



**International
Regulatory Outlook
November 2005**



Promoting efficient, orderly and fair markets






Helping retail consumers achieve a fair deal

Improving our business capability and effectiveness

**Financial Services Authority
International
Regulatory Outlook
November 2005**

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Preface

In January this year we published our first International Regulatory Outlook (IRO) which highlighted the extent to which new regulatory requirements arising from international initiatives, particularly European Union legislation, were likely to have an impact on consumers, markets and regulated firms. Such measures continue to account for the majority of new FSA regulation. The international dimension to our work is also underlined by the global nature of the UK financial markets, as well as the significant presence of UK-based firms in international markets.

From the feedback we have received it is apparent that the first IRO has been extremely helpful in providing key messages and showing readers where they can find more detailed information on developments that may affect them. So we have decided to continue producing an IRO on an annual basis and to review and develop the format of the report in the light of your comments.

Three key messages arise from this report:

- firms that underestimate the continuing heavy implementation challenge arising from EU

measures during 2006-08 are likely to incur significant last-minute costs and/or additional compliance risk;

- if stakeholders wish to influence the development of international policy initiatives, it is important that they do so as early in the process as possible and are alert to consultation documents as they are published; and
- to maximise the scope for effective policy-making, stakeholders should support calls for international bodies to develop a better regulation agenda focused on transparent, evidence-based policy-making that incorporates adequate time for consultation and market failure analyses and cost-benefit analyses.

The international agenda is a heavy one and this shows no sign of abating in the short term. Influencing and understanding the implications of this agenda – particularly the risks and opportunities this presents – involves a significant commitment in terms of our resources, including senior management time. To help readers understand the way in which we structure our work in this field, we have described how we

address international policy work at the FSA on page 19. We also continue to work closely with the Treasury and the Bank of England to promote a joined-up approach to financial services regulation in the international sphere.

This is particularly the case as regards EU policy, where all three UK authorities have jointly adopted a tripartite approach in responding to EU consultations and defining and explaining UK objectives in respect of EU financial services legislation. Together we have established working groups and roundtables to provide additional means by which stakeholders can provide their views. We recognise the importance of the UK authorities working effectively with both financial services companies and their customers in understanding and influencing the potential impact of EU legislation on UK markets. In this context we are committed to working with the other relevant authorities and with the market.

John Tiner

Executive Summary

After publishing the first edition of the IRO in January 2005, and an update in June, we have moved publication of the main IRO to November. The comments that we received following the release of our earlier documents showed that there is a substantial demand for a publication of this type. The revised

timing allows us to discuss various international regulatory issues ahead of the production of the FSA's Business Plan in February. We will continue to produce IRO updates to help ensure that stakeholders are informed of major developments as they evolve.

Key Points

- We remain concerned about the challenges facing many firms arising from the need to comply with new EU obligations during 2005-08. Firms need to devote adequate resources, including senior management time, to address implementation issues and manage their compliance risk.
- The European Commission has stated that its legislative programme for financial services will enter a consolidation phase during 2005-10 and that new legislative proposals will have to pass a rigorous cost-benefit process. This additional discipline in policy-making is welcome.
- There are several important issues that the Commission is studying that might give rise to proposals, particularly in respect of asset management, mortgages and clearing and settlement services. It is very important that any work in these areas is underpinned by a detailed and objective assessment of the costs and benefits of various options. Stakeholders need to be alert to consultations on these subjects and should respond in good time to influence decision-making.
- The Capital Requirements Directive (CRD), due for implementation from January 2007, has now been approved by the European Parliament and endorsed by the Council of Ministers. However, the timetable for implementing Basel 2 in the US has been delayed. We published our Feedback Statement on Strengthening Capital Standards in September and are working towards publishing a second Consultation Paper (CP) in February 2006.
- On the Markets in Financial Instruments Directive (MiFID), the EU Commission's formal proposal for Level 2 implementing measures now looks unlikely to emerge before December. In parallel, the Council of Ministers and the European Parliament are considering the proposal from the European Commission to delay implementation of MiFID by 12 months. The UK Presidency has recently tabled a proposal that would see a further extension of 6 months, which would result in a final implementation date of 1 November 2007. In light of these developments, the FSA has reviewed its planning for domestic implementation and plans to issue its main CP on key aspects of UK implementation in March 2006.
- Insurance solvency and capital adequacy continue to be considered at both the European (Solvency 2) and broader international level (International Association of Insurance Supervisors – IAIS).
- Globally, there is an active debate on the regulatory approach to hedge funds, in particular the appropriate balance between regulatory intervention and risk mitigation through market mechanisms.
- The industry has taken a number of steps to review practices in the area of wholesale market counterparty and structured finance risk management (e.g. the work of CRMPG2, a group of market practitioners). Regulators remain concerned about the development of confirmation backlogs in the credit derivatives sector, and the FSA, in collaboration with US regulators, is taking steps to address this issue.
- Within the EU, and more widely, the need to contain the regulatory burden on firms by achieving a reasonable balance between the levels of engagement of home and host country supervisors continues to exercise regulators and firms.
- There is a growing debate among national regulators from a number of major economies relating to the oversight of – and risks to markets arising from the market dominance of and resulting reliance on – the so-called 'Big Four' accounting and audit firms.

Outline

The international policy agenda is very broad and raises issues relevant to each of the FSA's statutory objectives – maintaining market confidence, protecting consumers, increasing consumer understanding and reducing financial crime. The IRO updates stakeholders on a range of global and EU measures affecting financial regulation in the UK. It also describes our participation in international policy-making and identifies opportunities for stakeholders to influence discussions in EU and global fora. We address these issues in the four sections of this paper.

- Section A** Gives a general overview of some of the major themes affecting firms and consumers in the near to medium term. In an EU context, this includes the volume of implementation work implied by recent and future legislative changes, moves towards establishing a better regulation agenda and the debate on regulatory convergence. In a wider international context, it considers recent developments affecting the process for setting global regulatory standards.
- Section B** Provides coverage of the more important measures affecting FSA stakeholders in the context of specific sectors: Capital Markets; Banking; Insurance; Asset Management; Retail Intermediaries; Accounting and Auditing; Consumers; Financial Crime; and Financial Stability. As an integrated regulator, we prefer – wherever possible – to treat common issues in a consistent way across industry sectors. But within the IRO we also provide sectoral coverage, reflecting the fact that international policy work is often conducted along sectoral lines.
- Section C** Indicates timelines for EU measures, highlighting when the measure is expected to be finalised, expected FSA and Treasury consultations, and the deadline for implementation by firms. It is important to note that these timelines can be subject to change and information will be more tentative for those measures at the earlier stages of negotiation.
- Section D** Outlines the work programmes of some of the more prominent international and European fora in which we are engaged.
- The UK policy context** While we participate in various EU fora, responsibility for representing the UK in negotiations on EU Directives and other legal measures is a matter for the UK Government. This is also the case for changes to UK legislation, with the Treasury taking the leading role on financial services. In the case of the Basel Committee, the Bank of England participates alongside us. And there are many other instances of cross-public sector involvement in regulatory policy-making. In particular, the Treasury, the Bank and the FSA work closely on a tripartite basis in dealing with EU measures affecting financial services. So while the IRO is an FSA publication, readers should bear in mind that policy-making in this area involves a wider set of relationships.

Future updates to the IRO

The feedback that we received after publishing the first IRO in January 2005 was very helpful. If you wish to offer views about this publication please contact us at IRO@fsa.gov.uk.

In outlining issues that may be relevant to stakeholders, we wish to draw attention to certain initiatives that we believe are of general interest. However, we cannot provide a definitive description of all measures that may be important to particular firms or other stakeholders. No statements in the IRO constitute rules or guidance under the Financial Services and Markets Act (FSMA) 2000.

Commentary

Overview

In this section, we consider EU developments and discussions in global regulatory fora in turn. This recognises that EU legislation has a direct effect on those subject to FSA regulation, whereas the adoption of global codes and best practice standards tends to have a more indirect effect. Despite this separation for the purposes of this report, there are important linkages between global and European policy-making that should not be overlooked. The CRD, for example, introduces a capital adequacy framework that has its origins in work undertaken by the (global) Basel Committee on Banking Supervision to create a revised Basel Capital Framework (Basel 2) for banks. Similarly, various globally-recognised guidelines produced by the Financial Action Task Force (FATF) to counter money laundering and terrorist financing have been made mandatory via EU Directives.

European developments

Outstanding legislative agenda

The principal (current and future) legislative measures and other EU projects that affect our stakeholders are described in Sections B, C and D. Timelines for implementation are given in Section C. This shows that during the period 2006-2008 many firms will continue to face significant implementation challenges arising from the roll-out of EU initiatives. These will result in major changes to parts of our Handbook, with significant implications for both prudential and conduct of business requirements.

Each of these measures relates in one way or another to our statutory objectives. In many cases, their aim is to provide a framework of international requirements that should help the FSA and other national regulators achieve their objectives in consistent and mutually reinforcing ways. But we are also acutely conscious of the current implementation challenge firms are facing as a by-product of the range and depth of the EU's recent legislative drive. Firms will need to continue to devote sufficient resources to ensure adequate preparation for forthcoming rule changes. Failure to do so will result in heightened compliance risk.

Moreover, as well as considering these measures individually, firms and regulators will need to be aware of the potential linkages between different EU measures (e.g. the adoption of international accounting standards and the CRD or Solvency 2).

Given their relevance to a range of FSA stakeholders and the importance of near-term developments on both Directives, it is worth summarising the current position regarding MiFID and the CRD. Other measures at an earlier stage in the legislative process (e.g. Solvency 2 or the Payment Services Directive) are likely to raise

important issues for various sectors in due course.

The European Commission formally proposed in June that the implementation deadline for MiFID should be extended to the end of April 2007 – representing a 12-month extension on the previous deadline. The UK Presidency recently tabled a proposal that would give industry an additional six months in which to finalise their preparations, resulting in an implementation date of 1 November 2007. The revised draft amending Directive would also set 31 January 2007 as the date by which national authorities in Member States must transpose MiFID's requirements into domestic law. The European Parliament, which must also agree to the proposal, is scheduled to vote on the text in December.

MiFID is a framework Directive. Its core provisions (the Level 1 text) came into force in April 2004. These high-level provisions will be complemented by more detailed rules (Level 2 measures – see section D). The Committee of European Securities Regulators (CESR) submitted its advice on various Level 2 measures during the first half of 2005. Discussion of the Level 2 measures continues in the European Securities Committee with the Commission's recommendations expected to emerge in December and final adoption of the measures expected possibly in April or May 2006.

Following the further delay in release of the Commission's recommendations on Level 2 and in the overall timetable, the FSA has reviewed its plans for domestic implementation and now plans to issue its CP on MiFID implementation in March 2006. To the extent that the Level 2 measures as adopted differ from the Commission's recommendations, a second domestic consultation on relevant aspects will be required in the second half of 2006.

In order to provide firms with an indication of the key impacts of MiFID, the FSA has also published a 'Planning for MiFID' document. This is a short factual document, whose purpose is to encourage the senior management of firms to begin planning for MiFID implementation. It aims to highlight some of the likely key impacts of MiFID, and those areas where review of firms' operations, systems and business practices and procedures is likely to be necessary, and for which firms will need to budget in the coming financial year.

Following the European Parliament's approval of the CRD in September 2005 and subsequent endorsement of the European Parliament's amendments by EU finance ministers on 12 October, we plan to publish our second CP on UK implementation in February 2006. It will take account of discussions with stakeholders since we issued our initial CP – Strengthening Capital Standards – in January 2005 and of changes arising out of the final text of the CRD. Our intention is to put final rules in place in October 2006.

To assist firms planning to use the advanced approaches in the CRD, we have been prepared to accept applications since July. Any firm wishing to use these advanced approaches from the outset will need to apply to us by the end of December 2006.

In October 2005, the federal authorities postponed the implementation of Basel 2 in the US until 1 January 2009. This will have no impact on the European timetable for implementation via the CRD. In consultation with the US authorities we shall be examining how we can ease the practical problems that could arise in the meantime for UK-based groups with significant operations in the US and US-based groups with significant operations in the UK.

In keeping with our general practice, in our implementation of MiFID and CRD we will introduce rules going beyond the requirements set by the Directive (known as super-equivalence) only in cases where there is a clear need to do so, justified by market failure and cost-benefit analysis.

To encourage early, focused inputs to our planning for implementation of MiFID and CRD we have set up dedicated FSA-chaired liaison groups with the trade associations for the sectors principally affected. These have appropriate representation from the Treasury and the Bank of England. Regular discussions in those groups and in associated expert groups and round-table meetings also provide an opportunity for keeping all parties abreast of negotiations on the terms of the Directives themselves. More details of these bodies and accounts of their proceedings are available at www.fsa.gov.uk/Pages/About/What/International/basel/ and www.fsa.gov.uk/Pages/About/What/International/EU/fsap/.

Better regulation

For the FSA, market failure analysis is the starting point for assessing the case for regulatory intervention. The case for regulatory action requires, as a first step, the demonstration of a market failure, which relates to the objectives of financial regulation, and is not expected to be self-correcting. We then use cost-benefit analysis (CBA) to determine the most proportionate response. It is a requirement of the Financial Services and Markets Act (FSMA) that all new rules – including those arising from international commitments – are subject to a formal CBA.

Given that such a large proportion of new FSA rules and guidance derives from EU and other international policy initiatives, we

believe that similar disciplines should equally be applied in international fora. This would help us in meeting our statutory requirements. More fundamentally, it would also help to ensure that regulatory actions taken in a broader – e.g. European – context are proportionate to the problem under consideration. As our chairman, Callum McCarthy, has noted, the FSA can be given responsibility for implementing decisions that would not necessarily pass the market failure and CBA tests that we apply in the UK. In particular he has cited MiFID, which has not been subject to a comprehensive EU-wide CBA, as a case in point¹.

We have been assessing the costs and benefits of MiFID and, as part of our consultation on FSA implementation, we will offer our assessment of costs and benefits from a UK perspective.

We particularly welcome the European Commission signalling the importance of applying CBA in the financial services arena. The Commission's recent Green Paper on Financial Services Policy (2005-10) stated it was 'committed to act only where European initiatives bring clear economic benefits to industry, markets and consumers'. Following the recent period of intensive legislative activity, it described the coming period as a time for consolidation. In discussing the Green Paper, the EU Internal Market Commissioner Charles McCreevy reinforced this message. He also noted that the Commission's Directorate General for Internal Market and Services had launched an evaluation programme to regularly monitor existing Internal Market rules. He has said he will

not hesitate to propose to modify or even scrap rules that do not pass the quality tests². This proposal to scrap ineffective regulation is welcome, though it will be important not to underestimate the practical issues involved.

