

CHAPTER X

INTERNATIONAL CO-OPERATION: CSSF INVOLVEMENT IN INTERNATIONAL GROUPS



1. Co-operation within European institutions
2. Multilateral co-operation

INTERNATIONAL CO-OPERATION

Article 3 of the law of 23 December 1998 creating a *Commission de surveillance du secteur financier* as amended appointed it, inter alia, to deal with and participate in the negotiations concerning problems involving the financial sector, at both European Union and international level. In accordance therewith, the CSSF participates in the work of the following bodies.

1. Co-operation within European institutions

1.1. Groups attached to the European Commission

1.1.1. The Banking Advisory Committee

The Banking Advisory Committee was established by article 11 of the first banking co-ordination directive (Directive 77/780/EEC). It is made up of decision makers of the highest level in the banking supervisory and regulatory authorities of each Member State. It was chaired by Mrs Tumpel-Gugerell of the Austrian Central Bank until June 2003. Mr Roldan of the Spanish Central Bank was elected as interim chairman until December 2003. Mr Guill, Luxembourg Treasury Director, was elected chairman on 10 December 2003. The Committee's mission is to assist the European Commission in the proper implementation of directives and in the preparation of new proposals for directives. In addition to this consultative function, the Committee assumes a regulatory role in the comitology procedure as part of the executive power of the European Commission. The Committee is not entitled to examine specific problems concerning individual credit institutions.

During 2003, the Committee was informed several times by the European Commission on developments in the new supervisory and regulatory architecture as far as banking is concerned.

Following the publication on 5 November 2003 of the proposal for a directive aiming notably at reforming the Banking Advisory Committee into a level two committee within the framework of the implementation of the Lamfalussy process concerning banking supervision, the representatives of supervisory authorities and central banks will not participate in the works of the Banking Advisory Committee as from 2004. Indeed, the latter will constitute the members of the Committee of European Banking Supervisors, which is the level three committee within the scope of the Lamfalussy structure as regards banking supervision.

As far as the works accomplished in 2003 are concerned, the Committee has been kept informed as in the past on the development of the prudential supervisory systems and the legislative framework of the applicant countries for membership in the EU.

The Committee continued to discuss the review of the regulations concerning own funds, initiated in 1998 concurrently with the work of the Basel Committee on Banking Supervision. The members of the Committee regularly discussed the progress reports provided by the technical subgroup and its working parties. The Committee discussed the question of the most appropriate legislative approach with regard to capital adequacy and the question of prudential supervisory convergence.

The European Commission regularly submitted verbal reports to the Committee on the progress of the action plan concerning financial services.

The Committee continued to follow the development of the banking sector's solvency in Member States, by means of the annual report prepared by the contact group. Additionally, the Committee examined the report developed by the contact group on outsourcing of banking services.

In 2003, the Committee assumed only once its regulatory function within the framework of the implementing powers of the European Commission in the application of the comitology procedure.

1.1.2. The Committee of European Banking Supervisors

The Committee of European Banking Supervisors (CEBS) has been established by the European Commission Decision 2004/5/EC of 5 November 2003. It is in charge of reflecting, discussing and giving advice to the European Commission in the fields of banking regulation and supervision. The Committee also cooperates with the other competent committees in banking matters, notably with the European Banking Committee instituted by European Commission Decision 2004/10/EC. The CEBS is chaired by Mr José-María Roldan (Banco de España, Spain). The Vice-Chair is Mrs Danièle Nouy (Commission Bancaire, France). Mr Andrea Enria (Banca d'Italia) has been appointed General Secretary. The Chair is supported by a 'Bureau', comprising Mr Andres Ittner (Oesterreichische Nationalbank, Austria), Mr Helmut Bauer (Bundesanstalt für Finanzdienstleistungsaufsicht, Germany) and Mrs Kerstin af Jochnick (Finansinspektionen, Sweden). The Committee's Secretariat will be based in London.

CEBS took up its duties in January 2004 and held its first meeting in Barcelona on 29 January 2004. The CSSF is represented by Mr Arthur Philippe, Director.

The CEBS will fulfil the functions of Level 3 Committee for the banking sector in the application of the Lamfalussy process.

The role of the Committee is to:

- advise the European Commission either at the Commission's request, within the time limit which the Commission may lay down according to the urgency of the matter, or on the Committee's own initiative, in particular as regards the preparation of draft implementing measures in the field of banking activities;
- contribute to the consistent application of Community directives and to the convergence of Member States' supervisory practices throughout the Community;
- enhance supervisory co-operation, including the exchange of information.

The CEBS is composed of high-level representatives from the banking supervisory authorities and central banks of the European Union. The EU acceding countries will participate as observers until 1 May 2004. The European Economic Area (EEA) countries will participate as observers on a permanent basis.

1.1.3. The *Groupe de Contact*

The *Groupe de Contact*, which has been created in 1972, is at the origin of informal co-operation on Community level and comprises representatives of the banking supervisory authorities of Member States. It is chaired by Mr Keith Pooley of the FSA (United Kingdom) since 2002, year of the *Groupe's* 30th birthday.

The *Groupe*, which is a body appreciated for informal exchanges concerning the situation of individual credit institutions, particularly in the event of problems, follows the development of national regulations, discusses practical aspects of prudential supervision of credit institutions and conducts general comparative studies.

Within the new European structure of the regulation of the banking sector, the *Groupe de Contact* will henceforth also act as main working group of the Committee of European Banking Supervisors and, in that capacity, assist the Committee with a view to achieve convergence of the prudential supervisory practices in the European Union.

In 2003, the *Groupe de Contact* continued to focus on the implementation of the supervisory review process, the second pillar of the new capital adequacy framework at Community level.

Following the development of high-level principles in this field, the group started to study different elements, i.e. the capital adequacy assessment process, the evaluation process and the risk assessment system of the supervisory authorities. The results of this study will soon be submitted to the Committee of European Banking Supervisors.



