



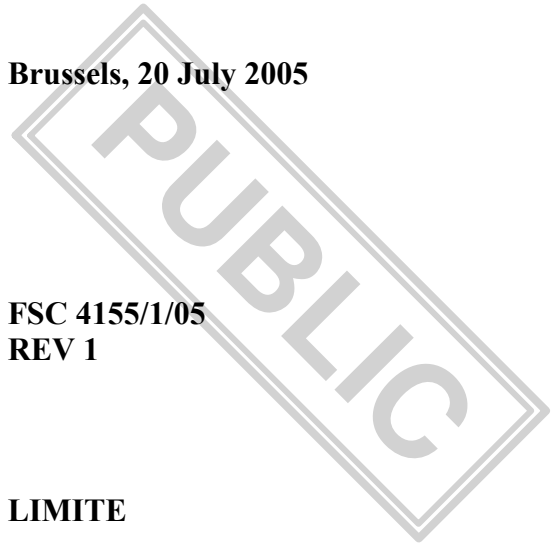
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NOTE

from : FSC Secretariat
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Subject : FSC Report on Financial Supervision - Draft

Delegations will find attached a report on financial supervision, as prepared by the FSC subgroup chaired by Mr. Thierry Francq. This report was discussed at the informal FSC meeting on 8th July.

FSC - Report on Financial Supervision – Draft

| | |
|--|-----------|
| Executive Summary | 3 |
| Introduction | 5 |
| Section 1. Objectives, context and structure of the report | 6 |
| 1.1 Objectives | 6 |
| 1.2 Context | 7 |
| 1.3 Structure of the report | 8 |
| Section 2. Overview of the present framework within the perspective of current market trends... | 8 |
| 2.1 Financial integration is set to increase significantly in the years to come | 8 |
| 2.2 Overview of the current legislative framework | 9 |
| 2.2.1 The division of powers between supervisors | 9 |
| 2.2.2 Information exchange | 10 |
| 2.2.3 The home/host principle | 11 |
| 2.2.4 The supervision of financial groups | 12 |
| 2.2.5 Enforcement powers | 13 |
| 2.3 Cooperation has intensified within the Level 3 committees | 13 |
| <i>Box 1 Some examples of cooperation under Lamfalussy arrangements</i> | 14 |
| Section 3. Assessment of challenges facing the current supervision framework | 15 |
| 3.1 Ensuring effective day-to-day cross-border supervisory cooperation | 15 |
| 3.2 Enhancing supervisory convergence..... | 16 |
| 3.3 Improving cost-efficiency for firms and investors | 18 |
| 3.4 Finding the right balance between more centralised prudential supervision and the location of responsibilities at the national level | 18 |
| 3.5 Ensuring accountability in the current institutional context | 19 |
| Section 4. Developing supervisory tools | 20 |
| 4.1 Fostering supervisory cooperation | 20 |
| <i>Box 2 Suggestion for a mediation mechanism</i> | 21 |
| 4.2 Promoting supervisory convergence | 23 |
| 4.3 Enhancing the cost-efficiency of the EU supervision system | 23 |
| 4.4 Improving cross-border supervision | 25 |
| <i>Box 3 Delegation of tasks and responsibilities</i> | 26 |
| 4.5 Furthering accountability | 28 |
| 4.6 Suggestion for a timeframe for action | 28 |
| Conclusion | 29 |
| | |
| Annex I Timeframe for action | 31 |
| Annex II FSC Mandate to the subgroup | 34 |
| Annex III Hearings | 35 |
| Section 1- Analytical summary of the hearings | 35 |
| Section 2- List of hearing interviewees | 37 |
| Section 3- Questionnaire | 38 |
| Annex IV Overview of the legislative framework | 41 |
| Section 1- Key components of the current framework | 41 |
| Section 2- Prospective view on EU legislation and its implementation | 53 |

FSC - Report on Financial Supervision – Draft

Executive Summary

- I. The Council (ECOFIN), in its 7 December 2004 conclusions, invited the FSC to provide strategic overview on **how the framework for financial regulation and supervision should be developed over the next few years**. The FSC entrusted a small group of its members with the task of providing a practical contribution to the debate on developing supervisory cooperation and convergence.
- II. The efforts deployed in the last five years have overhauled the institutional framework for financial services, laying the ground for an enhanced contribution of the European financial system to the Lisbon objectives. The FSAP has widened the scope of common rules, rationalised and updated the traditional division of powers among supervisors, while strengthening the obligation to cooperate. The Lamfalussy reform has established the basis for addressing the challenge of supervisory convergence, through the work of the Level 3 committees.
- III. **Some challenges however need to be addressed in order to achieve greater consistency and efficiency of financial supervision, as well as to ensure that the decentralised supervisory structure is able to attain its prudential and consumer protection goals.** Cooperation and convergence between supervisors is not an easy task and the Level 3 committees need clear and renewed political support by EU institutions to make the available tools effective, and subject to an appropriate accountability framework. Furthermore, it is imperative to analyse possible ways of reconciling the demand by some of the industry for more centralised group prudential supervision with the location of responsibilities at the national level. To help address these challenges, the report sets out a number of **practical proposals to enhance the operation and efficiency of the existing supervisory framework:**

- IV. Fostering supervisory cooperation: there is significant scope within the existing legislative framework for more effective cooperation, including joint inspection teams, staff exchanges/secondment schemes and common training programmes. It is also suggested to explore setting up a **(non-binding) mediation mechanism** among supervisors for cooperation issues.
- V. Promoting supervisory convergence: the use of **peer review** and moral persuasion ought to be encouraged, including through the use of the above mentioned mediation mechanism. **Possibilities of allowing market participants to trigger the mediation mechanism for issues related to the application of rules should be explored.** A prerequisite also consists in all supervisors sharing fairly similar powers: a careful analysis of any missing competences in the harmonised minimum set of supervisory powers should be conducted.
- VI. Enhancing the cost-efficiency of the EU system: supervisors need to work together to **streamline data processes** and define **common data requirements** for firms, as well as to create **common data bases**. One goal should be for firms to be able to supply data in a specific area to only one supervisory authority, which shares it with the other supervisors.
- VII. Reflecting on ways to improve prudential cross-border supervision: all parties involved (Level 3 committees, Commission, Parliament, FSC) could explore different options to deal with streamlining the supervision of groups, keeping in mind the need to align powers with responsibilities. **Delegation** would be a useful tool to explore further, including in combination with a **collegial approach** where relevant.
- VIII. Ensuring accountability within the present institutional framework: **Level 3 committees should report to the European Parliament, the Council (FSC) and the Commission on a regular basis** about their achievements in terms of supervisory cooperation and convergence, pending more in-depth analysis on what an accountability system could be.
- IX. Suggested time frame: proposals for exchange of staff, joint inspection teams, secondment **schemes** as well as the **streamlining of data collection and exchange** could be made before the **middle of 2006**. Concrete proposals for **mediation** and **delegation** could be developed by **early 2007**.

Introduction

1. Over the past five years, **the EU Financial Services Action Plan (FSAP)** has contributed to modernize and develop the legislative framework designed to stimulate and accompany the emergence of a Single Market in financial services. At the end of May 2005, 39 out of the 42 FSAP measures had been adopted.
2. In taking stock of this near-completion, **the Council (ECOFIN)** stressed, in its June and November 2004 conclusions, that it supported an approach to further integration of the financial sector where **the emphasis should be on convergence of supervision and implementation**. It further stated that full and consistent implementation as well as effective **enforcement** by the Member States must have top priority.
3. After carrying out a public consultation on the basis of the four sectors expert groups¹ reports, **the Commission has recently published a Green paper²** for public consultation on its intended course of action. This latter document highlights, *inter alia*, the key role of supervisory cooperation in underpinning financial integration and calls for greater clarity in the roles and responsibilities of supervisors and further convergence of supervisory practice.
4. Substantial contributions to the debate have also been provided by some **national authorities³** and, at the European level, by the Committee of European Securities Regulators (CESR)⁴. The Committee of European Banking Supervisors (CEBS) and the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) are also in the process of doing substantial work on this issue.
5. Against this background, the **Council (ECOFIN)**, at its 7 December 2004 meeting, invited the FSC to provide strategic overview on how the framework for financial regulation and supervision should be developed over the next few years. In particular, this overview should be

¹ *European Financial Integration: progress and prospect - Reports of four independent groups of experts*, DG Internal Market, 2004, http://europa.eu.int/comm/internal_market/finances/actionplan/stocktaking_en.htm

² This document is available from the Commission website at the following address:
http://europa.eu.int/comm/internal_market/finances/actionplan/index_en.htm#actionplan

³ E.g. more recently, *Supervising financial services in an integrated European Single Market: A discussion paper, January 2005*, jointly published by UK's HM Treasury, FSA and Bank of England; or *Supervising European Financial Groups and Institutions: a discussion paper (March 2005)* by Erkki Sarsa, Ministry of finance (Finland)- both documents are available on the respective websites.

⁴ *"Which supervisory tools for the EU securities markets? Preliminary Progress Report"* ("Himalaya Report"), published on 28 October 2004 and available on CESR's website. Public consultation ended on 31 January 2005.

used as a basis for the EFC discussion on supervision in the September 2005 Financial Stability Table (FST).

6. The FSC therefore mandated a subgroup of its members and observers to develop FSC's analysis of the issues and submit a draft report for discussion and adoption at the FSC's July meeting and **subsequent submission to the EFC-FST in advance of their September meeting.**
7. It was agreed this subgroup report would provide overview of the functioning of the current supervisory framework, taking into account the ongoing regulatory preparations, and would identify the key challenges to be overcome and the possible tools in order to ensure EU supervisory convergence⁵.

Section 1. Objectives, context and structure of the report

1.1 Objectives

8. The Council mandate to the FSC is based on the consideration that political declarations insisting on supervisory convergence and enforcement by the Member States must effectively be followed up by a concrete assessment of the underlying supervisory framework and the subsequent analysis of **evidence-based proposals to enhance it**, so as to make it deliver its full potential and address any possible flaws.
9. The objective of the report is therefore **to identify and analyze the supervisory tools necessary to effectively and efficiently implement financial legislation**, especially the recently adopted FSAP measures. This should allow the European supervision system to fully play its role in underpinning the contribution of an **integrated, open, efficient and competitive EU Single Market for financial services to the Lisbon process of economic reform**. In order to achieve this goal, the supervisory framework must seek to attain three objectives:
 - Effectiveness in the fulfilment of the two main economic functions which warrant its very existence: prudential soundness as the basis for financial stability and consumer protection;

- Make the Single Market work, by contributing to the exercise of the basic freedoms enshrined in Community law and ensuring a level playing field;
 - Minimise the costs of supervision and as a result, the supervisory burden on business, in particular for those institutions which carry out cross-border business.
10. The report should be considered as a contribution towards the overall objective of enhancing supervision. **Further complementary work will be necessary**, alongside the progressive build-up of additional experience drawn from the application of recent or forthcoming legislation.
11. It is also worth pointing out that, since this report aims to focus on enhancing supervisory cooperation and convergence within the EU, it does not intend to cover issues related to cooperation with third-country authorities. Nor does it purport to cover specific arrangements related to financial crisis management⁶.

1.2 Context

12. **The work of the FSC subgroup is complementary to the on-going reflection process** on the future of supervision in Europe (above) and is focussed on developing an assessment of relevant issues **from the viewpoint of Finance Ministries**.
13. The analysis and conclusions drawn by the FSC sub-group have **benefited from informal individual hearings held in May 2005** by the members of the subgroup in cooperation with the Level 3 committees. These hearings, **spanning the securities, banking and insurance and occupational pensions sectors**, have made it possible to better evaluate concrete problems and possible solutions in light of the views expressed by a selected number of industry members⁷, on a number of topics including cost-efficiency and competitiveness issues. Institutional issues⁸ were outside the remit of these hearings.

⁵ See the complete FSC mandate to the subgroup in Annex II.

⁶ The MoU recently endorsed by the ministers of Finance, Central Banks and national supervisory authorities aims to address the threats of possible systemically relevant crises originating in the banking sector.

⁷ See Annex IV- section 1 "Analytical summary of the hearings".

⁸ Specific institutional issues, such as the use of supervisory vetting powers in the context of cross-border take over bids, were also considered as outside the remit of the subgroup mandate.

1.3 Structure of the report

14. **Section 2** begins with a presentation of current market trends and provides an analytical presentation of the present framework: European legislative rules, insofar as they underpin supervisory competences in key prudential areas, Level 3 committees functioning and more generally, voluntary cooperation arrangements.
15. **Section 3** briefly assesses the effectiveness and efficiency of this framework. It lists out the key challenges that the European supervision system has to face, or will be confronted to, in a context where recently adopted, or forthcoming, legislation will come into application.
16. **Section 4** identifies a number of existing practical tools, which, subject to further testing where relevant, could be further developed to enhance the working of the current framework, and proposes arrangements for organising further work, including a suggestion of time frame.