The Commission also outlined its methodology for assessing the consequences of regulatory change earlier this year in its Impact Assessment Guidelines (June 2005)³. This describes the policy-making disciplines Commission staff should follow to ensure that potential measures are proportionate. And it sets the benchmark for regulatory decision-making within the Commission. So stakeholders wishing to contribute to EU consultations may find it helpful to refer to that document when framing their responses on the likely impact of new proposals or CBA work. In the area of ex post CBA, the Commission has announced recently that it will conduct a legal and economic analysis of various measures that formed part of the Financial Services Action Plan once they have been implemented by Member States.

One result of the recent Commission initiative to review its legislative agenda for potentially redundant measures has been the decision not to proceed with the proposal for an EU Regulation on Sales Promotion in the Internal Market – listed in the January 2005 IRO.

The Commission has indicated that it does not envisage a new legislative programme on the scale of that seen during 2000-05. However, there are several sectors that are being examined in EU fora with a view to possible EU initiatives. These include asset management, retail financial

services (including mortgages) and clearing and settlement. This could amount to a significant future agenda with implications for UK regulation. Given past experience, it is important that firms, trade bodies and consumer groups with an interest in these areas engage with EU policy-makers as early as possible if they wish to contribute to this process.

Regarding mortgages, the Commission published a Green Paper in July on mortgage credit in the EU. In the paper, the Commission invites views on the desirability of intervention. The Commission's concern is that national markets are not integrated and the full range of mortgage products is not available in each Member State. So consumers may face a reduced choice of products or even be excluded from the mortgage market altogether.

The Green Paper is supported by a study produced by London Economics. This identifies that any benefits from integration would not be evenly shared across member states. The UK would be the least likely to gain because the major benefit comes from increasing market 'completeness'. So benefits to other Member States arise from increases in product diversity and accessibility to levels already seen in the UK.

In assessing costs and benefits on the basis of a package of interventions, the study does not allow sufficient understanding of the respective costs and benefits of specific measures. This means the study is an insufficient basis for identifying the 'optimal' selection of measures. We believe there should be a more detailed analysis of the costs and benefits of specific measures intended to facilitate integration. And while there may be

1 Speech by Callum McCarthy, FSA Annual Public Meeting, 21 July 2005.

2 Speech by Charles McCreevy, Exchange of Views on Financial Services Policy 2005-10, Brussels, July 2005.

3 See http://europa.eu.int/comm/secretariat_general/impact/key.htm

real benefits from more integrated markets, there may well be linguistic, cultural and legal issues as well as regulatory ones that limit such integration. Without clear evidence on this basis, the case for intervention has not been made. The Commission has said that a White Paper is likely to follow in 2006 but that stakeholders should not assume from this that legislation is inevitable.

Given the recent emphasis on CBA by the Commission, it is also essential that any further work affecting asset management and clearing and settlement should be of high quality.

Lamfalussy process and supervisory convergence

The Lamfalussy approach to financial services regulation is now functioning in all three major sectors (see Section D). As regards legislation, this creates a framework in which core legislative requirements (Level 1) expressed in relatively high-level terms, are set by framework Directives. As primary legislation, such Directives are subject to the usual legislative process involving the Commission, European Parliament and the Council of Ministers. The general requirements of a framework Directive are then expanded through the more detailed provisions of secondary or delegated legislation made by the Commission and known as Level 2 measures. The process for writing Level 2 measures relies heavily on technical input by supervisory agencies.

This technical input is provided by three sector-focused committees, known as the Lamfalussy Level 3 committees⁴: the Committee of

European Insurance and Occupational Pensions Supervisors (CEIOPS), the Committee of European Banking Supervisors (CEBS) and the Committee of European Securities Regulators (CESR). CEIOPS and CEBS became operational in 2004, joining CESR, which has been working on capital market and securities issues since 2001. As we noted in our response to the Commission's May Green Paper: '...we welcome the [Commission's] continued endorsement of the Lamfalussy structures and recognition of the important role of CESR, CEBS and CEIOPS in ensuring that significant internationally active financial services institutions and market structures are subject to an effectively co-ordinated set of managed regulatory relationships.'

In addition to advising the Commission on legislation, the Level 3 committees have two other functions. First, they improve co-ordination and convergence between regulators by providing a platform for co-operation and exchange of information. Second, they provide a means of promoting consistent application of EU legislation in Member States. As Callum McCarthy recently commented, this provides an opportunity over the long-term for achieving regulatory convergence and it is essential that the Lamfalussy structures make full use of this⁵. This comes against a background in which regulated firms operating on a cross-border basis – both in the EU and more widely – are increasingly calling on regulators to address national requirements that are duplicative or in some cases even inconsistent.

The theme of regulatory convergence was addressed earlier this year in a tripartite paper by the Treasury, the Bank of England and the FSA⁶. This set out practical suggestions for streamlining the regulation of international firms. The proposed approach is risk-based, with particular focus on those firms that are systemic or high impact (i.e. firms whose failure could result in a widespread loss of confidence and/or the failure of other firms). The paper outlined how greater information sharing and regulatory co-operation could be put in place without requiring changes to existing legal duties and responsibilities.

A welcome development on this front is the recent initiative by CEBS to produce guidelines for co-operation between consolidating supervisors and host supervisors. This work is made particularly relevant by the need to implement the CRD in a collaborative manner given the way in which banks are increasingly centralising their risk management functions. This is recognised in Articles 129 (joint model validation), 131 (co-operation between home & host supervisors) and 132 (supervisory action) of the Directive. A public hearing on the guidelines was held in October 2005, before CEBS consultation closed in early November. For its part, in September CEIOPS produced a first progress report on supervisory convergence in the areas of insurance and occupational pensions. It indicated those areas where it has sought to enhance regulatory convergence, particularly in relation to the continuing work on the Solvency 2 project.

4 The role of these Lamfalussy committees and their role in the EU legislative and supervisory process are outlined in section D.

5 Financial Times article by Callum McCarthy, Europe's financial regulators must exploit existing ties, 22 August 2005.

6 Supervising financial services in an integrated European Single Market: A discussion paper, January 2005.

Another possible approach to convergence that has been flagged in the Commission's Green Paper would involve the simplification and consolidation of EU and national rules. This potentially covers a wide range of options, which run from merely collating relevant EU financial services legislation to creating a single EU rulebook from existing EU and national financial services provisions. Full consolidation would represent a huge undertaking and would also require the alignment of contract and insolvency law to achieve its intended effect. The resource costs and disruption arising from such an undertaking would be very large. However, there could be significant benefit were the Commission to improve the internal coherence and consistency of the existing corpus of EC law. But this would still be a significant undertaking and any material changes that resulted would need to be supported by a proper impact assessment.

There are, however, some areas where rationalisation would clearly

prove useful to the industry and consumers. For instance, the MiFID, the Distance Marketing Directive, the Electronic Commerce Directive, Consolidated Life Directive, UCITS⁷ Directives and the Insurance Mediation Directive all contain requirements about the provision of information to consumers. Where services are provided cross-border some of these requirements will be for the home state to monitor and enforce, some for the state of establishment and some for the state of destination. Member States may not necessarily share the same view of which Member State is responsible for what. This creates potential for overlaps and gaps and is certainly a source of confusion – and hence risk – to consumers.

Developments in global standards

Beyond the EU, we engage with international regulatory bodies on a number of levels. Much of this

work involves identifying common issues and approaches to regulation, recognising the increasing links between financial centres and markets. This allows regulators to develop international solutions to common regulatory problems. We also aim to promote best-practice regulation through the development of regulatory core principles.

Governance in standard setters

International bodies have been issuing recommended best practice standards for many years. This process received particular impetus following the East Asian financial crisis (1997-98). In 1998, the Financial Stability Forum endorsed a set of 12 key standards and codes (see box). These form a minimum threshold for regulatory structures and practices for any jurisdiction active in international financial markets. These are the foundation on which the International Monetary Fund (IMF)/World Bank Financial Sector Assessment Program (FSAP) assessments have been developed, resulting in an

FSF endorsed standards and codes

The 12 key standards and codes (with the sponsoring institutions in brackets):

- Code of Good Practices on Transparency in Monetary and Fiscal Policies (IMF)
- Code of Good Practices in Fiscal Transparency (IMF)
- Special Data Dissemination Standard/General Data Dissemination System (IMF)
- Principles of Corporate Governance (Organisation for Economic Co-operation and Development, OECD)
- International Accounting Standards (International Accounting Standards Board, IASB)
- International Standards on Auditing (International Federation of Accountants, IFAC)
- Core Principles for Systemically Important Payments Systems (G-10 Committee on Payment and Settlement Systems, CPSS)
- Recommendations for Securities Settlement Systems (CPSS/International Organization of Securities Commissions, IOSCO)
- 40 Recommendations of the Financial Action Task Force/9 Special Recommendations Against Terrorist Financing (FATF)
- Core Principles for Effective Banking Supervision (Basel Committee on Banking Supervision, BCBS)
- Objectives and Principles of Securities Regulation (IOSCO)
- Insurance Core Principles (International Association of Insurance Supervisors, IAIS)

7 Undertakings for Collective Investment in Transferable Securities.

increasingly high profile for the standards and codes themselves. For market participants, the fact that regulators are seeking to apply or maintain standards that are notably more robust than those applied in the past should materially affect their confidence in financial systems or markets.

The heightened profile of standards to be followed by regulators, central banks and others has focused greater attention back on the standard setters themselves. Their governance, priority-setting, disclosure and consultation processes are rightly scrutinised increasingly closely by those affected by their statements. These demands for greater transparency do not necessarily signal a challenge to the legitimacy of the standard setters. Rather, they are a sign of increased maturity and that the standard setters' output is being taken increasingly seriously.

Core governance standards relating to securities, insurance and banking have been reviewed recently by IOSCO, IAIS and BCBS, with more thorough implementation guidelines also developed. Two private sector standard-setters for accounting and auditing practices, the IASB and the IFAC respectively, have established public interest bodies to oversee their work. Recently, more formal consultation processes have been set out by both the Joint Forum and IOSCO, both of which establish principles that may subsequently form the foundation for national rule making. In the case of IOSCO, interested parties now also have the ability to comment on the organisation's work programme on the basis of more thorough and timely notification of work plans than hitherto.

While these are all positive steps, there will continue to be expectations that international standard setters should ensure that their own processes also reflect accepted best practices. This is likely to involve:

- greater scrutiny of their governance and accountability arrangements;
- the inclusiveness of their decision-making processes, increasing use of quantitative analysis, including cost-benefit analysis and impact assessments;
- reliance on risk-based approaches; and
- searching for consistency across sectors.

Ultimately it will be for the standard setters themselves to take these lessons forward. At the initiative of the UK Government, the Financial Stability Forum (FSF) has been asked to work with the standard setters to examine how best practice can be embedded in their internal processes.

Standards and codes review

The last year has seen a review of the FSAP process and Report on the Observance of Standards and Codes (ROSC) assessments by the IMF and World Bank. The FSF has discussed the lessons learned from these reviews. While the reviews focused largely on the way the IMF prioritises countries for assessment, they also highlighted several issues of direct relevance for the standard setters. Drawing upon experience in compiling FSAP and ROSC reports, the IMF/World Bank drew the attention of standard setters to a number of instances of cross-sector inconsistencies. The standard setters themselves – specifically the Joint Forum – have undertaken work to

address such concerns in the past. The latest reports are likely to prompt further work in this area.

The IMF/World Bank reviews noted, unsurprisingly, the importance of effective implementation. The efforts of the standard setters to provide implementation guidance is therefore helpful. The reviews also suggested that, given constrained resources both for assessors and the assessed, the standard-setting bodies could usefully explore the prioritisation of the principles within a standard, which could help jurisdictions set implementation priorities and undertake follow-up assessments/updates.

The question of effective enforcement has been specifically raised in the context of recent corporate scandals. In March 2005, IOSCO issued a report on the financial reporting irregularities associated with Enron, WorldCom and Parmalat. This contained an important message for both the regulated and regulatory communities. The report's conclusion was that the problems exposed by these financial scandals were not the result of a lack of appropriate standards or guidance. IOSCO noted that in many cases, there already exist international standards and principles designed to address the weakness identified by the IOSCO Task Force. However, absent thorough implementation and enforcement by all securities regulators, these weaknesses will remain.

Financial market developments and regulatory change

As financial markets continue to integrate geographically and gain in complexity, so the demands on regulators to work co-operatively and effectively across borders and sectors continue to grow. Major developments and innovations in financial markets affect standard setters and similarly demonstrate the increasing relevance of standard setters to global financial markets.

One example of this cross-institution co-operation has been the joint Basel/IOSCO Trading Book Review. After consulting the industry on its revised Capital Adequacy Framework (or Basel 2), the Basel

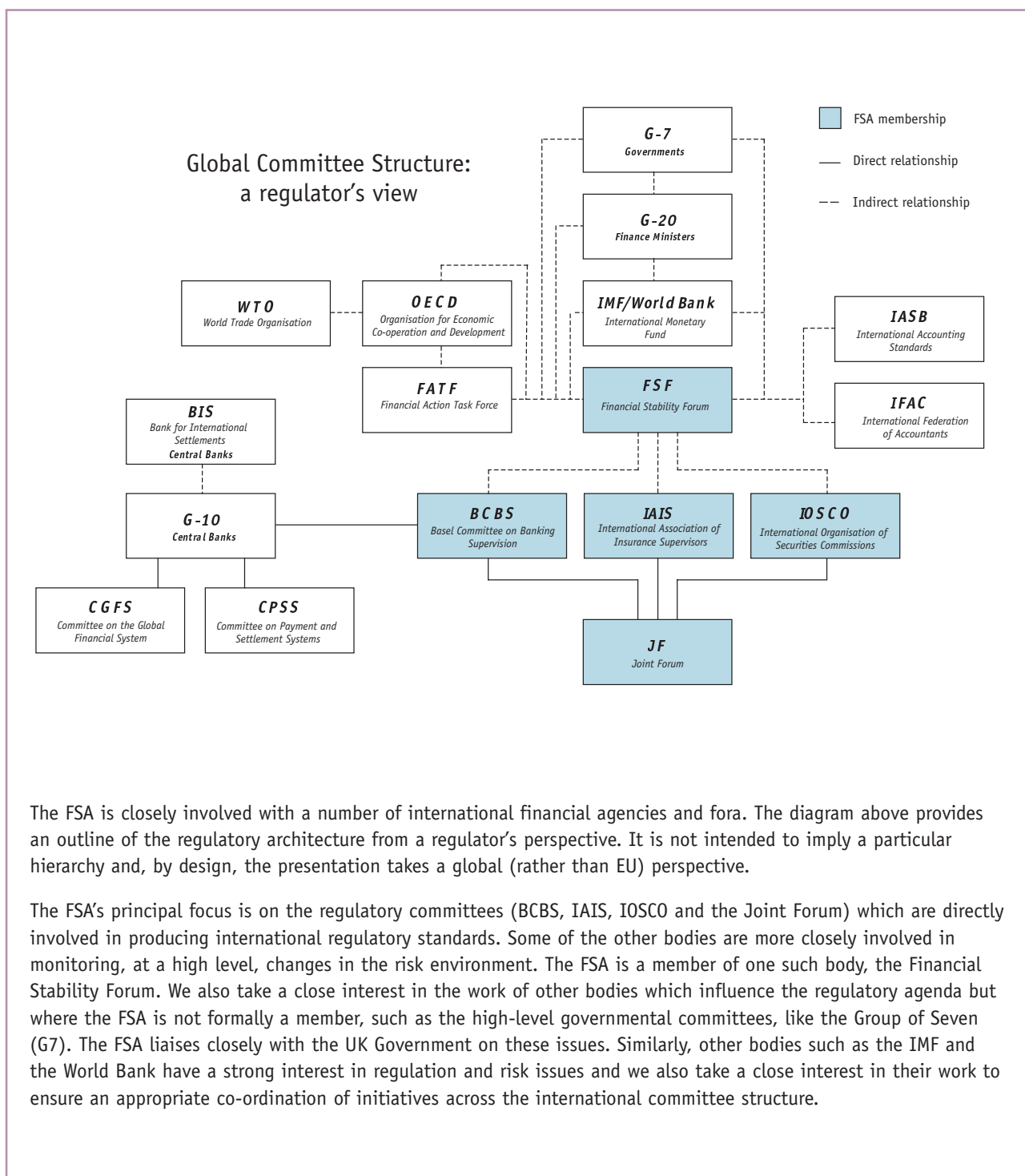
Committee worked with IOSCO to consult further with industry representatives and other supervisors on five specific issues related to double default and trading activities prior to the implementation of the Basel 2 Framework. The conclusions of the review are now being incorporated into the Basel 2 implementation processes.

