the FST with an annual cross sector report on risks. The first part of the report dealt with conglomerates and the second part of the report dealt with possible regulatory arbitrage between the insurance and banking sectors deriving from the application of IFRS. For the same meeting, the Committees also provided a survey on EU approaches to supervision of offshore financial centres.

In addition to the above, the Committees also commented jointly on proposals made by EU institutions where felt necessary and appropriate. The three Committees sent a joint technical letter to the European Commission in September 2006 regarding the proposal to amend the procedural rules and evaluation criteria for the prudential assessment of acquisitions and increase of shareholdings in the financial sector. Following the letter, changes to the proposed directives were made.

During the course of 2006, the Commission gave the three Level 3 Committees a mandate to work on issues relating to the 3rd Anti-Money Laundering Directive (Directive 2005/60/EC). A cross-sector Task Force on Anti-Money Laundering issues has been set up by the three Committees, under the chairmanship of the CEBS Secretary General. A cross-sector mandate was agreed by all Committees in the autumn. The Committees will conduct a stocktaking of the responsibilities of EEA financial supervisors, survey practical issues facing supervisors, and provide expert input into the contributions that the EU Committee of the Preventions of Money Laundering and Terrorist Financing (CPMLTF) will request from the three Committees.

6.5 ♦ Supervisory Convergence beyond CESR

D - Information exchange

In addition to the items covered under sections A, B and C of the 3L3 Work Programme the Committees have exchanged information on all issues set out under this section of the Work Programme, which is resulting in

benefits such as identical or similar developments in areas such as peer review, impact assessment and mediation, as well as in the abovementioned work on substitute products and on the cross sector changes to directives on acquisitions.

NEXT STEPS

The analytical reports on Supervisory Co-operation, Reporting requirements and Internal Governance will be finalised during the first half of 2007, following which a decision regarding how to proceed in relation to these areas will be made.

In 2007 the Committees will continue and strengthen their common work according to the new 3L3 Work Programme 2007 (Annex [x]). The work will be very heavily focused on the Lamfalussy review that takes place in 2007, which will require considerable common work in relation to the reports that the three Level 3 Committees will produce, and the May 2006 ECOFIN conclusions.

The three Level 3 Committees will also endeavour to define a more strategic view of their common work and will during the course of the spring hold a meeting of a joint 3L3 strategic task force with a view to establishing a common longer term perspective on 3L3 work.

6.5 ♦ Supervisory Convergence beyond CESR

3L3 Work Programme 2007

This 3L3 work programme for 2007 is developed in accordance with the Joint Protocol of 24 November 2005. The items included have been selected on the basis of a “significance test” based on three criteria: CESR, CEBS and CEIOPS agreed to focus their joint work only on those topics for which a) there is a high risk of disruptive regulatory arbitrage, b) cross-sector co-operation can deliver obvious gains in the effective conduct of supervisory activities, and c) co-operation between the three Committees could bring about a real efficiency gain. In the work programme some issues are referred to as “priority”, meaning that they will be treated as especially important and will be done in 2007. The Committees may find other areas of common concern during the course of the year, depending (inter alia) on changes in the markets and regulatory initiatives and the results of analytical reports which are currently being prepared.

A- Joint Work

This section of the work programme sets out work which is to be carried out jointly by the three Committees, and which should result in joint output.

1. Financial Conglomerates (priority issue)

The joint Interim Working Committee on Financial Conglomerates (IWCFC) will focus on the identification and mapping of conglomerates and on the framework and process for supervisory co-operation.

Technical input to the Commission will be provided in the area of capital requirements for financial conglomerates, focusing on (a) a comparison of sectoral rules for eligibility of capital instruments, (b) an analysis of the consequences of the sectoral rules for the supervision of financial conglomerates, (c) recommendations relevant to the supervision of financial conglomerates.

In close connection with related work for banking, the IWCFC will also provide technical analysis of the equivalence of third countries supervision, focused in particular on Switzerland and the United States.

2. Integrity

The Committees will work jointly to ensure consistency of approaches in the prevention of money laundering and Terrorist financing (AML/CFT) and in the approach to Off-Shore Centres and non-co-operative jurisdictions (OFCs).