Section 2. Overview of the present framework within the perspective of current market trends

2.1 Financial integration is set to increase significantly in the years to come

17. **As for now, progress in financial integration differs between market segments:** a snapshot of the current state of play, with all the drawbacks of such a limited picture, reveals a heterogeneous image.
18. Moreover, **intra-EU market access takes place in direct and indirect ways:** establishment-based trade is relatively **widespread** and a number of groups with significant presence in more than one EU-countries have emerged for now, mainly through the use of subsidiaries. Direct cross-border activity largely takes place in big volume markets. Delivery of many products to the end-user continues to be organized through local distribution networks (branches or local intermediaries).
19. Nonetheless, **financial integration is accelerating** and is therefore set to increase significantly in the years to come, thanks to the action of **driving forces** such as the **search for consolidation-based efficiency gains**, including through **cross-border mergers; centralisation and outsourcing of key business functions** and the **emergence of the Internet** as a prominent element in distribution channels, within the emerging **EU regulatory framework**.

20. These developments must be seen within **the broader picture of increasing international competition and innovation in a global market**, all of which provide incentives for EU financial service providers to increasingly enhance **innovation** and efficiency so as to compete, both within the EU and beyond. However, this process alone would fail to deliver its full benefits to investors and consumers and to the business community. International competitiveness also requires **top-class regulation and supervision within the EU**, which allows for robust global competitors to emerge.

2.2 Overview of the current legislative framework⁹

21. The **FSAP** has revamped financial legislation, widening the field of high-quality common rules, removing obstacles to the Single Market and adapting the traditional supervisory model to the needs of each market segment.

2.2.1 The division of powers between supervisors

¹⁰

22. In general, the supervisory duties and powers assigned by the EU legislation fall within two main categories, which broadly reflect the differences between the objective of ensuring the **prudential soundness** of financial institutions (which are subject to licensing and quantitative requirements, i.e. on solvency, liquidity, large exposures, qualifying holdings...) and those of promoting **consumer/investor protection** as well as the **transparency and the good functioning of the markets** (i.e. institutions' conduct of business, information provided by issuers and individual conduct in securities markets).

23. In the case of financial institutions, the "competent authorities" in charge of granting authorisation have **broadly comparable powers** in terms of, e.g. vetting the fit-and-proper nature of shareholders/ directors, accessing all necessary information, carrying out on-site inspections within their jurisdiction. Sector-specific powers are of course noticeable, such as the

⁹ Eleven Directives are being analysed -- see tables in Annex IV--, namely: in the banking sector, the Consolidated Banking Directive currently in force and the draft Capital Requirements Directive; in the insurance and occupational pensions sector, the Recast Life Directive, which contains provisions comparable to those of the Non-Life Insurance Directives, the Insurance Groups Directive, and the Occupational Pensions Directive; in the securities and asset management sector, the UCITS Directive (as last amended in 2002) and the four "Lamfalussy Directives" on Market Abuse, Prospectus, Transparency, Markets in Financial Instruments; last, the Financial Conglomerates Directive. However, implementing legislation for the MiFID is still under preparation; a number of Level 2 provisions will therefore complement substantially the EU regulatory framework for financial regulation and supervision. These measures are expected to be adopted by the beginning of 2006.

¹⁰ Specific powers of consolidating supervisors, host MS supervisors, and supervisors of the "Member State of the commitment" in the insurance sector, are in separate sections ("home/host" and "Group") below.

margins of assessment provided to supervisors by the draft Capital Requirements Directive in the banking sector, or the authorisations of portfolio transfers and other powers related to the disposal of assets in the insurance sector.

24. Nearly-identical provisions concern the extensive **list of minimum powers** conferred upon supervisors of securities markets across the **Lamfalussy Directives** (e.g. access to all relevant information, carrying out on-site inspections, freezing/sequestration of assets), thus similar to the prerogatives of banking/insurance supervisors. However, it is worth recalling that these powers should be "in conformity with national legislations".

2.2.2 Information exchange

25. **In banking, insurance and asset management (UCITS)**, provisions on cooperation and information exchange ensure that, in the respect of professional secrecy rules, competent authorities may exchange information and use them. This legal capacity to exchange information intertwines with a general duty to cooperate as provided also by the same sectoral Directives.
26. In order to further clarify the scope of this duty, the draft banking **Capital Requirements Directive** defines the "essential information" that the consolidating supervisor¹¹ has a duty to gather and disseminate. In general, the legislation confers a particular role of dissemination to the home Member State authority (also in the insurance sector), consolidating supervisor (see above) or coordinator (for the supervision of financial conglomerates).
27. **In the securities sector**¹², the Lamfalussy Directives contain a general obligation to cooperate and exchange information. This is further qualified in the Market Abuse Directive, which lists out specifically defined cases where the obligation to supply information to another authority does not apply. This directive also foresees a mediation role for the concerned Level 3 committee (CESR) in case of non compliance with a request of information. The Markets in Financial Instruments Directive provides for extensive cooperation and exchange of information requirements and specifies that information should be exchanged via single contact points. Moreover, in the context of the preparation of implementing legislation for the MiFID, the

¹¹ See below section 2-2-4.

¹² Outside asset management.

Commission is exploring effective ways of transaction reporting and exchange of all relevant information among competent authorities.

2.2.3 The home/ host principle

28. Practically all the legislation under consideration assigns a **prominent role to the home Member State authority** in the prudential supervision of an individual institution, which it has authorised¹³.
29. Insofar as consumer protection is concerned, **conduct of business** is typically the **host** Member State authorities' legal responsibility in the context of **banking and insurance** Directives. On the contrary, in the **securities/asset management field**, the MiFID and UCITS Directives have established **home** country control as a general principle, subject to limited exceptions¹⁴. Where the service is provided on a cross-border basis, home Member State contractual rules may also apply in extensive areas. The supervision of **financial information** of issuers is eventually assigned to the home Member State authority, determined on the basis of the type of securities issued and, in some cases, depending on issuer's choice.
30. As regards the **supervision of branches** in other Member States, branches are covered by the authorisation granted by the home Member State supervisor. **Subsidiaries** are, in general, treated as domestic firms and are therefore authorised and prudentially supervised by their local supervisor (see below).
31. Further general considerations have to be added. First, the counterparty to this prominent role assigned to the **home** Member State authority consists in an **obligation** for it to **cooperate and transmit relevant information to the host Member State authorities**.
32. Second, practically all the legislation concerned with the supervision of financial institutions contains **residual prerogatives for the host member State authorities; nevertheless these prerogatives have been largely abolished in the MiFid, where derogations to the home country principle for reasons of "general interest" will not be possible anymore**. Host authorities may impose statistical reporting requirements to foreign banks, investment firms and

¹³ In the concerned Directives (Prospectus and Transparency), this will depend on the type of securities concerned, i.e. whether shares or bonds.

¹⁴ Under the MiFID, the host Member State's authority retains competences for a branch's compliance with a restricted number of local rules, e.g. on conduct of business, conflicts of interest or order handling rules.

UCITS management companies operating within their territory provided they are treated on the same footing as locally registered institutions. Moreover, there are circumstances in which the host member State authority has the legal capacity to take **emergency measures**, when, following notice by the host member State authority, the home authority has failed to address properly a breach to which these emergency measures apply. Host Member States are competent for **the enforcement of local rules**¹⁵ on foreign branches.

33. Last, home/host cooperation is also crucial in **the inspection of host Member State branches** by the home member State authority, which is subject to prior information of the host member State authority (and its possible participation in the case of life insurance undertakings).

2.2.4 The supervision of financial groups

34. **The progressive emergence of a consolidating supervisor** cooperating with foreign supervisors has strong implications for the definition of a group-wide supervisory strategy, including inspections of foreign branches and subsidiaries, and the collection and dissemination of information.
35. **In the banking sector**, the draft Capital Requirements Directive would further extend the role of the “consolidating” **supervisor**, towards validation of internal models (as a fall-back to a collegial decision). It would also confirm the possibility to delegate tasks from one supervisor to another (which is already provided for in existing banking legislation, although this provision has never been put into effect) and further specify that additional tasks may be entrusted to the consolidating supervisor.
36. **In the insurance sector**, consolidated supervision appears to be less formalised. The Directive on supplementary supervision of insurance groups specifies that the competent authorities "may reach agreement" as to which of them will be responsible for such supervision. Furthermore, the Recast Life Assurance Directive contains a specific provision for third-country undertakings with a network of branches in several Member States (incl. e.g. Community "consolidated" calculation of the solvency margin) and a central role for the competent authority which is to supervise the solvency of the entire business of agencies/branches throughout the Community.

¹⁵ These local rules include e.g. minimum liquidity ratios in the banking sector or labour and social rules for the running of occupational pensions schemes.

Importantly the aforementioned Insurance Groups Directive allows for sub-consolidation, but does not clarify its rules of application.

37. As noted above, international cooperation with third-country authorities is beyond the remit of this report. It is nonetheless worth noting that the supervision of risks borne by **third-country components of EU-based groups** remains a challenge to effective group supervision, in light of constant financial innovation and of the importance of off-shore operations.

2.2.5 Enforcement powers

38. Another general cross-sector feature in the supervision of financial institutions is that **competent authorities must have the power to take measures** to address breaches of legal rules, which can go as far as withdrawing the authorisation¹⁶. These powers are essential to allow competent authorities to comply with their responsibility on the soundness of financial institutions.
39. In the case of **securities markets**, all four "Lamfalussy" Directives contain a series of identical provisions in this respect: they refer to Member States for the imposition of "proportionate and dissuasive penalties". A clear preference for administrative sanctions has been expressed in all Lamfalussy directives.

2.3 Cooperation has intensified with the Level 3 committees

40. It is worth recalling that **supervisory cooperation between national supervisory authorities did not start with the Lamfalussy structure** and is not restricted to activities within the Level 3 committees¹⁷. Indeed, before the establishment of CESR, CEBS and CEIOPS, national supervisory authorities were already co-operating both bilaterally and multilaterally, in formalised and informal ways, including through the use of MoUs, sets of principles and protocols. The Siena and Helsinki Protocols¹⁸ in the insurance sector and the FESCO MoU on

¹⁶ See Annex IV.

¹⁷ Consider the Memorandum of Understanding on cooperation between payment systems overseers and banking supervisors in Stage 3 of the Monetary Union (January 2001), or the MoU on high-level principles of cooperation between banking supervisors and central banks in crisis management situations (March 2003), which has been recently supplemented by a second MoU involving Ministries of finance-- see footnote 6.

¹⁸ The Siena Protocol (October 1997) mainly focuses on the exchange of supervisory information and mutual assistance in case of cross-border onsite inspections, whereas the Helsinki Protocol (May 2000) focuses on the co-ordination of committees with respect to the relevant cross-border insurance groups.

the exchange of information and the surveillance of the securities markets (January 1999), are good examples of such pre-existing multilateral cooperation arrangements.

41. The Lamfalussy reform was conceived as a way of delivering a Single Market while keeping the decentralised supervisory structure. A key part of the four-level architecture was the creation of committees of national supervisors entrusted with ensuring **more consistent and timely day-to-day application** of Community legislation in Member States¹⁹, through improving co-ordination and cooperation among the EU's national supervisory authorities. These Committees of national supervisors operate as a network, which, through consensus and peer group debate, can enhance co-ordination and cooperation among them. As a result, a few practical illustrations of such cooperation are listed below.

Box 1:

Some examples of cooperation under Lamfalussy arrangements

CEIOPS is expected to finalise this year a Memorandum of Understanding (MoU) for the cooperation between competent supervisory authorities in the implementation of the IORP Directive, as well as a MoU for the implementation of the Insurance Mediation Directive.

CEBS will propose common reporting guidelines (under the Capital Requirements Directive).

CEBS will propose guidelines and/or identify best practices for co-operation between home and host supervisors.

CESR has developed preliminary guidance regarding certain operational requirements of the Market Abuse Directive (MAD).

CESR is developing a database which sets out decisions by national enforcers on the application of EU financial information requirements.

CESR has developed a specific mediation system under the MAD and considers developing a more general mediation system.

CESR has developed Level 3 recommendations for the consistent implementation of the Prospectus Directive.

¹⁹ The charters of CESR, CEBS and CEIOPS specify that they contribute to common and uniform day-to-day application of Community legislation: issuing guidelines, recommendations and standards that the members will introduce in their regulatory practices on a voluntary basis; undertaking reviews of supervisory / regulatory practices within the single market.

