



ANNUAL REPORT 2011



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FOREWORD BY THE CHAIR

STEVEN MAIJOR

I am pleased to present the European Securities and Markets Authority's (ESMA) Annual Report for 2011, our first year of operations.

The first year has been a very eventful period both, for us, as a new European Supervisory Authority (ESA), and for Europe's financial markets. When ESMA assumed its role as the European regulator for securities markets on 1 January 2011, those markets were in a fragile state, which worsened later in the year when European markets suffered sharp declines in value.

However, regardless of the state of Europe's financial markets, the role assigned to ESMA was clear and I believe that we rose to the challenge laid down by the European Union (EU). This was achieved by EU-wide market surveillance, in close co-operation with the National Competent Authorities (NCAs), establishing strong co-ordination with our sister authorities, the European Banking Authority (EBA), European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB), in order to identify the build-up of risk. ESMA also worked on implementing the different pieces of new financial market legislation which are designed to tackle some of the shortcomings in financial market regulation and supervision that were highlighted by the financial crisis.

In beginning the lengthy process of legislative change, and its implementation, ESMA gave physical form to Europe's comprehensive response to the financial crisis, along with the other new European bodies and supervisors at national level. I personally view ESMA's creation as the beginning of a new era in how we go about protecting investors, and ensuring that we have well-functioning and stable markets across the European Union. The positive feedback and support I have received over the last 12 months as Chairman of ESMA reassure me that we are taking the right steps towards achieving these goals.

ESMA, as well as its role in rulemaking and co-ordination, is the only ESA currently exercising direct supervisory responsibilities for market participants. This it exercises in the crucial area of the supervision of credit rating agencies (CRAs), which had previously not been subject to regulation. Since July 2011, ESMA is the sole supervisor for CRAs in the EU and any CRA wanting to conduct business here has to apply to ESMA for registration. In 2011, ESMA registered a total of 16 CRAs, which included the main market players such as Fitch, Moody's and Standard & Poor's, but also a range of other ratings providers operating in the EU. Bringing CRAs under the umbrella of European supervision is a milestone achievement, and a prerequisite for a sounder rating process which can contribute to better functioning markets. In order to ensure CRAs' continuous compliance with the new rules on transparency, independence and internal governance, ESMA has also undertaken its first on-site inspections in December 2011 which, although only the first step in implementing the oversight regime for CRAs, will become a regular feature of our supervisory work in this market sector.

However, while CRAs were an important area of focus for ESMA in its start-up year, it was part of a broad range of activity undertaken during the course of the year. Highlights included addressing issues such as the proposed conduct rules for firms engaging in High-Frequency Trading (HFT) and the selling of structured investment funds or Exchange-Trade-Funds (ETFs), and the policy work on those new EU rules where ESMA has to deliver advice or technical standards. Indeed at times it would seem that we were also the regulator for acronyms with securities legislation revelling in such monikers as MiFID II, EMIR, UCITS, AIFMD and CRA III.

I believe that during 2011 ESMA has come some way in establishing its credentials in relation to one of our key objectives, namely taking an active role in enhancing EU investor protection, with a number of actions aimed at fostering sound and resilient markets where investors have the information necessary to make informed investment decisions. In the current market conditions retail investors continue to be eager to obtain the highest returns possible, leading them into unfamiliar areas. In response to the growing popularity of one group of such products, ESMA issued a first ever EU-wide investor warning about the risks involved in investing in foreign exchange products.

Retail investors are not alone in requiring protection so when concerns arose last autumn about the potential effects of rumours and short-selling, ESMA was successful in co-ordinating and harmonising the introduction of bans on net short positions in financial institutions across a number of European markets. Additionally, ESMA issued statements on the correct application of accounting rules when dealing with sovereign debt.

I would also like to take this opportunity to personally thank all the individuals that have contributed to a successful 2011 for ESMA. My thanks go to my colleagues from the EU's national authorities who, as members of the Board of Supervisors, have guided the work of ESMA during these challenging times. While my fellow members of the Management Board deserve thanks for their diligence and application in focusing on the running of the Authority, including the development of a multi-annual work programme, budgeting and staff resources.

Finally, I would like to express my sincere thanks to all of ESMA's staff for their commitment over the past year, and the excellent quality of the work they have produced on behalf of the organisation, in realising ESMA's objectives of enhancing investment protection and reinforcing stable and well-functioning financial markets in the EU.

I look forward to leading this ever growing team of dedicated Europeans.

Steven Maijoor
Chair

European Securities and Markets Authority



FOREWORD BY THE EXECUTIVE DIRECTOR

VERENA ROSS

Last year saw the creation of the new European Securities and Markets Authority. I am proud, as Executive Director, to be able to report on this important first year of ESMA's operation.

Setting up a new European Authority can be a challenge in any circumstances, but the set-up of ESMA occurred against the background of both a difficult period in European financial markets and a significant surge in legislative initiatives following the financial crisis. Moreover, there was only a very short time period between the final decision to set up ESMA, and its fellow European Supervisory Authorities, in September 2010 and the actual first day of operation on 1 January 2011.

The early months were dominated by designing and embedding the operational and procedural basis of the new Authority, including decision making procedures, the selection of the Chair and Executive Director, as well as initial financial and HR procedures. In addition to these early administrative challenges ESMA also moved its offices across the Seine to its new headquarters in the 7th arrondissement of Paris.

In its first year ESMA has successfully delivered against many of its new objectives. The main focus was to maintain, throughout the transition period, a high level of operational effectiveness – so that the important targets set out in our ambitious work programme relating to delivering policy output and starting direct supervision of CRAs, as well as boosting investor protection, financial stability and supervisory convergence activities were achieved.

In terms of operational set-up, ESMA subsumed 35 staff from CESR (Committee of European Securities Regulators) at the start of 2011, but by year's end this increased to 60 with recruitment spread across all areas of the organisation. The arrival of the new Chair and myself as Executive Director in the spring/summer of 2011 prompted a restructure of the internal setup resulting in the creation of a number of new divisions

and units to reflect ESMA's legal responsibilities. To support the new structure a number of key appointments needed to be made and following a lengthy and thorough selection process a number of highly qualified and impressive candidates, with backgrounds in government, international organisations, regulatory bodies and the private sector, were selected to lead the new areas. This gave the organisation a strong management structure from the autumn onwards, which supported its ability to deliver on its responsibilities.

As an EU agency, ESMA needs to ensure that its financial, procurement and other administrative procedures follow the strict rules laid down under EU legislation. The organisation successfully implemented the EU accounts system (ABAC) and overhauled its existing internal procedures to ensure compliance with these new rules. ESMA's first annual accounts statement for 2011, which can be found in Annex B of this report, shows that our expenditure for 2011 was 20% under budget which, in the first of operation of a new EU Authority, is a good outcome. One area where our activity was behind schedule was in IT, where the delay of much of the legislative agenda has meant that fewer projects than had been originally planned could be started in 2011.

I would like to join Steven in thanking all the ESMA staff for their hard work, dedication and the enormous contribution they have made individually and collectively to ESMA's successful first year. In particular, I would like to thank those who have worked so hard during the transition period to set up the new organisation and have seen it grow during 2011. My special thanks go to Carlo Comporti who left ESMA at the end of 2011, but who has contributed significantly to the organisation's set-up.

Verena Ross
Executive Director
European Securities and Markets Authority

The graphic features a dark blue background with a pattern of white stars of varying sizes, reminiscent of the European Union flag. Overlaid on this are several glowing white lines that form a network or orbital pattern, with bright white points at their intersections. The text 'ESMA'S ROLE AND OBJECTIVES' is prominently displayed in white, bold, sans-serif capital letters in the upper right quadrant. In the bottom left corner, the numbers '01' are partially visible in a large, white, sans-serif font.

ESMA'S ROLE AND OBJECTIVES

ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the EU. ESMA achieves this by building a single rule book for EU financial markets and ensuring its consistent application across the EU.

ESMA's mission is to enhance the protection of investors and promote stable and well-functioning financial markets in the European Union (EU). As an independent institution, ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. ESMA contributes to the regulation of financial services firms with a pan-European reach, either through direct supervision or through the active co-ordination of national supervisory activity.

The organisational characteristics of ESMA

The following six characteristics describe ESMA and how it achieves its mission and objectives.

- **European:** When carrying out its tasks, ESMA acts in the interest of the EU. The organisation reflects the diversity of the EU;
- **Independent:** ESMA is independent of the EU institutions, national authorities and financial markets participants;
- **Co-operative:** ESMA forms, together with the national authorities, an EU network of financial markets supervisors. It co-operates with all relevant European bodies, including the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Systemic Risk Board (ESRB), and with regulators outside the EU;
- **Accountable:** ESMA's decision-making is transparent and it deals with its stakeholders in an open and inclusive manner. The organisation is accountable to the European Parliament, European Council, European Commission and the wider public;
- **Professional:** ESMA strives for professional excellence by employing high-quality staff with strong technical expertise, knowledge and experience of financial markets, and through following sound practices and procedures; and
- **Effective:** ESMA uses its resources efficiently in order to maximise its impact in promoting investor protection and stable and well-functioning markets in the EU.

The governance of ESMA

ESMA is governed by two major decision making bodies: the Board of Supervisors (BoS) and the Management Board (MB). ESMA has a full-time Chair, Steven Maijoor, and an Executive Director, Verena Ross. The Chair and the Executive Director are both based at ESMA premises in Paris and serve a five year term which may be extended once. The Chair is responsible for preparing the work of the Board of Supervisors and chairs both the meeting of the Board of Supervisors and the Management Board. He also represents the Authority externally.

The Executive Director is responsible for the day to day running of the Authority, including staff matters, developing and implementing the annual Work Programme, developing the preliminary draft budget of the Authority and preparing the work of the Management Board.

ESMA's Board of Supervisors

The Board of Supervisors is composed of the heads of 27 national authorities, with observers from the European Commission, EBA and EIOPA and the ESRB. In addition, Norway, Iceland and Liechtenstein¹ were invited to attend as permanent observers. The Board guides ESMA's work and has decision making responsibility regarding the adoption of ESMA opinions, guidelines and recommendations, decisions and the issuance of technical standards and advice to the EU institutions.

The Members of the Board and summaries of their meetings can be found on ESMA's website:

 [http:// www.esma.europa.eu/bos](http://www.esma.europa.eu/bos)

ESMA's Management Board

The Management Board is composed of six members selected from the Board of Supervisors by its members. Steven Maijoor, ESMA Chair, is also a member of the Management Board which he chairs. The Executive Director and a representative from the European Commission (EC) attend as non-voting participants (except that the EC will have a vote on budget matters).

The main role of the Management Board is to focus on the management aspects of the Authority, such as the development of a multi-annual Work Programme, the budget and staff resources.

The Members of the Board and summaries of their meetings can be found on ESMA's website at:

 [http:// www.esma.europa.eu/mb](http://www.esma.europa.eu/mb)

1. The Liechtenstein FMA submitted a request to ESMA after the Liechtenstein Parliament adopted a law amending the Financial Market Authority Act ('FMAA') which came into force on 1 January 2011. The FMAA constitutes a legal framework for co-operation and exchange of information between the FMA and its foreign counterparts. The FMAA substantially modified the mechanisms of assistance that can be offered by the FMA with the purpose of complying with international standards in the field of supervisory co-operation and exchange of information, such as the ESMA/ESMA MMoU and EU legislation.

ESMA's Securities and Markets Stakeholder Group

The Securities and Markets Stakeholder Group was established under ESMA's founding Regulation to help facilitate consultation with stakeholders in areas relevant to ESMA's tasks. ESMA is required to consult the Group on its draft guidelines and technical standards. The Group's 30 members first met in July 2011 and were appointed by ESMA for a period of two and a half years following an open call for candidates. They variously represent financial market participants and their employees', consumers and other retail users of financial services and small and medium enterprises.

In 2011, the Group elected Guillaume Prache as its Chair, a consumer representative. He is supported by joint Vice-Chairs Peter de Proft, a representative of users of financial services, and Judith Hardt, a representative of financial market participants. The Group held three plenary meetings during 2011, and summaries of its meetings can be found at:

 <http://www.esma.europa.eu/smsg>

ESMA's objectives

Sound and effective regulation of securities markets is key for the growth, integrity and efficiency of the European Union's (EU) financial markets and economy. Effective regulation is a vital factor in securing and maintaining confidence amongst market participants. In order to foster these conditions, ESMA was created as an independent EU Authority to improve harmonisation in both supervisory rules and practices.

In order to achieve harmonised rules and their implementation throughout the Union, ESMA serves as a standard setter in relation to securities legislation and provides technical advice where mandated by the Commission. It also has an important role in directly supervising financial players with pan-European reach, such as currently credit rating agencies or trade repositories (TRs) in the future.

ESMA's annual report is an important tool to ensure accountability regarding the Authority's delivery against its objectives and annual Work Programme. To facilitate a better understanding of ESMA's role, it has set itself six objectives to which its work contributes, namely:

Supervision

ESMA's direct supervisory powers are currently focused on a single group of participants in the financial markets, namely credit rating agencies. Since 1 July 2011, ESMA is the responsible body regarding the registration and supervision of CRAs in the European Union. Additionally, new EU regulations have added future direct supervisory powers to ESMA's remit regarding trade repositories.

In undertaking supervision of financial market participants with pan-EU reach who may have an impact on the integrity of the EU's financial markets, ESMA contributes to sound and safe financial markets thereby supporting investor protection.