- AML/CFT: the Committees will support convergence of supervisory practices in the implementation of Directive 2005/60/EC (so-called Third Anti-Money Laundering Directive). In particular, they will conduct a mapping of responsibilities, resources and instruments of national authorities – by mid-2007 – and a survey of practical issues emerging in the implementation of the Directive – by late 2007.
- The Committees will jointly work to fulfil the tasks included in the terms of reference of the Financial Stability Table of the EFC. In the course of 2007 they will develop sector specific databases facilitating the exchange of supervisory information concerning OFCs. The Committees will also start exploring possible approaches for the supervision of financial business in such jurisdictions, focusing in particular on internal governance issues. This work, to be conducted in close connection with global forums such as the Financial Stability Forum, will extend into 2008.

3. Joint overview of ‘fit and proper’ criteria on managers

The Committees will review the “fit and proper” criteria for managers across the sectors with a view to have a clear benchmark for convergence of supervisory practices when new legislation in the area of cross-border mergers is in place. This is a priority project, but the precise timing will be defined with reference to the finalisation of the review of relevant Community legislation.

B- Consistency projects to reduce supervisory burdens and streamline processes

This section of the work programme sets out mapping and comparison of sector work projects that aim at streamlining processes and developing con-

6.5 ♦ Supervisory Convergence beyond CESR

sistent approaches across sectors. This might lead to future joint initiatives. A number of tasks have been introduced under this heading which can be derived from the implementation of the so called Francq report, endorsed by ECOFIN in their conclusions of 5 May 2006.

1. 3L3 Consistency on Francq report issues (priority issues)

The 3L3 Committees will actively co-operate to ensure consistency of approaches in the implementation of the ECOFIN recommendations on financial supervision (so-called Francq recommendations). In particular, close connections will be established between sector work on:

- Efforts to enhance a common supervisory culture (training, staff exchanges, etc.)
- Peer review and mediation
- Better regulation, with a particular focus on impact assessments
- Delegation of tasks

2. Own funds (priority issue)

Following the comparison of capital elements eligible for (and deductible from) own funds of banks, investment firms and insurance companies, the 3L3 will analyse in 2007 the impact of the differences and consider how relevant issues can be addressed.

3. Finalisation and follow up to other analytical work from 2006 (priority issue)

In the first quarter of 2007 the Committees will complete analytical reports on:

- Internal governance
- Reporting requirements
- Supervisory co-operation
- Substitute products and related level playing field issues

The reports should serve as the basis for a first analysis by the three Committees, assessing whether there are different approaches, highlighting where each Committee might benefit from experience gained in other sectors, and checking whether further detailed

analysis and/or cross-sector harmonisation are deemed useful.

In particular – following the initial work - the issue of the selling and marketing of substitute products (financial instruments, bank saving products, and insurance saving products) may require joint work in a manner to be defined under heading A during the course of 2007.

For more detailed information, reference is made to the 3L3 Work Programme 2006.

4. Commodities firms' supervision - possible 3L3 item

The CEBS' review of prudential supervisory practices and prudential risks that arise from conduct of commodities business advice on commodities firms, will be finalised in 2007. As a contribution from CESR is expected within the framework of the call for evidence on commodities firms recently issued by the Commission, CEBS and CESR will co-operate closely to ensure consistency of approaches in this area. CEIOPS will continue to liaise with CEBS and CESR in view of its work on Solvency II.

C - Reports to European Institutions

1. Financial market trends, cross sector risks/ convergence (priority subject)

On cross sector risks and on cross sector convergence, the Committees will continue to report jointly to European institutions and/or EU committees, such as the ECON Committee of the European Parliament, the Financial Stability Table of the EFC or the Financial Services Committee (FSC).

2. 3L3 joint Annual Report/medium term agenda

A joint 3L3 report for 2007 will be prepared for the FSC, including a backward looking section on the results already achieved under the Joint Protocol and the 3L3 Work Programme 2006, and a forward looking section to identify a 2/3 years' work agenda and priorities.

¹⁶ Final Report of the Committee of Wise Men on the Regulation of European Securities Markets (Brussels, 15 February 2001), http://europa.eu.int/comm/internal_market/securities/docs/lamfalussy/wisemen/final-report-wise-men_en.pdf, page 37f

6.5 ♦ Supervisory Convergence beyond CESR

D - Information points for the exchange of experiences

On the following issues the Committees will exchange information on their respective work in progress, with the aim of identifying the need for any further specific action. Need for such information may be on a continuous basis or on an ad-hoc basis.