42. Even if their track record is relatively short, the work of Level 3 committees has already contributed significantly to supervisory convergence. Yet, as the Himalaya Report suggests, they may well encounter problems to achieve their goals in the next five years if the available tools are not underpinned by a reinforced political and institutional impulse.

Section 3. Assessment of the challenges facing the current supervision framework

43. **The current framework of supervision still has to become fully established.** The Lamfalussy arrangements, still relatively new, have been extended to banking, insurance/occupational pensions and asset management (UCITS) quite recently, while some of the measures contained in the Financial Services Action Plan will only be implemented in coming years.

44. It must therefore be emphasised that the present analysis is based on an "interim shot" of the ongoing evolution of the EU supervision framework, and that further benefits are expected from the concrete application of the most recent, or forthcoming, legislative measures of the FSAP. Looking ahead to further developments, it is useful to stress **the need for continued monitoring of the evolution of this framework.**

45. This being said, **five main challenges can already be identified at this stage:** ensuring effective day-to-day supervisory cooperation; enhancing supervisory convergence; improving the cost-efficiency of the supervision framework; finding the right balance in the functioning of the home/host cooperation; and ensuring appropriate accountability within the present institutional context.

3.1 Ensuring effective day-to-day cross-border supervisory cooperation

46. Financial integration **increases the risk of cross-border contagion** during or following financial crises and hampers the effectiveness of consumer protection and market transparency rules. This is reinforced by the fact that financial groups increasingly organise themselves across business lines (and not along legal or national boundaries).

47. The FSC believes that effective supervision of these cross-border risks and consistent application of conduct of business and financial information supervision are essential to

maintain consumer confidence, financial stability and market integrity, for the **credibility of the Internal Market**. While financial integration is not a new phenomenon, a change in the level of this integration can be expected in the years to come²⁰, thus **requiring a similar change in the level of cooperation between national supervisors**. There is a need to go beyond existing pre-Lamfalussy arrangements in terms of concrete benefits for **daily supervisory cooperation**, e.g. improvements on **information collection and sharing or cross-border investigations**.

48. Enhanced cooperation will, of course, be facilitated by the implementation of the FSAP, which extends the range of tools available to supervisors in the discharge of their duties. Once the FSAP is fully implemented, EU legislation will allow for a range of models of cooperation, including coordination, collegiate discussions, and some forms of delegation. Supervisors will want to ensure criteria are in place in order to select the form of cooperation they deem most appropriate for a given situation. Moreover, the effective and widespread application of the tools will require a **strong commitment on the part of the supervisors to utilise the full range tools at their disposal and support on the part of the Member States** to ensure that their national supervisors have the resources and incentives needed for active cooperation.
49. Another prerequisite for that enhancement of supervisory cooperation is that all supervisors should undertake to get a **clear and common understanding of the comprehensive array of tools** they have at their disposal to further supervisory cooperation. Experience shows that this precondition is not equally met in all constituencies and the role of Level 3 committees is crucial in going through this step.

3.2 Enhancing supervisory convergence

50. Differences in the application of rules shared by the Member States are often reported to **hamper cross-border activities** and undermine the level playing field between market participants. Therefore, the FSC unreservedly supports the initiatives already undertaken by the Commission in this area, such as transposition working groups, network of single contact points, transposition tables.
51. Yet, this is only a first step towards **convergence of supervision, which may be defined as more consistent and common decision-making and enforcement practices among supervisors**. The reports of the four independent expert groups published by the European

²⁰ See section 2 "The pace and forms of financial integration".

Commission in May 2004 as well as recent feedback from industry leaders in the context of the aforementioned hearings show that many **financial firms with cross-border activities or multi-jurisdiction issuers request a more consistent approach** to decision-making and enforcement by the supervisory authorities.

52. In order to enhance convergence, **a prerequisite consists in all supervisors sharing fairly similar powers**, noting that concerns on a potentially hindering **disparity of the supervisory competences needed** have been raised by CESR regarding the supervision of the securities sector. The FSC welcomes the mapping and clarification efforts undertaken in this respect by the Commission, noting that Member States have the duty under the EC Treaty to provide their competent authorities with all the necessary powers, and in keeping with the objective of full and consistent implementation of EU legislation. Without prejudice to further continued monitoring alongside the adoption of future legislation (Levels 1 and 2), the FSC notes that this should be further completed by **a careful analysis, lead by the Commission and involving Level 3 committees, of any missing competences in the harmonised minimum set of powers**. Any new legislative initiative would, of course, have to be initiated by the Commission and gather the consensus of both the Council and the European Parliament.

53. In the securities sector, **CESR's "Himalaya paper" has raised the issue of what is considered as the inability of supervisors to effectively abide by common application guidelines** adopted within Level 3 committees. Without national arrangements that enable supervisory authorities to voluntarily abide by such interpretations or appropriate Minister's commitment to help their supervisory authorities do so, Level 3 networks' agreements could fail short of ensuring true supervisory convergence. Moreover the FSC believes the effectiveness of such non-binding standards can be optimised by:

- the greater use of the “comply or explain” principle when implementing standards so that a lack of implementation of such standards by a Member State is fully explained in a transparent manner;
- the greater involvement of market participants in the development of such standards, where relevant;
- the setting-up of colleges of supervisors (in cases where several supervisors share responsibility for supervising a cross border entity) sharing information and views and adopting common understandings about how to implement the non-binding standards.

3.3 Improving cost-efficiency for firms and investors

54. As expressed in the independent expert group reports and recalled by industry leaders in the aforementioned hearings, **cross-border groups favour rationalisation of the European supervision system in order to reduce supervision costs** and lighten the regulatory burden.
55. They first expect policy makers and supervisors to ensure that the national structure of the European supervision system **does not prevent an organisation based on business lines and centres of expertise**. They also look for **a rationalisation of information collection processes** based especially on single contact point ("one stop shopping") and standard reporting and disclosure formats. They would welcome common reporting templates, provided this brings about real streamlining, and does not merely aggregate national requirements. They eventually want to ensure that the EU supervisory arrangements in general are **as cost-efficient as possible and avoid regulatory duplication**. It is also crucial for **market participants and investors to have access to financial information at competitive rates**.
56. The FSC stresses the importance of having an efficient system of supervision for Europe's financial services markets in terms of costs and regulatory burdens for market participants. **Costs need to be kept under control** to prevent the European supervision system from becoming an obstacle to integration and competition within the EU. At least, authorities should have a clear idea of the economic impact of any significant measures taken (especially as regards those that entail important IT investments). Efficiency, as well as the avoidance of regulatory duplication, are key to **keeping Europe's financial market competitiveness compared with other major financial markets**. Here again, the **credibility and the attractiveness of the European regulatory and supervisory system** are at stake.

3.4 Finding the right balance between more centralised prudential supervision and the location of responsibilities at the national level

57. The **home-host** principle, underpinned by the concept of mutual recognition, and the additional principle of **consolidated supervision** are **at the core of the European supervision system**, but there are **perceptible tensions in both**, and faster integration of the financial sector could well test the operation of this system.

58. On the one hand, the demand of market participants for a rationalised supervision system and the need for identifying growing cross-border risks related to the supervision of groups call for **streamlining arrangements to give increased powers to the parent company's supervisor²¹**.
59. On the other hand, there is **a fundamental obstacle to this trend in the present institutional framework, due to the responsibility of local supervisors for maintaining financial stability in their own jurisdiction, which entails controlling the soundness of the concerned local entities**.
60. In the case of branches, there might be **a need to increase the information available to, and to provide for better participation of the host supervisor** under certain circumstances, in particular where the activity of the branch is systemically significant. Yet, in this case, incentives are better aligned, as the problems in a branch will directly affect the balance sheet of the company in the home Member State and the deposits would be covered by the Deposit Guarantee System of the home Member State. It is also worth noting that **some players might convert a large number of subsidiaries in other Member States into branches**, helped by Community law.

3.5 Ensuring accountability in the current institutional context

61. National supervisory authorities are already accountable to their respective Member States, according to national rules. As regards the Level 3 committees, some transparency and reporting **mechanisms also exist**: the FSC has for instance decided to question the Level 3 committees every year about progress in the area of supervisory cooperation and convergence.
62. However, since the guidelines that the Level 3 committees produce have significant potential effects on markets and firms - though legally non-binding - the question has been raised of **ensuring that the Level 3 committees function with the necessary transparency and that they provide adequate information by reporting to the concerned EU institutions**.

²¹ Whether this supervisor is labelled as "consolidating", "coordinating" or sometimes, though this is legally inaccurate, "home supervisor".

Section 4. Developing supervisory tools

4.1 Fostering supervisory cooperation

63. The FSC believes there is a **need to develop a set of indicators**, illustrating how cooperation increases over time. These could be developed in cooperation with Level 3 Committees, so as to allow regular reporting to Ministers on progress in this field.
64. Furthermore, the FSC would stress that **trust among supervisors**, and between firms and supervisors is key to the development of a supervisory environment adapted to the Single Market. The FSC fully supports initiatives to promote a deeper culture of trust and cooperation. In particular, the FSC encourages CEBS, CESR and CEIOPS to investigate and jointly report back on establishing **secondment schemes** among their members and on any outstanding obstacle to **the creation of inspection teams** staffed by supervisors from different Member States. Further lasting benefits may also be expected from the establishment of **common training systems**, so as to **promote a genuine European supervisory culture**²².
65. When disputes and disagreements arise²³, **appropriate mechanisms have to be in place to resolve them and mediation can be an effective tool in this regard**. For instance, in the financial markets sector, the Market Abuse Directive (MAD) already provides for the introduction of a mediation mechanism designed to facilitate cooperation between supervisors. The FSC therefore believes consideration should be given to the idea of arranging a **Level 3 mediation process between supervisors to settle cooperation problems**.
66. By definition, mediation mechanisms are non-binding and should respect the institutional boundaries set by the EU Treaty. However, through effective peer pressure and common trust and understanding between supervisors, **they may have a considerable impact**. The FSC stresses the importance of a strong voluntary commitment on the part of the supervisors and support by their Member States to ensure the effectiveness of such a procedure. In its own

²² It is worth noting that some limited common training programmes already exist, which should be encouraged and brought more systematically to a European scale. Moreover, there is no overestimating the importance of building trust and cooperation reflexes, not only among senior managers, but also between operational interlocutors such as heads of division and their officers. This is especially crucial in the sectors where supervisory practice is being influenced by recent legislation (as is currently the case for securities), or still has to palliate, for a number of years, the obsolescence of the EU legislative framework whilst avoiding uncoordinated national stances (as is the case in the insurance sector).

²³ The aforementioned hearings have provided a number of concrete cases, such as, e.g. 3-year long -unresolved- divergences on the eligibility of assets pooled into the European treasury structure of a given insurance group.

sectoral remit, CESR is examining the possibility to extend the mechanism foreseen under the MAD (see above) to other areas requiring cooperation between supervisors.

67. By taking into account their different needs and timing, **the FSC invites the Level 3 committees to work on how a mediation mechanism could be developed** within the existing legal framework to produce rapid and effective solutions in the case of cooperation shortcomings or implementation problems. **The following box presents some suggestions on how such a mediation mechanism might work, which should not be considered as foreclosing further progress on this debate.**

Box 2:

Suggestions for a mediation mechanism

68. Mediation could prove useful in two different situations. In the **first case**, the mediation mechanism would address **purely cooperation issues between supervisors**; in the **second case**, the mechanism would be focused on the **application of rules, concerning cross-border issues**. In this latter case, and whilst fully respecting the existing institutional framework, possibilities of **allowing market participants to trigger the mechanism under certain conditions** should be explored. In both situations, the **Commission** would need to be appropriately informed of all the cases subject to mediation.
69. In the first situation, the mediation mechanism, to be triggered only by supervisors, would be established to address **cooperation issues among supervisors on the basis of peer assessment**. That mediation mechanism would concern **practices and enforcement**, and would need to be carefully articulated with the work and prerogatives of Commission services, whilst leveraging on experience built with existing peer-group pressure mechanisms, such as CESR-Pol²⁴. Its strength would be based on the shared principle of **a duty to cooperate** loyally, against which supervisors involved in a "cooperation failure" would have to explain themselves. This mediation would be more suited to remain in a "peer context". Nevertheless, **Ministers of Finance could be requested to provide some political "underwriting"** to the aforementioned principle of loyal cooperation.

²⁴ CESR-Pol was set up in 2002.