Two other issues that are significant in a regulatory context are the appropriate regulatory treatment of hedge funds (and hedge fund advisers) and the development of confirmation backlogs affecting the market in credit derivatives.

The profile of the first issue has been raised as a result of the decision to

require from February 2006 the mandatory registration of US hedge fund advisers with the US Securities and Exchange Commission. This will be an important change to the regulatory environment in which hedge funds operate. The extra-territorial reach of the new requirements has already prompted comment and advisers based outside the US may fall within SEC requirements if they have sufficient US clients.

The regulatory issues affecting hedge funds and confirmation backlogs affecting credit derivatives are considered further in the Capital Markets sector message (see page 21).



International policy within the FSA

International policy initiatives, particularly those arising in the EU, have major implications for the FSA in terms of opportunities, risks and resources. The breadth of our responsibilities, together with the range of topics under discussion in international fora and the implications of these for our domestic agenda, mean that all our major business functions need to engage with global and EU policy work. In particular it represents a major priority and time commitment for the executive members of the FSA Board.

It is essential that those individuals in the FSA with relevant sector-specific expertise play a major role in international discussions affecting their portfolios. New EU legislation or proposals are, accordingly, allocated to a policy 'lead' in the policy unit responsible for the topic being addressed. The intention is that 'international' work is largely integrated into our day-to-day activities, rather than separated from them. Policy leads will closely support the responsible Government Department – typically the Treasury – on negotiation of European Directives.

At the same time, work on major international policy initiatives will typically involve collaboration between FSA departments and a substantial element of cross-team project working. The development and roll-out of the Basel 2 Capital Adequacy Framework, for example, has required close engagement by both our Retail and Wholesale Business Units. Similarly, work on Solvency 2, while led by our Wholesale Business Unit, draws together supervisors and policy specialists from across the FSA. 'Front line' supervisors who have day-to-day interaction with firms and markets have an important contribution to make at all stages of policy development. This reflects their insight and experience derived from being engaged with the regulated community. Their level of involvement inevitably tends to increase as measures approach the implementation stage however.

While international policy work needs to be embedded in our business units, it is also important that we have the capacity to maintain an overview of international policy developments. We need to influence thinking on international policy (global and EU) at an early stage, to monitor emerging issues, assess what these mean for the FSA and ensure that we engage with those that are potentially important issues. To help senior management with this, we have an International Strategy and Policy Co-ordination Department (ISPC) operating within our Finance, Strategy and Risk Division (FSR). In addition to the 'early warning' function outlined above, ISPC also acts as the FSA's relationship manager with a number of key stakeholders in the international arena.

New rules and guidance arising from international commitments are also subject to market failure and cost-benefit analysis (CBA). We therefore involve members of our Economics of Financial Regulation Department (also in FSR) at an early stage in advising on any perceived market failure and alternative policy options – as well as reviewing CBA work later in the process – to help us promote good practice internationally as well as meet our statutory obligations.

Sector Messages

Capital Markets Sector

■ Leader *Sally Dewar*

■ Manager *Rebecca Jones*

In addition to the busy agenda for implementing European Directives, regulators and market participants alike have recently taken forward several initiatives with particular relevance to capital markets.

Hedge funds are increasingly important players in global financial markets. We recently issued a Discussion Paper ‘DP05/4 Hedge funds: A discussion of risk and regulatory engagement’ setting out our assessment of the risks arising in the sector and outlining current, planned and potential actions to mitigate those risks. Market participants had until 28 October 2005 to comment on the issues and questions raised in this document. We have also been working closely with other regulators in international fora, sharing findings and best practice. Hedge funds will remain for the foreseeable future on the agenda of these international committees. In parallel to these regulatory initiatives a number of industry bodies have sought to contribute to the debate on best practice. The Alternative Investment Management Association, the Managed Funds Association and the revived Counterparty Risk Management Policy Group (CRMPG2) have all recently published helpful documents that aim to raise standards in the industry.

The credit derivative markets are another area we and other international regulatory bodies have focused upon recently. In February 2005 we issued a ‘Dear CEO’ letter drawing attention to a number of operational issues arising in the credit derivative markets. In particular, we expressed concern about the development of significant backlogs in the confirmation of credit derivative trades. After we published this letter, supervisors incorporated these issues into the risk mitigation programmes developed for a number of participants in the credit derivative markets. More recently we requested that significant market participants complete a short quantitative and qualitative questionnaire. We wanted this to enable us to assess the impact that individual firm and industry-wide initiatives have had upon these backlogs. (Such initiatives include the recent establishment of a protocol for trade novations and assignments by the International Swaps and Derivatives Association.) The findings of this survey will be used to guide any additional regulatory action that may be required. Given the global nature of this issue, we have been liaising collaboratively with regulators in other jurisdictions – particularly the Federal Reserve Bank of New York and the Securities and Exchange Commission – to facilitate a coherent international regulatory approach.

A further area of concern for us and other regulators has been the degree of transparency in secondary bond markets. Our interest has been prompted by a number of factors, the key one being the need to prepare for a forthcoming review by the European Commission. That review, required under Article 65 of MiFID, will involve the Commission considering whether the extensive transparency requirements that the Directive sets out for markets in shares should be extended to other markets, including those in bonds.

To ensure that we are prepared to contribute effectively to the Commission’s review, which is expected to begin early in 2006, we published in September 2005 a Discussion Paper, ‘DP05/5 Trading transparency in the UK secondary bond markets’. The DP provides background information on the scale and operation of the secondary bond markets and outlines the academic literature on the impact of market transparency. It also attempts to encourage the debate by asking whether levels of transparency in the bond market could give rise to a market failure. We identify two broad avenues through which a market failure might manifest itself:

- inefficiency in the price formation process (if investors find it difficult to ascertain at what price levels bonds are being bought and sold); and

- a failure of best execution (if firms that owe this duty to clients face the same problem).

Our initial discussions with industry participants suggest that no material market failures exist at the wholesale end of the market, but that retail investors may struggle to obtain access to trading information. In addition, it was suggested that further transparency might help at the margin with better valuation of debt portfolios and credit derivatives. We hope the DP will stimulate debate in the industry so that we receive broad input before the Commission's review begins.

Banking Sector

■ *Leader Thomas Huertas*

■ *Manager Yannick Cox*

As highlighted in the January 2005 IRO, regulatory change in the banking sector continues to be driven mainly by European initiatives.

Legislation

Details about of the main Directives affecting banks is given in section C. The main EU initiatives that both regulators and banks will focus most closely on in 2006 are:

- **CRD:** We are preparing to issue our second CP on UK implementation in February 2006. All firms must adopt the new framework by January 2007, unless they opt to remain on Basel 1 for a further year or decide to apply for an advanced approach, in which case they have until January 2008. While US banking regulators have announced a delay to their Basel 2 timetable, implementation in the EU via CRD is unaffected.
- **MiFID:** Based on the assumption that the proposed revised deadline for MiFID implementation will be 1 November 2007 as proposed recently by the Presidency, the

FSA plans to consult on various aspects of MiFID implementation from the first quarter 2006 until mid-2006. MiFID is expected to have a significant impact on banks undertaking investment business and firms are urged to engage fully in the forthcoming consultations, both directly and via trade associations.

- A number of other new or proposed Directives still under negotiation and possible other legislative initiatives have the potential to affect the banking sector and should remain on firms' radar screens: including the Credit for Consumers Directive, the Payment Services Directive, the Unfair Commercial Practices Directive, and a possible Directive on clearing and settlement services. The Commission also issued a CP on the Deposit Guarantee Schemes Directive in July 2005. It plans to put forward policy recommendations in the spring of 2006.

Besides these Directives, several other EU and international activities are likely to affect banks. In particular, there is international work covering credit derivative confirmations and assignments, the DG Competition sector inquiry into retail banking, and the review of the definition of own funds (i.e. eligible capital) in Basel and the EU. The European Commission is also expected to begin work shortly on reviewing the large exposures regime contained in the CRD.

Credit derivatives and operational risk

For some time, we have been reviewing the operational risk position of those firms active in the credit derivatives market in the UK. Our principal concerns relate to controls over assignments and confirmation practices. More detail on the issue can be found under the Capital Markets section.

DG Competition sector inquiry into retail banking

On 13 June 2005, the European Commission's competition services, DG Comp, launched a sector inquiry in the area of retail banking. The inquiry is a complementary initiative to the Commission's Internal Market Directorate's drive to remove regulatory barriers within the Single Market for financial services. The objective of the inquiry is to ascertain whether there are features of the sector which may be restricting or distorting competition within the EU; in particular whether high entry barriers and lack of effective consumer choice (due, for example, to information asymmetry, excessive switching costs and product bundling) may be to blame for the lack of cross border competition. Initially, the inquiry will focus on the market for payment cards and then move onto other retail banking products/services. To begin with, DG Comp will simply be carrying out an information-gathering exercise – it has sent detailed fact-finding questionnaires to payment card networks and a sample of 300 banks across the 25 Member States with challenging deadlines for responses. The results could lead to specific enforcement initiatives by DG Comp or national competition authorities. DG Comp is not expected to announce its conclusions on the inquiry until the end of 2006 or the beginning of 2007, having commissioned an external study on retail banking due to be delivered during autumn 2006. An interim report on payment cards is expected at the beginning of 2006.

Review of Own Funds

In parallel with the publication of the revised Basel Framework in June 2004 the Basel Committee on Banking Supervision signalled its intention to review the definition of capital. But it committed not to

introduce any changes until after 1 January 2008. Paul Sharma, Head of Prudential Standards at the FSA, has been appointed as chair of the Basel Committee working group set up to undertake this review. Despite earlier indications that this work would start before the end of 2005, this is now increasingly unlikely.

In anticipation of work beginning in Basel, the European Commission has set up an Own Funds Working Group under the direction of the European Banking Committee. In June 2005 the Working Group requested technical advice from CEBS covering the implementation of current EU capital requirements, the development of new capital instruments and an analysis of the types of capital EU institutions currently hold.

Insurance Sector

■ *Leader David Strachan*

■ *Manager Amy Leonard*

Since 2001, we have focused on designing and delivering a modernised regulatory regime for UK insurance firms. Now largely implemented, the reforms have been threefold:

- new and more robust capital and governance requirements;
- enhanced disclosure to consumers; and
- smarter and more risk-based supervision, targeting our resources at the insurance firms that pose the greatest risks to the FSA's objectives.

The introduction of the new regime has required a significant effort by the UK insurance industry. Meanwhile, we continue to engage fully with the range of European and international regulatory and legislative developments, mindful of the impact that they may have on

UK firms and the domestic regulatory regime.

Having introduced our own new risk-responsive capital requirements, the work on an updated pan-European solvency regime (Solvency 2) continues to be a key priority for us. Progress is now gathering pace with CEIOPS having provided comprehensive technical advice on a number of issues to the European Commission. Going forward, active industry involvement – particularly via the Quantitative Impact Studies – will be crucial for development of the Directive. And we urge firms to engage with developments now to help ensure that the resultant legislation is proportionate and takes full account of robust cost-benefit analysis. It is particularly important that medium-sized and smaller firm engage in this process sufficiently early.

2006 will also be an important year for European reinsurers.

Reinsurance companies are already regulated in the UK. However, the introduction of the Reinsurance Directive will help establish a sound and prudent regime across the EU that does not impose additional requirements on pure reinsurers that are not justified on prudential grounds. We expect to consult on the implementation of the Directive in the third quarter of 2006, with a view to implementing changes to rules by the end of 2007.

Important progress is also expected with the Insurance Guarantee Schemes Directive. The UK already has a domestic insurance guarantee scheme in the form of the Financial Services Compensation Scheme (FSCS). This protects UK consumers if an insurance company is unable to meet its commitments. Having set up a working group to consider guarantee schemes for policyholders in the case of an insurance company getting into financial difficulties, the Commission is now looking to

promote parity with the banking and securities sectors for EU consumers. We recognise the benefits that such a level playing field could deliver and in the coming period will continue to be fully engaged in discussions over the Directive. A key priority for us is that the strengths of the current UK arrangements should not be undermined.

Although MiFID does not apply to insurance companies as such, the implementation of that Directive is likely to require major changes to our Conduct of Business Sourcebook (COB). We are considering the extent to which changes should be applied to our regulation of the investment business of insurance companies, in the interests of consistency for consumers and fair and effective competition. Firms are urged to participate fully in the consultations.

In the coming period, we will also be keeping a watching brief on progress made by DG Competition in its sector inquiry into business insurance. Such inquiries must be considered in parallel with the Commission's recent Green Paper on Financial Services Policy (2005-2010). The main trade associations in the UK have already responded to questionnaires issued by the Commission, and we stand ready to contribute our own views and experiences of the UK's market.