Single rulebook

In its role as a standard setter, ESMA works on establishing harmonised regulatory technical standards (RTS) in different areas of securities regulation. By drafting those standards, ESMA contributes to establishing a single EU rulebook applicable to all market participants and creating a level-playing-field across the Union. The single rulebook will drive a rise in the quality and consistency of national supervision, the enhanced and consistent protection of investors across the Union and the strengthening of oversight of cross-border groups.

Convergence

ESMA was set up help foster supervisory convergence thereby reducing regulatory arbitrage resulting from different supervisory practices as they have the potential of undermining not only the integrity, efficiency and orderly functioning of markets but ultimately also financial stability.

In order to foster fair and balanced supervisory practices, ESMA conducts peer reviews of existing EU legislation in the field of securities regulation. In addition, ESMA has a number of tools to achieve regulatory convergence, including issuing opinions, and as a last resort, a breach of Union law procedure.

The Authority aims to use its convergence work to also drive its activities in other areas of the Work Programme, including enhancing the single rulebook through issuing guidelines and recommendations in areas where difference of application exist and through providing advice to the Commission on areas where revised legislation might be necessary to align supervisory practices.

Investor protection

The Regulation setting up ESMA gave a leading role to the Authority in promoting transparency, simplicity and fairness in securities markets for consumers of financial products or services. In order to ensure that investors enjoy the same level of protection regardless of the point of sale or the product being sold, ESMA collects, analyses and reports on consumer trends, while promoting both financial literacy and education initiatives and contributing to the enhancement of common disclosure rules.

It is important for ESMA to monitor new and existing financial activities as this will allow it to assess whether to adopt guidelines and recommendations with a view to promoting safe and sound securities markets, and to ensure that investor protection across the Union is enhanced.

Should ESMA identify products which may inherently present serious threats to investors, it will consider issuing warnings. If current legislative proposals come into force ESMA can, as a last resort, temporarily ban certain products. ESMA's work in this area will include a focus on ensuring that the financial information provided by market participants to investors is clear, understandable and in compliance with existing rules.

Financial stability

In order for ESMA to contribute to safeguarding the financial stability of the EU's securities markets it is crucial that it continuously analyses trends and, at an early stage, identifies potential risks and vulnerabilities at a micro-prudential level, across borders and sectors. To achieve this ESMA will conduct economic analyses of European securities markets and model the impact of potential market developments.

ESMA will inform the other institutions in the European System of Financial Supervision, the other ESAs and the ESRB, on a regular and, if necessary, on an ad hoc basis about its findings. The aggregation of micro-prudential data collected at supervisory level is key to identifying the build-up of potential macro risks to the economy as a whole. Therefore, it will be crucial to regularly inform all necessary decision makers, including, at the EU level, the Financial Services Committee (FSC) and the Financial Stability Table of the Economic and Financial Committee (EFC-FST) to whom ESMA will send its regular reports.

Organisational set-up

In order for ESMA to deliver against its many tasks as standard setter and supervisor, It needs to work effectively and efficiently as an EU agency. This required to comply with the full range of EU rules and procedures. ESMA is committed to be a transparent and accountable organisation. This Annual Report is an important tool in explaining how ESMA delivers against its objectives, demonstrating its accountability to the EU institutions and the public at large.



THE ECONOMIC ENVIRONMENT: SECURITIES MARKETS IN 2011

02

2011 was a difficult year for the securities markets primarily as a result of the crisis in EU sovereign debt markets and the continued difficulties in the banking sector. While the first half of 2011 was characterised by a relatively stable environment, markets experienced a sharp decline in the second half of 2011.

ESMA's first year of operations took place against the backdrop of a difficult year for the securities markets primarily as a result of the crisis in EU sovereign debt markets and the continued difficulties in the banking sector. While the first half of 2011 was characterised by a relatively stable environment across asset classes, the financial markets generally experienced a sharp decline in the five months leading up to November 2011. There was a strong focus on the developments in the sovereign debt markets and the possible risks associated with this and related markets. In particular the developments in Greece and the spread of risk into other government bond markets and its impact on wider market sentiment dominated the securities markets in 2011.

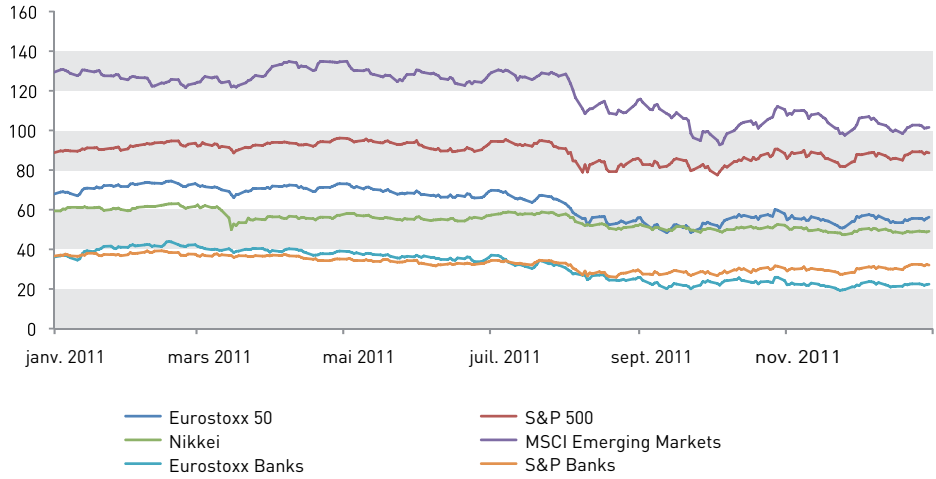
Sluggish equity markets in Europe, some positive signs from IPOs

In 2011, European equity markets recorded negative returns. Compared to 2010, the Eurostoxx 50 index declined by 20% amid concerns related to the European debt crisis. Over the same period, US equity markets remained flat, while Japanese and emerging markets indexes decreased by around 20% (Figure 1). At a sector level, the Eurostoxx banks index decreased by around 40%, whilst on a global level the Standard & Poor's (S&P) banks index decreased by 10% as American banks were less exposed to European sovereign bonds than their European counterparts.

In the first half of 2011, European stock markets indexes remained relatively flat. However, due to the debt crisis, they experienced a sharp decline in mid-July 2011. Since then, they have remained stable at lower levels, compared to US indexes which rebounded due to positive economic developments in the US.

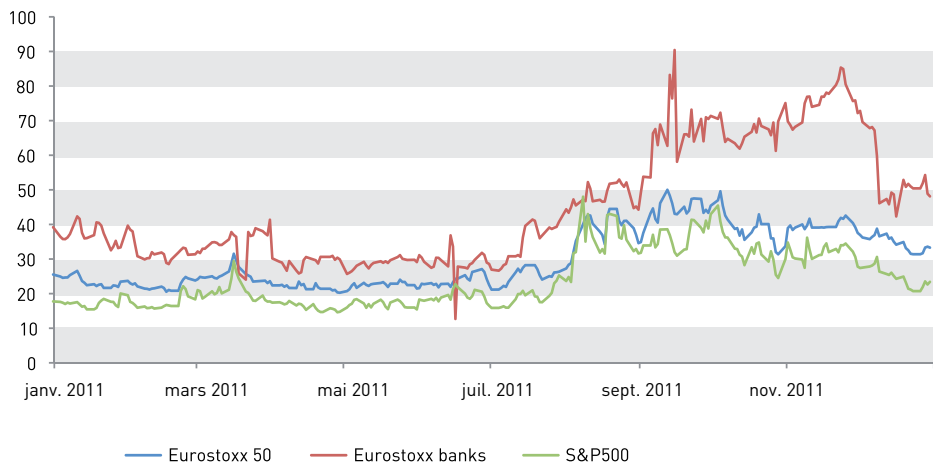
From a longer-term perspective, the Eurostoxx 50 index lost 45% of its value since January 2007, whilst the S&P500 only lost 11% over the same time period; the Eurostoxx banks index lost 75% while the S&P bank index 67% over the same period. The MSCI index of emerging markets on the contrary increased by 2%.

FIGURE 1: STOCK MARKETS PERFORMANCE (BASE=100 IN JANUARY 2011)



Part of the downward trend in European equity markets in 2011 was linked to an increase in perceived risk, which was mirrored by increased implied volatilities in option markets (Figure 2). The large increase in risk since August 2011 (with implied volatility reaching 50% in October 2011 against less than 30% before July) sent the European stock market down. However, expected volatility has declined again in December 2011, but with no further improvements in the European equity index. European stock market performance in 2011 can be partly explained by more structural factors, such as a poor economic outlook in some countries such as Greece, Spain, Italy, Ireland and Portugal, and a risk of recession for the Eurozone in 2012.

FIGURE 2: 3-MONTH IMPLIED VOLATILITY IN STOCK OPTION PRICES



Signs of recovery in European IPOs

In 2011, there were signs of a revival of primary issuances by corporate firms and banks on European exchanges, with a strong rebound in initial public offerings (IPOs): 305 deals raised €31.6bn in the first half of 2011, against €22.7bn raised by 251 deals in the first half of 2010 (Figure 3).

At the global level, private equity fund raising remained subdued in 2011, around US\$192bn for the first three quarters (Figure 4). This could be linked to significant negative performance (-25%) by the private equity firms index over that period. At the end of 2011, the index had lost about 50% of its value compared to January 2007.

FIGURE 3: INITIAL PUBLIC OFFERINGS (IPOS) IN EUROPEAN EXCHANGES (€BN)

Source: PWC survey

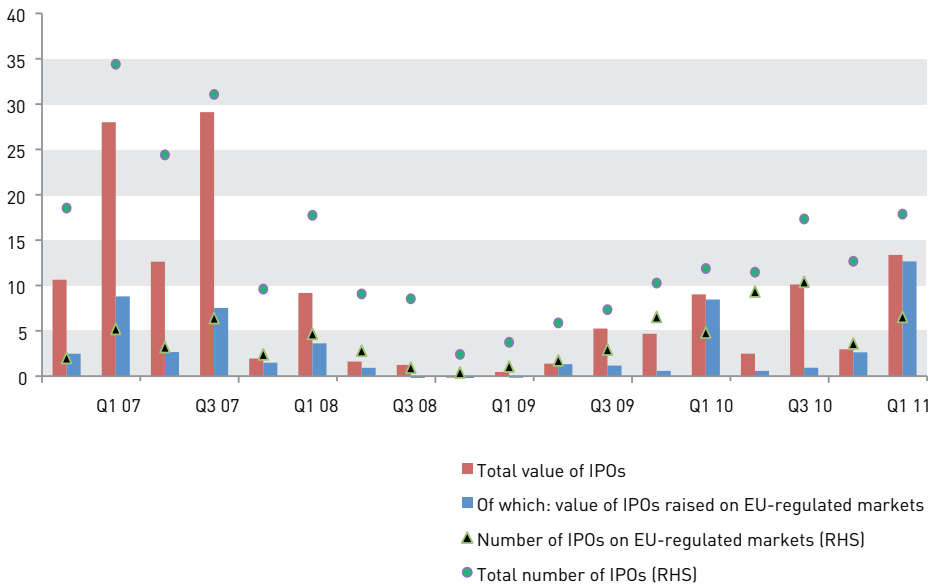
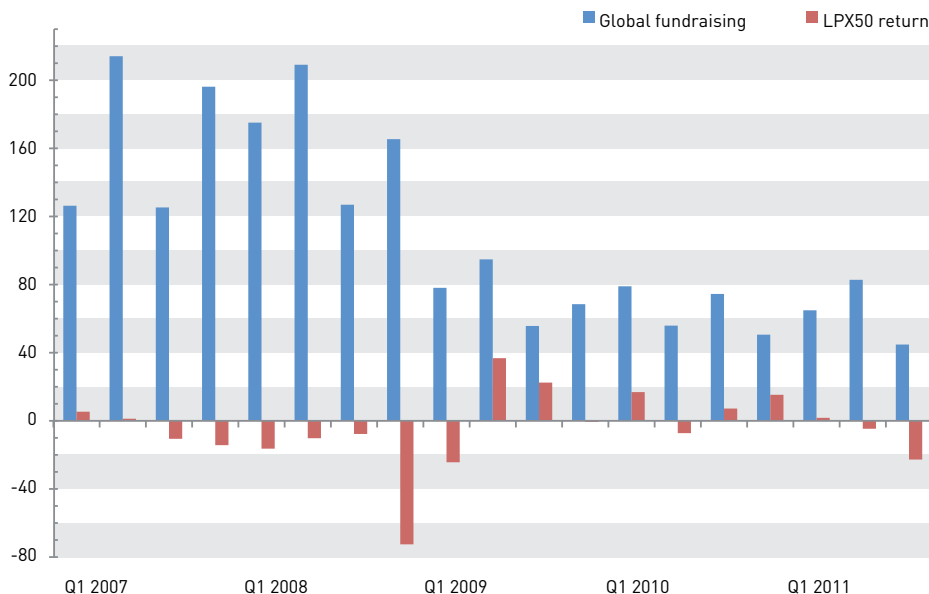


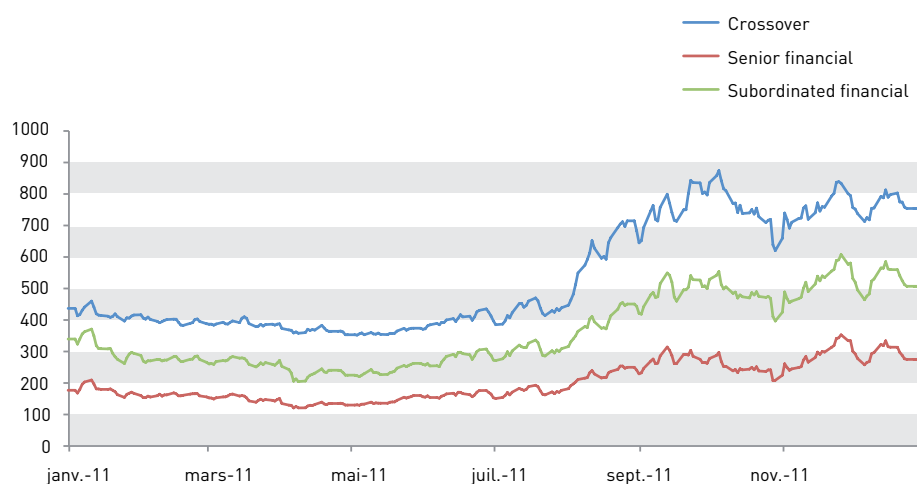
FIGURE 4: GLOBAL PRIVATE EQUITY FUNDRAISING (\$BN)



Bond markets: increase of sovereign credit risk

From July 2011 onwards, spreads in European credit markets experienced a substantial increase, reflecting market concerns about the development of debt. This was mirrored by a significant increase of spreads in the financial sectors over the whole risk spectrum (Figure 5).