70. In the second situation, the mediation mechanism would be focused on the **daily application of the rules to market participants – especially as regards cross-border operations - and could be triggered by the private sector under certain conditions.**
71. **Private operators are often best placed to detect harmful diverging interpretations.** As a preliminary suggestion, **the FSC proposes to consider a way to give a role to the private sector, under strict conditions that guarantee the correct functioning of the mediation.** The FSC is aware that at the beginning, firms may be reluctant to trigger this mediation process.
72. The mediation mechanism could rely on a **"filter" in order to ensure that the mediation is only requested for cross-border issues (and not for purely national issues).** The mediation procedure would **guarantee the necessary degree of confidentiality of the information provided.**
73. The **final** decision, after the "filter" decision, would be taken by a college of supervisors, based on the peer principle. Despite its **non-binding status**, it is expected that possible publication could further reinforce its moral suasion effect.
74. As noted above, any mediation initiative should of course **respect the limits of the institutional framework**, including the four-level Lamfalussy approach, and therefore should not be seen as interfering with the competences of the EU institutions (e.g. the Commission's enforcement competences and those of the European Court of Justice in terms of interpretation of EU law).
75. It is also essential that the mediation mechanism provides for efficient **reporting of the submission of cases to mediation and the outcome of the mediation process to the European Commission.** There should be adequate reporting, including a constant communication channel between the mediation panel and the Commission regarding the cases brought into mediation, so as to allow the Commission services to make an efficient assessment on the legality of those cases.
76. A **rapid and clear decision-making process** would be needed to ensure that mediation can be seen as a credible dispute settlement tool. The different sequential steps of the procedure, with their respective deadlines, should be set out in detail.

4.2 Promoting supervisory convergence

77. The FSC is in favour of deepening the functions of Level 3 committees. **The use of peer reviews to measure the degree of convergence needs to be encouraged.** The FSC urges the Level 3 committees to use this type of mechanism and to report regularly to the FSC on the results of these peer reviews.
78. **Mediation in the context of the application of rules should also be fostered,** as explained in the box above. The FSC believes that resorting to mediation offers an interesting way **to promote not only cooperation but also convergence** in the supervisory decision-making process.
79. **Further analysis of missing competences in the harmonised set of minimum powers** should also be promoted. A comprehensive mapping of the powers provided under the Directives compared to those that Member States have granted to their authorities should be undertaken. This mapping could be monitored and reviewed on a regular basis by the FSC.
80. The FSC strongly supports carrying out a **"read-across exercise" lead by the Commission and involving the Council (FSC) and the European Parliament with the assistance of Level 3 committees,** which would help detect and prevent inconsistencies in financial services legislation²⁵.

4.3 Enhancing the cost-efficiency of the EU supervision system

81. Streamlining the provision and supply of data is one of the measures intended to lower supervision costs for the business community and thereby enhance efficiency. Supervisors need to work together – through the Level 3 committees – to define **common reporting and disclosure templates** and develop **common data languages**. In addition, supervisors should also work together through the Level 3 committees to develop arrangements that **avoid or minimise the duplication of reporting.**

²⁵ This is also foreseen in the concept of "dynamic consolidation" enshrined in the Commission Green Paper on its post-PASF strategy, on which the FSC is also entrusted with advising the EFC-FST and Finance Ministers.

82. As regards **common data templates**, the FSC encourages the Level 3 committees to continue their efforts to standardise the format, content, timing and frequency of the reporting from firms, in cooperation with the Commission. Bearing in mind this objective, the FSC supports the work undertaken by CEBS **to standardise inspection and audit data** and to develop common reporting templates such as **common reporting on banking solvency ratios**. The FSC also invites **CEIOPS** to analyse whether greater opportunities for data streamlining – for instance, within the context of the Solvency II project – may be envisaged, and put into practice in the medium term.
83. In the same direction, the FSC strongly encourages the Commission, in collaboration with Level 3 committees, **to achieve effective and efficient data collection and exchange, and develop common supervisory databases** (e.g. on transaction reporting; cases of disclosure infractions regarding listed companies etc.) depending on the needs and deadlines for implementation of each Lamfalussy directive involving the creation of such a database. A number of questions will need to be solved for that purpose, in identifying those responsible for paying, arranging and running/maintaining the concerned databases. In order to avoid blockage in the process, there is a need for **strong political impetus**. The issues raised, in this respect, by the implementation of the MiFID and of the Transparency Directive will need to be addressed in a timely manner, on the basis of forthcoming Level 2 measures clarifying data collection and dissemination requirements in the specific circumstances provided for by these Directives.
84. Against this background, the FSC would like to point out that greater streamlining and convergence of data provision should, insofar as possible, be in line with the technological standards in use by the industry and that it should lead to real and genuine efficiency gains for market participants, thus **avoiding to add a further layer of standards**.
85. The FSC also invites the Commission, working in collaboration with the Level 3 committees, to investigate **ways to simplify reporting procedures**. One area for further study would be how a firm could supply a single set of data to a single supervisor, and for that data to be shared seamlessly among supervisors. The aim should be progressively to eliminate as much as possible information requests other than those from the competent authority responsible for an institution.

4.4 Improving cross-border supervision

86. The FSC stresses the importance of **analysing possible adjustments to the legal division of powers and responsibilities** between the consolidating supervisor and the subsidiaries' supervisors, with a view to defining a common and consistent prudential approach able to assure soundness at reduced compliance costs.
87. In the short term, the practical application of the provisions in the **Draft Capital Requirements Directives** will offer a useful insight on the problems and options, which can serve as an input in the process leading to the future **Solvency II** regime for insurance. To deal with this sensitive issue, the FSC recommends to bear in mind the **following principles**:
- **Balance** between the objectives of **cost-efficiency**, on the one hand, and **prudential soundness and financial stability**, on the other hand;
 - Respect the **alignment of powers with responsibilities**, in order to provide the right incentives to supervisors;
 - The **legal structure of cross-border groups** should be **left to their managers and shareholders** to decide. In particular, there should be **no impediments to switching to a branch-structure** using the **European Company Statute**.
88. There are at least two (possibly complementary) ways to make headway in the short to medium term. The first one is **delegation of tasks**, which could enable authorities to take advantage of **proximity and local knowledge** ("delegation of the home to the host") but also help **minimize duplication** and ensure **better efficiency and consistency of supervision** ("delegation of the host to the home"). The terms of delegation would need to be clear and published, preferably in generic form so as to avoid moral hazard. The delegation could also **rely on a college of supervisors**, in order to have a common understanding and a global approach. This delegation of tasks would be **revocable at any time and monitored** by the delegating authority.

Box 3:

Delegation of tasks and responsibilities

89. **Where tasks are delegated**, the decision-making responsibility would remain with the delegating competent authority, but the other authority would carry out processes on its behalf and report the outcome back to the delegating authority or other interested authorities. This delegation of tasks would have to go beyond that of trivial tasks if it were to reduce the regulatory burden. In this case, the delegating supervisor would retain full political responsibility for all decisions made.

90. **Where responsibilities are delegated**, the delegating authority would delegate the power to make decisions on its behalf to the other authority. These arrangements would need much more study and elaboration. They would probably require legislative change, perhaps establishing a general legal framework in which delegation might take place. In this latter case, the delegating supervisor would be held legally and politically accountable of the decision to delegate and its on-going monitoring (which assumes it would keep the effective capacity to do so), but not accountable of the single decisions taken by the mandate recipient.

91. In both cases – delegations of tasks and of responsibilities – the regulator delegating would need to be assured that the supervisor to whom tasks and responsibilities were delegated **had the necessary powers to achieve the agreed outcomes**.

92. The second option would consist in a **collegial approach**, with a division of powers depending on the nature of the decisions. Building on the concept of a college of supervisors, this approach would attribute to the **consolidating supervisor** the final say in powers which are not essential for the subsidiaries' supervisors to discharge their responsibility (e.g. assessment of capital adequacy and internal control systems), while keeping enforcement powers in the hands of the latter.

93. A further consideration is that **both these approaches are actually included in some parts of the current EU legislation**. The option of a **collegial approach** would deepen the approach already adopted in the Financial Conglomerates Directive and in the Draft Capital Requirements Directive. As regards **delegations of tasks**, they are foreseen in the Banking Consolidated Directive – though, significantly, the concerned provision has met with little or no success –

and in the draft Capital requirements Directives. The EU legislation also provides for possible **delegations of responsibilities** in some specific cases. But this latter type of delegation is more complex to put in place, since it requires precise matching of the transferred powers and responsibilities as well as solid legal bases

94. Therefore, the FSC would recommend adopting a **step-by-step approach**. Without prejudice to the practical implementation of the collegial approach under the aforementioned banking and conglomerates Directives, **opportunities for delegating tasks could be developed in the short to medium term, on the basis of existing legislation**. The FSC invites the Level 3 committees to develop a framework dedicated at making these delegations work within the legal limits set by the EU directives.
95. The FSC would also invite the Level 3 committees to analyse whether there are legal, practical or accountability obstacles **to the operation of a system to delegate the supervision in the sectors where this delegation does not exist yet**. In the area of securities, this possibility can be developed under the Prospectus Directive.
96. **In a longer term perspective**, the final solution to the problem of the prudential supervision of groups is linked to progress in developing a satisfactory framework to determine the **allocation of legal and financial responsibilities** in case of a distressed institution. **Delegation of responsibilities** (see above) could prove to be a useful tool in this regard. The FSC recalls that it will address conflicts of interest issues in the **incoming crisis simulation exercise** and that the Commission has expressed its intentions to review the Directive on Deposit Guarantee Schemes.
97. **It is also important to monitor the operation of the combined home/host and parent/subsidiary supervision system** in the years ahead, particularly by **developing indicators** to assess the rise of distortion phenomena between the responsibilities of supervisors and the systemic or political importance of certain activities for their home Member State. Indicators linking the responsibilities of supervisors to the share of an issuer's activities carried on in their home territory could also be developed.

4.5 Furthering accountability

98. Depending on the relevant political context, **different levels of "accountability" may exist**. In some instances, "accountability" may only refer to informal reporting. In others, accountability relates to a general duty to formally report to related stakeholders. At its utmost level, accountability may even imply the capacity to call into question the responsibility of the accountable institution and have it change its procedures and policies, where relevant. At this stage, and in consideration of the rather recent set up of Level 3 committees in the banking and insurance/occupational pensions sectors, it would appear premature to decide on a final policy line regarding the assessment of their accountability. **The FSC would therefore stress the need for conducting a careful analysis in this respect and to define a common approach on this issue.**
99. In any case, supervisory convergence, which is a major European objective, will mainly rely in the present institutional framework on Level 3 committees. It is therefore necessary that these committees **report regularly to the relevant EU institutional parties – the European Parliament, the Council (FSC) and the Commission - on their achievements in the performance of their European tasks of supervisory convergence and cooperation.**

4.6 Suggestion for a timeframe for action

100. Systems to encourage and facilitate **training, exchange of staff and secondment** could be put in place, under the aegis of the Level 3 committees, as soon as the **middle of 2006**. Precise proposals by the Level 3 committees, in cooperation with the Commission, for more effective **streamlining of data supply** and more efficient **collection and exchange of data** could also be encouraged by that **same deadline**.
101. Concrete proposals to develop **mediation and delegation** mechanisms could be made by the Level 3 Committees, the Commission and the FSC by **early 2007**. A more detailed timeframe is provided in **Annex I**.

Conclusion

102. **The EU has reformed its framework for financial regulation and supervision in a rather smooth and rapid way.** Importantly, this evolution has largely been an institutional response to market developments rather than precipitated by some form of financial crises.
103. This accomplishment is a necessary precondition for reaching the goal of an integrated market for financial services in Europe, – a sound and globally competitive market, where all players are on an equal regulatory footing.
104. Nevertheless, **there is still much to be done**, in order to fully optimise the potential for supervisory cooperation contained in the present system of supervision. This challenge is, maybe, the most difficult, since it lies in daily supervision and cooperation. It necessitates enhanced trust between supervisors, and progressive convergence of their practices. It is not surprising that such kind of progress should take some time. But it should not take too much time either: **Europe shouldn't wait for too strong tensions to emerge in the system, before putting in place the necessary tools to facilitate its functioning.**
105. **These proposed tools are described in the report.** They rely on important prerequisites, such as fairly similar minimum powers for supervisors. They basically consist of prudential data streamlining; the creation of a mediation mechanism that the private sector could trigger under certain conditions; support to delegation of tasks and responsibilities between supervisors and finally developing a series of staff exchanges and training between supervisors to enhance mutual understanding and develop trust.
106. The European financial services market is evolving. To cope with the expected upsurge of integration, it could prove necessary to adapt the present institutional system of financial supervision. **It is therefore desirable to undertake regular assessments, like this one, and to be ready to prepare reactions** - further new tools or adaptations of the system – to any further challenging market developments.