As progress is made on all these (and other) fronts, there is more attention on supervisory collaboration between Member States. For example, CEIOPS has now consulted on a draft Protocol on co-operation between competent authorities on insurance mediation. The Protocol follows the introduction of the Insurance Mediation Directive and sets out practices and procedures for co-operation between competent authorities. This includes

co-operation over the content of information held on public registers, the notification of passporting firms and voluntary exchanges of information between supervisory authorities.

Supervisory collaboration is of course also important at a global level. The CEIOPS working group dealing with the supervision of insurance groups is seeking to develop a memorandum of understanding (MOU) with the insurance supervisor in Switzerland, and a template MOU for use with US state insurance departments. The objective is to facilitate the effective supervision of insurance groups through co-operation and information exchange.

As the UK representative on the International Association of Insurance Supervisors (IAIS), we will continue to press for greater information exchange and improved collaboration in the supervision of international insurance firms. We fully support the IAIS's role as a global standard setter. Here, a key priority for us is the IAIS framework and cornerstones for solvency and the consistency with progress on Solvency 2.

In the coming period, we look forward to the IAIS' progress on producing guidance on mutual recognition of reinsurers that will permit host-state supervision to take account of supervision in the home state. A supervisory guidance paper, was issued in October 2005, on the use of finite reinsurance. This sets out key characteristics, accounting treatment, issues and supervisory mitigating action relevant to finite reinsurance. The second global reinsurance market report, covering end-2004 data, is also expected to be published around the end of the year.

Asset Management Sector

- Leader *Dan Waters*
- Manager *Ian Lumb* (acting manager)

MiFID is likely to mean significant changes for asset managers. Our consultation on UK implementation is now planned for March 2006. For asset managers, the most relevant issues are the establishment of EU-wide standards for client classification, financial promotions, outsourcing of portfolio management services and best execution. The requirements on financial promotions will be covered in a separate CP (see section C).

Separately, the CESR Expert Group on investment management has two items on its agenda in connection with the UCITS Directive:

- clarification of certain key definitions in the UCITS Directive; and
- simplification and harmonisation of notification procedures.

The definitional work is focusing on aspects of eligible assets, including closed-end funds, and the treatment of embedded derivatives and structured financial instruments. The work on simplifying UCITS notification procedures across Europe is examining the process for registering UCITS in terms of the time it takes, the cost and the complexity of the procedures. The Expert Group will analyse these differences and recommend ways of streamlining these processes.

The CRD will provide a proportionate capital treatment for the operational risk of so-called 'limited licence' and 'limited activity' firms. It is expected that 'pure' asset managers – i.e. those who deal as principal but with limitations – will fall within the limited licence category. They

would then simply be required to hold minimum capital related to a fixed overheads formula or, if higher, the sum of their market risk and credit risk requirements.

Firms will need to map from their post-MiFID list of permissions to the CRD categories and this will not be straightforward in some cases. We are committed to work with trade associations to find ways of helping firms navigate to the new requirements relevant to them.

The Transparency Directive will make some changes to the levels at which asset managers are required to disclose significant holdings in portfolios they manage on behalf of clients.

The European Commission published a Green Paper on asset management in July. This offers policy options and an indication of the priority with which the Commission views those options. In the near term, the Commission has listened to industry calls for a slowdown in the pace of regulatory change and sees no case for major legislative change. However, it has begun a process of dialogue with stakeholders about whether (and if necessary, how) to modify the European framework for authorised funds. This would enable it better to balance a varied range of investment strategies with the need for consumer protection. In this context the Commission has examined the viability of a true management company passport and considered whether procedures to allow fund mergers and pooling will deliver worthwhile benefits such as economies of scale.

The Green Paper also raised the issue of the desirability of a depositories passport. For alternative investments (including hedge funds) the paper announces the creation of a working group to look into the merits of developing a common regulatory approach. The paper asked for

comments on tax/regulatory arbitrage from substitute retail products such as unit-linked insurance products and certificates.

Retail Intermediaries Sector

- Leader *Stephen Bland*
- Manager *Mandy Spink*

The UK retail intermediaries sector is made up of around 4,700 financial adviser firms that offer pension and investment advice to retail customers, 10,000 general insurance intermediary firms and 3,600 mortgage advice firms. Some firms engage in more than one of these activities. There are also additionally over 700 accountants and solicitors who offer similar intermediation and advice services on top of their ordinary business.

These firms have faced considerable change over the last year, mostly domestic but some European in origin. For financial advisers the largest change was domestic. Depolarisation – the removal of the restriction on firms to either provide tied advice or independent advice – presented firms with major challenges and opportunities. Mortgage intermediaries were brought within our regulatory regime by domestic legislation in October 2004, while regulation of insurance intermediation was introduced in January 2005 in line with the Insurance Mediation Directive (IMD). The majority of financial adviser firms are also caught by the IMD.

In terms of EU developments, the main issues are outlined below:

- MiFID is likely to be the most significant new piece of legislation for financial advisers. The UK Government is still expected to use the discretion given by Article 3 of the Directive to allow

financial advice firms not holding client money (and not wishing to use the passport to conduct cross border advice) exemption from the scope of MiFID in the UK. However, the Directive is likely to require major changes to aspects of our Conduct of Business Sourcebook as it bears on in-scope firms and activities. We will need to consider the extent to which similar changes should be applied to firms which are exempted and/or doing non-Directive business, in the interests of consistency for consumers and fair and effective competition.

As noted in the May 2005 sector newsletter – Depolarisation special – firms should be aware that in circumstances where advice is paid for on a fee basis, and commissions (including trail commissions) paid by the product provider are due and payable to the client, the firm may be deemed to be holding client money. This would threaten exempted status under MiFID. We have said that we intend to work with the industry to find a proportionate solution to this issue.

We are still supporting the UK effort to ensure that the European Commission undertakes (as provided for under Article 65 of MiFID) a robust review of the requirements for Professional Indemnity Insurance under the IMD and the MiFID. This is because we remain unconvinced that the requirements are justified on a risk basis. Under the current Presidency proposal for further adjustment of the MiFID timetable, this review is scheduled for completion by 31 October 2006. The outcome could be material for both investment advisers and general insurance intermediaries.

- In July 2005 the European Commission published a Green Paper on mortgage credit in the EU. In the paper, the Commission invited views on the desirability of intervention, with a closing date for responses of 30 November 2005. Firms conducting mortgage intermediation will need to monitor developments during 2006.
- Other pieces of EU legislation that are relevant to investment, insurance and mortgage intermediaries are the Third Money Laundering Directive and the Unfair Commercial Practices Directive.
- A number of financial adviser firms currently fall within the scope of the Investment Services Directive (ISD) and therefore the prudential requirements of the Capital Adequacy Directive (CAD). These firms should pay attention to the Capital Requirements Directive (CRD), scheduled for implementation from 1 January 2007. For further information please refer to our Policy Statement – with feedback on CP05/03 (Strengthening Capital Standards) – which covers the implementation of the CRD.

Accounting and Auditing Sector

- Leader *Kari Hale*
- Manager *Karin Walda*

In the UK the Financial Reporting Council (FRC) is the relevant regulatory authority for most matters relating to accounting and audit. We aim to work collaboratively with the FRC to ensure that we are managing effectively the related risks and opportunities to our objectives (notably maintaining market confidence) and those arising from our role as the UK's Listing Authority.

Accounting and audit issues and initiatives affect most, if not all, of our regulated community. This is a time of great change in financial reporting. Since January 2005 we have had International Accounting Standards (IAS/IFRS) for all EU listed groups, the biggest change in financial accounting since the introduction of the 4th and 7th Company Law Directives. The next two years will be crucial as IFRS are applied by nearly 8,000 listed group companies across the EU. We are working with CESR, CEBS and CEIOPS to ensure that we address the practical issues that arise with this implementation. In parallel there is a major international push towards both convergence of IFRS and US GAAP, and equivalence accreditation between IFRS and US, Canadian and Japanese GAAP⁸.

Such equivalence means:

- companies in one marketplace will be able to access investors in other markets without incurring the costly exercise of performing reconciliations to the local GAAP;
- companies will have access to a wider pool of capital, without incurring substantial additional costs;
- investors will benefit from a wider pool of equivalent financial reporting information, which will help to ensure that financial resources flow to those firms where it is most appropriate;
- securities regulators can ensure more easily that financial reporting information reflects company activities; and
- the whole of society gains from a lower cost of capital.

We have been working closely with UK and EU accounting bodies to increase such comparability of accounting standards and hence ease access to global markets. CESRfin, chaired by our chief executive, John Tiner, has been reviewing the equivalence to IFRS of three major GAAPs – Canada, Japan and US. It has advised the European Commission on whether issuers should be permitted to use these standards for prospectuses and financial accounts issued in the EU. CESRfin published its final advice for the Commission in June this year and believes that equivalent should not be defined as meaning ‘identical’. In CESRfin’s view a third country’s GAAP can be declared as equivalent when financial statements, prepared under such GAAP, enable investors to take similar decisions in terms of whether to invest, hold or divest, as they would using financial statements prepared on the basis of IFRS. Differences of detail between a third country’s GAAP and IFRS which would not give rise to differing investment decisions are not considered relevant. CESRfin’s conclusion was that Canadian, Japanese and US GAAP are, on the whole, equivalent to IFRS subject to certain remedies. Recently, the IASB and the Accounting Standards Board of Japan (ASBJ) have announced that they will launch a joint project to reduce differences between IFRS and Japanese accounting standards.

Under the Norwalk agreement in 2002, the Financial Accounting Standards Board (FASB) in the US and the IASB have also pledged to use their best efforts to make their existing financial reporting standards fully compatible as soon as practicable. A roadmap has been developed by the US Securities and Exchange Commission (SEC) which is intended to lead to the removal of the requirement to reconcile IFRS to US GAAP on the basis that IFRS is effectively and consistently applied across the EU.

A collaborative effort of the international financial regulatory community has brought about the creation of the Public Interest Oversight Board (PIOB). This has been formed by the International Federation of Accountants (IFAC) together with the International Organization of Securities Commissions (IOSCO), the Basel Committee on Banking Supervision (BCBS), the International Association of Insurance Supervisors (IAIS), the World Bank and the Financial Stability Forum joining forces. This body will oversee IFAC’s international standard-setting activities in the areas of audit performance standards, independence and other ethical standards for auditors, audit quality control and assurance standards, and education standards.

Looking forward, the EU 8th Company Law Directive on statutory audit will take effect from 1 January 2008. The Directive covers auditor independence, implementation of international auditing standards, public oversight arrangements for auditors and the role of audit committees. One significant proposal is that every listed company in the EU should have an audit committee to

8 Generally accepted accounting principles.

monitor the company's internal controls, audit and risk management. The audit committee is required to contain at least one person with financial competency and to be responsible for the appointment of the auditor. There must also be one independent director (as defined).

Over the next two years, there will be further work at an EU level on the endorsement of international auditing standards. The UK already fulfils many of the requirements of this Directive, but we and other regulatory bodies will have to consider the implications of the Directive requirements on audit committees.

In a similar vein the US Sarbanes-Oxley Act has sought to enhance and strengthen corporate governance for SEC registrants. This legislation created, among other things, the Public Company Accounting Oversight Board (PCAOB) to oversee and enforce audit quality, as well as internal controls, standards, and testing requirements.

The FRC has recently undertaken a review of the continued appropriateness of the Turnbull guidance on internal control and risk management. The review concluded that there was no need for significant changes to the Turnbull guidance and that it should continue to cover all internal controls, unlike s404 of Sarbanes-Oxley which focused on financial controls. The review also concluded against the s404 type disclosure requirement for management to publish an assessment of the effectiveness of internal controls over financial reporting. This was partly for cost-benefit reasons and partly because the concept of effectiveness was judged not to be considered meaningful when considering non-

financial issues. As a result of the review, only minor changes are expected to the Turnbull guidance.

Following the merger of PriceWaterhouse with Coopers & Lybrand and the collapse of Arthur Andersen, there has been a severe concentration of audit services for large companies. There is now a potentially significant risk to international and domestic markets' market confidence that could crystallise were the collective reputation of the so-called 'Big Four' to be collectively impaired, or were there to be a major problem at one of the firms leading to a contraction to three. As a result, the DTI and FRC have recently commissioned a study of how concentration of audit firms affects the provision and quality of audit service. The SEC is also undertaking a three-year inquiry into the issue. However the problem is global in that the 'Big Four' accounting and audit firms have global brands and structures built upon networks of local partnerships subject to national laws and regulations. Accordingly individual regulators do not have the scope to regulate the whole firm; but must focus on the local part. There is now a growing debate among national regulators relating to the oversight of – and risks to markets arising from the market dominance of and resulting reliance on – the 'Big Four' accounting and audit firms.

Looking at the overall picture, the world's standard setters are presently dealing with some of the most difficult technical issues surrounding financial reporting. However, there are also important practical issues on some of the existing standards where we need to ensure that the existing standards are being applied consistently and where we need to converge practice and eliminate divergent trends.

Consumer Sector

- Leader *Vernon Everitt*
- Manager *Toby Wallis*

Consumer issues are central to our work. Given the extent to which regulation is influenced by international developments, particularly in the EU, we need to be alive to the implications of these for consumers – and our statutory responsibilities for protecting and informing them. This is particularly the case where the provisions of EU measures are highly technical and/or directed principally at wholesale market players. In such cases, the implications for consumers may be indirect though still significant.

We are looking to develop a dialogue with consumer groups. This is to ensure that those parts of the international regulatory agenda that have consequences for consumers of retail financial products are being considered and that the interests of such consumers are being adequately addressed.

To help with this dialogue, we have summarised the main EU legislative initiatives that may affect our consumer-facing work (see table 1).

The importance of consumer issues at the EU level is reflected:

- by the establishment of the European Parliament's Committee on Internal Market and Consumer Protection (IMCO);
- the development of EU Impact Assessment Guidelines;
- reviews of the European retail market undertaken by the European Commission; and
- sector inquiries into retail banking and business insurance.

The IMCO is the newest of the 20 post-enlargement committees established by the European Parliament. Phillip Whitehead, president of the committee, has noted that its work *'is central to the dynamics of the European Union'* and that *'competitiveness and consumer protection must co-exist in a citizen's Europe'*.

The European Commission's Competition Directorate has started inquiries into retail banking and business insurance. These will examine whether competition is working in these markets and if they are sufficiently competitive to deliver full benefits to consumers. The Commission announced its plans in June this year.

The Commission is also reviewing the guarantee schemes in the banking, investment and insurance sectors. In response to this initiative the FSA together with the Bank of England and the Treasury issued a discussion paper, 'A Framework for Guarantee Schemes in the EU', in October 2005.