FIGURE 5: EUROPEAN ITRAXX CORPORATE CDS SPREADS (BP)



Sovereign risk continued to increase across the Eurozone (Figure 7). The monetary support provided by EU governments and the European Central Bank (ECB) had some positive effects, but funding pressures remained elevated for many member states. The rise in the perceived level of sovereign risk and resulting widening spreads at the end of 2011 appears especially problematic in light of the high rollover needs of EU governments.

However, the rising level of perceived risk did not lead to a significant demand for credit risk protection for peripheral countries, as witnessed in the cumulated 4-week change in sovereign Credit Default Swaps (CDS) net notional (Figure 8). Throughout 2011, the CDS net notional amount decreased for some countries such as Greece (-US\$3bn), Portugal (US\$3bn), Italy (-US\$5.9 bn) and Spain (-US\$1bn) while it increased for countries such as Germany (+US\$4.2bn) and France (+US\$ 4.3bn).

FIGURE 6: COST OF INSURANCE AGAINST SOVEREIGN DEFAULT: 5-YEARS CDS SPREADS (BP)

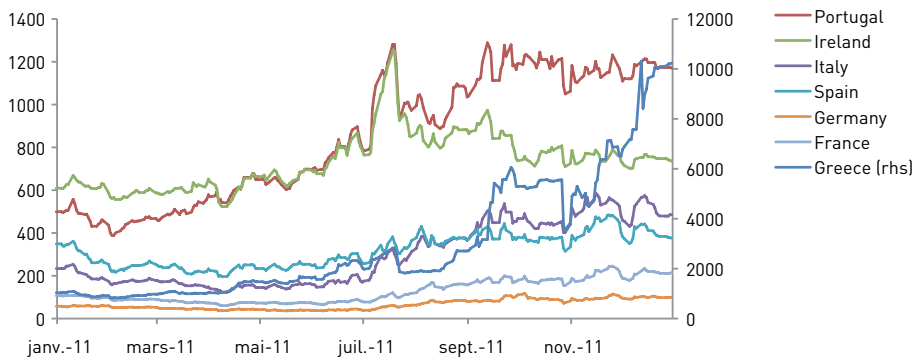
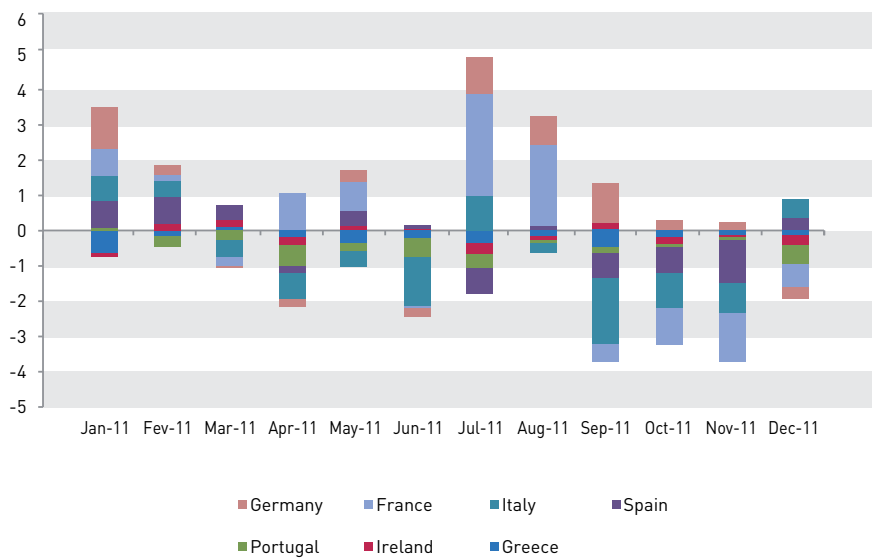


FIGURE 7: CUMULATED 4-WEEKS CHANGE IN SOVEREIGN CDS NET NOTIONAL (US\$ BN)



Continued deterioration in the European securitisation and covered bond markets

During 2011, sovereign risk continued to have negative spill over effects on the securitisation market. Distressed trading and declines in issuance activity were seen in highly indebted economies of the Eurozone, although the secondary-covered bond issuances remained steady relative to the year before.

FIGURE 8: EUROPEAN RESIDENTIAL AND COMMERCIAL MORTGAGE BACKED SECURITIES AAA RMBS SPREADS (BP)

Source: Markit

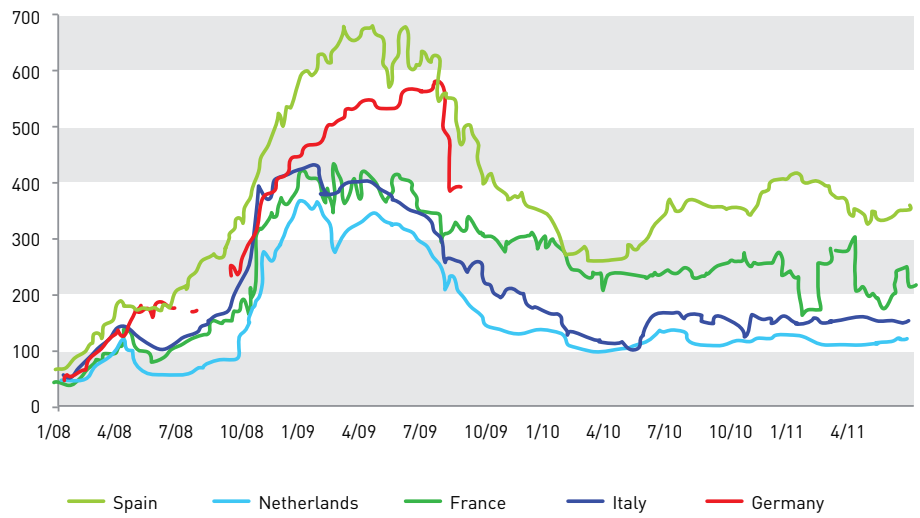
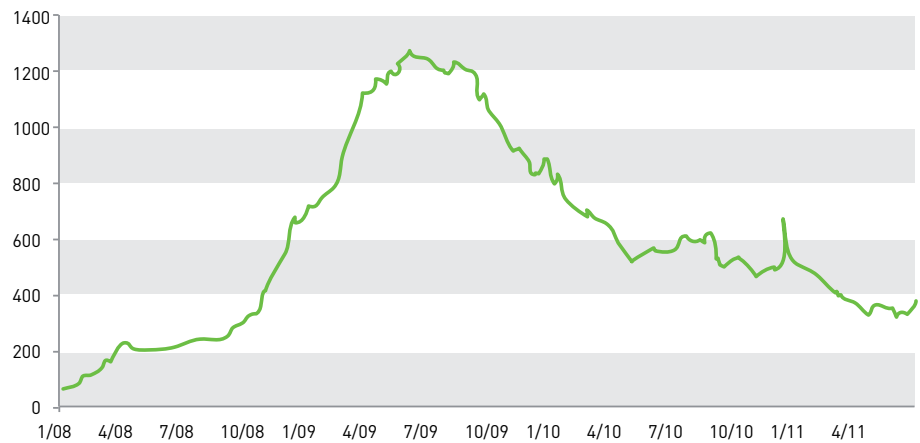


FIGURE 9: EUROPEAN 3-5 YEARS CMBS SPREADS (BASIS POINTS)

Source: Markit



In several Eurozone countries, European residential mortgage backed securities (RMBS) spreads remained elevated and volatile compared with pre-crisis levels (Figure 8). By contrast, conditions in the European commercial mortgage backed securities (CMBS) segment did not deteriorate further with spreads continuing to fall (Figure 9).

In parallel to the distress witnessed in the secondary markets, a growing perception of risk among investors caused a further decline in issuance in 2011, across all assets (Figure 10). While ABS issuance increased by about 35% compared to 2010, RMBS remained by far the dominant form of securitisation in Europe (Figure 11).

FIGURE 10: EUROPEAN SECURITISATION ISSUANCE (€ BN)

Source: Dealogic

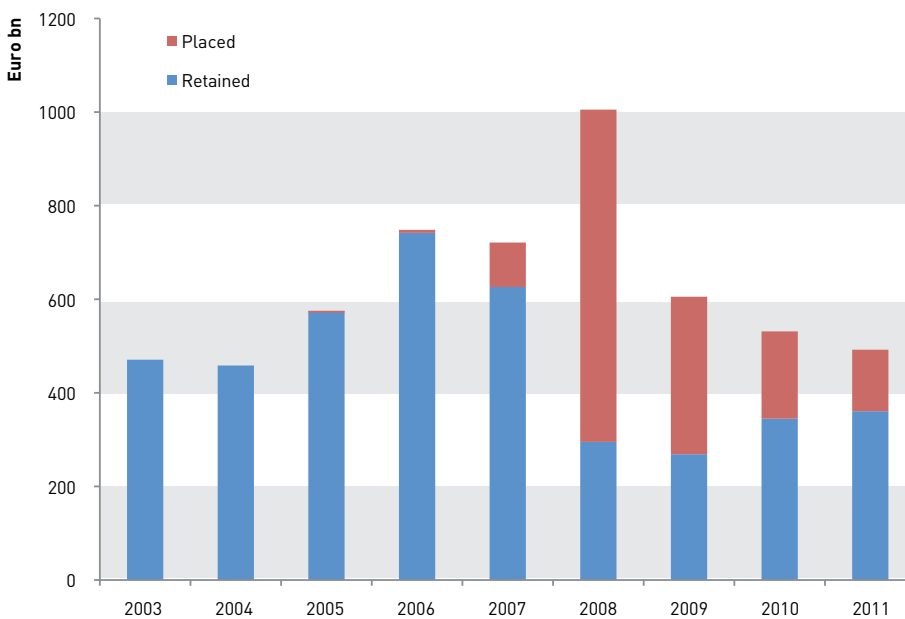
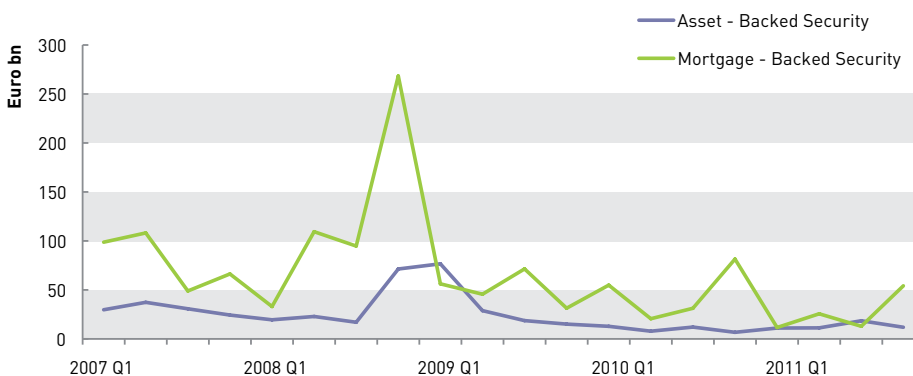


FIGURE 11: EUROPEAN SECURITIZATION ISSUANCE BY TYPE (€ BN)

Source: Dealogic

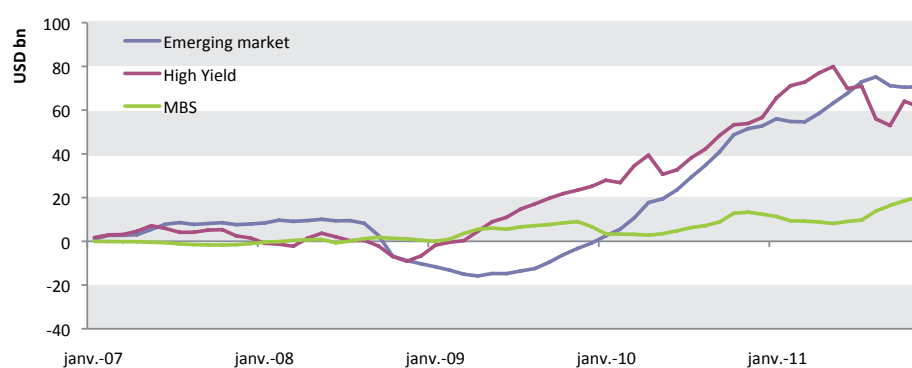


Retained European outstanding securitised debt stood at €131.5bn, e.g. accounting for about 27% of total issuance in 2011, compared with 70% of issuance in 2008. Retained issuance is predominantly AAA-rated RMBS. In Q2 2011, the UK was the largest European issuer of placed securitised debt with 46 % of total issuance followed by the Netherlands with 14%.