107. In any case, setting up these tools will not be enough. What will make a difference, is their effective use. **The outcome will therefore depend, first of all, on the capacity and the will of every concerned institution – the supervisors, the Commission, the Member States, the European Parliament – to dedicate real efforts to further progress in supervisory convergence and cooperation.**

108. The European financial industry and markets are evolving. The supervisory system must adapt and work effectively to meet the new challenges in its daily functioning. **Strong political impetus is therefore needed, at the EU level as well as in the Member States.**

Annex I: Timeframe for action:

| Objective n°1: foster supervisory cooperation | | | | |
|--|-------------------|---|--|--|
| Tools | Leader(s) | in coop. with | Deadline | Deliverables |
| 1. Secondment schemes | L 3 committees | | mid-2006 | joint L 3 committees' report to Commission, FSC |
| 2. Common training systems | | | | |
| 3. Cross-national inspection teams | L 3 committees | | mid-2006 end-2006 | - joint L 3 committees' report to Commission, FSC on obstacles -first pilot projects + indicators |
| 4. Mediation | L 3 committees | Commission | (mid-2006) early 2007 end 2007 | (- possible joint L 3 committees' interim report to Commission, FSC on outstanding obstacles) - start-up -first comprehensive report on the functioning of the mechanism to FSC and Commission |
| 5. Monitor progress in cooperation | - Commission, FSC | - Commission, L 3 committees - FSC, Commission | - end 2006 - early 2007 | - indicators - first reporting by L 3 committees incorporating these indicators |

| Objective n°2: promote supervisory convergence* | | | | |
|--|------------------|------------------------------|--|---|
| Tools | Leader(s) | in coop. with | Deadline | Deliverables |
| 6. Read-across exercise on FSAP Directives | Commission | Member States, L3 committees | yearly first one: end 2006 (following adoption of Level 2 implementing measures for MiFID) | - yearly findings report on progress from the Commission |
| p.m. 4bis. Mediation (see above) | L 3 committees | Commission | see above | see above + proposals & first report on the functioning of the mechanism to clarify preconditions to possible trigger mechanism for industry |

(*): without prejudice to existing initiatives under the aegis of:

- the Commission: e.g. transposition workshops, etc.
- Level 3 committees: e.g. CESR-Pol/CFESR-Fin meetings & hearings

| Objective n°3: enhance cost-efficiency of the EU supervision system | | | | |
|--|---------------------------------|---------------------------|---|---|
| Tools | Leader(s) | in coop. with | Deadline | Deliverables |
| 7. Common data templates for firms' reporting to supervisors + streamlining of timing & frequency of such reporting N.B. this concerns both regular reporting + data requirements for inspections | L 3 committees | Commission, Member States | - mid-2006 - final completion will depend on sectoral legislation: e.g. end-2006 for securities? end-2007 for banking? | - first presentation to Commission and FSC of comprehensive action programme, identifying target areas (e.g. solvency ratios)* - complete sets of data templates; agreed common timing and frequencies? - 2006/7 indicators of reduced regulatory costs for firms |
| 8. Common/streamlined systems for supervisory data exchange | L2 legislation + L 3 committees | Commission | - mid-2006 | - first presentation to FSC of comprehensive action programme, prioritising target areas in view of pilot projects |
| 9. Common supervisory databases | | | - mid-2007 | - progress report to Commission, FSC on pilot projects |

* taking stock of action already undertaken by L 3 committees, e.g. CEBS in the context of the preparation for the entry into force of the Capital Requirements Directives, and identifying outstanding issues.

| Objective n°4: improve cross-border supervision | | | | |
|--|---|---------------------------|--|--|
| Tools | Leader(s) | in coop. with | Deadline | Deliverables |
| 10. Delegation of tasks poss. 10.bis Delegation of responsibilities | L2 legislation + L 3 committees L2 legislation | Commission, Member States | (mid-2006) early 2007 end 2007 | (- possible joint L 3 committees' interim report to FSC on outstanding obstacles) -proposals by L 3 c ^{tees} with timetabling dependent on sector/legislation -first comprehensive report on the functioning of the mechanism to FSC and Commission |
| 11. Monitoring functioning of home/host and parent/subsidiary supervision system | L 3 committees | FSC and Commission | (mid-2006) end-2006? (yearly) | (- possible joint L 3 committees' interim report to FSC on outstanding obstacles and indicators) - first report by L 3 committees to FSC |

| Objective n°5: further accountability for Level 3 committees | | | | |
|---|--|----------------------|-----------------|---|
| Tools | Leader(s) | in coop. with | Deadline | Deliverables |
| 12. Enhanced reporting by L 3 committees to EU institutions + increased transparency thereof | -each concerned EU Institution: Council (FSC), European Parliament, Commission | | -yearly | - L 3 committees annual reports to be published indicating activities-report (public) |
| | - Inter-Institutional Monitoring Group* | | - yearly | |

* whose 6 members have been appointed by the three Institutions, with a mandate running up to end-2007.

Annex II - FSC Mandate to the subgroup

Mandate for the "Supervisory tools" subgroup as adopted by the Financial Services Committee at its 7th April's meeting:

The EcoFin Council, in its conclusions of 7 December 2004, invited the FSC to, *inter alia*, provide 'strategic overview on how the EU framework for financial regulation and supervision should be developed over the next few years from the finance ministries' viewpoint.

The EFC plans to hold an **orientation discussion** on how to develop the framework for financial regulation and supervision over the next few years in the **September 2005** Financial Stability Table.

The FSC invites the subgroup to prepare the FSC's contribution to this orientation discussion in the EFC-FST. For this purpose, the subgroup is invited to present by 20th June to the FSC, in view of the July 2005 meeting, a draft document, which should provide overview of the functioning of the current supervisory framework, taking into account the ongoing regulatory preparations. The document should set out the FSC's analysis of the key issues relating to supervisory practice, spanning the securities, banking and insurance sectors, and identify challenges to be overcome in order to ensure EU supervisory convergence. In particular, the document should include:

- a reaction from Ministries of Finance's viewpoint to the main issues raised in CESR's analytical paper on "Which supervisory tools in the securities sectors"²⁶, building on and reflecting the outcome of the FSC's discussion at its meetings of 21 January 2005 and 7 April 2005;
- a reaction to the contributions to the FSC 7 April 2005 meeting by CEBS and CEIOPS on strategic supervisory challenges in their sectors;
- suggestions for organising further work.

The FSC welcomes the plans of the Chair and members of the subgroup to jointly sound out the views of market participants in the securities sector and, insofar as possible, already in the other financial sectors. The objective is to get market participants' views (i.e. combining the financial industry's and users'/consumers' perspectives) on how the current EU framework for financial regulation and supervision functions, to identify obstacles to supervisory convergence and supervisory challenges to further sizeable progress in financial integration.

²⁶ "Himalaya report"

Annex III- Section 1

Analytical summary of the hearings

Organisation of the hearings

Two sessions of hearings were held on 20th and 25th May by the members of the FSC sub-group on supervision. Sixteen high-level industry representatives were interviewed²⁷ during one hour each, based on a questionnaire elaborated by the subgroup²⁸.

Outcome of the hearings

The hearings focused on two main topics: **the challenges and obstacles** to full and consistent application of EU legislation and **the possible tools** that may be developed.

Challenges and obstacles to full and consistent application

A number of participants started with the fact that supervisors have **differing mission statements**: while some Member States appear to favour consumer protection, others give priority to enhancing market capacity to function efficiently. Moreover, supervisors tend to have differing **implementation powers**.

Many participants stressed that implementation and enforcement would be easier if **the legislation were more precise and consistent** : *"problems should not be avoided at Level 1 and 2 and systematically transferred to Level 3"*. Participants also highlighted that in certain sectors, like insurance, **the degree of harmonisation is currently too limited**, thus providing national supervisors with excessive leeway.

For Level 3, **the question of non-binding standards was often raised from two different points of views**: for some, the non-binding nature of the standards agreed within CESR, CEBS and CEIOPS is a good point, insofar as these standards come from consensus and might, if relevant, be later upheld by the Commission. On the other hand, some participants stated that the non-binding nature of standards hampers financial integration because of the large interpretation margins they leave to national supervisors.

The question of the **home-host and parent/subsidiary supervision principles** was also often raised: some participants highlighted the discrepancies in the application of the Directives and in the behaviour of the national supervisors. As a result, some participants referred to the idea of **transforming subsidiaries into branches**, despite the importance of the related challenges.

A number of high-level representatives also expressed concern about **national supervisors choosing to interpret EU legislation and regulations in a heterogeneous and inconsistent manner**, and the regulatory burden this places on firms.

Although this was not raised in the questionnaire, the question of **political accountability** was also brought up, especially as regards **Level 3 committees**.

²⁷ The list of the 16 persons is included at the end of this annex.

²⁸ This questionnaire is attached as Annex [x].

Supervisory tools that could be further developed

Streamlining in the supply and sharing of data is supported by a majority of participants.. They pointed out that common formats should use standard technology or at least be in line with the formats currently in use in the industry. **New formats must be exclusive of the existing ones, and should not correspond to the mere aggregation of national requirements.** Common reporting templates would help curb compliance costs and ensure that the industry and supervisors share a common approach in terms of economic capital, especially in the insurance sector.

Mediation is also a suggestion that got significant support. Most participants made a clear distinction between **two forms of mediation**: a first one, which should take place only between supervisors, and a second one, which might also involve the private sector on cross-border issues. However, some markets participants expressed doubts as to whether the private sector would really dare to trigger the mediation mechanism against the supervisor which is supervising it on a daily basis. Some participants suggested that for the second kind of mediation – which would provide for a possible right to appeal from the private sector – a **mechanism of filter**, possibly a "wise men committee", could be put in place in order to avoid unjustified requests.

Delegation of tasks as well as delegation of responsibilities were also suggested as useful tools. Delegation of tasks was, for example, mentioned as regards cross-border investigations (and the subsequent collecting of all the relevant information) or as regards the assessment against CPSS/IOSCO standards. Delegation of responsibilities would represent a large step forward.

Most market participants agreed that **the institutional balance should be maintained** as it is now. Some participants pledged for **an increase in the Commission resources** dedicated to controlling the application of the European legislation (Level 4), which would require a significant reallocation of resources.

Eventually, many participants outlined the need for **a clear time-frame**, in order to give some visibility to the industry.

Annex III- Section 2

List of hearing interviewees:

Banks and investment firms:

Mr. Dominique HOENN, BNP Paribas, Senior Adviser

Dr. Siegfried JASCHINSKI, Landesbank Baden-Wurtemberg, Chairman of the Executive Board

Mr. José PÉREZ FERNÁNDEZ, Intermoney, Presidente

Dr. Bernard SPEYER, Deutsche Bank Research, Head of Banking, Financial Markets, Regulation

Mr. Radek URBAN, Erste Bank, Director asset management

Mr. Freddy VAN DEN SPIEGEL, Fortis, Chief economist

Insurance groups:

Mr. Mel CARVILL, Generali, Head of strategic planning and corporate finance

Mr. Denis DUVERNE, AXA, Director general finance, strategy and control

Dr. Adrian GLAESNER, Allianz, Syndikus, Group Legal Services

Exchanges and market infrastructure:

Mr. Adam KINSLEY, LSE, Head of Regulatory Policy

Mr. Olivier LEFEBVRE, Euronext, Member of the Managing Board

Mr. Poul Erik SKAANNING-JORGENSEN, OMX Exchanges, Senior Vice-President, Head of EU Regulations

Sir Nigel WICKS, Euroclear, Deputy Chairman

Asset managers (investment funds):

Mr. Wolfgang MANSFELD, Union Investment, Managing Director

Issuers:

Mr. Philippe CAMUS, EADS, (former) Chief Executive Officer

Mr. Santiago FERNANDEZ VALBUENA, Telefonica, Chief Financial Officer

Annex III-Section 3:

Questionnaire ("guidelines for discussion") for these hearings

Foreword for hearing participants:

Ministers of Finance have requested the EU Financial Services Committee to provide a strategic overview on how the **EU framework for financial regulation and supervision** should be developed over the next few years. Once completed the extension of the so-called "Lamfalussy process" to the banking and insurance sectors, the main challenge is now supervisory convergence. National regulatory authorities cooperate within sectoral networks (the so-called Level-3 committees: CEBS in the banking sector, CEIOPS in the insurance and occupational pensions sector and CESR in the securities sector), which have been entrusted, *inter alia*, with the functions of contributing to consistent application of EU law and supervisory co-ordination. The smooth performance of these functions is paramount for the achievement of an efficient, well supervised and integrated European financial services market.

In building on the current framework, the purpose of the foreseen exchange of views is to assess with key market participants from all sectors (securities, banking, insurance, pensions) and users' representatives the extent to which it meets their expectations (in terms of e.g. regulatory costs and administrative burdens) as well as the objectives of supervisory convergence and market integration.