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The *Groupe* has also developed high-level principles in the important area of outsourcing of banking functions. As far as comparative studies are concerned, the *Groupe* conducted its annual study on the solvency of credit institutions in the European Economic Area.

1.1.4. The Contact Committee on Money-Laundering

The Contact Committee on Money-Laundering met twice in 2003. The meetings and discussions of the Committee notably focused on the revision of the Forty Recommendations of the Financial Action Task Force concerning the fight against money laundering (FATF) and on subjects the European Commission could take into account when drafting the third directive on the fight against money laundering.

1.1.5. The Contact Group on UCITS

In 2003, the Contact group on UCITS, chaired by the European Commission, met five times in Brussels. During these meetings, discussion namely concentrated on the responses of the prudential supervisory authorities to the questionnaires on UCITS tracking an index, funds of funds, monetary market instruments and deposits with credit institutions.

The report of the task force on the use in financial derivative instruments, as well as the report of the working group on the simplified prospectus have been finalised. It is planned that the European Commission issues recommendations based on the conclusions of these reports.

The task force on the use of derivative financial instruments has been set up in order to achieve a common interpretation, notably as regards the following seven points:

- limitations of leverage through the use of financial derivative instruments under articles 36 and 21(3) of the amended directive 85/611/EEC;
- definition of global exposure linked to derivative instruments under article 21(3) of the amended directive 85/611/EEC;
- definition of exposure under paragraphs 2 and 3 of article 21(3) and article 22 of the amended directive 85/611/EEC;
- definition of cover;
- identification of transactions in financial derivative instruments for hedging and application of investment restrictions;
- methodologies for assessing counterparty risk;
- use of financial derivative instruments by passively managed UCITS.

The task force on the simplified prospectus has been set up to agree on a common interpretation, notably as regards the following four points of schedule C annexed to the amended directive 85/611/EEC:

- definition and presentation of information concerning the investment strategy of the UCITS and brief assessment of the UCITS' risk profile;
- definition and presentation of the UCITS' historical performances, including the use of benchmarks;
- definition and presentation of costs (fees and commissions), including the use of a Total Expense Ratio (TER);
- other important aspects (multiple-compartment UCITS, Exchange Traded Funds, tax system).

The conclusions of the report of the task force on the simplified prospectus led to a common interpretation on the majority of the points discussed. As regards the points on which no consensus could be reached, the report concludes that several interpretations are admitted.

Moreover, the Contact Committee drew up questionnaires on the regulations applying to management companies. These questionnaires aimed at collecting the opinion of the prudential supervisory authorities on the requirements concerning the taking up of this activity, the capital requirements, the activities, the conditions to outsource functions, the European passport and conflicts of interests.

1.1.6. The Working Group on the Interpretation and Application of the Banking Directives (GTIAD)

The Group held two meetings in 2003, which concentrated on directive 2000/46/EC on the taking up, pursuit and supervision of the business of electronic money institutions. The discussions notably aimed at defining the applicability of the directive to mobile telephone operators who provide, besides services relating purely to vocal telephony, supplementary services which are likely to fall under the scope of the directive. The discussions resulted in the consensus to publish, following the agreement of the Banking Advisory Committee, a public consultative document containing possible solutions as regards the application of directive 2000/46/EC to these particular cases.

1.1.7. The expert group on payment systems

The *ad hoc* group met twice in 2003 in order to prepare notably the public consultation paper concerning a new legal framework for payments within the single market. The public consultation having been closed in mid February 2004, the group will be kept informed on the responses of the different professional and consumer representations in the coming months.

1.1.8. The Mixed Technical Group on Financial Conglomerates

The technical group, which held three meetings in 2003, focused on the problems that arose within the context of the transposition of directive 2002/87/EC on the supervision of financial conglomerates, notably as regards the interpretation of different provisions of the directive. A working subgroup started to study the scope of the equivalence of the regulations and supervision of financial conglomerates of certain third countries, while another subgroup surveyed the financial conglomerates likely to fall under the scope of the directive.

1.1.9. The Contact Committee on accounting directives

The committee met once in 2003. The discussions mainly focused on questions and answers relating to the IAS regulation and the accounting directives. The European Commission has published these questions and answers in November 2003 in the form of observations concerning certain articles of the IAS regulation, as well as the 4th and 7th directive.

1.1.10. The Accounting Regulatory Committee

The Accounting Regulatory Committee, set up by the European Commission in accordance with article 6 of the IAS regulation, held four meetings in 2003. The agenda mainly focused on the IASB standards projects and a presentation thereon by EFRAG, the European Financial Reporting Advisory Group. At the meeting of 16 July 2003, the committee adopted all the international accounting standards including related interpretations, except for the IAS 32 and 39 dealing with the accounting and disclosure of financial instruments, and the related SIC 5, 16 and 17. The IAS standards 32 and 39, which were severely criticised by the financial sector, have not been included, as they have been submitted for review by IASB, in co-operation with European accounting experts.

1.1.11. The Peer Review Group

In the context of its expansion, the European Union assesses the extent to which the legislation and prudential supervisory policies of candidate countries comply with the existing Community rules. It also verifies the implementation and application of Community rules in candidate countries. To this end, the European Commission asked the supervisory authorities of Member States, the 'peers', to assess the relevant authorities of the candidate countries. For each candidate country, six authorities competent to supervise the financial sector (banks, financial markets and insurance) and a representative of the European Commission form a peer review team that visits the country concerned in order to meet the equivalent authorities and to assess their missions and responsibilities and how they operate (authorisation, on-site inspections, ability to impose sanctions).

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The European Commission requested a reduced team of supervisory authorities of Member States to assess the measures taken by the candidate countries' authorities following the recommendations given by the peer review team in 2001 and 2002.