The lower level of retention might have reflected a greater willingness by investors to take exposures to riskier assets or a perception of lower risk. EPFR data showed a continued growth throughout 2011 in investment flows into funds specialised in MBS securities and other high-yield securities (Figure 12).

FIGURE 12: CUMULATIVE FLOWS INTO HIGH-YIELD FUNDS (\$ BN)

Source: EPFR



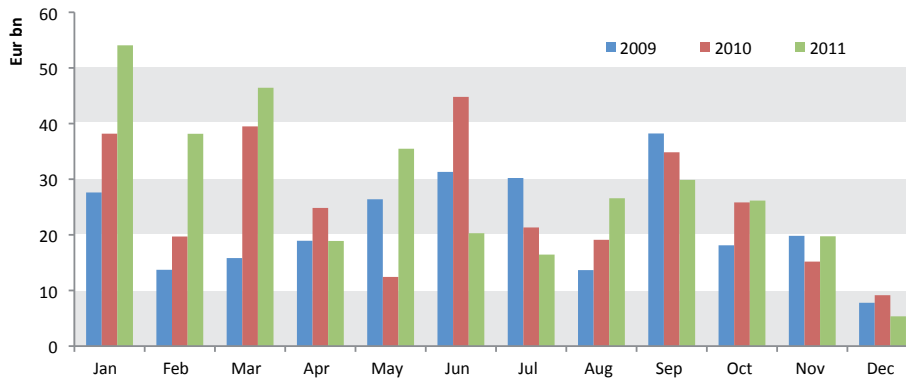
According to the Association for Financial Markets in Europe (AFME²), downgrades of securitised assets increased in 2011 as a consequence of securitised products backed by collateral from Eurozone states experiencing deterioration in creditworthiness. Generally, Credit Rating Agencies (CRAs) gave stable outlooks for French RMBS, German auto ABS, German SME, German RMBS, Dutch RMBS, UK credit card ABS and prime UK RMBS.

Activity in the primary covered bond market remained strong until June 2011 (Figure 13). However, activity has slowed down since. In the secondary market, elevated spreads between covered bond yields and euro interest rate swap rates indicated that concerns of persistent fiscal sustainability in some euro area countries had a significant negative impact on banks' ability to raise funds at a reasonable cost via covered bond issuance.

2. <http://www.afme.eu/Documents/Statistics-and-Reports.aspx>

FIGURE 13: EUROPEAN COVERED BONDS ISSUANCE (€ BN)

Source: Dealogic



A negative year for the hedge fund and private equity industries

The hedge fund and private equity industries experienced a severe setback in 2011 due to tightened funding conditions. Long-short equity funds positioned for rallying markets were hardest hit together with macro hedge funds and arbitrage funds. The S&P global private equity index collapsed (figures 14) relative to the previous year and the hedge fund global index continued to underperform all other major global indices throughout 2011 (Figure 14).

According to EurekaHedge³ data, net inflows into hedge funds continued to be positive until April 2011. Performance-based losses increased sharply from April 2011 onwards, amounting to \$16.5bn by October 2011. The number of fund closures remained comparable to pre-crisis figures.

In Europe, UCITS III hedge funds have significantly outperformed equities and fund of funds by a factor of two to ten. This is despite restrictions on their upside potential which is linked to regulatory liquidity requirements and limits on leverage.

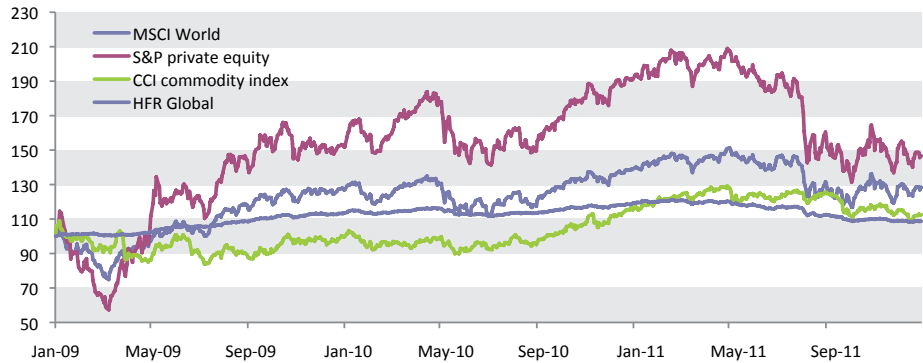
UCITS III compliant hedge funds in 2011 also attracted proportionally greater asset flows and experienced greater population growth, owing to the fact that they could offer better risk adjusted returns to investors. Further, hedge funds compliant with the UCITS III have become more popular as investors have sought greater transparency and better risk management.

Concerning risk management, there was a trend towards a more even distribution of assets among the top ten prime brokers. Following the collapse of Lehman and more recently MF Global, hedge funds tended to build relationships with more than one prime broker and migrated to larger and financially stable prime brokers. This has been especially true for the largest hedge funds according to EurekaHedge data.

3. <http://www.eurekaHedge.com/database/europeanhedgefunddirectory.asp>

FIGURE 14: HEDGE FUNDS, PRIVATE EQUITY AND COMMODITY INDEX RETURNS (BASE=100 IN JANUARY 2009).

Source: Datastream



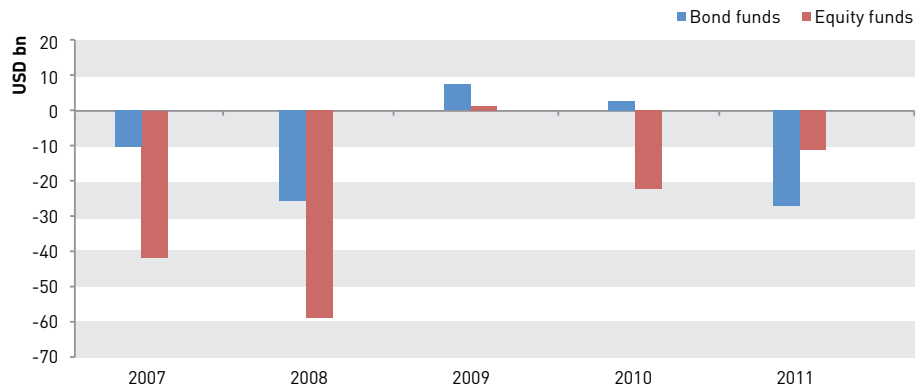
Net inflows into European investment funds deteriorated further in 2011

The European investment fund industry witnessed negative growth in 2011. There were persistently low inflows into equities. While bond funds experienced a sharp setback equivalent to that experienced in 2008 (Figure 15).

Mutual fund flows tended to be strongly pro-cyclical which contributed to heightened instability in equity and bond markets. Italian, Spanish, and Irish bond markets witnessed the largest outflows. A drying-up of foreign fund flows put further downward pressure on liquidity and subsequently asset prices. US and European money market funds witnessed further outflows most likely owing to their exposure to Eurozone financials, and offered low yields as central banks maintained short term interest rates close to the zero bound.

FIGURE 15. FLOWS INTO EUROPEAN EQUITY AND BOND FUNDS (US\$ BN)

Source: EPFR



Gross notional CDS amounts decreased

In 2011, gross notional amounts of all types of credit derivative products decreased by 15% totalling at US\$21.5tn, according to data from DTCC⁴. The decline in gross notional amounts can be partly explained by structural changes such as trade compression and the increased use of central counterparties (CCPs), as over the same period net notional amounts have slightly increased (+2%).

Data on net notional amounts show that interdealer trades increased by 20% in 2011, while “other trades”⁵ decreased by 40%. Interdealer trades increased among all credit derivative products (Figure 16), the rise has been particularly dramatic for CDX products (+60%).

Among single-name CDS, only sovereign CDS net notional remained stable in 2011 (+US\$ 32bn), while financials and consumer services decreased by US\$1,025bn and US\$950bn respectively (Figure 17).

FIGURE 16: GROSS NOTIONAL AMOUNTS OF ALL CREDIT DERIVATIVE PRODUCTS (US\$ TRN)

Source: DTCC

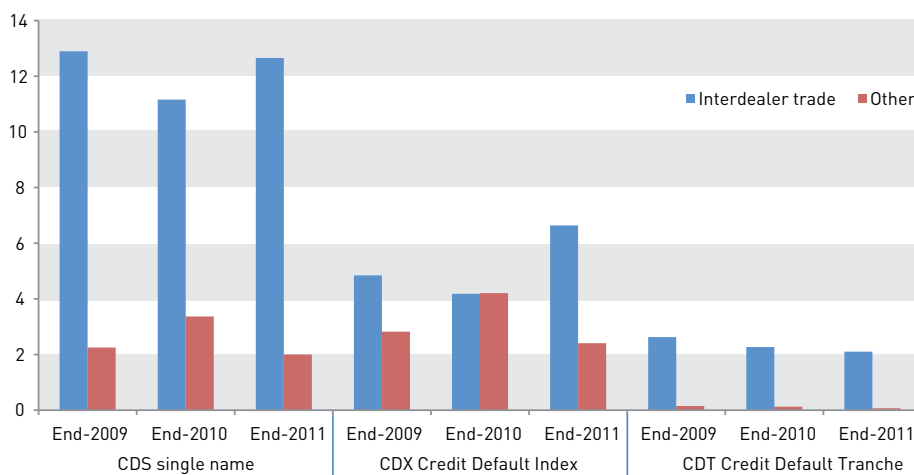
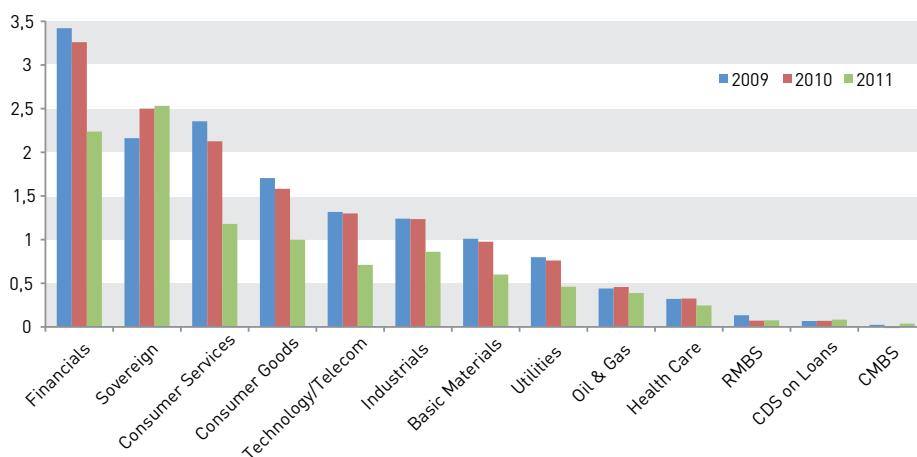


FIGURE 17: SINGLE NAME CDS GROSS NOTIONAL AMOUNT, BY REFERENCE ENTITY TYPE (US\$ TRN)

Source: DTCC



4. The depository trust & clearing corporation (DTCC) stores OTC derivatives data in a global repository, the Trade Information Warehouse. While DTCC data are based on CDS records registered in the warehouse, the BIS data rely on dealers' reports to national central banks. See the Box, "The size of the global CDS market-BIS and DTCC data", in BIS Quarterly Review, December, p23-25. It is worth keeping in mind that the DTCC data do not currently include CDOs and ABS.

5. Other trades refer to trades involving at least a non dealer or a customer at the buy or sell side.

ESMA ONE YEAR ON – TOPICS, TASKS AND ACHIEVEMENTS

03

Effective and sound regulation and supervision of securities trading is key in both ensuring the growth, integrity and efficiency of financial markets and at the same time maintaining investor protection.

ESMA's first year of operation was marked by three key drivers: a further developing strand to the financial crisis, the continuation of the regulatory change agenda and the implementation of CRA supervision. Against the background of a difficult market situation, ESMA assumed its key co-ordination role in EU markets supervision, which included actively monitoring developments and risks, and co-ordinating action by national competent authorities, especially regarding short-selling, financial reporting, market microstructures and clearing and settlement. ESMA also moved quickly to take up its new role as EU standard setter for securities markets across different new or soon to be revised pieces of legislation. These dealt with markets (MiFID), their infrastructure (EMIR), transparency (TD, PD, IFRS) and orderly functioning (short-selling, MAD), with rules for financial market participants such as CRAs (CRA II and III) and investment funds (UCITS, AIFMD). ESMA continued its work on facilitating the sharing of experience and best practices between national supervisors, in particular in the area of market surveillance but also in areas such as prospectuses and takeover bids. ESMA established strong and successful working relationships with the other ESAs, both bilaterally and through the Joint Committee, and with the ESRB.

CRA supervision, policy and investor protection in focus

ESMA's main regulatory objective of developing sound supervision of pan-EU market participants saw early progress with it becoming the sole supervisor for CRAs in Europe by July 2011. The Authority, together with national supervisors, registered a total of 15 CRAs by year end, including key players such as DBRS, Fitch, Moody's and Standard & Poor's. Following their registration, late 2011 saw the first on-site inspections by ESMA, aimed at examining whether CRAs complied with the requirements laid out in the CRA Regulation.