Participants' views are especially invited on the following set of issues. Views on other issues they consider relevant to the debate would also be welcome. Participants should also note that this questionnaire, and the subsequent hearing, are dedicated to looking at the issues about how best to enhance the convergence of supervisory practice within the current institutional framework, and are not aimed at bringing about institutional or legislative change.

Questions:

Ensuring full and consistent application of EU legislation

Over the last year, the Council of Finance Ministers (ECOFIN) has stressed repeatedly that priority should be given to full and effective implementation and enforcement of EU legislation in financial services.

1. Based on your own experience, what are the main challenges/obstacles to reaching the objective of full and consistent application of EU legislation?

Ensuring a level playing field in applying EU legislation through CESR's / CEBS' / CEIOPS' adoption of common standards

A core aspect of bringing about greater convergence of supervisory practice between the national supervisory authorities is the adoption of common standards and practices. These standards and practices are adopted through a common agreement and are non-binding.

In the securities sector, according to CESR's analysis, the process of adopting non-binding common standards could, in certain circumstances, hinder the objective of supporting a truly integrated market. Non-binding standards have clear advantages in terms of flexibility, but they might also entail drawbacks in terms of ensuring compliance and legal certainty for market participants..

2. How can the effectiveness of these non-binding common standards and practices be optimised? What is the scope for mediation mechanisms and for peer pressure?

Reducing the regulatory costs for market participants and users

The need to boost the streamlining of regulatory/supervisory requirements (e.g. on disclosure formats) has already been brought to the attention of EU institutions, especially the European Commission, and made the target of coordinated improvement planning with the Member States. In general, there is wide awareness among EU institutional stakeholders that more needs to be done on this front, but clear indications of the amounts at stake and of the related priorities are needed from industry.

3. Where do you see the major opportunities to reduce cross-border regulatory costs?

Home/Host issues

The current European supervisory framework relies on the backbone concepts of *home* Member State (where a company has its registered office) and *host* Member State (where a company conducts a particular business through the establishment of a branch or by free provision of services). Community legislation assigns different supervisory tasks and responsibilities to supervisory authorities, depending on whether they are home or host competent authorities.

Recent conferences and publications, including CESR's Himalaya paper for the securities sector, have raised the awareness of challenges for both the supervisors and the supervised entities. These challenges stem from the concrete application of the home/host supervisory framework to particular activities/corporate cases.

4. What is your experience of dealing with a combination of home /host supervisor(s), especially as regards possible differences in supervisory powers?
5. What is the impact of the current practical implementation of the home/host framework in respect of the optimisation of your business organisation (e.g. foreign branches vs. subsidiaries)?
6. Are there significant examples of practical gaps/overlaps, which better "home/host" cooperation could contribute to address?
7. Could you rank the major challenges which your organisation faces in terms of supervisory compliance?

Ensuring better supervisory cooperation through better use of existing tools

Optimising the current supervisory tools available to Europe's supervisors, within the current institutional arrangements, is imperative to the creation of efficient and effective supervisory arrangements. Recent papers, which *inter alia* include the CESR paper on supervisory tools, set out a number of areas where the possible range of tools potentially available within the present EU framework could be enhanced, i.e. beyond the current supervisory practice.

In the securities sector, CESR's Himalaya paper mentions more than 20 tools, which may be regrouped as follows:

▪ **Tools for consistent application:**

- developing peer pressure and mediation within the Level 3 Committee, to foster convergence;
- developing transparency tools (databases of enforcement decisions, common information pools available to groups or colleagues of regulators...);
- introducing pre-clearance processes within the Level 3 Committee.

▪ **Tools for supervisory co-ordination:**

- data centralisation and standardisation (transactions report, regulatory information);
- co-ordinated /joint investigations, whether or not under the umbrella of the Level 3 Committee;
- secondment of staff between supervisors;
- ad-hoc or standard MoUs to organise cooperation and delegation (where legally possible) of powers between authorities involved in the supervision of multi-jurisdictional market players;
- where this is grounded in EU legislative texts, a "co-ordinating supervisor" mechanism.

8. In your view as a market participant / users' representative, which of the (potentially) available tools should be further developed as top priority within the present EU framework?

The present framework and your needs

As explained in the foreword, this exchange of views is building on the current EU framework. Nonetheless, there might be concrete cases where your key expectations as to the necessary convergence of supervisory practice and standards cannot be met with the tools in use by the competent authorities, or, in general, available to them within this framework.

9. If you believe that the expected benefits of supervisory convergence your organisation needs cannot be attained within the present institutional framework, explain why and which particular options could then be considered?

Annex IV - Overview of the legislative framework:

Section 1 - Key components of the current framework (incl. pending enhancements expected to be brought about by would-be Capital Requirements Directive)

| | Banking (consolidated banking Directive in force) BCD | Additional provisions brought forward by draft Capital Requirement Directives (as of 07.12.2004) | Key direct Insurance Dir.: non-Life Directives & recast Life (taking the latter, 2002/83/EC, as a the main reference) + insurance groups Directive | Occupational Pensions Directive | UCITS Directive (i.e. harmonised investment funds) as last amended by Dir. 2001/107/EC and 2001/108/EC |
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| Harmonised minimum supervisory powers | <p><u>Articles 4-8; 53-54, 56:</u></p> <p><u>No particular list of minimum powers</u>, but competent authority in charge of authorisation (Art.4&53) shall be provided with all necessary information (Art.5-8) and be satisfied with the quality of shareholders and the group structure (Art.7); this is monitored on an on-going basis (control of qualifying holdings in a credit institution, Art.16).</p> <p>Competent authorities have a general duty to exchange information as needed (Art.28), subject to professional secrecy (Art.30).</p> <p>The home Member State authority has the right to carry out on-the-spot verification of the information re Art.28 in foreign branches following prior information of the host Member State's competent authority (Art.29);</p> <p>Without prejudice to the procedures for the withdrawal of authorisations</p> | <p>The intended new legislation would strengthen requirements on internal organisation/controls and risk management processes within the supervised institutions (new drafting of <u>Art.22(1)</u>), thus providing supervisors with more powers and margins of assessment in their supervisory review process (<u>Art.124</u>).</p> <p>Adaptation of Art.29 in the case in the context of consolidated supervision (see "Group" below, Art.129(1))</p> | <p><u>e.g. Recast Life Directive</u> (mutatis mutandis, the same remarks apply to non-life legislation, except in one minor point which is mentioned below):</p> <p><u>Articles 4, 5-7; 8; 10, 13; 14; 15:</u></p> <p>competent authority in charge of authorisation (Art.4), i.e. the home MS authority, has investigation powers, and shall be provided with all necessary information (Art. 5-7); it also has to be satisfied of major shareholders and group structure prior to the authorisation (Art.8); this is monitored on an on-going basis (control of qualifying holdings in an assurance undertaking, Art.15).</p> <p>Furthermore, the home MS authority is also competent to authorise transfers of portfolio (Art.14), after consulting the host MS in the case of a branch, and obtaining the agreement of the competent authorities of the Member States of the commitment</p> | <p><u>Articles 9(5) and 20</u> provide that, in the case of cross-border activity (i.e. an institution wishing to accept sponsorship from a sponsor undertaking located in another MS), the conditions of operation of the institution shall be subject to prior authorisation by the competent authorities of the home MS.</p> <p><u>Article 13</u> provides the competent authority with powers to access information and carry out on-site inspections. There are additional information requirements in the case of cross-border activities (Art.20(3)).</p> <p><u>Article 14 sets out a number of powers of intervention and duties of the competent authorities:</u></p> | <p><u>Article 4-5h, 13a-13c, 21, 49-50</u></p> <p><u>No particular list of minimum powers</u>, but general principle that the competent authorities must be granted all the necessary powers to carry out their task (Art.49). The competent authority in charge of authorising the UCITS (Article 4) must be satisfied with the fit-and-proper quality of the UCITS management company's director also in respect of the type of UCITS to be managed and of the depositary's directors, as well as the suitability of the management company's shareholders.</p> <p>The recent harmonisation of conditions for taking up business and operating conditions for management companies has beefed up the</p> |

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| | <p>and the provisions of criminal law, the competent authority must have power to adopt/ impose penalties or measures aimed specifically at ending observed breaches or their causes (Art.32);</p> <p>the competent authority in charge of exercising consolidation on a consolidated basis, in general that in charge of the parent's authorisation (Art.53), may in some cases decide on the form and extent of consolidation (Art.54);</p> <p>in the case where the parent is a mixed-activity holding company, information relevant to the supervision of its banking subsidiaries may be required from it or from them, and be subject to on-the-spot inspections (Art.55);</p> <p>precisions on powers for the exercise of consolidated supervision (Art.56): see below ("group").</p> | | <p>(see below);</p> <p><u>Article 13 sets out a number of minimum supervisory powers</u> for the home MS authority, including on the basis of accounting, prudential and statistical information.</p> <p>Regarding on-the -spot verification of foreign branches, Article 11 of the Recast Life Dir. contains the same provision as in BCD's Art. 29, except that it is here specified that the host MS auth. may participate in the verification.</p> <p>The Directive also contemplates the powers of the host MS (see below, home/host) and a of an entity, which is specific to insurance legislation: the "<u>Member State of the commitment</u>", i.e. where the policy holder has his/her habitual residence or the establishment to which the contract relates.</p> <p>The authorities of that latter MS have a general competence and responsibility as to the contractual law (without prejudice of possible waivers), and the application of general good principles to the marketing of services within their territory. The authorities of the MS of the commitment have a right and duty of alert re the home MS authority when they consider that the activities of an assurance undertaking might affect its financial soundness (Art.10 - worth noting this explicit duty is</p> | <p>these include, inter alia, the power to restrict or prohibit the free disposal of the institution's assets in certain conditions; transferring the power to run the institution to a special representative; prohibiting or restricting the activities of an institution.</p> <p><u>Article 15</u> on technical provisions: the actuarial method on the basis of which their calculation shall be executed and certified must be recognised by the competent authority.</p> <p><u>Article 16(3)</u> on the funding of technical provisions: the home MS authority shall intervene in accordance with powers of Article 14, where an IORP acting on a cross-border basis does not have its technical provisions fully funded. The authority may require ring-fencing of assets and liabilities.</p> | <p>harmonised set of prudential rules and principles, both of a quantitative and qualitative nature, the compliance of which must be monitored by competent authorities. (This EU-harmonised set of rules was, until the 2002 legislative update, mostly limited to investment limits and rules for UCITS themselves).</p> <p>Competent authorities have a general duty to collaborate closely and communicate to each other all information required (Art.50).</p> <p>Regarding specifically the case where a management company operates in host MS through the provision of services or by the establishment of branches, the competent authorities of all the MS concerned have a duty to "collaborate closely" (Art.52a).</p> <p>Regarding on-the -spot verification of foreign branches, Article 52b contains the same provision as in BCD's Art. 29.</p> |
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| | | | specific to <u>life</u> assurance). They can also be super-equivalent for consumer information on essential parts of a contract (Art.36(3)). | | |
| Information exchange | <p><u>Articles 28& 30 and 56 above.</u></p> <p><u>Article 28:</u> the information to be exchanged covers:</p> <ul style="list-style-type: none"> - the management and ownership of the credit institution; - <i>inter alia</i>, information regarding the liquidity, solvency, deposit guarantee, the limiting of large exposures, administrative and accounting procedures and internal control mechanisms. <p><u>Article 30:</u> subject to professional secrecy rules, competent authorities may nonetheless exchange information between themselves and with other public authorities and bodies; conditions for the use of such information are listed.</p> <p><u>Article 56:</u> see precisions below ("group")</p> | <p><u>Article 129(1)</u> provides that the consolidating supervisor shall coordinate the "gathering and dissemination of relevant or essential information in going concern and emergency situations"</p> <p>Art. 132 provides, in particular, that competent authorities shall communicate on their own initiative all "essential information", which is defined in that same Article.</p> | <p>e. g. in the Recast Life Directive:</p> <p><u>Article 16 (similar to Article 30 of the BCD):</u></p> <p>subject to professional secrecy rules, competent authorities may nonetheless exchange information between themselves and with other public authorities and bodies; conditions for the use of such information are listed.</p> <p><u>Article 49</u> also provides for the home MS authority to collect and, "within a reasonable time and on an aggregate basis", disseminate to the other MS authorities information on cross-border transactions.</p> <p>See also under "Group" below</p> | <p>No special provision, except:</p> <ul style="list-style-type: none"> - <u>Art. 20</u> on the cooperation between home MS's and host MS's authorities in the case of cross-border sponsorship of an institution; - <u>Art. 21(1)</u> providing that MS shall ensure the uniform application "through regular exchanges of information and experience with a view to developing best practices in this sphere and closer cooperation..." | <p><u>Articles 22(4); 50; 52a</u></p> <p>Regarding the product (UCITS), provisions concern mostly home-host cooperation (below), except the general principle that competent authorities must exchange all information required to carry out their supervisory task (Art.50(1)), and specific information on certain categories of bonds, which UCITS may invest in up to a derogatory (higher) limit -- which the Commission collects (Art 22(4)) and puts on its website.</p> <p>Regarding specifically the case of management companies' operation through the provision of services or through branches, MS authorities must supply one another on request with information on management/ownership and "all information likely to facilitate the monitoring of such companies" (Art.52a).</p> |