The CSSF took part in the reduced group's Securities Team that visited Cyprus from 13 to 15 March 2003 to assess, in co-operation with its Greek equivalent, the Capital Market Commission, the progress made by Cyprus as regards the legislative framework and the supervision of securities markets. The CSSF took also part in the Securities Team of the reduced group that visited Latvia from 5 to 7 May 2003 to follow-up on the legislative framework and the supervision of the Latvian securities markets.

1.2. Groups operating at European Union Council level

The CSSF is a member of the groups working on proposals for directives concerning financial services. The groups of government experts meeting at Council level play an important role in the Community legislative process, since they format the consensus texts, referring only political difficulties to the Permanent Representatives Committee and the Council of Ministers of Finance. The groups are chaired by a representative of the Member State, which presides the Council. Greece thus presided during the first half of 2003 followed by Italy during the second half. The list of directives under negotiation at Council level and a brief description thereof can be found in chapter XI.

1.3. The Banking Supervision Committee of the European Central Bank

The Banking Supervision Committee of the European Central bank is a committee made up of representatives of the banking supervisory authorities and the central banks of Member States. It is chaired by Mr Meister, a member of the Board of Directors of Deutsche Bundesbank. The missions concerning prudential supervision conferred by the Treaty and the statutes of the European Central Bank on the ESCB (European System of Central Banks) are carried out by the Banking Supervision Committee on behalf of the ESCB. The Committee is a forum for the exchange of opinions on the supervisory policies and practice in Member States. It should also be consulted on proposals for directives and bills tabled by Member States affecting matters within its competence.

In carrying out its mandate in 2003, the Banking Supervision Committee was assisted mainly by two working groups made up of members of central banks and national supervisory authorities, namely the Working Group on Macro-Prudential Analysis and the Working Group on Developments in Banking.

In order to systematise the analysis of macroeconomic data with a view to identifying in reasonable time and as far as possible the factors likely to weaken the financial institutions as a whole and therefore the financial system, the Working Group on Macro-Prudential Analysis monitors the macroeconomic environment and reports to the Committee on trends and facts likely to be relevant to the prudential supervision of the financial sector.

Each year, the working group draws up a report on the stability of the financial sector. This report, which has been prepared under the aegis of the committee for two years now, is also discussed by the Executive board of the European Central Bank.

In 2003, the group analysed more particularly the risks stemming from the failures of small- and medium-sized companies for the banking sector. Other analyses concerned the risks of a prolonged slowdown of the European economy, the persistent imbalances in the United States and the impact of the expected development of the real estate sector. The working group also initiated a study on derivative credits and other factors shifting the credit risk of the banking sector towards other sectors.

As in the previous year, the Working Group on Developments in Banking focused during the first half of 2003 on the drawing up of its structural report. This annual report aims to identify and monitor the structural trends marking the European banking sector as a whole. The 2003 report concentrated in particular on the impact of the economic slowdown on the dynamics of globalisation, consolidation and disintermediation of banking activities in Europe. During the second half of 2003, the group concentrated, as usual, on thematic analyses. Thus, it launched a study on the development of the bank-insurance phenomenon in Europe. The final report of this study is expected to be published in the second half of 2004.

2. Multilateral co-operation

2.1. The Basel Committee on Banking Supervision

2.1.1. The new capital adequacy framework

In 2003, the Basel Committee continued to concentrate its efforts on the new capital adequacy framework, resulting in the publication of a third consultative paper (CP3) on 29 April 2003. This publication coincided with the appointment of Mr Jaime Caruana succeeding Mr William McDonough as chairman of the Committee on 1 May 2003.

- **Results of the Quantitative Impact Study (QIS3)**

The third Quantitative Impact Study (QIS3), aimed at assessing the impact of the new rules before the publication of the third consultative paper, was launched on 1 October 2002. More than 350 banks from 43 countries volunteered to participate in that exercise.

The overall results of the QIS3 are presented in the document "Quantitative Impact Study 3 - Overview of Global Results" published by the Basel Committee on 5 May 2003. Following public interest in the QIS3 results, a supplementary document ("Supplementary Information on QIS3"), which provides more detail on some areas of the results, was published on 27 May 2003.

The Committee noted that the QIS3 results were overall consistent with the objectives and thus confirmed the decision to modify certain areas of the new regime as it was foreseen in the second consultative paper.

The participation of the CSSF in the QIS3

The CSSF has been a member of the working group entrusted with overseeing the quantitative impact studies of the New Basel Accord within the Basel Committee for Banking Supervision since the first QIS exercise. As regards the third quantitative impact study, the CSSF was one of the member countries involved in the technical aspects of setting up this *ad hoc* reporting.

At national level, the CSSF held a meeting at its premises with the so-called "systemic" credit institutions on 4 July 2002, in order to set the practical modalities of the study. The CSSF then invited, by means of its circular letter of 25 October 2002, all the credit institutions under Luxembourg law to carry out this impact calculation on a voluntary basis. Several Luxembourg responses have been sent anonymously to Basel in order to be included in the overall assessment.

The CSSF's objective however exceeded that of a simple calculation and also aimed at a qualitative assessment within the context of the supervision of credit institutions. Thus, each response was thoroughly analysed by CSSF agents, often at the premises of the participating banks. These visits also enabled both supervisors and the credit institutions to perform a first gap analysis with respect to the qualitative requirements of the Accord.

The first conclusions allowed to draw up a model questionnaire, part of which has been submitted to the credit institutions by means of the CSSF's circular letter of 17 December 2003.



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Quantitative results of the QIS3 for Luxembourg credit institutions

The CSSF received 18 responses to the questionnaire, covering between 50% and 55% of the balance sheet total and of the banks' own funds, as defined in the numerator of the solvency ratio of the 122 Luxembourg-registered credit institutions that must comply with the solvency ratio defined by the CSSF as of 31 December 2002. The sample included a wide range of banks, from universal banks to specialised banks. The coverage of assets included in the study exceeded in any case 80% of the exposures of the institutions' individual consolidated or sub-consolidated balance sheets.