1. Solvency II/Basel II
2. Enforcement of IFRS
3. Audit Committee representation
4. Deposit insurance/Investor compensation/Insurance guarantee
5. Mutual Funds/Hedge Funds
6. External Credit Assessment Institutions/Credit Rating Agencies
7. Clearing and settlement
8. IT data sharing arrangements, including sharing of set-up and maintenance costs.
9. Crisis Management

Draft 3L3 Secretariats' Note as annex to the 3L3 Section of 2007 Annual Reports

Use of 3 Level 3 Definitions - 'Standards', 'Guidelines', 'Recommendations'

CEBS, CEIOPS and CESR (the 3L3 Committees) issue Standards, Guidelines and Recommendations for their financial services sectors.

In doing so they fulfil a core function set for them. The Lamfalussy report¹⁶, now covering the securities, banking, insurance and occupational pensions financial sectors, provides their key objective as "to greatly improve the common and uniform implementation of Community rules" and that therefore, they should:

- "produce consistent guidelines for the administrative regulations to be adopted at the national level;
- 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;

- compare and review regulatory practices to ensure effective enforcement throughout the Union and define best practice;
- periodically conduct peer reviews of administrative regulation and regulatory practices in Member States, reporting their results to the Commission and to the ESC."

It is clarified that "the outcome of this work would be non-binding although clearly it would carry considerable authority." This applies to each of the three titles, so that the use of any of them would have that effect.

The 3L3 Committees have their own individual constitutional Charters. Their financial sectors have sector-specific law, regulation, rules and practice. There is some crossover, yet there are consequential differences between the sectors as to purposes and meanings.

To clarify, and help distinguish where there is EU supervisory cross-sector convergence, the 3L3 Committees have jointly reached an understanding regarding the future use of the titles 'Standards', 'Guidelines' and 'Recommendations', for their publications:

- The titles will continue to be used for those Level 3 publications which aim to achieve the common and uniform implementation of Community rules.
- The 3L3 Committees' choice between the three titles may be sector-specific.
- The 3L3 Committees may therefore use the titles either independently of each other, without subjecting them to 3L3 parallel use, or jointly with each other, for example to reflect some 3L3 parallel use.
- The titles will be used for publications linked to future peer pressure, where possible and useful, supported by a Level 3 Committee mechanism, for example peer review or mediation.
- If a 3L3 Committee does not need a particular title, it need not use that title at all.
- Publications which do not have the aims stated above, should be given different titles from these, such as Reports, Q&As, Agreements executed by all Members, Speeches, or Press Statements.

6.5 ♦ Supervisory Convergence beyond CESR

6.5.2 – EU/US dialogue

SEC

The Committee of European Securities Regulators (CESR) and the US Securities and Exchanges Commission (SEC) established on 2 August a joint work plan. The work plan is the direct result of the December 2005 meeting between CESR's Chairman, Arthur Docters van Leeuwen and Christopher Cox, Chairman of the US SEC, at which they emphasised their desire to build on the dialogue between CESR and the SEC in a concrete and practical manner.

The work plan will serve to guide the CESR - SEC Dialogue in the immediate future. The main focus of the work plan is the application by internationally-active companies of US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) in the European Union and the United States, respectively. In addition, the staff of CESR and the SEC will forge a closer dialogue on the modernisation of financial reporting and disclosure information technology, and regulatory platforms for risk management.

It is expected that the close co-operation between the staff of CESR and the SEC on the application of US GAAP in the European Union and IFRS in the United States will promote:

- the development of high quality accounting standards;
- the high quality and consistent application of IFRS around the world;
- full consideration of international counterparts' positions regarding application and enforcement; and
- the avoidance of conflicting regulatory decisions on the application of IFRS and US GAAP.

In practical terms, as part of its regular review of corporate filings, the staff of the SEC will review issuers' implementation of IFRS in the United States. Staff of CESR Members will also continue to review US GAAP implementation by US issuers in the European Union. Under the work plan, the output of these reviews will be used in the following ways:

- The staff of CESR-Fin, the expert group within CESR focused on financial reporting, and the staff of the SEC, will share information about areas of IFRS and US GAAP that raise questions in terms of high-quality and consistent application of these standards.
- Where appropriate, the staff of CESR Members and the staff of the SEC will consult on issuer-specific matters regarding the application of US GAAP and IFRS in order to facilitate a solution that contributes to the consistent application of US GAAP or IFRS by companies that are both listed in the EU and registered with the SEC.

These two levels of discussion will help ensure that high standards are maintained and consistent financial reporting is achieved.

The first meeting between the SEC and CESR-Fin representatives took place in Washington on 25 October. Paul Koster, Chair of CESR-Fin, led a delegation of CESR-Fin representatives to discuss with the SEC the practical arrangements necessary to start sharing the information at the two levels described above.