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| <p>Home/host cooperation</p> | <p><u>Article 1(6)&(7):</u> definitions</p> <p><u>Articles 13 & 26:</u> As a general principle, prudential rules are set by the home MS, whose authorities have the competence of control.</p> <p><u>Article 20:</u> right of establishment is subject to successful completion of notification procedure.</p> <p><u>Article 22:</u> host Member State may impose reporting requirements on branch for statistical purpose (subject to non-discrimination)s; in case of irregularities, host MS authority may take emergency precautionary measures in case home MS authority fails to act, and subject to Commission ex-post validation.</p> <p><u>Article 26:</u> host MS retains responsibility for liquidity supervision in cooperation with the home MS authority + measures resulting from implementation of monetary policy.</p> | <p>planning on-site verifications of foreign branches as part of overall supervisory activities: see Art. 129(1) under "Group" below.</p> | <p>e. g. in the Recast Life Directive:</p> <p>General principle of home MS supervision (Article 10) , but the host MS authority maintains certain prerogatives.</p> <p>In particular, <u>Articles 40-42, 46 and 49</u> :</p> <ul style="list-style-type: none"> - notification requirement to the host MS to set up a branch (Art.40) and to work under free provision of services (Art.42); - possible application of conditions in the interest of the general good by the host authority; - possible adoption of measures in case of breaches of obligations by the host MS authority; - possibility to request any information that is requested from locally-registered undertakings (Art.46). <p>Note that there is no similar provision to e.g. BCD's Article 22, i.e. reporting requirements by host MS authority. Here, the host MS authority has to depend on the home MS authority (re: Art.49 above on "Information exchange").</p> <p>Worth noting that, in the special case of <u>transfers of portfolio</u> (re Art.14) from branches/agencies whose <u>head offices are outside the Community</u>, the MS of the transferring branch/agency must</p> | <p><u>Article 20:</u></p> <p>An institution wishing to accept sponsorship from an undertaking located in another MS must notify its intention to the competent authorities of its home MS which will transmit the information to the authorities of the host MS</p> <p>The institution shall be subject to:</p> <ul style="list-style-type: none"> - the relevant host MS's requirements of social and labour law, - any information requirements imposed by the host MS's competent authorities; - if identical or stricter rules are applicable in the host MS, investment rules and ring fencing requirement as laid down in Art.18(7), for the concerned part of their activity. <p>For that host MS part of its activity, the institution is under the supervision of the host MS competent authority., which may ask the home MS's authority to decide on the ring-fencing of the concerned assets/liabilities.</p> <p><u>Article 20(9)-(10)</u> provides for breaches to the host</p> | <p><u>Article 1a (5) & (6):</u> definitions</p> <p><u>Art. 6</u> (for the management company) and <u>49</u> (for the product-UCITS) lay own the general competence of the home MS, except residual host MS competences, in particular on marketing and advertising the product (Art.44& 49(3)).</p> <p>Following the 2002 legislative update, the UCITS Directive now contains two notifications procedures:</p> <ul style="list-style-type: none"> - relating to the product passporting (Art.46); - relating to the management company's passporting (Art. 6a-6b). <p>That latter procedure is largely modelled on the mould that inspired e.g. BCD's Art.20.</p> <p><u>Art. 6c:</u> also related to the management companies' cross-border operation, similar prerogatives to those in BCD's Art.22, i.e. possible reporting requirements and steps towards emergency precautionary measures in case of irregularities.</p> |
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| | | | also obtain the prior agreement of the competent authorities of the MS of the commitment, where different. | MS's labour and social law to be first reported the host MS's competent authority to the home MS's one. If the latter's action proves insufficient/ineffective, the host MS's authority may take measures, including preventing the institution from operating in the host MS for the sponsoring undertaking. | |
| Enforcement | <p><u>Article 14:</u></p> <p>The home MS authority has the power to withdraw the authorisation, by motivated decision, against a precise set of preconditions.</p> <p><u>Article 22(5)-(8):</u></p> <p>The host MS authority retains the power to take measures to prevent or punish irregularities, incl. by preventing further transaction within their territory.</p> | <p><u>Article 136:</u></p> <p>A minimum list of measures available to competent authorities is provided, including a specific own funds requirement in excess of the standard minimum level when other measures alone are unlikely to prove effective enough.</p> <p>It is worth noting that this is related to a widened scope for the supervisory review process (re: Art. 124 above) and the prudential requirements applicable to supervised institutions, both quantitative (own funds requirements under Art.75) and qualitative (Art. 22(1) above).</p> | <p><u>E.g. in the recast Life Directive (2202/83/EC):</u></p> <p><u>p.m. Article 13(3)</u> allows the competent authority to take any measures with regard to the undertaking, its directors/managers or persons who control it, to ensure compliance with laws /regulations ... and prevent or remedy any irregularities prejudicial to policy holders.</p> <p><u>Articles 37-39 & 46:</u> prudential measures to be taken in particular cases, i.e. when policyholders' rights are threatened or when an undertaking fails to comply with its obligations:</p> <ul style="list-style-type: none"> - limits to the free disposal of assets; - examination of financial recovery plan (when policy holders' rights are threatened)/ plan for the restoration of a sound financial position - imposition of a short-term finance scheme - imposition of higher required | <p><u>See Article 14 above.</u></p> | <p><u>On the product -UCITS:</u></p> <p><u>Article 52</u> splits the competence to take action between the home MS, where measures may go up to withdrawal of authorisation via suspension of repurchase or redemption, and, for its residual area of competence, the host MS.</p> <p><u>On the management company:</u></p> <p><u>Article 5a(5)</u> provides an exhaustive list of 6 possible grounds on which authorisation may be withdrawn.</p> |

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| | | | <p>solvency margin or downward revaluation of the available solvency margin</p> <ul style="list-style-type: none"> - withdrawal of authorisation refusal of authorisation and prohibition to conclude new contracts in case of non compliance with the right of establishment /freedom to provide services. | | |
| Groups | <p><u>Article 12</u>: prior consultation of competent authority in other Member State for the authorisation of a credit institution which is a subsidiary of credit institution/parent of a credit institution authorised in that MS or controlled by the same persons</p> <p><u>exercise of consolidated supervision</u>:</p> <p><u>Article 52(1)-(4)</u>: defines its personal scope, incl. the power for the Member state or responsible competent authority to adjust such scope by excluding entities. Article 54 is concerned with the form and extent of consolidation.</p> <p><u>Article 52(5)-(7)</u>: defines its material scope:</p> <ul style="list-style-type: none"> - supervision of solvency, the adequacy of own funds to cover market risks and control of large exposures: on a consolidated basis; - non-financial qualifying holdings: on a consolidated or subconsolidated basis - possibility of waiving, as a counterparty, application of the | <p><u>Section 2, subsection 1</u> of the draft Re-casting banking Directive (Art. 68-73) governs the level of application of prudential requirements on the minimum level of own funds, internal risk-management processes and large exposures. In particular:</p> <ul style="list-style-type: none"> - Art. 69 introduces a waiver to individual application subject to preconditions, notably on the parent; - Art. 70 provides for possible subconsolidation, subject to a partly similar set of preconditions. <p>Articles <u>125-127</u> further flesh out the personal scope of consolidated supervision and the main principles for appointing the consolidating supervisor (particularly in the case of parent bank holding companies).</p> <p>By adapting Art.29 of the BCD, <u>Article 129(1)</u> entrusts the consolidation supervisor with</p> | <p><u>e.g. in the recast Life Directive (2202/83/EC)</u>:</p> <p>Competent authorities have an obligation to cooperate and exchange information in checking a group structure prior to authorisation: first introduced by the Financial conglomerates Directive, the scope of the obligation will be extended with the Reinsurance Directive, i.e. Art. 59(2) introducing new Art.9a in the Recast Life Dir. (re: Art.57(1) of the Reinsurance Dir. for non-life):</p> <p>prior consultation before granting an authorisation where the insurer is subsidiary of a reinsurer, a subsidiary of the parent undertaking of a reinsurer of an insurance company, is controlled by the same person who controls an insurer or a reinsurer, or is s subsidiary of a credit institution or an investment firm,...</p> <p><u>Article 56: special treatment for EU branches of third-country institutions</u></p> <p>An insurance undertaking which has</p> | <p><u>Article 5b</u> applying to management companies' authorisation: similar to BCD's Art.12</p> <p>Qualifying holdings in management companies are monitored by the home MS authority (Art.5e).</p> | |

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| | <p>concerned rules on an individual or subconsolidated basis;</p> <p><u>Article 52(8)-(9) clarifies le role of the foreign subsidiary's supervisors:</u> - application of the rules on individual/subconsolidated basis to a subsidiary in another MS; nonetheless, possibility to <u>delegate</u> supervision to the parent undertaking's supervisors</p> <p><u>Article 53</u> sets out some rules for determining the competent authority responsible for consolidating supervision.</p> <p><u>Article 54:</u> that competent authority may in some cases decide on the form and extent of consolidation.</p> <p>In the case of groups with a mixed-activity holding company (<u>Art.55</u>), special cooperation is foreseen according to the rules laid down in <u>Art.56</u> (below) for insurance subsidiaries and entities situated in another Member State.</p> <p><u>Article 56:</u> the competent authorities must have the capacity to exchange information (Art. 56(2)-(3)); this includes cooperation with the competent authorities/supervisors of insurance undertakings and authorised investment providers within a group subject to consolidated banking supervision (Art.56(4)); in this context, the organisation of verifications on a</p> | <p>planning and coordinating supervisory activities, incl. for on-site inspections of branches in cooperation with the host MS authorities.</p> <p><u>Article 129(2) gives a prominent role to the consolidating supervisor insofar as the validation of group internal models is concerned.</u></p> <p><u>Article 131</u> includes a requirement on written coordination and cooperation arrangements, and specifies that additional tasks may be entrusted to the consolidating supervisor.</p> | <p>requested/obtained authorisation in several MS may benefit from the following prudential advantages: - Community "consolidated" calculation of the solvency margin; - central pooling of assets representing the guarantee fund; - central lodging of the amount of the minimum deposit (in respect of the required solvency margin) in the MS which is to supervise the solvency of the entire business of the agencies/branches within the Community.</p> <p>The competent authority selected shall obtain from the other Member States the information necessary for the supervision of the overall solvency of the agencies and branches established in their territory.</p> <p><u>Directive 98/78 on the supplementary supervision of insurance undertakings in an insurance group:</u></p> <p><u>Article 4:</u> in case the insurance undertakings belonging to the same group are authorised in different MS, the concerned competent authorities "may reach agreement" as to which of them will be responsible.</p> <p><u>Article 6:</u> the concerned competent authority(ies) shall have access to any relevant information, may carry out on-the-spot verification in their territory and ask the competent auth.</p> | | |
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| | cross-border basis depends on the other Member State's competent authorities (Art.56(7)). | | of another MS to have verification carried out. <u>Article 7:</u> The competent authorities of each MS shall communicate to one another on request all relevant information and shall communicate on their own initiative any information which appears to them to be essential for the other competent authorities. (see Art. 129(1) of the draft CRD) <u>Article 8:</u> Competent authorit(ies) exercise general supervision over intra-group transactions. | | |
| Crisis management | (nothing, except emergency powers under Art.22 see above, which provide for some cooperation) | (<u>Article 129(1)</u> entrusts the consolidating supervisor with planning and coordinating supervisory activities also in emergency situations) <u>Article 130</u> provides that in emergency situations with stability implications, the consolidating supervisor shall alert other authorities, using "where possible, existing defined channels of communication" | (nothing, except: - emergency powers for the host MS authority: see above home/host; - <u>Art.37</u> on assurance undertakings in difficulty provides that the home MS authority will inform other concerned MS authorities of any measures taken and the latter will, on its request, take the same measures.) | (nothing, except emergency powers for the host MS authority: see above home/host) | (nothing, except: - emergency powers for the host MS authority: see above home/host; - <u>Art.52</u> provides that any decision to withdraw authorisation of a UCITS or any other serious measure ... must communicated without delay to the authorities of the other MS where it is marketed) |
| Level 2/ Comitology measures foreseen | N/R | (to be completed by Commission / CEBS) | N/R | N/R | Possible Comitology measure(s) clarifying a number of definitional points on assets eligible for UCITS investment. |