Financial Crime Sector

■ Leader *Philip Robinson*

■ Manager *Edna Young*

Much financial crime has an international dimension. This is most visibly the case with terrorist financing and money laundering but it also applies to various forms of fraud (e.g. identity theft, cross-border investment business by unauthorised persons and advance fee fraud). Sharing analysis and seeking common solutions is desirable both for regulators and for firms operating in more than one jurisdiction. So we attach great importance to international collaboration as part of our overall efforts to counter financial crime.

We work closely with other national authorities and international agencies to develop guidelines covering anti-money laundering and counter terrorist finance (AML-CTF) activity. The main forum for advancing this work is the Financial Action Task Force (FATF), comprising representatives of finance ministries, regulators and central banks. FATF is viewed as the premier international body charged with safeguarding the global financial system against money laundering and terrorist finance. It comprises 33 countries and 27 observers. Also incorporated within this structure are a number of linked regional bodies that cover other jurisdictions in Africa, Asia, the Middle East and China.

FATF work is undertaken through a broad range of working groups that address topics such as 'evaluation and implementation', 'terrorist financing', 'typologies' or the study of particular crime scenarios, and 'non-cooperative territories'. Underpinning elements of FATF are the mutual evaluations that are conducted across member countries and the drafting of interpretative notes. These notes complement the agreed 40 global money laundering recommendations and the nine Special Recommendations on Terrorist Finance.

Current topical issues for FATF include: a greater focus on understanding the relationship between corruption and money laundering, and typologies work on four key themes. These are e-money; trust and company service providers; emerging trends in terrorist financing/money laundering; and trade-based money laundering.

Within the EU, FATF's work may be the basis for legislative measures. A current example of this is the Third Money Laundering Directive.

This should be formally adopted towards the end of 2005 with an implementation period of 24 months. Although the new Directive has more detailed 'customer due diligence' provisions than the existing one, these are tempered by a risk-based approach – consistent with the approach currently followed in the UK. In addition, an EU Regulation on information accompanying transfers of funds will come into force in January 2007. This will ensure that basic information about the payer is available to the authorities responsible for combating money laundering and terrorist financing.

Money launderers are quick to exploit weak spots in any system designed to limit their activities. Many countries have made efforts to strengthen their domestic legislation and enforcement mechanisms in this area. Our expectation is that there will be a continued emphasis on this – as, for example, EU member states yet to fully implement the EU's Second Money Laundering Directive do so, and all begin implementing the Third Directive. In addition, the IMF and World Bank have enhanced their monitoring of member states' compliance with FATF standards and report on this in their published Financial Sector Assessment Program (FSAP) reports. The FATF's list of non-cooperative countries and territories (NCCTs) has shortened in recent years. But it remains crucial that firms exercise proper diligence that combines professional judgement and knowledge of their customers and their businesses rather than rely on narrow or formulaic approaches.

Domestically, key developments include the publication in March 2005 of the Joint Money Laundering Steering Group's (JMLSG) consultation draft on

new Guidance. This is an important step forward in the fight against money laundering and terrorist finance. The draft Guidance is strongly risk-based and contains a blueprint for a more streamlined customer identification (ID) regime, very much in line with the key propositions set out in our 'Defusing the ID issue' progress report, which we published in October 2004. The Guidance will be key to our objective of creating a system where firms meet their legal obligations to identify customers effectively, but without unnecessary bureaucracy and customer inconvenience.

Alongside the revised Guidance, our recent consultation on proposals to replace the FSA Money Laundering Sourcebook with high-level provisions in the Senior Management Arrangements, Systems and Controls (SYSC) module of our Handbook will help develop a more effective anti-money laundering/terrorist financing

regime in the UK. These proposals emphasise the need for firms to take a risk-based approach; senior management responsibility and accountability for financial crime risk; and the need to manage money laundering risk properly and proportionately.

Financial Stability Sector

- *Leader Oliver Page*
- *Managers John Milne and Jonathan Elven*

Moves are taking place to enhance the EU's practical arrangements to address the eventuality of a cross-border financial crisis. As part of these, in July 2005 the FSA (along with the Treasury and the Bank of England) entered into a Memorandum of Understanding (MOU) on co-operation in such crisis situations with the other EU banking supervisory authorities, central banks and finance

ministries. The MOU covers principles and procedures for sharing information, views and assessments. These would facilitate authorities' pursuit of their respective functions and help preserve financial system stability. The new MOU complements previous co-operation arrangements, in particular the 2003 MOU between banking supervisors and central banks in the area of crisis management.

On business continuity, the Joint Forum concluded in February 2005 that high-level business continuity principles would contribute beneficially to the resilience of the global financial system. A formal working group of the Joint Forum, chaired by the FSA, was established to draft high-level principles for consultation with both financial authorities and finance industry participants. The draft principles will be published before the end of 2005.

Table 1

EU measure	Purpose	Consumer issue
Prudential standards		
Capital Requirements Directive	Promotes a more risk-based approach to setting capital requirements for banks and investment firms.	Protects customers collectively by maintaining the financial soundness of banks and investment firms.
Solvency 2 Directive	Aims to promote a more risk-based approach to capital requirements for insurance firms.	Protects customers collectively by maintaining the financial soundness of insurance companies.
Reinsurance Directive	Ensures that reinsurance firms in the EU are subject to regulation.	Reinsurers already subject to FSA supervision.
Conduct and transparency rules		
Markets in Financial Instruments Directive	Revises conduct of business and related rules to promote cross-border provision of investment services.	Broadly underpins most existing UK protections. Also promotes investor protection by revising conduct of business standards for securities firms and exchanges.
UCITS (amendments)	Clarifies EU standards for regulatory oversight for management of collective investment vehicles.	Provides greater clarity about regulatory regime (and consumer protection).
Transparency Directive	Addresses disclosure requirements for firms in respect of regular reporting and major shareholders.	Requires a high standard of continuous reporting by companies, enabling shareholders to make informed investment decisions.
Financial crime and market abuse		
Third Money Laundering Directive	Revision to anti-money laundering standards to reflect international best practice. Reinforces know-your-customer requirements.	Benefits to society by assisting in the fight against money laundering and terrorist financing.
Draft EU Regulation on information accompanying wire transfers	The draft Regulation seeks to transpose into EU legislation Financial Action Task Force ("FATF") Special Recommendation VII on originator information accompanying wire transfers.	Benefits to society by assisting in the fight against money laundering and terrorist financing.
Unfair Commercial Practices Directive	Introduces a general prohibition on unfair commercial practices that harm consumers' economic interests.	The Directive's requirements are largely in place for regulated financial services other than in the area of banking, where the Banking Code is relevant.
Scope of supervision and compensation		
Payment Services Directive	Seeks to introduce prudential and conduct of business regulation for payment service providers to promote cross border provision.	Seeks to ensure consistent consumer protection and improve transparency in the payment services market across the EU.
Credit for Consumers Directive	Intended to promote a single market in consumer credit.	Whether a 'one-size-fits-all' approach may undermine some existing consumer protection measures.
Guarantee Schemes review	Examine guarantee schemes for banking, insurance and securities.	Extent to which national discretion exists in setting compensation levels.
Other measures		
Clearing and Settlement	Addresses access to clearing and settlement systems for securities.	Possibility of new standards affecting cross-border settlement of securities transactions.



Directives and other EU initiatives

Work leading to finalised directive

Post directive implementation

Directives Timelines

The table below outlines a number of EU legislative measures that will have material implications for UK financial services over the next three years. This is intended to give stakeholders a sense of when measures will be implemented, which Directives are likely to affect their sector and when they may have an opportunity to influence discussions on particular issues.

The creation of EU legislation and its implementation can be divided into several stages. For simplicity, the timelines below distinguish between the period leading to a 'Finalised Directive' (which also includes other measures such as finalised EU Regulations) and 'Post directive implementation'. The purple bar shows work leading up to the point when an EU legislative measure is finalised. Up to this point, such measures may be subject to extensive change. The blue bar then shows the period leading to the date by which the relevant EU measure should be implemented; this may include time taken to develop secondary EU legislation and national rules, as well as the time available to firms once all rules have been finalised.

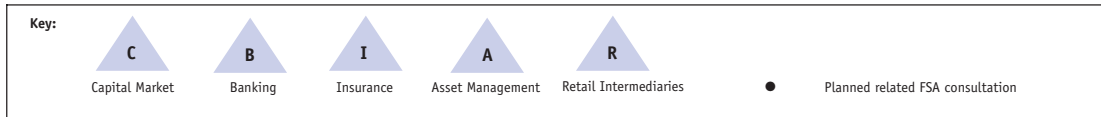
It is often not possible to provide exact timings in respect of future measures. So the timelines in this section are indicative only and should be interpreted alongside the accompanying text.

As part of the commentary on each measure, we outline our 'regulatory aim' for the FSA in dealing with that measure. We have specific responsibilities for implementing certain measures. So the regulatory objectives given below provide an FSA perspective, although one that should be read in the context of tripartite statements issued by the Treasury, the Bank of England and us.

2005–2008 Directive Outlook

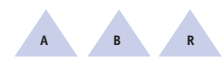
Work leading to finalised directive

Post directive implementation



Measures adopted but not yet implemented in the UK

Capital Requirements Directive (CRD)



Purpose The CRD introduces a modern, risk-sensitive prudential framework for credit institutions and investment firms across the EU. It is closely linked to the Revised Basel Framework, agreed in June 2004, which applies to internationally-active banks. Like the Basel Framework, the CRD is based on three ‘pillars’:

- quantification of the market, credit and operational risks arising from an institution’s activities (Pillar 1);
- a stronger constructive dialogue between regulators and firms on the risks run by the latter and the level of capital which should be held to support them (Pillar 2); and
- a series of robust public disclosure requirements on firms to encourage a stronger role for market discipline in ensuring firms hold a level of capital appropriate to their business (Pillar 3).

Regulatory aim In CP05/3 ‘Strengthening Capital Standards’, published in January 2005, we set out our general overall approach to UK implementation of the CRD. In line with our approach to the implementation of EU Directives, we are committed to adopting a ‘copy out’ approach in implementing the CRD, adding additional guidance only where this can be clearly justified on the basis of CBA. Following publication of our feedback statement to CP05/3 in September, we are continuing to work closely with individual firms and other stakeholders in an effort to provide clarity as early as possible on key policy and practice choices that are project-critical to regulated firms’ implementation plans.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	•											

Timetable The European Parliament approved the CRD in September 2005 and the European Parliament’s amendments were subsequently endorsed by EU finance ministers on 12 October. Following this we plan to produce our second CP on UK implementation in February 2006 which will take account of discussions with stakeholders since we issued our previous CP – Strengthening Capital Standards – in January and changes arising out the final text of the CRD. Our intention is to have final rules in place by the third quarter of 2006.

All firms must adopt the CRD by 1 January 2007. However, firms may move to the standardised approach for credit risk under the CRD or elect to remain on Basel 1 rules until 1 January 2008. From 1 January 2008, all firms must apply the standardised or internal ratings based approaches for credit risk and either one of the simple approaches or the Advanced Measurement Approach for operational risk. To assist firms planning to use the advanced approaches contained in the CRD, we have been prepared since July 2005 to accept applications. Any firm wishing to use the advanced approaches from the outset will need to apply to the FSA by the end of December 2006.

In October 2005, the US federal authorities announced a postponement to 1 January 2009 of the implementation of Basel 2 in the US. This will not affect the European timetable for implementation via the CRD.

FSA comment Firms (whether large or small), seeking to adopt the IRB approach and/or the AMA, face a significant challenge in undertaking the necessary systems and risk management work required by the draft Directive. The potential demands of that work and the costs involved should not be underestimated.

Sector-specific issues Some small UK investment firms will need to wait for the UK's implementation of MiFID to know whether they fall within the scope of the CRD. For many of these firms, the implications of the CRD are expected to be relatively minor, given the treatment afforded to certain categories of investment firms to reflect the limited risks posed by their business.

Markets in Financial Instruments Directive (MiFID)



Purpose MiFID is a wide-ranging Directive, constituting a major element in the EU's Financial Services Action Plan. The Directive substantially revises the current Investment Services Directive and is intended to promote a single market for wholesale and retail transactions in financial instruments. MiFID widens both the scope of investment services requiring authorisation by Member States and the range of investments falling within the ambit of regulation. In relation to these and other investment services and activities, MiFID significantly improves the 'passport' for investment firms. This enables them to conduct cross-border activities across Europe on the basis of their Home State authorisation. Firms will be able to establish branches in other Member States and offer cross-border services in a wider range of cases.

Regulatory aim Our primary aim, working in close consultation with industry and other stakeholders, is to support the Treasury in the crucial continuing European negotiations on the Level 2 implementing measures. We shall be looking to deliver proportionate implementation in the UK by following an intelligent 'copy out' approach of the Directive. We will only impose additional requirements that go beyond the Directive when cost-benefit analysis concludes that this is strictly justified by reference to our objectives under FSMA.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
		•	•	•								

Timetable Subject to approval by the Council of Ministers and the European Parliament, we now expect the revised proposed deadline for Member States' transposition of MiFID to be 31 January 2007. The MiFID requirements are expected to take effect on 1 November 2007, by which date firms will have to comply with the Directive. Draft Level 2 legislation is currently being negotiated in the European Securities Committee (ESC). The European Commission is now expected to present its Level 2 proposals formally to the Council of Ministers and the European Parliament in December. Discussions will follow in the ESC and European Parliament with the final Level 2 legislation likely to be adopted by April/May 2006.

Following the recent UK Presidency proposal of a further extension and the subsequent changes to the overall timetable, we now plan to issue a CP on MiFID implementation in March 2006. This will cover all MiFID-scope apart from requirements on marketing communications and systems and controls. The former will be consulted upon in the financial promotions CP now expected to be published in the second quarter of 2006 and the latter in a SYSC CP planned for in March 2006. In the course of 2006 we will consult on certain non-scope material not directly affected by MiFID with the aim of making all new rules by October 2007. Where feasible, we shall also consult on consequent changes for the retail intermediaries sector.

FSA comment MiFID implementation will require significant revisions to large parts of our Handbook, particularly to our conduct of business rules. We will recast the whole of the COB Sourcebook round a new structure, as outlined in our CP 05/10 published in July, taking the opportunity to simplify our rules.