A delegation of staff from the Office of the Chief Accountant of the SEC attended the CESR-Fin meeting of CESR in December 2006.

NEXT STEPS

Protocols for the sharing of confidential information between the staff of CESR Members and the staff of the SEC are currently being finalised and will be put in place between SEC and individual CESR Members. The process of developing and agreeing the separate protocols will start during the first half of 2007.

Meetings between CESR and the SEC will continue in accordance with the provisions of the work programme.

It is anticipated that work on the modernisation of financial reporting will continue during the course of 2007, on the assumption that the necessary strategic choices in relation to the storage of financial information within the EU have been made.

Work will also begin on risk management practices in accordance with the third item in the work plan.

6.5 ♦ Supervisory Convergence beyond CESR

CESR - CFTC Task Force

To enhance transparency in the transatlantic derivatives business, a joint task force of regulators from the Committee of European Securities Regulators (CESR) and the U.S. Commodity Futures Trading Commission (CFTC) has published 'Frequently Asked Questions' in the form of "online guides" for conducting derivatives business in the US and the European Union (EU). These guides include country specific information regarding regulation and supervision in the US and in Europe, with information provided by CESR Members in Germany, Ireland, Luxembourg, the Netherlands, Poland, Sweden and the UK. Further country profiles have been added since the first publication, and profiles for other European countries will continue to be added on an ongoing basis.

The publication of these guides marks the first step in addressing the proposals articulated in the joint work programme and announced on 28 June 2005, by the CFTC and CESR. The joint task force from the CFTC and CESR was established in June 2005 to implement the proposals set out in the work programme. The priorities identified are intended to enhance transparency and clarity of regulatory developments in the US and Europe, and to simplify access and recognition procedures.

The online guides are intended to be practical in nature and are divided into sections for each category of user: exchanges, investment services and end-users. In addition, the guides provide useful contact details for specialists within the authorities and links to detailed information (including rules) applicable in the US and in each Member State. General information on the regulators, exchanges, clearing organisations, investment

services, and how to find information about the end-users in each jurisdiction is also provided. The country profiles may be accessed through the CFTC's and CESR's websites or, via the web pages of the individual EU national supervisors.

The initiatives proposed under the joint work programme, of which country profiles form a part, are intended to facilitate transatlantic derivatives business, and reflect considerable industry input. In particular, the work programme was developed after a Roundtable with US and EU practitioners and a public comment period which took place in early 2005. As such, the work programme incorporates the views and priorities identified by organised derivatives markets, intermediaries and end-users from the United States and the European Union concerning practical operational issues that they encounter when conducting transatlantic business in exchange-traded derivatives and related transactions. The objective of this dialogue has been to promote the establishment of a transatlantic business environment that will ensure, to the extent possible, that compatible business and regulatory initiatives can be developed and adopted.

On 13 October, the CESR secretariat was visited by the CFTC Chairman Reuben Jeffrey and the head on international affairs Jackie H. Mesa to discuss the current work plan and a possible need to update it.

NEXT STEPS

A letter will be sent to the participants of the 2005 roundtable in order to ascertain the need to update it.

6.5 ♦ Supervisory Convergence beyond CESR

6.5.3 – Other third country contacts

Meeting with the Swiss Federal Banking Commission – SFBC

CESR, represented by Arthur Docters van Leeuwen, Kaarlo Jännäri, Kurt Pribil, Fabrice Demarigny and members of the secretariat, met on 18 October 2006 with Chairman Eugen Haltiner, Vice-Chairman Jean-Baptiste Zuferey and a group of other high-level representatives of the SFBC.

CESR and the SFBC had a fruitful exchange of information regarding the possibility of the SFBC to assist CESR Members with information in market integrity cases.

CESR visit to Russian securities authority

In September, Arthur Docters van Leeuwen and Fabrice Demarigny visited the Russian securities supervisor, FFMS Federal Financial Markets Services, and two Russian Exchanges, the Moscow Interbank Currency Exchange (MICEX) and Russian Trading System (RTS).

The visit marked a continuation of the contacts between CESR and the Russian authorities, which visited the CESR secretariat in 2005.

Accountability and reporting to the EU Bodies

7

7.1 ♦ Financial Services Committee (FSC)

The Financial Services Committee (FSC) is an EU Council Committee that gathers together representatives of the European Union's Finance Ministries. CESR participates on an observer basis at these meetings.