A large tranche of ESMA's resources were devoted to new policy developments on trading requirements under MiFID, with ESMA assessing the compliance of three new proposals for MiFID pre-trade transparency waivers, publishing its final view on automated high-frequency-trading (HFT) and continuing its work on commodities and all aspects of the on-going MiFID review process. In relation to post-trading issues, following the regulatory roadmap laid out by the G20, ESMA undertook preparatory work for proposed technical standards for the regulation on OTC derivatives, Central Clearing Counterparties (CCPs) and Trade Repositories (European Market Infrastructure Regulation - EMIR). In the fund management sector the key directives on UCITS and AIFMD saw ESMA produce detailed rules for alternative investment fund managers, develop practical arrangements for the late transposition of the UCITS IV Directive and start looking into Exchange-Traded Funds and structured UCITS in order to ensure that the same level of investor protection and product transparency exists for all funds.

Ensuring that the right level of transparency exists through high quality information was another important topic on ESMA's 2011 agenda. This involved monitoring and promoting the Authority's viewpoint on these issues to the international financial reporting community and international standard setting bodies. In pursuit of this role, ESMA contributed to the development of International Financial Reporting Standards (IFRS) and provided opinions on accounting related issues, such as the application of IFRS when dealing with sovereign debt.

Alongside this important policy role, ESMA continued its work on sharing experiences and promoting discussions between national supervisors on market surveillance issues and matters relating to the Prospectus (PD) and Transparency Directives (TD), Takeover Bids, etc. ESMA also progressed its joint work with the other ESAs and the ESRB.

Besides enhancing financial consumer protection through additional rules and requirements for intermediaries and fund managers, ESMA also issued its first pan-European product warning on foreign exchange to investors. The purpose of this was to warn and inform investors about the risks that may be entailed in such products.

ESMA as an EU agency

In addition to focusing on its role in policy and supervision, ESMA also developed its internal organisation. This included shaping and implementing rules and procedures to allow ESMA's governance to function properly and to fulfil its duties as intended by its founding legislation. Areas covered were finance, human resources, information systems (IT) and logistics.

ESMA both designed and implemented its organisational rules and procedures in order to align it with EU requirements – such as procurement, payment and recruitment rules. Together with the further building up of its infrastructure, these procedures supported ESMA's growth from 35 staff in January 2011 to 100 staff at the end of 2012. The arrival of the new Chair and Executive Director in the spring/summer of 2011 prompted a restructure of the internal organisation which resulted in the creation of a number of new divisions and units to reflect ESMA's legal responsibilities.

ESMA successfully implemented the EU accounts system (ABAC) in its first few months of operation and created the necessary financial procedures to allow it to follow the EU rules in committing future expenditure and making payments. To allow ESMA to operate, procurement procedures also needed to be implemented and strict and transparent processes followed in any selection of providers.

In mid-2011, ESMA moved offices within Paris to its new home at 103 Rue de Grenelle. The move was necessary to accommodate the growing staff numbers but also to expand the number of meeting rooms to accommodate meetings with national competent authorities and outside parties, such as open hearings. The move was a logistic challenge for a young organisation such as ESMA but was completed without any disruption to the running of the business.

The day-to-day logistical challenges of a fast growing organisation were significant, including on the IT side. Besides this, ESMA continued to run the cross-EU data base for transaction reports and developed a successful IT solution for the publication of CRA historical ratings. The progress on a number of other IT projects was slower than expected due to the significant delays in the legislative processes, for example in the area of OTC derivatives.

3.1 Credit Rating Agencies Regulation

During 2011, ESMA prepared for its new supervisory role as the sole pan-European supervisor for CRAs as envisaged by the Regulation. The Authority facilitated the EU registrations of CRAs that already had applied to NCAs in 2010 before ESMA existed⁶; it conducted its first on-site inspections in late 2011⁷, built a central rating repository and data analysing tool⁸ and began to take up its role as European standard setter in issuing first draft guidelines and technical standards on CRAs⁹.

The financial crisis highlighted the role CRAs play in supporting market integrity, which is why the European Parliament and Council on 23 April 2009 introduced an EU Regulation¹⁰ on CRAs (CRA Regulation) aimed at creating an EU-wide system for the registration and supervision of CRAs. The CRA Regulation was subsequently revised in December 2010 (CRA II), giving ESMA sole responsibility for the registration and supervision of CRAs in the EU, thereby ensuring better protection for investors by increasing market transparency and integrity in the field of credit ratings.

ESMA facilitates CRAs registration in the EU

With CRA II entering into force in July 2011, ESMA assumed responsibility for supervising CRAs registered in the EU. During the first half of the year, along with on-going policy work, ESMA finalised its internal organisational structure to carry out its supervisory tasks. As the number of registered CRAs gradually grew during 2011, the role of ESMA progressively moved from ensuring consistency across the assessment of the applications for registration being undertaken by national authorities to its current policy and supervisory role.

By 7 September 2010, 45 CRA legal entities had applied for EU registration and one for certification. These applications were sent to the national NCAs of the home Member States where they were based as required by the first CRA Regulation (CRA I), published in 2009. They were examined by the NCAs of the home Member States and the other members of the supervisory colleges in the course of 2011. Amongst the applicants there were three CRA groups, namely Fitch, Moody's and Standard & Poor's (S&P), composed of 16 legal entities based across the EU. All of these entities were registered by ESMA on 31 October 2011. By December 2011, 15 CRAs were registered and one, the Japan Rating Agency Ltd, was certified¹¹. In the course of 2011, two applications were refused and four withdrawn, including a group of CRAs with nine legal entities. The assessment of another three applications was still on-going at the end of 2011.

6. <http://esma.europa.eu/page/List-registered-and-certified-CRAs>

7. <http://esma.europa.eu/system/files/2012-220.pdf>

8. <http://cerep.esma.europa.eu/cerep-web/>

9. <http://esma.europa.eu/page/CRA-documents>

10. EU Regulation on Credit Rating Agencies 1060/2009/EC or: <http://eur-lex.europa.eu/JOHtml.do?uri=OJ:L:2009:302:SOM:EN:HTML>

11. The list of registered and certified CRAs is published on ESMA's webpage: <http://esma.europa.eu/page/List-registered-and-certified-CRAs>

During 2011, ESMA continued working to ensure a coherent application of the CRA Regulation¹² using the tools provided in it. In particular, ESMA provided advice on the completeness and compliance of the applications and participated as an observer in the supervisory colleges that were set up in order to facilitate the exercise of the NCAs assessment tasks. During 2011, ESMA provided one piece of advice on completeness for a CRA which subsequently withdrew its application. ESMA also provided compliance advice in cases of disagreement among the members of the college or where a member of the college requested advice. Additionally, ESMA took the initiative to provide advice when it considered it appropriate in order to promote convergence across NCAs' and colleges' decisions. ESMA provided a total of ten sets of advice: six to NCAs and four to supervisory colleges.

Furthermore, ESMA facilitated co-operation and co-ordination of NCAs, among college members and across applications. ESMA's CRA Technical Committee also acted as a forum where NCAs exchanged their views on the application of the Regulation.

ESMA gears up for ongoing CRAs supervision, first inspections in 2011

In March 2010 CESR, ESMA's predecessor, established a task force on the transition of CRA supervision to ESMA with the aim of finalising the organisational set-up within ESMA and of ensuring a smooth transition from the national to the EU level. After its establishment ESMA built on the task force's advice when structuring the CRA Unit's internal organisation, including the Units human resources from five to twelve staff during the year.

The supervision of CRAs is carried out according to an internal risk assessment by ESMA that is based on various information sources including: market intelligence gathered by the CRA Unit and other departments within ESMA; the central rating repository of ESMA (CEREP); the periodic data reported to ESMA by CRAs;¹³ the registration process; and the exchange of information and co-operation with NCAs or non-EU Authorities. ESMA's supervision consists of both on-site and desk-based investigations and inspections.

ESMA conducts first on-site inspections to assess CRAs' compliance

ESMA carried out its first on-site inspections and general investigations of CRAs during December 2011. The site inspections results, combined with the desk-based investigations, formed the basis of ESMA's report on its general findings on these inspections which was published at the end of March 2012.

12. Regulation (EC) No 1060/2009 of the European parliament and of the Council of 16 September 2009 on credit rating agencies as amended by the Regulation (EU) No 513/2011 of the European parliament and of the Council of 11 May 2011.

13. Available on the ESMA website at: http://www.esma.europa.eu/system/files/2011_464.pdf

NEXT STEPS

During 2012, ESMA will follow-up on the observations set out in its March 2012 report and will continue to carry out on-going supervisory tasks which include: monitoring of any material change to the initial conditions for their registration, handling of complaints and monitoring the periodic reports provided by each registered CRA. ESMA also intends to select one or more supervisory projects with a focus on certain cross-cutting risks within CRAs, identified according to ESMA's internal risk assessment. These will take the form of thematic reviews and will cover a selected number of CRAs over a limited period. It is envisaged that the CRA Unit will increase in terms of staff numbers to 20 by the end of 2012.

ESMA builds central rating repository and data analysing tool

In 2011, ESMA established a Central Rating Repository (CEREP) where all registered and certified CRAs make publically available information on the historical performance of their ratings. CEREP's purpose is to improve the transparency of credit ratings and to contribute to the protection of investors by providing consistent public information on the performance of ratings. ESMA also facilitated CRAs' submission of historical data (covering around ten years of their rating activity) during the year.

 [http:// cerep.esma.europa.eu](http://cerep.esma.europa.eu)

Finally, and to support an efficient, standardised and secure treatment of ratings data for supervisory purposes, ESMA started developing another IT tool for CRA supervision called SOCRAT. Once put in place, SOCRAT will facilitate ESMA's processing of ratings data in a standard and automatic manner and support ESMA in its supervisory activities.

ESMA issues guidelines, standards and policy advice on CRA Regulation

To support its CRA supervisory work, the Authority has been very active in policy development in the course of 2011, following mandates by the European Commission on issues relating to the amended CRA Regulation. In May 2011, ESMA published guidelines on the application of the endorsement regime¹⁴ and provided the Commission with its advice on technical aspects of the future Commission Regulation on fees for CRAs¹⁵. ESMA has also been given the responsibility for developing several RTS on the following topics, all of which were consulted on and finalised in 2011:

- a) information to be provided by CRAs for applications for registration and certification¹⁶;
- b) information provided by CRAs to CEREP¹⁷;
- c) the assessment of the compliance of the rating methodologies¹⁸; and
- d) the content and format of ratings data periodic reporting from CRAs¹⁹.

ESMA conducted public consultations and cost-benefit analysis on these draft RTS, including seeking the opinion of ESMA's Securities and Markets Stakeholder Group and the other ESAs. The final draft RTS were submitted before the end of 2011 for endorsement by the European Commission.

The Technical Committee on CRAs recently established within ESMA is mandated to provide advice to ESMA on policy decisions regarding CRAs. More specifically, this covers technical advice to the Commission, guidelines and recommendations concerning policy in the area of CRAs, technical standards, assessment of a non-EU country regime and the relevant co-operation agreements or any other policy issues on which advice is requested.

NEXT STEPS

According to Art. 13 of ESMA Regulation, after the adoption by the College of Commissioners, the European Parliament and the Council shall have up to one month (renewable once) to object. The RTS will then be published in the EU Official Journal.

14. Guidelines on endorsement and clarifies the use for regulatory purposes of credit ratings issued outside the European Union after 6 June 2011 [ESMA/2011/146]: http://esma.europa.eu/system/files/ESMA_2011_146.pdf

15. ESMA's Technical Advice to the Commission on Fees for CRAs [ESMA/2011/144]: http://esma.europa.eu/system/files/2011_144.pdf

16. Regulatory technical standards on the information for registration and certification of credit rating agencies [ESMA/2011/463]: http://esma.europa.eu/system/files/2011_463.pdf

17. Regulatory Technical Standards on the presentation of the information that credit rating agencies shall disclose in accordance with Article 11(2) and point 1 of Part II of Section E of Annex I to Regulation (EC) No 1060/2009 [ESMA/2011/461]: http://esma.europa.eu/system/files/2011_461.pdf

18. Draft RTS on the assessment of compliance of credit rating methodologies with CRA Regulation [ESMA/2011/462]: http://esma.europa.eu/system/files/2011_462.pdf

19. Draft RTS on the content and format of ratings data periodic reporting to be requested from credit ratings agencies for the purpose of on-going supervision by ESMA [ESMA/2011/464]: http://esma.europa.eu/system/files/2011_464.pdf

ESMA makes progress on endorsement and equivalence of third-country CRA regimes

Article 4(3) of the CRA Regulation provides that, in order for an EU-registered CRA to endorse a credit rating issued in a non-EU country, the regulatory framework of the non-EU country should set requirements 'as stringent as' those provided by Articles 6 to 12 of the CRA Regulation. Moreover, Article 4(3) also requires that there is an appropriate co-operation arrangement between ESMA and the relevant non-EU competent authority of the CRA.

In 2011, four registered CRAs applied to endorse credit ratings issued in non-EU countries. Therefore, ESMA undertook assessments of non-EU countries from which CRAs have indicated their intention to endorse credit ratings. This assessment worked accelerated following the entry into force of CRA II on 1 June 2011.

ESMA considered Japan and Australia as endorsable in 2011. ESMA will have endorsed Argentina, Canada, Hong Kong, Mexico, Brazil, Singapore and the United States of America (USA) in early 2012.

With the on-going recognition process of other non-EU countries, ESMA granted a transitional period of three months, until 31 January 2012. This transitional period allowed market participants to continue using the EU credit ratings issued in non-EU countries, while the convergence assessment with the CRA Regulation requirements continues.