Sector-specific issues **Capital Markets:** MiFID introduces a new pan-EU regime for multilateral trading facilities (electronic trading platforms increasingly competing with established exchanges), and a more comprehensive pre-and post-trade transparency regime across different trading venues. It also sweeps away the so-called 'concentration' rule under which some Member States currently force equity shares trading to be on-exchange. Key areas of changes for Capital Markets are:

- Regulated Market and MTF Standards – MiFID establishes new minimum standards for regulated markets (i.e. exchanges) and for multilateral trading facilities (MTFs). Our existing standards for recognised investment exchanges and ATSS will require changes (as will the legislative underpinning in the FSMA).
- Pre-trade equity transparency on Regulated Markets.
- Quoting obligations for systematic internalisers.
- Post-trade equity transparency for firms transacting outside a Regulated Market or MTF.
- Transaction reporting obligations.

In addition, commodity derivatives are now a financial instrument for the purposes of MiFID but not all firms trading commodity derivatives will necessarily fall within the scope of the Directive. It will depend on whether they fall within an exemption contained in Article 2 of MiFID.

Banking: MiFID will have a wide-ranging impact on the investment business of banks and building societies. The Conduct of Business Sourcebook will be redrawn significantly with, for example, changes to client classification and information and suitability requirements for both professional and retail clients and to organisational requirements.

Insurance: MiFID requires the European Commission to report to the European Parliament and Council on the continued appropriateness of the requirements for professional indemnity insurance (PII) in the Insurance Mediation Directive and MiFID. It is not clear that the level of those requirements (e.g. €1.5 million of aggregated annual cover for even the smallest firm covered by the IMD) is justified on a risk basis. Life Insurers and Friendly Societies will also be affected by the changes to our Conduct of Business Sourcebook (COB) that will be brought about by the implementation of MiFID. See also Retail Intermediaries.

Asset Management: For asset managers, the most relevant issues are the establishment of EU-wide standards for client classification, financial promotions, outsourcing of portfolio management services and best execution. See also Retail Intermediaries.

Retail Intermediaries: MiFID widens the scope of the Investment Services Directive (ISD) to include investment advice as a core activity. The Government is still expected to use the discretion given by Article 3 of the Directive to allow financial advice firms not holding client money (and not wishing to use the passport to conduct cross-border advice) to choose to be exempted from the scope of MiFID in the UK. But, on competition grounds, as well as for simplicity, we shall be considering the extent to which the MiFID conduct of business standards should be applied to our more discretionary regimes for non-MiFID firms and investment business, including those for insurance companies, friendly societies and financial advisers (which compete for retail customers with banks and building societies). This may bring wide-ranging changes to our conduct of business requirements for example to client classification, information to clients, advice, suitability, reporting and the management of conflicts of interests. The FSA will make such changes only where there is appropriate cost-benefit justification.

Firms brought under the scope of the Directive for the first time will be subject to capital requirements. The conduct of business obligations prescribed by MiFID will be significantly more detailed than those required by the ISD which MiFID replaces. They will bite directly on some retail business, such as the sale of UCITS by banks and stockbrokers, carried on in competition with firms that will be exempt from MiFID.

As noted in the special May 2005 edition of our Retail Intermediaries newsletter, firms offering advice for a fee under depolarisation but with commission offset should be aware that they may be holding client money unless they have adequate procedures in place to rebate these monies promptly. This would therefore threaten any exempted status under MiFID. We intend to work with the industry to find a proportionate solution.

Reinsurance Directive

1

Purpose The Directive aims to introduce harmonised supervision of reinsurance across the EU. It is intended to create a single market in reinsurance (similar to that which already exists for direct insurance) and to remove remaining barriers to trade within the EU. It will establish the supervision of reinsurers by competent authorities in their 'home' country, on the basis of which they will be able to operate throughout the EU.

More specifically it aims to:

- bring EU regulation of pure reinsurers more into line with the existing insurance Directives;
- develop a set of harmonised reinsurance supervision rules, facilitating a more efficient and secure cross-border market in reinsurance
- end the collateralisation requirements currently imposed by other EU Member States; and
- ensure an appropriate level of policyholder protection across the EU.

The Directive is intended to be an interim measure, generally applying the requirements of the current Solvency 1 Directives for direct insurers to reinsurers. We expect a full re-examination of reinsurers' solvency requirements as part of Solvency 2.

Regulatory aim Our objective has been to establish a sound and prudent regime that does not impose additional requirements on pure reinsurers that cannot be justified on prudential grounds.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable We currently expect publication of the Reinsurance Directive in the Official Journal of the European Union in November/December 2005, marking the beginning of the two-year implementation period. This means that we expect the deadline for the implementation of the Directive to be November/December 2007.

Depending on when the Directive is published in the Official Journal, we are planning to publish our consultation on implementation in the third quarter of 2006, including any changes in relation to group solvency requirements and special purpose vehicles. This should enable us to publish our final rules at the beginning of 2007, ready for implementation by the end of the year.

FSA comment As reinsurance business in the UK is already supervised in broadly the same way as direct insurance, the main effect of the Directive will be to bring the standard of supervision of reinsurers in other EU Member States up to that existing in the UK. The Directive also serves to reinforce the principle that reinsurance business should be regulated and that regulator-imposed collateral requirements should no longer be permitted. However, we will need to consider the implications for insurance and reinsurance special purpose vehicles.

Sector-specific issues Insurance: The Directive aims to provide a 'single passport', under which an EU reinsurer would be able to write business anywhere in the EU under home state authorisation and supervision. As UK reinsurers – along with those in several other major jurisdictions – are already supervised, the main consequence of the measure is likely to be the implementation of similar supervisory requirements in other jurisdictions. This should improve prudential standards across the EU.

Third Money Laundering Directive



Purpose The Directive is designed to strengthen the fight against money laundering and terrorist financing. The main purpose of the Directive is to provide a common EU basis for implementing the revised Financial Action Task Force (FATF) Recommendations (issued in June 2003). It will replace the First and Second Money Laundering Directives.

Regulatory aim To continue to support the Treasury in negotiations over secondary legislation at the EU level and implementation of the Directive into UK law in a risk-based and proportionate way.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable The European Council adopted the Directive in September with implementation to take place within 24 months of when it appears in the Official European Journal.

FSA comment The main issue for firms will be the revised customer due diligence requirements.

Sector-specific issues The provisions of the Directive will be relevant to all FSA-regulated firms currently subject to money laundering obligations.

Transparency Directive



Purpose The Transparency Directive establishes disclosure requirements on an ongoing basis for issuers who have securities admitted to trading on a regulated market situated or operated within the EU for investors who invest in these securities.

Regulatory aim To ensure appropriate regulation of periodic financial information and to ensure that no damage is done to the existing major shareholding notification regime in the UK.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable The Directive must be implemented by 20 January 2007.

FSA comment The Transparency Directive requires substantial revisions to the Listing Rules, particularly Chapter 9, which sets out some of the issuer’s Continuing Obligations. The Transparency Directive imposes disclosure requirements on major shareholders with holdings above certain thresholds. The Department of Trade and Industry (DTI) is currently responsible for this area of regulation under the Companies Act. On implementation of the Transparency Directive, responsibility for the major shareholding regime will move to the FSA.

Sector-specific issues **Capital Markets:** All issuers, who have securities admitted to trading on a regulated market situated or operated within the EU, will be covered by the Transparency Directive. The Transparency Directive will require these issuers to disclose periodic and ongoing information for investors on a pan-European basis.

Unfair Commercial Practices Directive (UCPD)



Purpose UCPD seeks directly to protect consumer economic interests from unfair business-to-consumer commercial practices. In particular, commercial practices will be unfair if they are misleading (this includes both actions and omissions) or aggressive. The Directive is minimum harmonising measure for financial services.

Regulatory aim To implement the Directive in the FSA Handbook effectively and cost-efficiently.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable UCPD came into force on 12 June 2005 and must be transposed into UK law by 12 June 2007. Those laws are then required to enter into effect by 12 December 2007.

FSA comment Implementation for financial services is expected to be delivered mainly through the DTI’s umbrella legislation implementing UCPD for all sectors. The DTI is about to publish a high-level consultation document on the general implementation of the Directive.

Although a minimum harmonisation approach has been adopted for financial services, we may need to make some technical changes to the Handbook. We propose to implement any necessary changes at the same time as our simplification changes to our conduct of business requirements.

Sector-specific issues **Asset Management, Banking, Insurance and Retail Intermediaries:** We consider that the Handbook already prohibits unfair commercial practices in the area of financial services. So we intend to make only minimal changes to our rules. Similarly, in the area of banking – which is generally not subject to FSA conduct of business requirements – the Banking Code also already addresses the types of unfair commercial practices which the Directive seeks to prohibit.

Measures proposed but not yet adopted

Credit for Consumers Directive (CCD)

Purpose To promote the development of a Single Market in relation to consumer credit. The CCD will apply to all providers of unsecured credit to consumers (such as banks and building societies), and all unsecured credit intermediaries. A limited set of requirements apply for overdrafts and social lending (e.g. by credit unions).

Regulatory aim A revised proposal was published by the European Commission on 7 October 2005. This is significantly more limited in scope than the original proposal, and several provisions have been removed. Consequently, this moves us towards the regulatory aim outlined in January of preventing a ‘one size fits all approach’ that could give rise to unnecessary regulatory burden or the loss of consumer protections.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable Now that a revised proposal has been published, the UK presidency is looking to convene meetings of the Council Working Group to restart Council negotiations which had stalled. Changes made by the Commission have removed some of the most contentious issues (e.g. excluding all secured credit and leaving to national law the approach to connected lender liability). However, considerable debate is still likely over the appropriate level of harmonisation, the introduction of mutual recognition, the approach to disclosure and advice and the requirements on credit intermediaries. Given these difficulties agreement is unlikely before 2007, with member states then having two years to implement most of the requirements.

FSA comment The original proposal for the Directive could have significantly altered how lending business was undertaken and would have entailed changes to the mortgage conduct of business regime. The exclusion of all secured lending removes this immediate risk, although similar issues may arise in the follow-up to the recent EU Green Paper on mortgage credit.

Sector-specific issues **Banking and retail intermediaries:** The exclusion of secured lending from the CCD means that the Directive’s impact is broadly restricted to the activities of regulated firms that are not regulated by the FSA.

Regulation on information accompanying wire transfers

Purpose The draft Regulation seeks to transpose into EU legislation FATF Special Recommendation VII on information accompanying wire transfers. The requirement is for transfers of funds to be accompanied by accurate and meaningful originator information (including verified identity information about the originator or for transfers within the EU for verified information to be available within three days). Financial institutions would be required to monitor incoming transfers and to detect those without full originator information.

Regulatory aim To support the Treasury in trying to ensure that the Regulation is consistent with the Third Money Laundering Directive.

2005	2006				2007				2008			
Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4

Timetable The Regulation is due to be in force by 1 January 2007.

FSA comment This measure is separate to the requirements of the Third Money Laundering Directive. It specifically relates to the need for information about transfers of funds to be immediately available to the authorities engaged in anti-money laundering and terrorist financing.

Although a minimum harmonisation approach has been adopted for financial services, we may need to make some technical changes to the Handbook. We propose to implement any necessary changes as part of our simplification changes to our conduct of business requirements.

Sector-specific issues This measure is likely to affect all firms which are involved in the transfer of funds as part of their business.

Measures not yet proposed

Clearing and Settlement Directive



Purpose The European Commission has indicated that a Directive in this area could be a means to liberalise and integrate clearing and settlement in the EU by giving all markets, clearing and settlement service providers and investors full choice on how and where to clear and settle cross-border transactions. To enable such rights of choice, any Directive could grant all providers of clearing and settlement services rights of access to one another. In addition to the rights of access and choice, the Commission suggest that a Directive could apply a common regulatory framework and appropriate governance arrangements to clearing and settlement providers.

Regulatory aim While supporting the objective of promoting safe and efficient cross-border clearing and settlement in the EU, the UK authorities have emphasised that a full market failure and cost-benefit analysis needs to be conducted before any legislative action is proposed.

Timetable In April 2004, the Commission published a Second Communication on Clearing and Settlement. The UK authorities (the Treasury, Bank of England and FSA) submitted a joint response to the Communication in July 2004. The Commission is currently developing a Regulatory Impact Assessment on clearing and settlement, and is expected to publish this in the first half of 2006. Until this is published we do not know whether any Directive proposals will be developed.

FSA comment The implications of any Directive in relation to Clearing and Settlement may extend beyond the scope of traditional clearing and settlement service providers. Banks that have significant custodian operations, as well as those which are active on international markets, should watch developments and consider responding to further communications.

Sector-specific issues Possibility of new standards affecting cross-border settlement of securities transactions.

Payment Services Directive (PSD)



Purpose The draft Directive seeks to create a single payment market in the EU. The aim is to allow citizens and businesses to make payments across the EU as easily, safely, timely and cost-efficiently as within national borders. It seeks to remove the legal barriers to the provision of payment services across the EU.

The Directive will require payment service providers to be authorised by a Competent Authority. Providers will be required to comply with prudential and conduct of business requirements, including, for example, information disclosure and execution times. Providers are likely to include banks, building societies, credit unions, e-money issuers, money transfer operators, informal value transfer systems (e.g. Hawala), mobile phone operators and independent automated teller machine (ATM) operators. Services are likely to include debit and credit card payments, direct debits and credits, standing orders, e-money issuance and money transfers. Cheque transactions are explicitly excluded from the scope of the Directive.

Credit institutions and e-money providers will be able to rely on their authorisation under the Consolidated Banking Directive and the E-money Directive. Small providers may be eligible for a waiver from the authorisation and prudential requirements. Those that qualify for a waiver will have to register with the Competent Authority. They will still need to comply with the conduct of business requirements. The Directive will also require payment systems to offer access to and operation of the payment system on a non-discriminatory basis.

Regulatory aim The UK is seeking to ensure that the Directive is risk-based and proportionate to the underlying market failures.

Timetable The Commission is currently expected to publish its formal proposal for a Directive in November 2005. This Directive is then expected to be implemented in 2008.

FSA comment The Treasury is the UK lead on the Directive and we will continue to support actively its work in this area. The decision on who will be made Competent Authority(ies) is not expected to be taken until later in the development process.

Sector-specific issues Likely more extensive regulatory requirements will require changes to systems and procedures.