In February an FSC subgroup chaired by Thierry Francq published its report on financial supervision which includes a number of recommendations on convergence and cooperation, to which CESR provided input during the course of 2006.

In May, ECOFIN endorsed the report of the subgroup, providing a strong political signal that the findings and recommendations of the report had the necessary political backing. The report included a number of recommendations regarding the supervisory

convergence tools that are necessary to be put in place by set deadlines in order to make supervisory convergence a reality. The report's recommendations have driven a lot of CESR's Level 3 work during 2006 and will be a significant part of CESR's 2007 work plan. As mentioned above under 6.1 CESR provided the FSC with its second progress report on supervisory progress in June of 2006.

NEXT STEPS

In 2007 CESR will continue to report to the FSC on the development regarding supervisory convergence, and will submit a package of contributions for the FSC's discussions regarding the Lamfalussy review

Accountability and reporting to the EU Bodies

7.2 ♦ Financial Stability Table of the European Financial Committee (EFC/FST)

The Economic and Financial Committee is a Committee with high level representatives from the Ministries of finance, chaired by Mr Xavier Musca. The EFC holds in its Financial Stability Table format (FST) two meetings each year – in April and September. In 2006, CESR contributed to the discussions held at both of these meetings.

For the April meeting of the FST, CESR contributed to the discussions with a report on cross-sector aspects regarding the functioning of bond markets in the European Union. CESR's report was based upon the input received both from CEBS and CEIOPS (CESR's counterparts in banking and insurance) as well as a group of private sector participants in a CESR wholesale day held in Paris in February 2006. The report, which was very well received, dealt with the primary and secondary markets of bonds and also raised a number of aspects highlighted by market

participants during the CESR wholesale day held in February 2006.

CESR also provided the FST with a report on major trends, developments and risks in the EU securities markets during the second half of 2005 and the first months of 2006.

For the September FST, CESR and the other Level 3 Committees provided the FST with the Level 3 Committees' yearly report on cross-sector risks. The report contained a section on conglomerates and a further section on possible regulatory arbitrage between the insurance and banking sectors deriving from the application of IFRS.

The 3L3 Committees also further provided the FST with a report on a survey done on the supervision of off-shore financial centres (OFCs). This report contained an update of the stock take that the 3L3 Committees undertook in 2005.

NEXT STEPS

CESR will continue to report to the EFC twice a year. Following reports delivered to the EFC in August, the next report will be submitted for the spring Financial Stability Table. (For more details see ECONET Section 6.4.3 of Chapter 6.4 of this annual report) and it will identify major trends, developments and risks in the EU securities markets and hedge funds classification methodologies. A further report which will be presented in September 2007 which will cover the subjects of cross-sector risks and Offshore Financial Centres (OFCs).

In addition 2007, will be marked by the Lamfalussy review which will end with the Ministers' discussion in the ECOFIN in December. These discussions will be prepared by the EFC/FST. CESR will contribute to these discussions during the course of the year.

Accountability and reporting to the EU Bodies

7

7.3 ♦ The European Parliament - ECON

In 2005, CESR and the European Parliament agreed that CESR'S accountability to the European Parliament should be strengthened. Details of this accountability framework were published in a press release in September 2005. CESR and the European Parliament have agreed that:

- CESR notifies ECON of all working mandates and keeps ECON informed of work carried out at Level 3 of the Lamfalussy procedure;
- CESR makes ECON an official recipient of the key letters and other documents that CESR sends to the Commission and the Council;
- CESR submits periodic written reports to the European Parliament on its activities and the progress achieved on supervisory convergence;
- CESR provides the European parliament at an early stage with information on key issues and work likely to have a legislative impact; and that
- CESR participates in a parliamentary hearing at least twice a year.

During 2006, CESR has appeared in front of the European Parliament on several occasions:

- Paul Koster, Chairman of CESR-Fin appeared before ECON twice:
 - On 20 June 2006 he reported on the work of CESR-Fin in relation to three issues:
He outlined the key principles set out in CESR's advice on the equivalence of reporting standards to those of IFRS reporting standards, he also briefly touched upon the issue of the 2009 equivalence requirement and the work that CESR is doing together with SEC on the IFRS and US GAAP.
 - On 12 September 2006 he spoke again in ECON on the issue of equivalence and the postponement decision (until 2009) and the issue of equivalence of third country GAAPs.