As regards credit risk, it has to be noted that 16 banks completed the Standardised approach, 10 banks the IRB Foundation and 3 banks the IRB Advanced approach. 14 banks were in a position to complete the Standardised approach for operational risk. None of the banks provided results on the Advanced Measurement Approach.

As far as credit risk is concerned, overall results are in line with those obtained for the other European Group 2 banks. Capital requirements thus increase by 8% for the Standardised approach (7% if account is taken of the changes introduced in CP3), mainly due to the increase in requirements on bank exposures and the newly introduced capital charge for operational risk, whose impact has been directly incorporated.

Capital requirements however decrease by 22% (21% according to CP3) in the IRB Foundation approach driven by the substantial reductions in the corporate and retail asset classes. It should also be noted that additional simulations have shown that capital requirements would decrease by 11% if banks applied the explicit maturity, reflecting an average maturity clearly below 2.5 years, notably for interbank exposures.

Capital requirements for operational risk reached 6.29% for the Basic Indicator Approach, and 6.11% for the Standardised approach. Results by bank substantially diverged and depended on the distribution of activities. Indeed, the distribution of requirements across business lines largely reflected their respective weighting levels (beta factor).

- **Results of the third consultation**

On 29 April 2003, the Committee published its Third Consultative Paper (CP3) containing an outline of the new capital adequacy rules. The results of this QIS3 entailed several modifications to the preceding version, i.e. the QIS3 Technical Guidance. Furthermore, the CP3 confirmed the favourable treatments of debtors who are individuals and small- and medium-sized companies, as proposed in the latter, but not included yet in the CP2.

During this consultation period, which ended on 31 July 2003, more than 200 responses were received, the majority of which confirmed their support for the overall structure of the New Accord, as well as the need to adopt a more risk-sensitive regulatory framework.

Following the analysis of the responses, the Basel Committee published a press release on 11 October 2003 announcing its intention to solve, by the end of 2004, when the New Accord is expected to be published, the problems identified and to improve several aspects of the new framework that have been criticised. The implementation date of 31 December 2006 has been maintained.

The press release also invites the banks to comment on the new calibration proposal of the IRB approach, according to which the capital requirements would be based solely on the unexpected loss portion.

From October 2003 onwards, the Committee and its subgroups working on the Accord concentrated on the following issues:

- changing the calibration of the IRB approach which will be based solely on unexpected losses (UL);
- simplifying the treatment of securitisation under the IRB approach;
- revisiting certain aspects of the rules concerning credit risk mitigation.

- **The subgroups working on the revision of the Accord**

Working Group on Overall Capital and Quantitative Impact Study

The group stems from the merger of the Working Group on Overall Capital, entrusted with the calibration of the New Accord as a whole, with the Working Group on Quantitative Impact Study, which concentrates on the quantitative impact studies. Since the publication of the third consultative paper and the results of the third impact study, the group has been charged with verifying the impact of the provisions, as well as the coverage of expected losses under the two internal ratings-based approaches.

Working Group on Expected Loss/Unexpected Loss

This working group has been entrusted with analysing all the technical details related to the shift from the approach consisting in measuring risk-weighted assets based on expected and unexpected losses, towards a measurement based solely on unexpected losses, as mentioned in the press release of the Basel Committee of 11 October 2003.

Securitisation Group

In 2003, the Securitisation Group mainly focused on the development of methods of securitisation treatment under the IRB approach. It took into account the comments submitted by the banking sector on the third consultative round in order to draw up a new formula to calculate the capital requirements of the tranches, which are not externally rated, and to define the risk weightings applicable to the listed tranches. Furthermore, the group paid particular attention to the development of the treatment of liquidity lines under the Asset-Backed Commercial Paper programs.

Risk Management Group

In 2003, the group carried out an extensive working program with a view to implement the AMA approach. In this context, it focused in particular on taking into account the insurance policies as operational risk mitigation technique, as well as on the problem concerning the application of the AMA approach in a cross-border context (approval/acceptation by the host authorities of the advanced method as regards subsidiaries of international banking groups).

In order to respond to the concerns of the banking industry, the group prepared a document, in conjunction with the Accord Implementation Group, dealing with this issue, which has been published for consultation with the banking industry.

Furthermore, the working group published the document "Sound Practices for the Management and Supervision of Operational Risk" in February 2003. The consultation paper "Principles for the Management and Supervision of Interest Rate Risk" was published in September 2003 for a short consultation period with the industry before being finalised.

Accord Implementation Group

In August 2003, the Accord Implementation Group published, under the aegis of the Basel Committee, the document "High-level Principles for the Cross-Border Implementation of the New Accord". In order to respond to the concerns of the banking industry regarding the application of the New Accord for banking groups operating on a cross-border basis, the document sets out six guidelines governing the functioning of the cross-border application of the New Accord.

The first principle provides that the New Accord will modify neither the legal responsibilities of the national supervisory authorities as regards the regulation of banking institutions under their competence, nor the consolidated supervisory regime as already set up by the Basel Committee on banking supervision. Thus, the home country supervisor is responsible for the



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implementation of the New Accord by all the banking groups on a consolidated level, while it is in the host country supervisor's interest to accept the methods and approval processes that the bank uses at a consolidated level in order to reduce the compliance burden and avoid any regulatory arbitrage.

An enhanced and pragmatic co-operation should be established between the supervisory authorities with legitimate interests. The home country supervisors should lead this coordination effort.

Another principle provides that the supervisory authorities should avoid, as far as possible, to perform redundant and uncoordinated approval and validation work in order to reduce the implementation burden on the banks and spare supervisory resources.

Transparency Group

In the beginning of 2003, the Transparency Group mainly focused on fine-tuning pillar 3 of the New Accord (market discipline) for the publication of the third consultative paper of the Committee on 29 April 2003.