NEXT STEPS

ESMA expects to feed the information it gathers in its supervisory and risk analysis activities into the development of supervisory guidance and comply with any potential mandates to draft RTSs under the upcoming amendments of the Regulation.

3.2 ESMA legislation and tasks

In its first year, ESMA had already made use of its toolbox by issuing a first ever pan-European investor warning on foreign exchange (forex), which was translated into the official EU languages and published Union-wide. A further boost to investor protection was given by establishing ESMA's financial innovation committee²⁰. In 2011, ESMA contributed actively to the ESRB and to joint ESA work²¹, supporting the financial stability agenda.

The financial and economic crisis created real and serious risks to the stability of the financial system and the functioning of European financial markets. The Regulation establishing ESMA published on 24 November 2010 boosted the co-ordination between regulators on a national and EU level both in terms of micro-prudential and macro-prudential supervision. In addition, ESMA was given a leading role in promoting transparency, simplicity and fairness in the market for retail consumer financial products or services across the EU, including the power to temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity or stability of the EU's financial markets.

ESMA issues first pan-EU investor warning

On 5 December 2011, ESMA made use of its investor protection powers for the first time by publishing its first investor warning in terms of Article 9(3) of the ESMA Regulation²², which gives ESMA the ability to issue warnings in the event that a financial activity poses a serious threat to its objectives. ESMA decided to warn European retail investors against dealing with unauthorised firms and individuals offering foreign exchange investments, and alerted retail investors across the Union to the main risks involved in forex trading.

Through its BoS members, ESMA had noted concerns about unauthorised entities offering forex trading and aggressive marketing campaigns by (mostly unauthorised) forex firms. Other emerging trends noted by some national regulators were:

- (i) an increasing number of offerings over internet platforms, in particular from unauthorised firms;
- (ii) a growing interest from firms to be authorised and to enter into forex business;
- (iii) an increase in marketing campaigns (some aggressive) that target a wide range of retail investors; and
- (iv) a tendency for firms to 'disappear' when approached by a national regulator seeking information about their activities.

Therefore, given the size of the forex market (the largest and most liquid financial market in the world with the average daily traded value of transactions of approximately \$4 trillion²³), and increasing retail investor participation in it (encouraged by the increasing use of electronic online trading platforms), ESMA sought to take pro-active action by warning retail investors about the risks of forex trading - as part of its 'enhancing investor protection' objective.

20. <http://esma.europa.eu/page/Financial-Innovation-Standing-Committee>

21. <http://esma.europa.eu/page/European-Supervisory-Framework>

22. Regulation establishing ESMA (2009/77/EC): http://esma.europa.eu/system/files/Reg_716_2010_ESMA.pdf
Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission decision 2009/77/EC.

23. April 2010, Bank for International Settlements (BIS); and BIS 'Triennial Central Bank Survey: Report on global foreign exchange market activity in 2010', Monetary and Economic Department, December 2010.

ESMA establishes financial innovation committee to boost investor protection

In September 2011, ESMA established its Financial Innovation Standing Committee (FISC) with the appointment of its first Chair, Anneli Tuominen, Director General of the Finnish FSA. FISC aims to assist ESMA in fulfilling its investor protection tasks and responsibilities by facilitating a co-ordinated approach to the regulatory and supervisory treatment of new or innovative financial activities. Its remit is to identify risks to investor protection and to financial stability, in the financial innovation area, and then to produce a risk mitigation strategy. This involves a large analysis role for FISC, and means that the scope of its work will be driven as issues arise or as risks are identified, through data analysis, in the area of financial innovation.

ESMA is also part of the Joint Committee of European Supervisory Authorities' work on financial activities, financial innovation and consumer/investor related issues (through the Joint Committee's Consumer Protection Sub-Committee).

FISC follows Task Force on ESMA's powers regarding investor protection

Prior to the establishment of FISC, the ESMA Article 9 Implementation Task Force was established in December 2010 to ensure that ESMA had in place the necessary internal committee and/or governance structure to consider and develop ESMA's approaches to its investor protection objective and roles as set out in Article 9 of the ESMA Regulation.

In the first quarter of 2011, the Task Force finalised work on its high-level survey of NCAs. This survey aimed at getting an overall view about their respective implementation approaches for investor/consumer protection responsibilities. While views on investor protection are not widely divergent across the EU, the responses demonstrated that there are large differences in both experience and knowledge between Member States/NCAs with regard to investor protection best practice, but also that there is a wealth of information and experience that ESMA can use at an EU level.

Task Force assesses ESMA powers regarding product intervention

From May 2011 up to the establishment of FISC in September 2011, the Task Force considered certain issues and priorities for further and future ESMA work, including:

- the issuing of warnings (or investor alerts) where a financial activity poses a serious threat to one or more of ESMA's objectives;
- developing an ESMA framework for the co-ordination, at ESMA level, of (the conditions of) supervisory product intervention at national level; and
- any operational role for ESMA in the process of temporarily banning the distribution of a specific product or the provision of an activity, when a NCA has not taken sufficient measures to address the threat. This is foreseen in the MiFID review proposals.

In this regard, the Task Force undertook a mapping exercise, in July and August 2011, of existing or envisaged national measures for banning products/activities (product intervention). The aim of the mapping exercise was to get a view as to what extent NCAs can, and do, intervene in any product design and approval process and to gather information on any factors or criteria that NCAs take into account when assessing whether to exercise any banning powers they may have. The exercise was also aimed at collecting information on any forthcoming national initiatives in this regard.

The exercise revealed an increasing recognition at national level about the possibility of widening the scope for investor protection by intervening in the product design and approval process (i.e. well before point-of-sale). Interventions by a NCA may occur at different stages of the life of a product: at the design level, or at point-of-sale. Some common trends were observed such as reliance on the application of the MiFID and/or the UCITS Directive requirements, often complemented by specific actions such as setting qualification requirements for salespeople. Supervisory led interventions include interventions at firm level where firms may have non-compliant product design or distribution practices. Some NCAs can also defer their approval of a given product until the firm or issuer has made

amendments so that the product is compliant with the regulation. Various other tools exist focusing on increasing transparency or disclosure. In practice, NCA interventions regarding products usually consist of a combination of several types of investor protection measures concerning different stages of the product's life.

Besides measures regarding product intervention, the exercise demonstrated that several NCAs are increasingly cognisant of banning powers as a tool for investor protection, anticipating, to some extent, that these powers were likely to form part of the Commission proposals as a result of its consultation on the MiFID review. The results demonstrated the need for ESMA to play an important role focusing on investor protection issues.

Need to collect data

In addition, the Task Force concluded that the broad types of data that are likely to be most useful to ESMA in fulfilling its investor protection responsibilities are complaints data, products sales data, and thematic supervisory review data. In Q3-Q4 2011, the Task Force developed and rolled out a more detailed survey of data held and collected by NCAs in order to establish more precisely what data is available to be collected by ESMA on a regular basis.

ESMA prepares contingency measures

In January 2011 ESMA published a report on the contingency measures in place for financial crises in the different EU Member States²⁴. The publication of the report followed a mapping exercise conducted by ESMA in line with its responsibilities in emergency situations under the ESMA Regulation, whose aim was to improve ESMA's, NCA's and the EU institutions ability to respond in emergency situations. The mapping aimed to provide an overview and understanding on the general availability of emergency powers and contingency measures at a national level and promote better co-ordination in future crisis events.²⁵

In the event of adverse systemic developments and, in case of emergency situations declared by the Council, ESMA has both the general role of facilitating and co-ordinating the actions to be undertaken at national level and the power to adopt individual decisions in certain conditions. During 2011 ESMA reviewed its emergency powers and procedures and also looked at specific scenarios to ensure that there was a good common understanding of what possible actions ESMA could take in such situations.

ESMA contributes to ESRB and joint ESA work

ESMA forms part of the European System of Financial Supervision, the ESFS, which consists of the ESRB and the three ESAs. The ESRB monitors and assesses potential threats to financial stability that arise from macro-economic developments and from developments within the financial system as a whole (macro-prudential supervision). ESMA contributes to the work of the ESRB, by providing data and undertaking risk analysis in close co-ordination with the fellow ESA's and the ESRB.

ESMA is also a voting member of the ESRB's General Board, along with the other ESAs, the European Commission, the President and Vice-President of the ECB, the Governors of the national central banks, the Chair and Vice-Chairs of the ESRB's Advisory Scientific Committee and the Chair of its Advisory Technical Committee. In 2011, ESMA provided its assessment of the trends, risks and vulnerabilities in financial markets to the ESRB and to other European Committees.

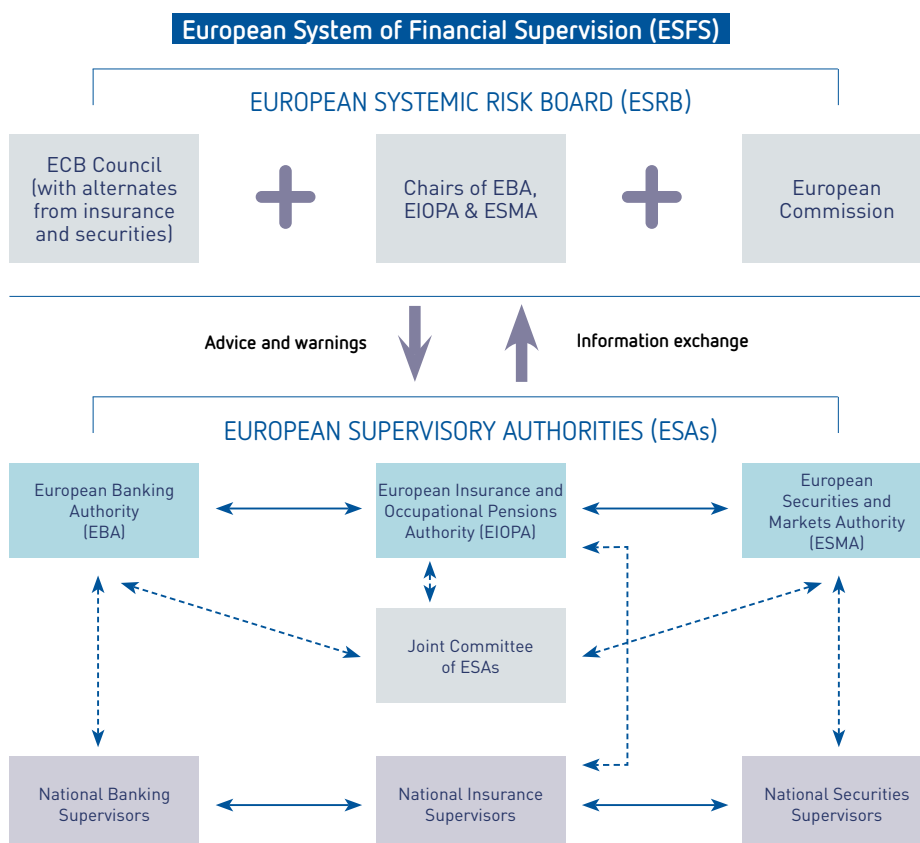
 <http://www.esrb.europa.eu/news/pr/2012/html/index.en.html>

24. *Summary Report on the mapping of contingency measures (ESMA/2011/26)*: http://esma.europa.eu/system/files/11_26.pdf

25. *According to Article 18(2), where the Council has adopted a decision on the existence of an emergency situation the Authority may adopt individual decisions requiring NCAs to take the necessary action in accordance with the legislation referred to in Article 1(2) to address any such developments by ensuring financial market participants and NCAs satisfy the requirements laid down in that legislation. According to Article 1 (2, 2a) ESMA Regulation, the Authority shall act within the scope of the EU *acquis communautaire* in the securities sector.*

ESAs establish joint committee for common cross-sector work

Along with EBA and EIOPA, ESMA forms part of the Joint Committee which works to ensure cross-sector consistency and joint positions in the area of supervision of financial conglomerates and on other cross-sector issues.



In January 2011, the three ESAs officially established the Joint Committee as required under their respective establishing Regulations. The Committee frequently exchanged information and discussed sector, cross-sector and joint risk assessments, and possible policy options in the light of market developments.

In 2011, the Joint Committee established the following four Sub-Committees:

- (i) Sub-Committee on Financial Conglomerates** - which assesses the scope of application, internal governance, and supervisory empowerment and sanctions issues contained in the Commission's Call for Advice issued in April 2011, as part of its fundamental review of the Financial Conglomerates Directive (FICOD). Furthermore, the Joint Committee published on their respective websites, the list of identified Financial Conglomerates, and their respective NCAs as required under the FICOD;
- (ii) Sub-Committee on Cross Sector Developments, Risks and Vulnerabilities** - which has produced cross-sector risk reports for the EFC-FST meetings in March and September;
- (iii) Sub-Committee on Anti Money Laundering** - which identified differences in Member States' practices in relation to the identification of the Ultimate Beneficial Owner (UBO) and the application of SDD measures under the 3rd Money Laundering Directive (MLD), which may create gaps in the EU's Anti-Money Laundering/Crime Fighting Team regime;
- (iv) Sub Committee on Consumer Protection and Financial Innovation** - which is in the process of being set up to work on some consumer protection issues at a cross sector level, for example financial literacy and education initiatives, in order to ensure cross sector consistency.

Finally, the forming of the Impact Assessment Network was initiated, which aims at assisting the ESAs' staff in its consideration and production of technical standards, guidelines and consultations.