- Carlos Tavares, Chairman of the Transparency Expert Group visited the ECON on 4 July 2006 where he presented CESR's advice to the Commission in relation to the Transparency Directive and commented on the Commission's proposed implementing measures for the Directive, and those areas where the Commission's proposals deviated from CESR's advice.
- Arthur Docters van Leeuwen appeared on 19 December 2006 in a hearing before the ECON. The CESR Chairman outlined in a speech the developments of CESR during the last year and reported on changes to CESR'S charter, to the changes of CESR into a more operational organisation, to developments on important issues like MiFID, Clearing and Settlement and cross-sector 3L3 work. Arthur Docters van Leeuwen took questions from the MEP's of the ECON dealing with a wide range of subjects including MiFID and its implementation, the issue of hedge funds, and supervisory convergence.

NEXT STEPS

CESR will during the course of 2007 continue to meet its accountability obligations to ECON.

8.1 ♦ An enhanced capacity embedded in the founding Charter

Following the successful finalisation of the legislative and regulatory phase of the Financial Services Action Plan (FSAP), CESR has decided to shift its priorities to more operational tasks so as to deliver effective supervisory convergence across the EU. This policy orientation was confirmed in the Commission's White Paper (White Paper on Financial Services Policy 2005-2010, December 2005) and by the recent ECOFIN Conclusions of 5 May 2006 (8500/06). The EU institutions and CESR recognise that the continued success of the FSAP is now dependent upon an intensification of supervisory convergence. CESR has responded with a number of changes to the way that it now works in order to become more operational in nature and to function as a cohesive network of supervisors who act in a convergent manner. The key rationale of the change in CESR's profile is developed in its recent supervisory convergence report to the FSC (Ref. CESR/06-259b).

In order to further embed this new dimension, for the first time since its creation in 2001, CESR is amending its Charter (Ref. CESR/06-289c) to include:

- a more straightforward decision making procedure, including the possibility to vote (Art 5.5, 5.6 and 5.7);
- a mediation mechanism between Members to facilitate a rapid outcome (Art 4.4 and specific protocol);
- the integration of the Review Panel into the Charter, which will permit a more thorough cross examination on the way in which Members apply the new legal framework (Art 4.3. A specific protocol will be published in the next months);
- a commitment to respect data protection rules when developing databases (Art 5.2);
- greater legal certainty of confidentiality to allow the secretariat to fully assist the Members on operational issues (Art 7.4).

8.2 ♦ CESR's work programme for 2007

In 2007, all Directives adopted under the Financial Services Action Plan will be implemented and functioning. This will be the case in particular for the Transparency Directive in January and the MiFID in November. Accordingly, as can be seen in the detailed Work Programme set out below, practical day-to-day application and operational co-operation will be the key focus of CESR's activities in 2007.

As regards markets and intermediaries, MiFID represents the most significant evolution for the EU Single Market for financial services. To be smoothly implemented, this Directive will require significant efforts from all parties. In order to assist the industry in their preparation for the new regime, CESR will provide guidelines on the manner in which supervisors intend to apply certain provisions of the Directive where more predictability is expected. The intention is to provide such common approaches sufficiently in advance so as to allow enough time for market participants to adopt their systems and procedures. In fact, EU supervisors and CESR are equally pressed to adapt their system to properly fulfil their tasks in the new environment. Transaction reporting is one example: the Members of CESR must put in place or adapt the national transaction reporting systems, and CESR has to establish an IT data sharing system for them to exchange the transaction reports needed for their supervisory tasks. This will require significant financial and human resources from all parties.

The area of investment management will also be high on CESR's agenda as the Commission will propose a targeted modernisation of the UCITS directive and CESR Members intend to put in place more operational co-operative tools to converge in practice.

During the course of 2007, CESR will evaluate the functioning of the Prospectus Direc-

tive and the first year of application of the IFRS Regulation. In both cases, CESR will put in place mechanisms to facilitate implementation by making public common approaches or decisions in a reactive manner to answer market participants' needs for clarification. In addition, CESR stands ready to follow-up its' various proposals of advice to the Commission regarding the Transparency Directive and, in particular, on storage of regulated information.

To facilitate a more straight forward access to regulatory and supervisory information necessary for the smooth implementation and day-to-day application of the FSAP directives, the CESR website will be significantly redesigned.

A key event in 2007 will be the evaluation of the Lamfalussy approach. CESR intends to contribute actively to this process by measuring the progress achieved, fostering supervisory convergence (mediation, Review Panel, exchange of staff, common training, etc.) and defining a common view of supervisory needs beyond 2007.