| | Market abuse Directive | Prospectus | Transparency | MIFID | Financial conglomerates |
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| Harmonised minimum supervisory powers | <p><u>Article 12 (2)</u></p> <p><u>Extensive list of minimum powers, including at least the right to:</u> access to any document, demand information from any person, carry out on-site inspections, require existing telephone and existing data traffic records, require the cessation of any practice that is contrary to the Directive, suspend trading, request the freezing and/or sequestration of assets and to request temporary prohibition of professional activity.</p> <p>Some of these powers may be exercised by other authorities or by application to the competent judicial authorities.</p> <p><u>Article 14</u></p> <p>Member States must be in position to impose proportionate and dissuasive <u>penalties</u>.</p> | <p><u>Article 21(3)</u></p> <p><u>A list of minimum powers</u> for competent authorities approving a prospectus, including at least the right to: require supplementary information from a defined range of persons, suspend or prohibit a public offer or advertisements, suspend trading and make public any infringement.</p> <p>Where necessary under national law, the competent authority must ask the relevant judicial authority to decide on the use of some of these powers.</p> <p><u>Article 21(4)</u></p> <p><u>A list of minimum powers</u> for competent authorities which have approved a prospectus, including at least the right to: require disclosure of material, suspend trading and carry out on-site inspections in its territory in accordance with national law, where necessary under national law, by applying to the relevant judicial authority and/or in cooperation with other authorities.</p> | <p><u>Article 24 (4):</u></p> <p><u>Extensive list of minimum powers</u> for competent authorities including at least the right to: require supplementary information from a defined range of persons, suspend, prohibit, or request suspension of, trading, monitor the disclosure of information, make public any infringement, take appropriate measures in case of infringement and carry out on-site inspections.</p> <p>Where necessary under national law, the competent authority may use this power by applying to the relevant judicial authority.</p> <p><u>Article 28</u></p> <p>Member States must be in position to impose proportionate and dissuasive <u>penalties</u></p> | <p><u>Article 50 (2)</u></p> <p><u>Extensive list of minimum powers</u> for competent authorities including at least the right to: access to any document, demand information from any person, carry out on-site inspections; require existing telephone and existing data traffic records, require the cessation of any practice that is contrary to Directive, request the freezing and/or the sequestration of assets, request temporary prohibition of professional activity; as well as require information from auditors, adopt any type of measure to ensure that investment firms and regulated markets continue to comply with legal requirements, require the suspension of, or removal from trading in a financial instrument, refer matters for criminal prosecution, allow auditors or experts to carry out verifications or investigations.</p> <p>Some of these powers may be exercised by other authorities or by application to the competent judicial authorities.</p> | <p><u>Article 16</u></p> <p>Obligation for the coordinator (mixed financial holding companies) or the competent authorities to take the necessary measures.</p> <p><u>Article 17</u></p> <p>Pending further harmonisation of sectoral rules, competent authorities shall have the power to take any supervisory measure deemed necessary to avoid circumvention of sectoral rules.</p> <p>Member States shall ensure that penalties may be imposed.</p> |

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| | | <u>Article 25</u> Member States must be in position to impose proportionate and dissuasive <u>penalties</u> | | <u>Article 51</u> Member States must be in position to impose proportionate and dissuasive <u>penalties</u> | |
| Information exchange | <u>Article 16:</u> <u>An obligation to cooperate and to supply information</u> , except in specially defined cases. CESR mediation role in case of non compliance with a request for information. | <u>Article 22(2):</u> <u>An obligation to cooperate and to supply information.</u> | See Article 25 below. | <u>Article 58</u> <u>An obligation to exchange information</u> via single contact points | <u>Article 11</u> Defines the tasks of the coordinator (coordinating competent authority for a conglomerate) |
| Home/host cooperation | | <u>Article 2</u> Different definition of the terms Home/Host member state for shares and bonds. <u>Article 17:</u> Approval of prospectus sole responsibility of Home member state. <u>Article 18:</u> Obligation for Home MS to notify host MS (where the share/bond in question is to be offered or traded) within short time limits. <u>Article 22 (2):</u> | <u>Article 2</u> Different definition of the terms Home/Host member state for shares and bonds. <u>Article 25(2):</u> General obligation to cooperate and render assistance to each other. | Essentially responsibility for supervision rests with the home Member State, but the Directive assigns some competences to the host Member State, e.g. <u>Article 32 (7)</u> . <u>Article 56</u> General obligation to cooperate and render assistance to each other, via a single designated contact point, <u>Article 59</u> A competent authority may refuse to cooperate in a request only in certain | <u>Article 12</u> Imposes on an obligation to cooperation and exchange of information between competent authorities supervising the regulated entities in a conglomerate. The cooperation shall at least provide for the gathering and the exchange of information regarding the issues specified in the Directive. |

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| | | Cooperation between home and Host competent authority in case of suspension or prohibition of trading | | defined circumstances. <u>Article 61</u> Host Member States have the powers to carry out their assigned tasks, see below. <u>Article 62</u> Host Member State must notify home Member State of any breach and may act in the absence of effective measures taken by the home Member State. | |
| Enforcement | <u>Article 16</u> (3) Notification of suspected cases of market abuse (4) Request to other competent authorities to carry out an investigation. CESR mediation role in case of non compliance with a request for an investigation. | <u>Article 23</u> Where host MS finds a breach it notifies home MS. If home MS does not react, the host MS may act to protect investors | <u>Article 26</u> Where host MS finds a breach it notifies home MS. If home MS measures inadequate, the host MS may act to protect investors | <u>Article 57</u> A competent authority may request the cooperation in supervisory activities, on-the-spot- verifications or in investigations. | <u>Article 15</u> A competent authority may demand that the competent authority in another Member State where an entity in a conglomerate is situated, carry out a verification. |
| Groups | | | | <u>Article 60</u> Obligation to consult before granting an authorisation to an investment firm which is part of a group. | The Directive only applies to financial conglomerates as defined in the Directive. |
| Crisis management | | | | (nothing, except emergency powers for the host MS authority: see above home/host) | |

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| <p>Level 2 measures (still partly under discussion)</p> | <p>Article 1 (definitions) Article 6 (disclosure of inside information) Article 8 (trading in own shares) Article 14(2) (drawing up of list of sanctions) Article 16(5) (exchange of information and cross border inspections)</p> | <p>Article 2 (definitions) Article 4 (exemptions) Article 5 (format of prospectus) Article 7 (minimum information) Article 8 (Omission of information) Article 10 (published information) Article 11 (Incorporation by reference) Article 13 (time limits for approval) Article 14 (publication) Article 15 (advertising) Article 20 (prospectuses from third countries)</p> | <p>Article 2 (definitions) Article 4 (6) (content of annual report) Article 5 (6) (content of semi-annual report) Article 9 (7) (notification of major holdings) Article 12 (8) (procedure for notification of major holdings) Article 14 (2) (procedure for publication of own shares holdings) Article 17(4) (Information requirements for shares admitted to trading on a regulated market) Article 18(5) (Information requirements for bonds admitted to trading on a regulated market) Article 19(4) (notification of Home Member State) Article 21 (4) (Access to regulated information) Article 22 (2) (Implementing measures to facilitate compliance with Article 19 and 21) Article 23 (4) Treatment of third country issuers)</p> | <p>Article 13 organisation requirements Article 15 (3) (suspension of request for authorisation by third country entities) Article 18(3) conflicts of interest Article 19 (10) conduct of business rules Article 21(5) best execution of client orders Article 22(3) client order handling rules Article 24 (5) eligible counter parties Article 25 (7) market integrity, transaction reporting and record keeping Article 27 (7) specification of certain criteria for internalisation Article 28 (3) Post trade disclosure Article 29 (3) Pre-trade transparency requirements for MTFs Article 30 (3) Post trade transparency requirements for MTFs Article 40(6) Admission of financial instruments to trading Article 45(3) Post-trade transparency requirements for regulated markets Article 58(4) exchange of information</p> | <p>Article 20 Commission may adopt technical adaptations to definitions and may coordinate measures adopted by Member States on risk concentration and intra-group exposures.</p> |
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**Annex IV - Section 2: Prospective view on EU legislation and its implementation:
- state of play of on-going implementation of recent securities legislation**

| Directive | Market Abuse | Prospectus | Markets in Financial Instruments | Transparency |
|--|--|--|---|---|
| Level 1 | | | | |
| Commission proposal | 30/05/2001 | 30/05/2001 (original) 09/08/2002 (amended) | 19/11/2002 | 26/03/2003 |
| 1st reading EP | 14/03/2002 | 14/03/2002 | 25/09/2003 | 30/03/2004 |
| Council common position | 07/05/2002 | 24/03/2003 | 07/10/2003 | - (political agreement reached 12/05/2004) |
| 2nd reading EP | 24/10/2002 | 02/07/2003 | 30/03/2004 | Not applicable |
| Date of adoption | 28/01/2003 ²⁹ | 04/11/2003 ³⁰ | 21/04/2004 ³¹ | 15/12/2004 |
| Date of publication in OJ/ Enters into force | 12/04/2003 | 31/12/2003 | 30/04/2004 | O.J. 31/12/2004 |
| Implementation deadline/measure comes into effect | 12/10/2004 | 01/07/2005 | 30/04/2006 | 20/01/2007 |
| Level 2 | | | | |
| Mandate to CESR | 18/03/2002 (first set of measures, provisional) 20/12/2002 (first set of measures, formal) 31/01/2003 (second set of measures) | 18/03/2002 (first set of measures, provisional) 31/01/2003 (second set of measures, provisional) 31/03/2003 (deadline extended for first set) 01/10/2003 (first and second set, formal) 25/06/2004 (third set, formal) | 20/01/2004 (provisional) 25/06/2004 (formal) | 25/06/2004 (formal) |
| CESR advice to Commission | 31/12/2002 (first set of measures) 31/08/2003 (second set of measures) | 31/07/2003 (first set of measures) 30/09/2003 (second set of measures – 1) 31/12/2003 (second set of measures – 2) | 31/01/2005 and 30/04/2005 | 30/06/2005 |
| Commission working document | 10/03/2003 (first set of measures) 10/11/2003 (second set of measures) | 07/11/2003 (first and second sets of measures, excluding second set - 2) | - | - |
| Formal Commission draft implementing measures | 09/07/2003 (first set of measures) 22/12/2003 (second set of measures) | 20/01/2004 (first and second sets of measures) | - | - |
| Agreement in European Securities Committee | 29/10/2003 (first set of measures) 19/04/2004 (second set of measures) | 30/03/2004 (first and second sets of measures) | - | - |
| Adoption by Commission | 22/12/2003 (first set of measures) ³² 29/04/2004 (second set of measures) ³³ | 29/04/2004 (first and second sets of measures) ³⁴ | | |
| Publication in OJ/Enters into force | 23/12/2003 for the first Regulation and 24/12/03 for the first two Directives 30/04/2004 (second set of measures) | 30/04/2004 (first and second sets of measures) | - | - |
| Implementation deadline/measure comes into effect | 12/10/2004 | 01/07/2005 | 30/4/2006 | - |

²⁹ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003

³⁰ Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003

³¹ Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004

³² Commission Directive 2003/174/EC, Commission Directive 2003/175/EC and Commission Regulation (EC) 2273/2003 of 22 December 2003

³³ Commission Directive 2004/72/EC of 29 April 2004

³⁴ Commission Regulation (EC) 809/2004 of 29 April 2004

- further (i) coming, (ii) announced and (iii) possible Directives likely to affect the competences of EU supervisory authorities

(i) Coming legislation:

- p.m. In the **banking sector**: the Capital Requirements Directives, expected to be adopted by end-2005 (see table in Annex II Section 1);

- In the **insurance sector**: Reinsurance Directive (which will also amend direct Insurance Directives 73/239/EEC, 92/49/EEC and Directives 98/78/EC and 2002/83/EC)

(ii) Announced legislation:

In the **insurance sector**: Directive Proposal on a new Insurance solvency framework ("Solvency II"), expected to be presented in October 2006;

(iii) Possible legislation:

In the **securities sector**:

- poss. Directive Proposal on post-trade financial services, whose impact assessment is expected to be completed by autumn 2005;
- poss. Directive on capital requirements for regulated markets (poss. Commission Proposal foreseen in order for the measure to coincide with the application of the Capital Requirements Directives).

(Source: Commission Green Paper, Annex II)