From August 2003 onwards, i.e. following the end of the consultation period, the group started to study the comments received. During this period, which should lead to a refined version of the disclosure requirements, the Group actively co-operated with the banking industry.

Owing to its direct involvement in the IASB advisory group charged with the review of the IAS 30, the standard setting disclosure rules for financial activities, the Transparency Group continued its pursuit to achieve maximum harmonisation between the accounting requirements and those of pillar 3. As the IASB has decided to use general principles requiring the disclosure on main financial risks instead of detailed requirements, the risk of incompatibility has been substantially reduced.

Moreover, the Transparency Group carried out its annual survey on disclosure practices on a sample of credit institutions of Member States of the Basel Committee on Banking Supervision. The results of the study will be published as a summary report.

Subgroup on Credit Risk Mitigation

Before the publication of CP3, the Subgroup on Credit Risk Mitigation finalised certain proposals relating to the treatment of repo-style transactions, as well as to the treatment of credit derivatives. Since the end of the third consultation round, the Subgroup concentrates on revising certain aspects of the rules concerning credit risk mitigation techniques considered as unsatisfactory, with a view to publish the final version of the new capital adequacy regime.

- **New developments in January 2004**

In its press release of 15 January 2004, the Basel Committee gave an overview of the decisions taken during their meeting that day. The industry welcomed the new treatment for expected (EL) and unexpected (UL) losses proposed in October 2003 and the works on its implementation continues. Furthermore, concrete proposals have been made to simplify the treatment of securitisation under the IRB approach; a detailed technical note is being drawn up. Finally, the Committee explains its viewpoint on the implementation of the second pillar of the New Accord.

2.1.2. The other subgroups of the Basel Committee

- **Accounting Task Force**

The Accounting Task Force is in charge of following-up on the developments in the accounting and auditing areas. There are two aspects to its mandate:

- following-up on the work of accounting and auditing standards setters that are of particular interest to the financial and banking sector, notably the work of the International Accounting Standards Board (IASB) and of the various committees, including notably the International Auditing and Assurance Standards Board (IAASB), that are operating under the aegis of the International Federation of Accountants (IFAC);
- developing principles and guidelines in the areas of accounting, auditing and, more recently, compliance.

As regards the follow-up on accounting standard setters, the Task Force's main focus continued to be on the rules applying to financial instruments (IAS 32 and IAS 39 standards).

During regular contacts with representatives of the IASB, the Accounting Task Force endeavoured to raise the accounting standards setters' awareness with regard to certain issues that are of particular interest to prudential supervisors, notably the area of provisioning and the issues in relation to the introduction of the fair value option. Besides these prudential aspects, the group also concentrated on the exposure-draft of the IASB proposing a method for the accounting treatment of the portfolio hedge of interest rate risk. The Task Force also contributed to the dialogue between the IASB and the banking industry, inter alia by means of a comment letter.

The Accounting Task Force also addressed other IASB draft standards, including the "Exposure Draft 2 Share-based Payments" and the "Exposure Draft 5 Insurance Contracts". Other developments in relation to the IASB are monitored through the participation of Basel Committee representatives in the Standards Advisory Council.

Furthermore of interest in the area of accounting is the ongoing work on a study on the impact of the accounting standards IAS/IFRS on regulatory capital; the study should be finalised during 2004.

As regards auditing, it is worth pointing out that several comment letters have been sent, as well as the significant contribution to the work on reforming the IFAC's structure and the creation of its oversight body, the Public Interest Oversight Board.

The Group also received the mandate from the Basel Committee to develop principles concerning the compliance function. A consultation paper thereon has been published in October 2003. The Committee proposes a definition of the compliance function as well as guidelines, in the form of best practice principles, with a view of establishing such a function. The proposed principles deal more specifically with the responsibilities of the governing bodies, the status of the function, its independence, its roles and responsibilities, organisational aspects, cross-border issues, the relationship with the internal audit department, as well as outsourcing issues. The final version of the paper is expected to be published this year.

- **Working Group on Cross-Border Banking**

The Working Group on Cross-Border Banking, which is a joint working group of the Basel Committee and the Offshore Group of Banking Supervisors, drafted a reasoned opinion for the Basel Committee on the methodology to assess the compliance with the forty revised FATF recommendations to combat money laundering and terrorist financing.

Furthermore, the Group continued to prepare guidelines based on the "Customer due diligence for banks" document published in October 2001 and which resulted in the publication of the consultation paper "Consolidated KYC Risk Management" in August 2003. This document

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stresses the importance for banks to apply the four principles governing a sound know-your-customer programme to all the entities of the banking group, namely:

- customer acceptance policy;
- customer identification;
- on-going monitoring of higher risk accounts;
- risk management.

2.1.3. Other publications

The documents “Risk Management Principles for Electronic Banking” and “Management and Supervision of Cross-Border Electronic Banking Activities”, prepared by the Electronic Banking Group of the Basel Committee, have been published in their final version.

The document “Risk Management Principles for Electronic Banking”, prepared in May 2001, sets out the main points to comply with to ensure adequate risk control in the field of e-banking, i.e. an effective management by the decision-taking bodies of the financial institutions, security controls (non-repudiation, authentication, etc.), as well as legal and reputational risk management.

The document “Management and Supervision of Cross-Border Electronic Banking Activities” covers risk management and the supervision of cross-border e-banking activities. The banks’ responsibilities as regards the management of the risks inherent in these activities have been identified. The document draws the attention on an efficient supervision of these activities by the supervisory authority of the home country and international co-operation between supervisory authorities.

2.2. The International Organisation of Securities Commissions (IOSCO) and IOSCO task forces

2.2.1. The XXVIIIth Annual Conference of IOSCO

The regulatory authorities of the financial and futures markets and other members of the international financial community met in Seoul, South Korea from 14 to 17 October 2003 on the occasion of the XXVIIIth Annual Conference of IOSCO.