Finally, high tribute should be paid to the Members of CESR that have accepted to significantly increase the resources of the secretariat for 2007, at a time when they are all also under heavy pressure to implement the FSAP directives. Accordingly, the current premises will be extended to accommodate five new permanent staff and a significant amount will be invested in IT projects. All the members of the secretariat should also be warmly thanked for their high quality work in preparing and implementing CESR's decisions.

(The detailed work programme Ref 06-627 can be viewed on the CESR web site: www.cesr.eu)



8.3 ♦ 2006 Annual Financial Statement

Profit and loss (Revenues and expenses)

As at December 31, 2006 (In Euros)	31/12/2006	31/12/2005
REVENUES		
Contributions from Members	2 450 001	2 400 000
Annual conferences	0	-9 000
Profit on marketable securities	60 507	39 135
Other	2 779	4
Total revenues	2 513 287	2 430 139
EXPENSES		
Salaries and employee benefits	1 382 796	1 162 285
External staff	308 299	307 873
Rental	457 052	448 249
Travelling	185 307	199 527
Office supplies	17 662	12 698
Organization and follow up of meetings	38 399	32 965
Telecommunications	39 532	32 724
Transportation and communication expenses	0	0
Printing	20 500	22 969
Computer & IT development	13 718	50 931
Professional fees	63 071	57 305
Depreciation of fixed assets excluding computer	35 268	31 533
Miscellaneous	4 690	11 293
Total expenses	2 566 293	2 370 352
Excess of revenues over expenses	-53 007	59 788