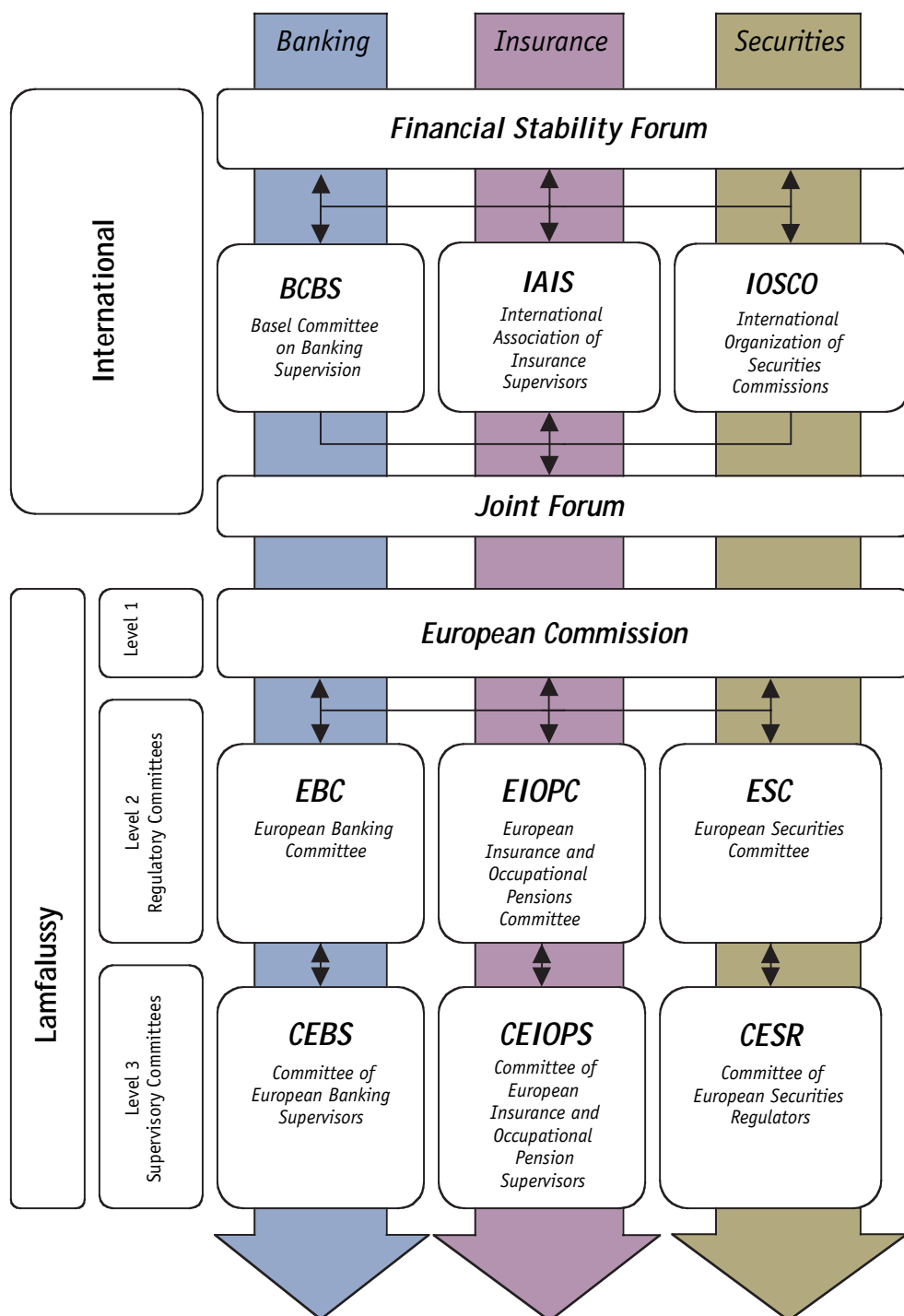
The eligible assets work is likely to result in practical changes to the eligibility of assets. This could have effects on UK UCITS schemes. We aim to ensure that any such effects are proportionate from a UK perspective.

Timetable The timetable for taking forward the definitional amendments to the UCITS Directive is given in the table above.

Sector-specific issues The UCITS III changes allow for a wider use of derivatives for UCITS schemes than previously. This change may result in products carrying risks that retail consumers are unfamiliar with. The UCITS ‘brand’ is generally perceived to be ‘retail friendly’ and the changes, with possible consumer loss, could, if introduced inappropriately, erode confidence in the ‘brand’.

EU and Global Committees

This chart gives a simplified representation of the international regulatory architecture for financial services. There are cross-cutting and sectoral (banking, insurance and securities) arrangements at both the international level and the EU level.



Lamfalussy Committees

The current EU structure for regulatory co-ordination and co-operation (or the Lamfalussy approach) has its origins in a report prepared by ‘The Committee of Wise Men’ on the Regulation of European Securities Markets – chaired by Alexandre Lamfalussy – and published in February 2001. This report gave rise to CESR, established under the terms of a European Commission Decision of June 2001. The report established the principle of EU supervisory activity being divided into four levels (see below). It also provided a benchmark for the development of comparable structures for the banking and the insurance markets.

Level 1

Legislative acts proposed by the Commission for consideration by the Council of Ministers and European Parliament. These are intended to set out the framework principles of the legislation as well as the implementation process.

Level 2

At Level 2, the Commission, after consulting the relevant Level 2 Committee, requests advice from the Level 3 Committee on technical implementing measures. The Level 3 Committee provides advice having consulted market participants, consumers and other relevant parties. The Commission then makes proposals to the Level 2 Committee regarding implementation. If there is a favourable vote in the Level 2 Committee, the Commission adopts the implementing measure (referred to as comitology).

Level 3

At Level 3, CESR, CEBS and CEIOPS work on consistent implementation can develop recommended common standards. The three Committees are also fora for the exchange of information and for practical co-operation among supervisors and aim to bring about increasing convergence in supervisory practice. The Level 3 Committees are outlined in this section.

Level 4

Involves the Commission, Member States and financial supervisory authorities working to ensure the implementation and enforcement of EU law.

International Regulatory Committees

Beyond the EU, various fora exist for co-ordinating regulatory activity on a global basis. There are three main sectoral committees that deal with banking, securities and insurance (Basel Committee, IOSCO and IAIS). More recently, the Joint Forum was created to take a cross-sector perspective of regulatory issues given that a number of topics and potential policy initiatives can affect more than one sector. The Financial Stability Forum, established in 1999, also has a wider perspective, focusing on potential threats to international financial stability. The major international committees are outlined below.

Consultation Overview

The table below provides a guide to consultations announced by the EU and international committees. However, as well as these publicly-announced consultations, the table contains consultations (indicated by blue date information) which are more speculative. So this information should be checked against the formal plans posted by regulatory committees and other fora.

	Agreed Consultation			Possible Consultation			
	2005			2006			
	Q4	Q1	Q2	Q3	Q4		
EU Banking							
CEBS							
Agreed Consultations							
Final guidelines on supervisory disclosure	■						
Possible Consultations							
Final guidelines of the Supervisory Review Process		■					
Own Funds		■					
Common EU reporting	■						
Final guidelines on external credit assessment institutions		■					
International Banking							
Basel							
Agreed Consultations							
Core Principles (review undertaken by the Core Principles Liaison Group)	■						

	2005			2006			
	Q4	Q1	Q2	Q3	Q4		
	EU Insurance and Occupational Pensions						
CEIOPS							
Agreed Consultations							
CEIOPS consultation on its medium term plan	■						
Second consultation on draft occupational pension protocol	■						
Third wave of calls for advice on Solvency 2	■						
International Insurance and Occupational Pensions							
IAIS							
Agreed Consultations							
IAIS common structure for the assessment of solvency			■				
Asset-liability management by insurance companies		■					
Standards of disclosure of technical performance and risks for life insurers			■				
Potential Consultations							
Guidance paper on fraud in insurers			■				
Guidance paper on mutual recognition of reinsurers			■				

The Committee of European Securities Regulators

<i>Chair:</i>	Arthur Docters van Leeuwen (Autoriteit Financiële Markten - Netherlands Authority for the Financial Markets).
<i>FSA representative:</i>	Callum McCarthy
<i>Secretariat:</i>	Paris, www.cesr-eu.org
<i>Members:</i>	25 EU Securities supervisors plus Norway and Iceland.



COMMITTEE OBJECTIVES

The three main roles of CESR are: (i) to improve co-ordination and convergence between securities regulators by developing an effective operational network mechanism to enhance supervision and enforcement of the Single Market for financial services; (ii) to act as an advisory group to assist the EU Commission particularly with preparing draft implementing measures for EU capital markets Directives and; (iii) to ensure a more consistent and timely implementation of EU legislation in the Member States.

FSA PRIORITIES

We fully support CESR's objectives and our current priorities include:

- ensuring consistent implementation of legislation and co-operation across all Member States;
- the development of CESR's role within Level 3 of the Lamfalussy structure; and
- taking an active role in CESR's expert groups and permanent operational groups.

KEY WORKSTREAMS

CESR provides technical advice on new legislation to the Commission through expert groups. All these issues are subject to a full consultation process and further details can be found on CESR's website.

Advice to the Commission

- *Markets in Financial Instruments Directive:* CESR has provided two sets of advice to the Commission on possible implementing measures under MiFID.
- *Transparency Directive:* CESR submitted advice to the Commission in June 2005 on implementing measures. It has recently received a new mandate to provide advice by June 2006 on the storage of financial information.

- *International Financial Reporting Standards:* CESR advised the Commission in June 2005 on the equivalence between Canadian, Japanese and US GAAP and IFRS.
- *Credit Rating Agencies:* CESR submitted advice to the Commission in March 2005 on possible legislative measures.
- *Prospectus Directive:* CESR has been mandated to provide advice about a possible amendment to Commission Regulation 809/2004 on the treatment of historical financial information.
- *UCITS:* A second CESR consultation paper is likely by end 2005. CESR has also been mandated to provide advice by January 2006 on some of the definitions relating to the eligible assets of UCITS.

Consistent implementation and convergence:

- *Market Abuse Directive:* CESR published guidance in May 2005 to promote consistent implementation of the Directive.
- *Clearing and Settlement:* A joint CESR/ESCB working group is developing an assessment methodology for its standards on clearing and settlement.
- *CESR Review Panel:* CESR has conducted a survey at the request of the Commission regarding implementation of the Commission's Recommendations on UCITS.
- *Mediation:* CESR published a consultation paper in September 2005 setting out a proposal for a mediation mechanism designed to facilitate the resolution of disputes between regulators.
- *UCITS:* CESR is developing guidelines on the notification process for cross-border marketing of UCITS.

Supervisory co-operation:

- CESR members have agreed guidelines for the exchange of information under the Market Abuse Directive and for the conduct of joint investigations.

The Committee of European Banking Supervisors

<i>Chair:</i>	José María Roldan (Banco de Espana)
<i>UK representatives:</i>	Clive Briault (FSA) Andrew Gracie (Bank of England)
<i>Secretariat:</i>	London, www.c-eps.org
<i>Members:</i>	EU banking supervisors and central banks



COMMITTEE OBJECTIVES

The three main roles of CEBS are: (i) to improve co-ordination and convergence between banking regulators, (ii) to act as an advisory group to assist the EU Commission particularly with the preparation of draft implementing measures for banking Directives and (iii) to ensure a more consistent and timely implementation of EU legislation in the Member States.

FSA PRIORITIES

We fully support CEBS's objectives and our current priorities include:

- ensuring consistent implementation of legislation and co-operation across all Member States; and
- participating in the CEBS consultation process to ensure consistent implementation of the Capital Requirements Directive (CRD) among EU banking supervisors.

KEY WORKSTREAMS

CEBS current priorities are seeking supervisory convergence in interpreting and implementing the CRD, developing a framework for enhanced co-operation and co-ordination among host and home supervisors of a cross-border banking group and providing advice to the Commission on the definition of own funds (i.e. capital). All these issues will be subject to a full consultation process and details can be found on the CEBS website.

Advice to the Commission

CEBS has advised on reducing the number and scope of national discretions in the CRD. It will also work on providing advice on the definition of own funds.

CEBS has provided advice (May 2005) on the review of Article 16 of 2000/12/EC on potential obstacles to cross-border mergers and acquisitions.

CEBS has provided advice (September 2005) on deposit guarantee schemes.

CEBS has provided advice (June 2005) on the E-Money Directive (Directive 2000/46).

Consistent implementation and convergence:

CRD-related issues:

In July 2005, CEBS consulted on its proposals for a collegiate approach to the supervision of cross-border establishments (e.g. home-host arrangements).

Following CEBS second consultation on the Supervisory Review Process in June 2005, CEBS plans to publish its final guidelines in the first quarter of 2006, which will include further guidance on stress testing.

Following CEBS consultation on its implementation and validation of the Advanced Measurement (AMA) and Internal Ratings Based (IRB) systems in July 2005, CEBS is doing further work in relation to Pillar 1 stress testing, advanced management approaches to operational risk and the model approval process.

CEBS continues to work on a (non prescriptive) framework for common reporting for banks' capital ratios and a standardised consolidated financial reporting framework.

CEBS proposes to finalise its proposals for External Credit Assessment Institution recognition, which it consulted on in June 2005, early in 2006. And it will continue to co-ordinate with CESR on this issue.

Following its consultation in June 2005, CEBS issued its proposals for disclosing supervisory information under the CRD.

Other convergence issues:

CEBS is continuing its work on developing prudential filters making a small number of adjustments to International Financial Reporting Standards to better reflect prudential requirements.

CEBS is due to provide a revised consultation on outsourcing, in the first half of 2006, based on responses it received to its consultation in 2004, and to take into account the final MiFID measures.

Supervisory co-operation:

CEBS is working on co-operation and information exchange for crisis events in large and complex financial organisations.

The Committee of European Insurance and Occupational Pensions Supervisors

<i>Chair:</i>	Henrik Bjerre-Nielsen (Finanstilsynet, Denmark)
<i>UK representatives:</i>	John Tiner (FSA) Tony Hobman (The Pensions Regulator)
<i>Secretariat:</i>	Frankfurt, www.ceiops.org
<i>Members:</i>	Insurance and occupational pensions supervisors



COMMITTEE OBJECTIVES

The three main roles of CEIOPS are: (i) to improve co-ordination and convergence between insurance and occupational pensions regulators by developing a forum for supervisory co-operation and the exchange of information on supervised institutions; (ii) to act as an advisory group to assist the EU Commission particularly with the preparation of draft implementing measures for insurance, reinsurance and occupational pensions Directives and; (iii) to ensure a more consistent and timely implementation of EU legislation in the Member States.

FSA PRIORITIES

We fully support CEIOPS's objectives and our current priorities for the FSA include:

- preparing advice for the Commission on Solvency 2, where we hope to share FSA's experience of introducing a risk-based capital regime;
- ensuring that key policy options for financial requirements under Solvency 2 are subject to appropriate cost-benefit analysis (CBA); and
- encouraging further efforts to promote practical co-operation in the supervision of insurers and reinsurers.

KEY WORKSTREAMS

CEIOPS has formed several working groups to deal with its main priorities. Working groups consist of national experts and the Commission can attend as an observer. The reports produced are subject to consultation and details can be found on the CEIOPS website.