The theme of the conference, “New Challenges for Securities Markets and Regulators”, was chosen in recognition that recent high-profile corporate failures, as well as other world events, have raised important regulatory challenges that securities regulators must address. Maintaining the integrity of international capital markets is a crucial part of the main mission of securities regulators, which is investor protection. Recent events have demonstrated that the integrity of capital markets fundamentally depends on the quality of financial disclosures made by issuers and on the appropriate resolution of conflicts of interests faced by professionals. Maintaining the integrity of capital markets requires that regulators prevent the use of international financial markets for any form of international financial crime.

In the context of enhancement of international co-operation, essential to achieve this goal, IOSCO announced that substantial progress has been made since the last conference, which was held in Istanbul in May 2002. Forty members of IOSCO have applied to become signatories of the Multilateral Memorandum of Understanding on co-operation and exchange of information (the “MOU”), which had been adopted unanimously in May 2002. The applicants will undergo rigorous screening review of their ability to co-operate according to the standards set by the MOU. By committing themselves to this process, they express their commitment to take part in an efficient system of information exchange with the aim of fighting against breaches of stock exchange regulations and any other form of international financial crime. Twenty-four of these candidates have already signed the MOU.

2.2.2. Groups of the International Organisation of Securities Commissions

The CSSF is a member of two IOSCO groups, i.e. the Standing Committee n. 1, dealing with subjects concerning accounting, and the Standing Committee n. 5 concerning UCITS and collective management.

- **Standing Committee n. 1**

In 2003, the Committee participated, as far as auditing is concerned, in discussions on the creation of a Public Interest Oversight Board (PIOB). Four of the PIOB's members will be appointed by IOSCO.

Furthermore, the Committee monitored in particular the development of the IAS/IFRS standards by providing comments on the related projects. It closely co-operates with the International Accounting Standards Board (IASB). IOSCO encourages IASB and the international standard-setters to continue their co-operation to come to a convergence allowing to facilitate cross-border offers and quotations and to encourage regulators to cope with the more vast issues concerning the coherence of interpretations, the implementation of the accounting standards and the sanction of non-compliance therewith.

The main obstacle to the finalisation of the project of international disclosure standards for multinational offers and listings of bonds was the diverging regulatory approaches of the members. Consequently, the project has been amended and the work will continue in 2004 in order to provide, on the basis of the standards developed in 1998 for shares, an analysis of standards and an explanation of the goals of the different approaches of the regulators.

After having conducted a study on periodic and continuous information requirements on issuers whose securities are listed, the Committee concentrated on finalising high-level standards in this field.

- **Standing Committee n° 5**

In 2003, the Committee has finalised a study on index funds and has worked on the document "Elements of International Regulatory Standards on Fees and Expenses of Investment Funds" which should be approved soon. Moreover, the Committee discussed in detail the issues arising regarding investment funds in the context of anti-money laundering measures. Finally, a new mandate given to the Committee concerns the rules applicable to the mergers between investment funds in the different member jurisdictions.

2.3. CESR and groups established within CESR

2.3.1. CESR (Committee of European Securities Regulators)

Established by the European Commission decision of 6 June 2001, CESR took over from FESCO (Forum of European Securities Commissions) in September 2001. CESR is one of the two committees proposed in the report of the Committee of Wise Men, which was endorsed by the Stockholm resolution of 23 March 2001. Composed of representatives of 17 supervisory authorities of securities markets in the European Economic Area (Member States of the European Union, Norway and Iceland), CESR is an independent body, which assists the European Commission in preparing technical measures regarding Community legislation on transferable securities, and is entrusted with ensuring harmonised and continued application of Community legislation in Member States. CESR also works towards strengthening co-operation between the supervisory authorities.



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In 2003, CESR concentrated its activities on work related to initiatives concerning the Financial Services Action Plan. In this context, CESR notably continued to concentrate on the mandates covering the development of implementing measures within the scope of the directive on insider dealing and market manipulation and the directive concerning the prospectus to be published when securities are offered to the public or admitted to trading.

CESR also started to work on the development of implementing measures concerning the Financial Instruments Markets Directive (ISD 2) by creating three expert groups, i.e. the expert group on intermediaries' issues, the expert group on markets and the expert group on co-operation and enforcement issues. The Steering Group ensures coordination between the three groups.

The Market Participants Consultative Panel, a committee gathering eleven members who are appointed in a personal capacity, was created in June 2002 following the recommendations of the European Parliament and the Committee of Wise Men, and assists CESR in the execution of these tasks. The committee held three meetings in 2003 on aspects concerning the Lamfalussy procedure, the consultation policy and the priorities and working methods of CESR and, on the other hand, more technical issues such as the disclosure obligation of quarterly reports, the so-called pre-trade transparency obligations under ISD2, clearing and settlement in Europe, the obligation of best execution and the execution-only activity.

CESR strengthened its initiatives regarding the integration of accession countries during the year by promoting their participation as observers in these groups. CESR recognised, within the scope of European legislative process, the need to start reflecting on its role and more particularly the Lamfalussy process.

Anticipating the adoption of the legal framework relating to the extension of the Lamfalussy procedure to the regulatory principles of collective management, as decided by the ECOFIN Council on 3 December 2002, CESR initiated on 30 October 2003 a consultation on its internal organisation, the organisation during the transitional stage and the areas in which CESR wished to start working as from now. In this context, CESR established an expert group on Investment Management.

Moreover, CESR held an *ad-hoc* meeting on the amended UCITS directive (UCITS III) in 2003, in order to discuss the topics where CESR could contribute to an enhanced co-operation between prudential supervisory authorities and to the common interpretation of the amended UCITS directive. During this meeting, CESR identified the areas and priority work streams it aims to concentrate on, in a first stage, in the field of investment funds.

In particular, CESR identified four general principles guiding its work:

- any work accomplished by CESR regarding the amended UCITS directive would have to be conducted in full coherence with the EU institutional framework;
- CESR should take a global vision of the so-called buy-side, referring to collective and individual management;
- CESR should not start to work on matters where the UCITS Contact Committee is about to finish its work;
- account should be taken of the work already accomplished by IOSCO.