ESAs foster common supervisory culture through cross-sector training

In 2011, the ESAs developed an updated manual on training, as required under the Commission's regime for ESAs, which has been submitted to the Joint Committee in November 2011. The objective of the manual is to ensure delivery of a successful European supervisory training programme for national supervisors and to provide practical guidance to the NCAs for the organisation and hosting of training events.

The changing regulatory environment and the delay in related legislation resulted in a number of challenges and modification in the training programme. The ESAs co-operated in the development of the common questionnaire aimed at assessing the demand for training needs in 2012 and to identify volunteers to host and organise seminars.

The cross-sector training programme for 2011 included the following seminars:

No.	Name of the seminar	Date & Location	Host	Number of participants
1	Reducing systemic risks in markets: a new parameter for overseers and supervisors	31 May-1 June, Frankfurt	BaFin-Deutsche Bundesbank	50
2	Supervisory Colleges: dealing with cross sector aspects in supervisory collèges	21-22 March	ISVAP, Italy	39
3	New European Regulatory and Supervisory Structure: functioning and impact on national supervisors	7-8 June	Frankfurt, EIOPA	40
4	Operational Risk Management	17 October	Frankfurt, EIOPA	27
5	IT assessment	3-5 October	Madrid	31
6	Risk assessment	19-21 October	Rome	57
IN TOTAL				244

The ESAs decided to provide financial support for participation in ESA training events to Authorities with financial constraints (partly due to the difficult economic situation of some Member States). This facility was used only by a few Member States.

The effort devoted to training staff of EU supervisory and regulatory authorities on a cross-sector basis during 2011 resulted in around 350 supervisors being trained, which means further strengthening our common supervisory culture.

3.3 European Financial Markets Legislation: MiFID, MAD and Short-Selling

In 2011, regarding MiFID: ESMA followed-up earlier work on micro-structural issues such as high-frequency-trading, where ESMA issued first guidelines²⁶, it assessed the compliance of new MiFID waivers to pre-trade transparency²⁷, looked into suspensions and removals from trading²⁸, consulted on aspects of the MiFID suitability requirements, investment advice and research²⁹ and intensively worked on improving the protection of investors. Regarding short-selling, ESMA co-ordinated the measures taken by NCAs regarding banning short-selling and started preparing for the standards ESMA will have to draft concerning the new Short-Selling Regulation³⁰. Regarding MAD, ESMA published its findings about Member States' actual use of sanctions and issued Q&As on inside information³¹.

The Markets in Financial Instruments (MiFID) and the Market Abuse Directive (MAD) provide the regulatory framework for fair and transparent trading in European financial instruments. Both texts can be seen as a cornerstone of EU's securities markets legislation with MiFID increasing market competition by opening up the field to trading venues other than exchanges, and MAD defining what is considered abusive behaviour. In 2010, the European Commission decided to overhaul the Directives' legal frameworks in order to adapt to changed market realities or, in the case of short-selling, decided to introduce a new regulation. As part of its role as the European markets regulator, ESMA is tasked to advise the Commission on these different pieces of legislation and foster regulatory convergence by preparing guidance and recommendations to both national regulators and firms.

ESMA updates MiFID database of shares admitted to trading

The operation of the MiFID market transparency regime requires that certain information regarding shares admitted to trading on EU regulated markets is made available to market participants. According to the MiFID Implementing Regulation, NCAs have to make certain calculations regarding shares admitted to trading on a regulated market, as they are relevant for MiFID pre- and post-trade transparency requirements. The information is aimed at market participants who need the information for the purpose of identifying liquid shares, which trigger the obligations for systematic internalisers according to Article 27 of MiFID. The information is also needed to determine the block sizes for waivers from pre-trade transparency requirements and for delayed post-trade publication.

26. *Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities* [ESMA/2011/456]: http://esma.europa.eu/system/files/2011-456_0.pdf

27. *Waivers from Pre-trade Transparency: CESR positions and ESMA opinions - updated April 2012* [ESMA/2011/241]: <http://esma.europa.eu/system/files/2011-241.pdf>

28. <http://esma.europa.eu/page/Secondary-Markets-documents>

29. <http://esma.europa.eu/page/IPISC-documents>

30. <http://esma.europa.eu/page/Short-selling>

31. <http://esma.europa.eu/page/Review-Panel-Documents>

Under ESMA's protocol for the operation of the MiFID database³² the NCAs collect and calculate the data while ESMA makes the data publicly available through the MiFID database which is available here:

 <http://mifiddatabase.esma.europa.eu>.

The database is updated annually with the new calculations published by ESMA at the beginning of March each year.

ESMA assesses compliance of MiFID pre-trade transparency waivers

In January 2011, ESMA published a revised version of its waiver document that summarises its positions on proposed waivers from pre-trade transparency obligations under MiFID³³. This includes assessments of proposals for pre-trade transparency waivers for trading systems and order types that are intended to be used by regulated markets and MTFs under MiFID. The MiFID compliance of these functionalities was assessed at ESMA level on the basis of the joint process that CESR launched in February 2009.

Although the legal responsibility for granting the waivers lies with NCAs, it has been agreed that when an operator of a regulated market or an MTF seeks to rely on a MiFID pre-trade transparency waiver, the arrangements will be considered at ESMA level at the initiative of the relevant NCA. Providing these opinions is part of ESMA's role in building a common supervisory culture and consistent supervisory practices across Europe. ESMA updated its waiver document³⁴ twice in July 2011 and once in December 2011, providing its position on whether certain waivers were considered MiFID-compliant or not.

NEXT STEPS

ESMA will continue to assess new pre-trade transparency waivers and update the information available in the waiver document as soon as these cases are agreed by the ESMA Board of Supervisors.

32. Protocol on the Operation of CESR MiFID Database (CESR/2009/172d): http://esma.europa.eu/system/files/09_172d.pdf

33. Waivers from Pre-trade Transparency Obligations under the Markets in Financial Instruments Directive (MiFID) (CESR/2009/324): http://esma.europa.eu/system/files/09_324_Update_22102010.pdf

34. Waivers from Pre-trade Transparency: CESR positions and ESMA opinions - updated April 2012 (ESMA/2011/241): <http://esma.europa.eu/system/files/2011-241.pdf>

ESMA follows-up on market micro-structural issues, guidelines issued

On 19 July ESMA published a consultation paper on guidelines on systems and controls in a highly automated environment for trading platforms, investment firms and NCAs³⁵, seeking stakeholder's views on proposed rules for issues such as High Frequency Trading (HFT). A dialogue with market participants was held at a public hearing on 27 September in support of the consultation process.

On 22 December, having taken into account the consultation feedback, ESMA published its final report³⁶ containing guidelines that have the two-fold aim of increasing the robustness of markets by maintaining their orderly-functioning and ensuring common, uniform and consistent application of MiFID and MA across the EU. ESMA expects all relevant NCAs and financial market participants to comply with these guidelines.

Guidelines cover most market participants involved in automated trading

The activities most directly affected by the guidelines are:

- the operation of an electronic trading system by a regulated market or MTF;
- the use of an electronic trading system, including a trading algorithm, by an investment firm for dealing on own account or for the execution of orders on behalf of clients; and
- the provision of direct market access or sponsored access by an investment firm as part of the service of the execution of orders on behalf of clients.

The guidelines will also have implications for firms not authorised as market operators or investment firms under MiFID. These include firms who sell electronic trading systems to market operators or investment firms, or act as the outsourced providers of such systems, or provide connectivity services to investment firms when accessing trading platforms. Such firms will be affected by trading platforms' and investment firms' obligations in relation to their electronic trading systems.

Firms exempted from MiFID who trade on their own account and access trading platforms directly as members, participants or users, or through direct market access or sponsored access are also covered by these rules. They will be affected by the guidelines on fair and orderly trading for trading platforms in relation to the requirements for members, participants and users who are not authorised, and the guidelines for trading platforms and investment firms relating to direct market access and sponsored access.

Guidelines clarify obligations of market participants

The guidelines set standards for systems and controls for trading venues, investment firms and NCAs to follow in relation to electronic trading systems (including trading algorithms), fair and orderly trading, market abuse and direct market access/sponsored access. Key points from the standards in the guidelines include:

- **Regulated Markets and MTFs** must have arrangements to maintain orderly markets including:
 - adequate pre-trade controls, such as the possibility to limit the number of orders which each member/participant or user can send to the trading platform;
 - conformance tests to ensure that the IT systems of members/participants or users are compatible with the trading platforms' electronic trading systems;

35. Consultation paper - Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities (ESMA/2011/224): http://esma.europa.eu/system/files/2011_224.pdf

36. Final report on guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and NCAs (ESMA/2011/456): http://esma.europa.eu/system/files/2011-456_0.pdf

- automatic and discretionary mechanisms to constrain trading or to halt trading in a specific financial instrument or more widely in response to significant variations in price to prevent trading becoming disorderly;
 - undertaking adequate due diligence of the member/participant or user before accepting their market access and the ability to check their respective controls and arrangements afterwards;
 - clear organisational requirements for members who are not regulated entities; and
 - rules and procedures designed to prevent, identify and report instances of possible market abuse and market manipulation that are proportionate to the nature, size and scale of the business done through the trading platform.
- **Investment firms** using algorithms must have organisational arrangements to maintain fair and orderly trading including:
 - an appropriate governance process for developing or buying algorithms, rolling out the live use of the algorithm in a cautious fashion and staff with necessary up-to-date skills and expertise to run and monitor the behaviour of their live algorithms;
 - pre-trade controls which address erroneous order entry and maintain pre-set risk management thresholds, including thresholds on maximum exposure to individual clients; and
 - are responsible for all order flow to venues from clients using direct market access or sponsored access, conduct adequate due diligence on clients using direct market access and sponsored access services and can immediately halt trading by these clients.

Accordingly, investment firms, regulated markets and MTFs must keep adequate records of their systems and controls to enable NCAs to assess their compliance with MiFID and other relevant regulatory obligations. These guidelines will become effective one month after publication by NCAs on their official websites in their national language. According to this schedule and unless otherwise informed, market participants should be able to comply with the guidelines by 1 May 2012.

Suspensions and removals from trading: ESMA revises its internal communications processes

In 2011, ESMA reviewed its Protocol on the operation of notifications of Article 41 of MiFID. That article sets out the obligations of NCAs in relation to the other NCAs in two cases:

- a) Following a decision by the operator of a regulated market to suspend or remove a financial instrument from trading, the national competent authority has to inform the NCAs of the other Member States.
- b) Following a decision by a national competent authority to suspend or remove a financial instrument from trading, it shall immediately make public its decision and inform the NCAs of the other Member States. The NCAs of the other Member States shall demand the suspension or removal of that financial instrument from trading on the regulated markets and MTFs that operate under their authority, except where it could cause significant damage to the investors' interests or the orderly functioning of the market.

ESMA's Protocol on the operation of notifications of suspensions and removals from trading³⁷ was created to help ensure effective co-ordination and communication between NCAs with respect to their obligations under Article 41 of MiFID.

However, after several years of experience some limitations were evident in the Protocol that needed to be addressed. In that context, ESMA revised the whole system in 2011 and decided to undertake two successive steps. The first stage would involve some minor amendments to the current system, while as a second stage, ESMA would develop a new internal communication system based on the information available on its existing Reference Data System. This new system would enable more effective monitoring of the notifications made under Article 41 and safer private communications between NCAs.

37. Protocol on the operation of notifications of MiFID Article 41 suspensions and removals of financial instruments from trading [CESR/2008/363]: <http://esma.europa.eu/system/files/08-363.pdf>

NEXT STEPS

In 2012, ESMA will continue the revision of its protocol on the operation of notifications of MiFID Article 41 and will develop and implement a sound internal communication system.

ESMA launches a task force focused on commodities derivatives

In 2011, ESMA followed-up work that had already been started by its predecessor CESR together with the European Regulators Group for Electricity and Gas (EREG) which was replaced in 2011 by the Agency for the Co-operation of Energy Regulators (ACER).

ESMA considers it important to centralise commodities expertise, so that it can contribute effectively to upcoming EU legislation, the international regulatory debate and any other related initiatives. Therefore, ESMA established a specific task force which will cover the interaction of commodity markets with financial markets, provide assistance to the relevant Standing Committees on the commodity aspects of upcoming regulatory proposals under EMIR, MiFID and MAD and conduct analysis of regulatory initiatives outside the EEA and a follow-up to the IOSCO proposals.

The Task Force is expected to conduct fact-finding exercises and economic and market analyses in order to support the future policy work in the field of commodity derivatives trading, as well as analysis of the European Commission's proposals put forward in relation to commodity markets. It shall take into account developments in other jurisdictions (mainly the US) and in international fora (e.g. IOSCO). The second main responsibility of the Task Force is to participate in, or provide support to, the European legislative process in the commodity derivatives field by drafting technical advice for the Commission and technical standards, and preparing additional input to the Commission where necessary.

ESMA consults on aspects of the MiFID suitability requirements

In December 2011, ESMA published a consultation paper on draft guidelines on certain aspects of the MiFID suitability requirements³⁸.

The purpose of the guidelines is to enhance clarity and foster convergence in the implementation of certain aspects of the MiFID suitability requirements, which is an important MiFID investor protection requirement. MiFID's suitability rules are intended to ensure that firms obtain the necessary information about the client's circumstances, and use that in making recommendations or taking investment decisions that are suitable for their clients.

Recent evidence³⁹ and supervisory experience indicates that full and effective compliance with the MiFID suitability requirements is not as consistent or as wide-spread across EEA Member States as it could or should be.