Advice to the Commission

The Committee submitted its report to the Commission covering its first set of advice on Solvency 2 in June 2005. Following consultation, it submitted its report on the second set, dealing mainly with key Pillar 1

financial requirements, in October. Public consultation on CEIOPS' further draft advice begins after the CEIOPS October meeting.

The development of advice on Solvency 2 is being pursued through four expert groups. We provide the Chair of the group dealing with Pillar 1 issues. The groups are being assisted by CEIOPS's Financial Stability Committee in developing and running a quantitative impact study to determine the practical implications of various proposals. The first QIS round began this autumn, with a more comprehensive round starting early in 2006. CEIOPS will also be consulting on further advice to the Commission in 2006.

Consistent implementation and convergence:

The Solvency 2 – Pillar 3 Expert Group also covers accounting issues. A key task is to deal with the relationship of supervisory reporting to public financial statements. Recently, CEIOPS published a paper on 'Implications of IAS Introduction for Prudential Supervision of Insurance Undertakings'.

The Occupational Pensions Committee continues to promote a common understanding of the Institutions for Occupational Retirement Provision (IORP) Directive. A Protocol on co-operation between supervisory authorities is planned to be finally adopted by the end of 2005.

Supervisory co-operation:

CEIOPS is currently consulting on an Insurance Mediation Protocol. The Protocol provides a framework for the co-operation of the supervisory authorities in implementing the Directive 2002/92/EC on Insurance Mediation.

The Insurance Groups Supervision Committee is pursuing the establishment of co-ordination committees for supervising multinational insurance groups. And it is seeking to develop memoranda of understanding with key third country supervisors.

International Organization of Securities Commissions

<i>Chair Executive Committee:</i>	Jane Diplock (New Zealand Securities Commission)
<i>Chair Technical Committee:</i>	Michel Prada (Autorité des Marchés Financiers, France)
<i>FSA representative:</i>	Hector Sants
<i>Secretariat:</i>	C/Oquendo 12, 28006 Madrid, Spain. http://www.iosco.org
<i>Members:</i>	Global securities regulators



COMMITTEE OBJECTIVES

Created in 1983, IOSCO's initial membership was based solely on the American continent but was expanded the following year with the inclusion of securities regulators from France, Indonesia, Korea and the UK. IOSCO membership has expanded over the intervening two decades and today covers more than 90% of the world's securities markets. IOSCO's objectives are: (i) the protection of investors; (ii) ensuring that markets are fair, efficient and transparent; and (iii) the reduction of systemic risk.

FSA PRIORITIES

- promoting high-quality standards of global securities regulation;
- ensuring that IOSCO remains responsive, transparent and an effective vehicle for information sharing and co-operation; and
- encouraging IOSCO to identify emerging issues of concern and mitigate them through appropriate and proportionate responses.

KEY WORKSTREAMS

In the last year IOSCO has been recognised for its work on the Code of Conduct Fundamentals for Credit Rating Agencies, its Report on Strengthening Capital Markets against Financial Fraud, its Multilateral Memorandum of Understanding and for leading the global initiative on non-cooperative jurisdictions.

As Credit Rating Agencies are regulated and operate differently in different jurisdictions, in December 2004 IOSCO developed a code of conduct giving guidance on implementing high-level objectives that ratings agencies, regulators, issuers and other market participants should strive toward in order to improve investor protection and the fairness, efficiency and transparency of securities markets and reduce systemic risk. This code of conduct is now being used as the basis of CESR advice in the EU.

IOSCO's February 2005 Report on Strengthening Capital Markets against Financial Fraud was prepared following a series of very high-profile financial scandals involving large publicly traded companies that created doubts in the minds of investors throughout the world about the integrity of global capital markets. The Report followed an

assessment of existing regulatory structures aimed at identifying possible weaknesses in the international financial system. At its heart lay two key findings. First, that regulatory principles or standards designed to address the weaknesses leading to financial frauds have largely been developed already and a focus is now required on universal implementation among national securities regulators. IOSCO is now concentrating its efforts in this area. Second, that the benefits of principles and standards could be defeated if financial regulators and law enforcement agencies lack the ability to take effective enforcement action, to share enforcement-related information, and coordinate investigations. To address this, IOSCO endorsed its Multilateral Memorandum of Understanding (MMOU) as the global benchmark for enforcement-related cooperation and exchange of information and has stipulated signature of the MMOU as a condition of IOSCO membership.

Since October 2004, IOSCO has entered into a dialogue with jurisdictions (including offshore financial centres) that appear to be unable or unwilling to co-operate and is endeavouring to resolve related issues. This represents one of IOSCO's most important activities and one on which it has been asked to provide advice to the Financial Stability Forum.

Detailed below are some of the more recent issues in which IOSCO has taken a close interest and initiated work. Further information on these issues can be found on the IOSCO website.

- Analysis of conformity with OECD principles on Board independence of listed companies
- Analysis of issues bearing on quality audits and auditor independence
- Consultation on proposed Debt Disclosure Principles
- IFRS regulatory database on decisions relating to IFRS application and enforcement
- Analysis of multi-jurisdictional information sharing for market oversight
- Proposed principles on the Compliance Function at Market Intermediaries
- Initial analysis on issues and risks relating to the valuation of hedge fund assets

Basel Committee on Banking Supervision

Chair: Jaime Caruana, Banco d'España
UK representatives: Oliver Page (FSA)
Nigel Jenkinson (Bank of England)
Secretariat: Basel www.bis.org
Members: Banking regulators and central banks.

COMMITTEE OBJECTIVES

The Basel Committee was established at the end of 1974 and meets four times a year. The Committee's members come from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and the United States. Member countries are represented by their central bank and the authorities with formal responsibility for the prudential supervision of banking business. The European Commission and the European Central Bank have observer status.

The Basel Committee formulates broad supervisory standards, guidelines and best practice in the expectation that the individual authorities will take steps to implement them through detailed arrangements – statutory or otherwise – which are best suited to their own national systems. In this way, the Committee encourages convergence towards common approaches and common standards without attempting detailed harmonisation of member countries' supervisory techniques.

The FSA and the Bank of England work together on the Basel Committee to provide an input on behalf of the UK.

FSA PRIORITIES

- maintaining prudent capital levels at banks and investment firms in the UK and gaining the benefits of improved approaches to risk and management across the international arena;
- ensuring that the implementation of capital requirements occurs in a cost-effective way for firms and regulators; and
- ensuring that national implementation is consistent and equivalent across member countries.

KEY WORKSTREAMS

The Committee is probably best known in recent years for its work on capital requirements. In 1988, the Committee recommended a capital measurement system commonly

referred to as the Basel Capital Accord. This provided a framework for credit risk measurement with a minimum capital standard of 8%. Since 1988 it has been progressively introduced in member countries and virtually all other countries with active international banks.

In June 1999, the Committee issued a proposal for a new Capital Adequacy Framework (CAF or Basel 2) to replace the 1988 Accord. The proposal consisted of three pillars: minimum capital requirements, which seek to refine the standardised rules in the 1988 Accord; supervisory review of an institution's internal assessment process and capital adequacy; and the effective use of disclosure to strengthen market discipline as a complement to supervisory efforts. Following extensive interaction with banks and industry groups, the revised Framework was issued on 26 June 2004. Within the EU, implementation has required the enactment of a new Capital Requirements Directive (CRD). Both the CRD and the CAF now include the results of the Trading Book Review.

The Committee currently has four main workstreams dealing with issues arising out of the CAF and other supervisory issues:

Accord Implementation Group

AIG deals with implementation issues of the CAF.

Capital Task Force

The CTF is the group dealing with the outstanding policy issues stemming from the CAF, including quantitative impact studies.

Accounting Task Force

The ATF aims to ensure a common approach between banking regulators in accounting and auditing issues.

Research Task Force

The RTF provides a research tool for the Basel Committee and has been established to foster the relationship between the Basel Committee and the academic community.

International Association of Insurance Supervisors

Chair: *Alessandro Iuppa (Maine, USA)*

FSA representative: *David Strachan*

Secretariat: *c/o Bank for International Settlements
CH-4002 Basel
Switzerland
www.iaisweb.org*

Members: *Global insurance supervisors.*



COMMITTEE OBJECTIVES

IAIS was established in 1994 to promote co-operation among insurance supervisors and with regulators in other financial sectors. The Association's membership consists of the supervisory authorities in around 180 jurisdictions. Some 80 trade associations, firms and other bodies have observer status.

The main objectives of IAIS are to contribute to improved supervision of the insurance industry on a domestic as well as an international level, promote the development of well-regulated insurance markets and to contribute to global financial stability.

IAIS develops principles, standards and guidance on insurance supervision and is active in promoting their implementation. The IAIS Insurance Core Principles are used by the IMF and World Bank in their country assessments. Decisions on adopting IAIS principles, standards and guidance are taken at the General Meeting held during the Association's Annual Conference.

FSA PRIORITIES

- reinforcing IAIS as a global standard setter;
- ensuring that IAIS work on solvency standards is compatible with UK objectives for Solvency 2;
- furthering the development of a global system of reinsurance supervision and mutual recognition that would permit host-state supervision to take account of supervision in the home state; and
- facilitating the exchange of information and improved collaboration in supervising insurers.

KEY WORKSTREAMS

Two papers adopted at the General Meeting in October 2005 represent a significant development in the IAIS's approach to achieving convergence of supervisory standards. A new framework for insurance supervision, 'Towards a common structure and common standards for the assessment of insurer solvency' (the Framework paper), describes the rationale and the contents of a framework for insurance supervision. 'Towards a common structure and common standards for the assessment of insurer solvency – cornerstones for the formulation of regulatory financial requirements' (the Cornerstones paper) sketches the contours of a common structure and standards.

Other standards that were agreed in October 2005 cover disclosures concerning investment risks and performance for insurers and reinsurers; and fit and proper requirements and assessment. Guidance papers on finite reinsurance and on combating the misuse of insurance companies for illicit purposes were also approved.

Looking forward to 2006, it is anticipated that the IAIS will develop the common structure for the assessment of solvency, and standards on asset-liability management and on disclosures concerning the technical performance and risks for life insurers. The Association is also working towards producing guidance on mutual recognition of reinsurers and on combating fraud on insurers.

The IAIS continues to provide input to the International Accounting Standards Board on its projects relating to insurance contracts, financial instruments and revenue recognition. The Association remains committed to producing global reinsurance market data, and a second report covering 2004 is in preparation. It also continues to encourage practical co-operation between supervisory authorities, and is examining whether there are significant barriers to the exchange of information in the group and conglomerate context.

Financial Stability Forum

<i>Chair:</i>	Roger Ferguson (US Federal Reserve Board)
<i>UK representatives:</i>	Callum McCarthy (FSA) Sir Andrew Large (Bank of England) James Sassoon (H.M. Treasury)
<i>Secretariat:</i>	Basel, www.fsforum.org
<i>Members:</i>	Regulators, central banks, finance ministries

COMMITTEE OBJECTIVES

The Financial Stability Forum was established in 1999, following the Asian and Russian financial crises of the late 1990s. Its role is to identify vulnerabilities and risks in the global financial sector and develop mitigation strategies. In many circumstances the FSF acts in a catalytic fashion to press the international regulatory community or national authorities to address a particular issue. In doing so it aims to promote international financial stability, improving the functioning of markets and reducing the potential for systemic risk. The Forum meets twice a year and brings together national authorities responsible for financial stability in major international financial centres, international financial institutions and representatives of international regulatory committees.

The 14th meeting of the FSF was held in London September 8-9 2005. Members considered the current set of potential vulnerabilities along with more specific threats to the financial system arising from market developments and structural risks and imbalances.

FSA PRIORITIES

- maximising the benefit derived from the opportunity to discuss issues affecting UK's regulated markets and sectors on a global basis as the FSF uniquely brings together senior regulators, central banks and financial policy officials with an interest in financial stability issues;
- ensuring that the FSF co-ordinates the international fora dealing with global financial issues so that issues are dealt with in a cost effective manner by the correct body and that duplication is avoided; and

- ensuring that potential gaps in regulation or implementation of standards and codes are identified and the appropriate international body or national authority takes action.

The Treasury and the Bank of England participate in the FSF as well as the FSA at Managing Director/Deputy Governor level.

KEY WORKSTREAMS

Detailed below are some of the more recent issues in which the FSF has taken a close interest and initiated both discussions and research. Further information on these issues and any relevant reports can be found on the FSF website.

- vulnerabilities and risk identification
- financial sector resilience
- hedge funds
- large & complex financial institutions
- market liquidity
- accounting and auditing issues
- standards and codes
- robustness of the standard setting process
- offshore centres
- business continuity

Joint Forum

<i>Chair:</i>	Ian Johnston (HKSF) Dirk Witteveen (DNB as of January 2006)
<i>FSA representatives:</i>	John Sloan, Richard Diggory, Paul Sharma
<i>Secretariat:</i>	Basel, http://www.bis.org/bcbs/jointforum.htm
<i>Members:</i>	National regulators, Basel, IOSCO and IAIS

COMMITTEE OBJECTIVES

The Joint Forum was established in 1996 by the Basel Committee (BCBS), International Organization of Securities Commissions (IOSCO) and the International Association of Insurance Supervisors (IAIS). It deals with issues common to the banking, securities and insurance sectors and the regulation of financial conglomerates.

The Joint Forum grew out of a predecessor organisation established to address issues specific to financial conglomerates. The Joint Forum's approach to these issues has included identifying best practice, cross-sectoral financial risks and their implications, the coherence of sector approaches and co-ordination with other international fora on issues of material interest.

In addition to receiving mandates from BCBS, IOSCO and IAIS, the Joint Forum has recently responded to direct requests from the Financial Stability Forum to examine cross-sector risks the FSF is concerned about (e.g. credit risk transfer and business continuity).

The Joint Forum usually meets three times a year and comprises senior bank, insurance and securities supervisors from 13 constituencies along with the representatives of the secretariats of the Basel Committee, IOSCO and IAIS and the European Commission. The most recent meetings were in June 2005 in Amsterdam and in November 2005 in Washington, D.C.

FSA PRIORITIES

- achieving a consistent cross-sectoral approach on key policy issues
- using the Joint Forum to identify, prioritise and give consideration to significant issues that cut across all three sectors and have an international dimension
- using the Joint Forum to address issues related to financial conglomerates
- using the Joint Forum to establish global standards that can ensure a greater degree of consistency as more detailed standards are set for regional or national entities (e.g. outsourcing, business continuity).

KEY WORKSTREAMS

Listed below are some of the more recent issues in which the Joint Forum has taken a close interest and initiated both discussions and research. Further information on these issues can be found on the Joint Forum website.

- credit risk transfer
- high-level principles on outsourcing
- funding liquidity risk
- high-level principles on business continuity
- review of regulatory and market differences that occur across a range of sectors

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