The following four areas have been identified as priorities:

- areas where input could be provided to the UCITS Contact Committee (delegation of functions, depositaries, scope of the European passport for management companies, money market instruments, UCITS tracking an index);
- areas where convergence of prudential supervisory practices and techniques should be achieved (elaboration of common prudential supervisory techniques by exchange of experience, notably in the area of risk management, marketing policy, fee structures, conflicts of interest);
- areas not covered by the UCITS directive (hedge funds, real-estate UCIs);
- areas where consistency with the EU legal framework and the other EU directives should be

achieved (investment services directive, e-commerce directive, distance marketing directive, impact of the International Accounting Standards).

CESR will start working in an *ad-hoc* working group and will also consult with a consultative group of market participants.

Following this meeting, CESR published a consultation paper on its role in the regulation of UCITS and asset management activities in Europe.

2.3.2. CESR expert groups

- The **Review Panel**, established by the Presidents of CESR following the decision of December 2002, is mandated to assist CESR in its task to ensure coherent and equivalent implementation of Community legislation in Member States. In 2003, the Review Panel has started its work with the scrutiny of the status of implementation of the CESR standards for Alternative Trading Systems and the rules of conduct in Member States.
- Carrying out an additional mandate regarding the directive on insider dealing and market manipulation, the **Market Abuse** expert group submitted its additional technical advice on implementing measures on 3 September 2003. The European Commission, in conjunction with the European Securities Committee and the European Parliament, will use this advice to establish implementing measures for the directive on market abuse. In accordance with the consultation policy recommended by the Committee of Wise Men and adopted by CESR, the project, published in April 2003, was submitted to professionals of the various Member States. The group has taken account of their comments (a public hearing was held and around hundred responses received) to finalise the document.

The document covers the following points:

- guidelines to determine accepted market practices according to the directive;
- definition of inside information for derivatives on commodities;
- maintenance of insider lists by issuers;
- disclosure of transactions by senior managers;
- obligation to report suspicious transactions to the regulator.

A consultative working group, composed of representatives of investors and market participants, including one representative of the Luxembourg Stock Exchange, assisted the expert group with drawing up the advice.

A mandate relating to the future work to be carried out under level 3 of the Lamfalussy procedure as regards the directive on insider dealing and market manipulation was given to CESRPOL in December 2003. CESRPOL is a permanent group within CESR, responsible for enhancing the exchange of information, coordination of surveillance and enforcement activities between CESR members.

- The **Prospectus** expert group, created in December 2001, has responded to the provisional mandates of 27 March 2002 and 7 February 2003 under the directive on the prospectus to be published when securities are offered to the public or admitted to trading, in accordance with the three deadlines that had been set: 31 July 2003, 30 September 2003 and 31 December 2003. Both mandates were formalised on 31 October 2003 following the adoption of the directive. The group took into account the 320 responses received and held three public hearings in the course of its consultation process.

The technical advice of the group covers the following six areas.

- The format of the prospectus.
CESR elaborated details concerning the presentation of the prospectus as a single document or three separate documents (registration document, securities note, summary), as well as the presentation of a base prospectus with supplements. CESR also provides a road map for



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companies, facilitating the identification of information to include in the prospectus for each type of issue.

- Minimum information to be included in the various prospectus schedules according to investor needs.
CESR proposed schedules for shares, retail and wholesale bonds, asset backed securities, banks non-equity, certificates issued on shares, derivatives securities, programs, units issued by closed-ended investment funds, securities issued by states as well as their regional or local authorities and securities issued by supranational institutions. These schedules are supplemented by building blocks in particular cases, such as guarantees, pro forma information, underlying equity. Particular importance has been attached to the historical financial information to be included.
- Annual information.
CESR proposed different means to publish the document that contains or mentions all information published during the year, taking account of the goals pursued by this publication and of rapid and cheap access for investors.
- Incorporation by reference.
CESR proposed the possibility to include by reference published information such as auditing reports, financial reports and articles of incorporation. Moreover, CESR considers that the prospectus and the documents incorporated by reference must be linguistically coherent.
- Publication of the prospectus.
CESR defined the provisions relating to the dissemination of the prospectus and proposed indications to include in the advice.
- Advertisements.
CESR chose to allow the use of all means of advertisement without imposing a ban before the publication of the prospectus.

This advice was integrated in a first stage into a working document that was published for comments by the European Commission in November 2003, and in a second stage, in formal proposals of the European Commission on the implementing measures of directive 2003/71/EC on prospectuses, presented in January 2004 in the form of a proposal for a regulation subject to the vote of the European Securities Committee.

- Under the oversight of a **Steering Group** and with the assistance of a consultative group consisting of 23 external experts (including one representative of a Luxembourg professional of the financial sector), three expert groups responded to the provisional mandate on the directive concerning financial instruments markets (ISD 2). These mandates were published by the European Commission on 20 January 2004.

The provisional mandates cover three main areas:

- the obligations for financial intermediaries (Intermediaries group);
- the transparency rules on financial markets (Markets group);
- the requirements for reporting on transactions and co-operation within the scope of the supervision of financial markets (Co-operation and Enforcement group).

The **Intermediaries** expert group addresses the comitology provisions relating to the internal organisation of financial intermediaries with the aim of protecting the investor. Two approaches aim at reaching this goal:

- an "internal" approach covering the organisational requirements, rules of conduct of business obligations when providing investment services to clients and the management of conflicts of interest;
- an "external" approach covering best execution of client orders and client order handling rules.

The **Markets** expert group is charged with:

- establishing criteria to set up transparency rules for the admission of securities to the regulated markets and defining the means to establish to control compliance with these rules;
- elaborating technical measures relating to the pre- and post-trade transparency requirements for regulated markets and multilateral trading facilities and post-trade transparency requirements for investment firms.