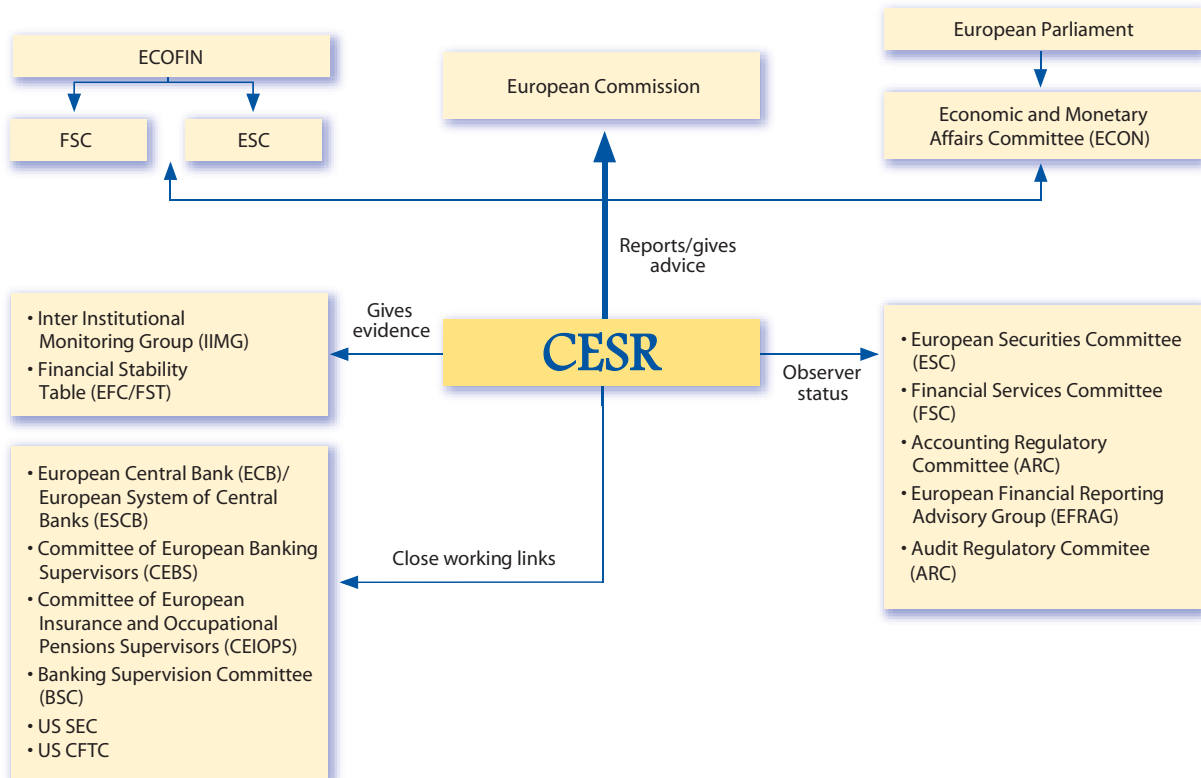


8.4 ♦ Statistics on Meetings

Group	Meetings in 2006
CESR	5
<i>Expert Groups</i>	
• Transparency	4
• Credit Rating Agencies Task Force	3
• ECONET	4
– Impact Assessment (IA)	6
• Clearing and Settlement	0
• Mediation Task Force	0
• MiFID Level 3 Expert Group	3
– Intermediaries	6
– Markets	5
• Prospectus Contact Group	3
• CESR-Tech	6
<i>Permanent Groups</i>	
• CESR-Pol	4
– CESR-Pol Surveillance & Intelligence Group	3
• CESR-Fin	4
– EECS	8
– EECS meetings with IFRIC/IASB	2
Markets Participants Consultative Panel	2
Review Panel	5
Public Hearings	6

A great deal of work was carried out via conference calls, emails and other means of communication.

8.5 ♦ CESR in context: CESR's inter-institutional relationships





The Secretariat of CESR visiting the house of Jean Monnet.

8.6 ♦ CESR's Secretariat

<table border="1"> <tr> <th colspan="2">IT Ari Voipio, Director</th> </tr> <tr> <td> <ul style="list-style-type: none"> • Jorge Fernandes Senior IT Expert • Elena Munoz Senior IT Expert • Eeva-Liisa Tuovinen Senior IT Expert • Nicolas Vasse Senior IT Expert </td> <td> <ul style="list-style-type: none"> • Set-up and running of TREM • Development and implementation of IT systems • IT Data sharing projects • Secretariat of CESR -Tech </td> </tr> </table>	IT Ari Voipio, Director		<ul style="list-style-type: none"> • Jorge Fernandes Senior IT Expert • Elena Munoz Senior IT Expert • Eeva-Liisa Tuovinen Senior IT Expert • Nicolas Vasse Senior IT Expert 	<ul style="list-style-type: none"> • Set-up and running of TREM • Development and implementation of IT systems • IT Data sharing projects • Secretariat of CESR -Tech 	<table border="1"> <tr> <th>Fabrice Demarigny Secretary General</th> </tr> <tr> <td>Deputy to the Secretary General Carlo Comporti Management office, Budget, Plenary, Market Participants Consultative Panel</td> </tr> </table>	Fabrice Demarigny Secretary General	Deputy to the Secretary General Carlo Comporti Management office, Budget, Plenary, Market Participants Consultative Panel										
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8.6 ♦ CESR's Secretariat

<ul style="list-style-type: none"> • Rebecca Ball, Assistant to the Secretary General • Samia Mehdi, Assistant • Karim Abdelali, Logistics 	
Financial Information Javier Ruiz, Director	
Accounting/CESR-Fin <ul style="list-style-type: none"> • Marion Bougel-Bomtemps Senior Officer • tba Accounting Officer 	<ul style="list-style-type: none"> • Enforcement of FRS/Database • Endorsement of IFRS • Audit • Liaison with ARC, EFRAG, AURC and EGAOB • Equivalence of GAAPs
Prospectus, Takeover Bids, Credit Rating Agencies <ul style="list-style-type: none"> • Raquel Garcia Senior Officer 	<ul style="list-style-type: none"> • Offering and listing prospectus • Supervisory convergence • Takeover bids • Credit rating agencies
Transparency <ul style="list-style-type: none"> • Anita Farkas Senior Officer 	<ul style="list-style-type: none"> • Dissemination and storing of regulated information • Periodic financial information • Shareholdings

2007



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8.7 ♦ List of Members



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COMMISSIONE NAZIONALE PER LE SOCIETÀ E LA BORSA (CONSOB)
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8.7 ♦ List of Members

-  **LIETUVOS RESPUBLIKOS VERTYBINIŲ POPIERIŲ KOMISIJA/LITHUANIAN SECURITIES COMMISSION**
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-  **COMMISSION DE SURVEILLANCE DU SECTEUR FINANCIER (CSSF)**
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-  **PÉNYÜGYI SZERVEZETEK ÁLLAMI FELÜGYELETE (PSZAF)/HUNGARIAN FINANCIAL SUPERVISORY AUTHORITY**
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-  **AGENCIJA ZA TRG VREDNOSTNIH PAPIRJEV/SECURITIES MARKET AGENCY**
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8.7 ♦ List of Members

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Member: Mr Jorgen HOLMQUIST

(Director General - DG Internal Market)

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