The **Co-operation and Enforcement** expert group concentrates on the following two areas:

- means to be established at national level to allow for the supervision of markets, mainly by elaborating the content of information relating to transactions (on and off stock exchanges) to be reported by the financial intermediaries to the competent authority;
- co-operation between supervisory authorities of Member States by covering the exchange of information as regards securities transactions, as well as exchange of information concerning the approval and activities of financial intermediaries.

The groups started their work by identifying the areas of convergence and divergence respectively, in the current regulations through questionnaires relating to the different areas covered. The first projects had been presented to the consultative group in January 2004 to collect the advice of these market participants before elaborating a more detailed technical advice. The consultation by means of working documents is due to be launched in June 2004 so as to comply with the deadline of 31 January 2005 set by the European Commission to submit the technical advices.

2.3.3. Permanent CESR groups

- **CESRFIN**, the permanent committee on financial reporting, continued its work on international accounting standards (IAS/IFRS), auditing and financial disclosure by listed companies, considering that the transition to international accounting standards will represent a major challenge for the 7,000 European listed companies. The introduction of international standards will improve transparency and comparability of financial information. The markets and investors will need to adapt to the new way financial information is presented and their correct enforcement should remain a high priority for supervisory authorities.

In 2003, the subgroup CESRFIN-Endorsement continued to closely follow the discussions and work concerning the IAS/IFRS standards and their enforcement at community level and expressed many comments and suggestions. Within the framework of the transition of listed companies to the international accounting standards IAS/IFRS in 2005, the sub-group issued on 30 December 2003 a recommendation for the transitional stage based on three main lines:

- the information a company can disclose before 1 January 2005 to inform the investors about the impact of the new accounting principles;
- the accounting rules to be applied to interim financial reports in 2005;
- the comparability between interim and yearly financial reports for 2005.

Following the publication in March 2003 of the first standard relating to financial information and dealing with the supervision of implementation of accounting standards in Europe, the sub-committee CESRFIN-Enforcement launched a consultation process on a second standard relating to financial information in October 2003. The standard proposes principles set to enhance coordination of enforcement practices of accounting standards in Europe, notably:

- that the supervisors should take into account the existing decisions and, where practicable, discussions should take place between authorities;
- that a database providing a record of previous decisions should be made available, on a confidential basis, to the different authorities;
- that regular sessions should be held between the different bodies concerned in the decision process, thus allowing to discuss the decisions taken and to share experience.

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- **CESRPOL**, responsible for enhancing the exchange of information, co-operation and co-ordination of the supervision and enforcement activities between members of CESR, held three meetings in 2003.

One of the main aspects of the activities of CESRPOL was the adoption of the format for a request for assistance and of criteria for treating these requests under the Memorandum of Understanding (MoU) of FESCO (predecessor of CESR) concluded on 26 January 1999.

Moreover, CESRPOL concentrated on updating the MoU in the light of the implementation of the Financial Services Action Plan, the priorities of the enforcement of legislative provisions in Member States, the Internet surveillance activities in order to detect unlawful financial activities, the problems with un-cooperative jurisdictions, as well as the possible impacts of the European Convention on Human Rights.

Responding to a mandate given by the group of presidents of CESR during its meeting on 11 and 12 December 2003, CESRPOL will elaborate more detailed measures relating to the defensive means against market abuse and accepted market practices in 2004, in accordance with level 3 of the Lamfalussy process. CESRPOL will regularly review the safe harbours within which prohibitions of market abuse do not apply. Furthermore, CESRPOL will analyse national and cross-border market abuses on a regular basis.

2.3.4. Joint CESR-ECB working group on compensation and securities settlement systems

On 27 September 2001, the European Central Bank (ECB) and CESR drafted the framework for co-operation between the European System of Central Banks (ESCB) and CESR as regards compensation and securities settlement systems in order to study subjects of common interests.

Following several meetings in the first half of 2003, the joint working group published a consultative report in July 2003 on the CESR website (www.cesr-eu.org). Following this publication, the working group held a public hearing at the beginning of October 2003 and received about fifty formal responses to the consultative report. These responses are dealt with as from the beginning of 2004 at the next meetings of the consultative group.

2.4. The informal groups

The Prospectus informal contact group

In 2003, the members of the informal contact group shared their points of view on three subjects, notably the prospectus itself, the public offers and the issues concerning markets in general.

As far as the prospectus itself is concerned, the discussions mainly focused on the use of a summary prospectus and the period of time needed by the competent authorities to approve prospectuses, as well as the issue of public offers without prospectus.

The development of the proposal for a directive on the prospectus to be published when securities are offered to the public or admitted to trading, as well as the proposal for a directive on takeover bids have also been discussed.

Finally, the discussions concerned the rules applicable to market makers, rating-based issues, information required in case of multiple listing in several States, of which one is not part of the European Economic Area, equivalence of information in case of multiple listings and allocation of shares by Internet and the publication of this information by the issuers on their website.

2.5. Institut Francophone de la Régulation Financière (IFREFI)

The *Institut Francophone de la Régulation Financière* (Francophone Institute for Financial Regulation), gathering the financial markets regulatory authorities of nine French-speaking countries (Algeria, Belgium, France, Guinea, Luxembourg, Quebec, Morocco, Switzerland and the West African Monetary Union) was created in 2002 by a charter.

IFREFI is a flexible structure of co-operation and dialogue and aims at furthering the exchange of knowledge and experience, drawing up studies and exchanging essential information relating to the financial markets between the Member States of the Institute. According to the charter, IFREFI also aims at promoting professional training by organising training seminars on specific topics.

During their annual meeting which was held in Montreal in June 2003, the presidents and representatives of the Francophone regulatory authorities discussed the current concerns of the world of finance following the failures of supervisory systems of general management and boards of directors of companies, notably corporate governance, as well as the scope of intervention of the regulators in this area.