38. *Consultation paper on guidelines on certain aspects of the MiFID suitability requirements (ESMA/2011/445):* http://esma.europa.eu/system/files/2011_445.pdf

39. See for example: *European Commission, Consumer Market Study on Advice within the Area of Retail Investment Services - Final Report, 2011*; *AMF, Evaluation des questionnaires MIF en France, February 2011*; *UK-FSA, Assessing suitability, March 2011*.

Generally, the main issues observed regarding compliance with the MiFID suitability requirements include:

- failure to ask clients the right questions;
- failure to collect the necessary and relevant information;
- failure to interpret correctly the information provided by the client; and
- even where the right information is collected, failure to recommend a suitable investment, or enter into in the course of providing a portfolio management service.

The aspects of the MiFID suitability requirements that the guidelines cover are:

- Information to clients about the suitability assessment;
- Arrangements necessary to understand clients and investments;
- Qualifications of investment firm staff;
- Extent of information to be collected from clients (proportionality);
- Reliability of client information;
- Updating client information;
- Client information for legal entities or groups;
- Arrangements necessary to ensure the suitability of an investment; and
- Record-keeping.

With these guidelines, ESMA is focusing on proper implementation and supervision under MiFID. The guidelines focus mainly on the need for firms to have in place appropriate policies and procedures in order to know their clients, and products, when recommending suitable investment choices. The intention is to help investment firms improve their implementation of the MiFID requirements and to strengthen investor protection.

NEXT STEPS

Stakeholders will have until February 2012 to respond to the consultation paper. ESMA will consider the responses it will have received and expects to publish a final report, and final guidelines, in Q2 2012.

ESMA consults on aspects of MiFID requirements for the compliance function

In December 2011, ESMA published its consultation paper on draft guidelines on certain aspects of the MiFID compliance function requirements⁴⁰. The MiFID requirements seek to ensure that firms have in place effective compliance arrangements so that any risk of failure by firms to comply with their MiFID obligations (including MiFID's provisions to ensure investor protection) can be detected and minimised.

The financial crisis has highlighted the need for better and tighter monitoring and managing of risk (including reputational risk) by investment firms, and for a more comprehensive and pro-active compliance strategy, especially in view of the range of evolving legislation and increasing levels of scrutiny from both regulators and investors.

Supervisory experience has also indicated that compliance risk often takes second place to other areas of risk within a firm, and this can lead to the deficient implementation of appropriate compliance processes. There is room for improving the prominence, effectiveness and importance of the role of the compliance function within investment firms.

⁴⁰ Consultation paper on guidelines on certain aspects of the MiFID compliance function requirements [ESMA/2011/446]: http://esma.europa.eu/system/files/2011_446.pdf

The purpose of ESMA's guidelines is to clarify the role of compliance, and the compliance function, in order to enhance clarity and foster convergence in the implementation of the MiFID organisational requirements relating to certain aspects of the compliance function. The guidelines are also aimed at reinforcing the importance of the compliance function.

The guidelines are targeted at:

- the responsibilities of the compliance function for monitoring, reporting and advising;
- the organisational requirements of the compliance function for the standards of effectiveness, permanence and independence;
- arrangements an investment firm should apply for:
 - the application of the exception set out in Article 6(3)(2) of the MiFID Implementing Directive;
 - and the extent of interaction of the compliance function with other functions, and
 - outsourcing compliance function tasks;
- NCAs by proposing approaches for reviewing the requirements of the compliance function.

NEXT STEPS

Stakeholders will have until February 2012 to respond to the consultation paper. ESMA will consider the responses it will have received and expects to publish a final report, and final guidelines, in Q2 2012.

ESMA starts work on draft remuneration guidelines

On 23 November 2010 CESR provided feedback to CEBS, the EBA's predecessor, on its guidelines on remuneration policies and practices. CESR noted that these guidelines focused mainly on the prudential supervisory framework, and that it would be useful for ESMA to develop a complementary set of guidelines focused on remuneration policies from an investor protection point of view.

Following confirmation from the European Commission that there is scope for ESMA to clarify these rules based on MiFID in order to foster the consistent application of existing MiFID rules on conflicts of interest and conduct of business in the area of remuneration practices, ESMA's Investor Protection and Intermediaries Standing Committee (IPISC) set about establishing the framework for this work.

IPISC developed a questionnaire aimed at:

- (i) gathering information from different Member States on remuneration practices of investment firms in relation to conduct of business risks and conflicts of interest rules, when providing investment services; and
- (ii) collecting information about the way supervisors in different Member States assess and challenge those remuneration practices.

This was also aimed at enabling ESMA to gain a better understanding of the nature and severity of the issues caused by remuneration structures.

The questionnaire focused on the risks that remuneration and other incentives could create to influence front-line staff resulting in poor outcomes for investors/consumers – i.e. situations where remuneration may encourage staff to act contrary to the best interest of the client.

The conclusions drawn fall into three main categories:

- (i) Understanding the relevant MiFID organisational and conduct of business requirements for firms when setting and operating remuneration structures. Responses indicated that the absence of specific requirements has led to firms having discretion in determining how to address the risks arising from their remuneration structure and other incentives influencing front line staff;

- (ii) Identifying practices that may be difficult to manage, responses highlighted several high-risk reward/incentive policies; and
- (iii) Corporate governance expectations when designing reward structures (responses indicated that some firms fall short when it comes to the governance of their reward schemes – failing to recognise their responsibilities to consider, for example, whether targets and incentives create particular risks that need to be managed).

NEXT STEPS

As a result of the analysis and conclusions drawn from the questionnaire exercise, ESMA will develop in early 2012 for consultation draft Article 16 guidelines on remuneration to promote the convergent application of the MiFID conflicts of interest principles and the conduct of business rules across Member States. ESMA is aiming to publish its consultation paper on these draft guidelines in Q2 2012.

ESMA publishes MiFID Q&A on investment advice and investment research

In April 2011, ESMA published an updated version of its MiFID Questions & Answers⁴¹. The MiFID Q&A mechanism sets out common positions agreed by NCAs, and is intended to provide market participants with responses in a quick and efficient manner to everyday questions that are commonly posed to NCAs or the public generally in relation to MiFID investor protection and intermediaries issues. While the answers provided do not constitute standards, guidelines or recommendations, they are provided in an effort to ensure a higher degree of harmonised implementation between NCAs.

ESMA establishes working group to promote common practices in investor protection

In April 2011, ESMA established under its IPISC a permanent Operational Working Group (OWG) as a forum for supervisors to share views and discuss practical supervisory issues that may emerge from the practical and operational implementation of MiFID. Its main aim is to promote common supervisory approaches and practices across Member States by enhancing mutual understanding, thereby improving convergence across Europe. The main areas of focus are issues related to the provision of investment services and activities by investment firms and credit institutions under MiFID and its implementing measures.

The group met in June and in October 2011 to discuss supervisory topics such as cross-border supervisory issues in relation to confirming 'fitness and propriety', and agents of investment service providers; introducing brokers (where, non-EU brokers use European firms as an introducing broker to access the EU market, but the EU firm's role is limited and the client is directly connected to the non-EU broker); suitability/appropriateness when promoting investment services; reporting requirements to supervise compliance with conduct of business rules; interpretation of certain aspects of Article 27 of the MiFID Implementing Directive; conduct of business rules for platforms giving access to complex products; and reporting requirements for conduct of business supervision.

⁴¹ MiFID Q&A in the area of investor protection and intermediaries (ESMA/2011/119): http://esma.europa.eu/system/files/2011_119.pdf

MiFID: ESMA works on improving transaction reporting

Taking into account the ongoing review of MiFID, ESMA considered whether its guidelines on harmonised reporting should be pursued in the short term or whether it would be more appropriate to await the finalisation of the relevant legislative framework.

The Commission proposal for MiFID II foresees technical standards being developed by ESMA on transaction reporting. Therefore, whilst acknowledging the legislative initiatives on MiFID and the Markets in Financial Instruments Regulation (MiFIR), both to be negotiated in the Parliament and Council during 2012, ESMA decided to carry out work on guidelines on harmonised transaction reporting taking into account the progress of the political negotiations.

NEXT STEPS

Should there be a significant difference in the content of guidelines under preparation and the final content of MiFID/MiFIR or too short of a time period before the expected publication of the guidelines and development of implementing measures or technical standards under MiFID/MiFIR, the work on the guidelines will be moved into future work on those implementing measures or technical standards.

ESMA co-ordinates short-selling measures and prepares for regulation

On 11 August 2011, under the co-ordination of ESMA, Belgium, France, Italy and Spain simultaneously introduced bans on short-selling, acquiring or extending net short positions. These restrictions were initially introduced for a period of 15 days, with the exception of Belgium, where the prohibition was to remain in force until further notice. On 8 August, Greece had already introduced a ban on short-selling due to exceptional conditions in its local market. The developments raised concerns for securities markets regulators across the European Union, including ESMA, which had increased its market monitoring and exchange of information with NCAs on the functioning of the markets and its market infrastructure.

In announcing the ban⁴², ESMA emphasised the requirements in MAD referring to the prohibition of the dissemination of information which gives, or is likely to give, false or misleading signals as to financial instruments, including the dissemination of rumours and false or misleading news. These actions were taken by the NCAs in the light of exceptional market conditions at the beginning of August and based on their respective powers.

On 25 August, the relevant NCAs announced the extension of the temporary measures and committed themselves to conducting an assessment of the bans before the end of September. This assessment was to be organised and co-ordinated by ESMA. Eventually, the authorities decided to renew or maintain their bans, while continuing to monitor closely market developments. On 11 November, a further extension was announced by the French and Italian regulators while the other authorities maintained their temporary measures until further notice.

Throughout the process, ESMA played an active co-ordination role in:

- the adoption of the emergency measures and their extension;
- aligning the interpretation and implementation of the measures; and
- helping to assess the situation to decide whether to lift or maintain/renew the temporary measures;

42. Public statement - harmonised regulatory action on short-selling in the EU (ESMA/2011/266): http://esma.europa.eu/system/files/ESMA_2011_266___Public_statement_on_short_selling.pdf

ESMA also tried to foster convergence in terms of implementation and interpretation of the bans. All NCAs concerned published Q&As to provide more details on how to implement and interpret the bans. Throughout the process, these authorities remained in constant contact with each other and ESMA in order to ensure further co-ordination towards a convergent implementation of the ban (e.g. the treatment of rolling over of positions on expiring derivatives, treatment of convertible bonds). This co-ordination resulted in several updates of the Q&As.

Decisions taken nationally in absence of EU regulation

In the absence of a European short-selling regulation the taking of such emergency measures remained a matter of national competence. This will remain unchanged until the new regulation on short-selling and certain aspects relating to credit default swaps is adopted.

While providing NCAs with the power to take temporary measures in exceptional circumstances, that regulation will strengthen the facilitation and co-ordination role of ESMA in the process, in particular when adverse events or developments that threaten financial stability or market confidence extend beyond one Member State or have cross-border implications. It will also provide ESMA with the power to adopt directly temporary measures in exceptional situations.

ESMA prepares for new regulation on short-selling and certain aspects of credit default swaps

In the aftermath of the 2008 emergency measures by a significant number of NCAs to restrict short-selling due to turbulent market conditions in the autumn of 2008, CESR considered it appropriate to launch a policy review on EU/EEA standards for short-selling.

In March 2010 CESR recommended to the European institutions to introduce a pan-European short-selling disclosure regime⁴³. These recommendations were supplemented by a report on technical details of the Pan-European Short-Selling Disclosure Regime in May 2010⁴⁴ and a contribution to the Commission in relation to a possible disclosure regime for sovereign bonds and relevant derivatives.

In September 2010, the Commission adopted a proposal for a regulation on short-selling and certain aspects of credit default swaps. This generally followed the CESR recommendations for a short-selling disclosure regime and also contained a number of significant additional provisions.

On 19 October 2011, the trilogue agreement by EU Council and Parliament on new rules for short-selling and CDS was announced. According to this agreement, the final text of the regulation is expected to be published in early 2012, ESMA must prepare a number of draft regulatory and implementing standards.

ESMA starts drafting short-selling standards

The Short-Selling Regulation requires ESMA to develop draft regulatory technical standards on the details of information on net short positions to be notified to NCAs and disclosed to the public, and draft implementing technical standards on the means by which information may be disclosed to the public. In these draft regulatory technical standards, ESMA will specify details of the information to be provided to by NCAs on a quarterly basis on net short positions in shares and sovereign debt, and any additional information which ESMA may request at any time from NCAs.

ESMA should also develop draft implementing technical standards to determine the types of agreements, arrangements and measures that adequately ensure that the shares will be available for settlement and the types of agreements or arrangements that

43. (CESR/2010/008)

44. Report - Technical details of the pan-European short selling disclosure regime (CESR/2010/453): http://esma.europa.eu/system/files/10_453.pdf

adequately ensure that the sovereign debt will be available for settlement.

In addition, ESMA is required to develop draft regulatory technical standards specifying the method for calculation of turnover to determine the principal venue for the trading of a share and draft implementing technical standards to determine:

- (i) the date on which and period in respect of which any calculations determining the principal trading venue for a share is to be made;
- (ii) the date by which the relevant competent authority shall notify ESMA of those shares for which the principal trading venue is outside the Union; and
- (iii) the date from which the list is to be effective following publication by ESMA.

Finally, ESMA also needs to develop draft regulatory technical standards to specify the method of calculation of a fall in value for various financial instruments that, if significant, may result in the regulator of that trading venue where the financial instrument concerned is traded deciding whether to take action.

ESMA prepares advice to Commission on delegated acts

The Commission requested ESMA to provide technical advice on the definitions contained in the regulation and in particular the definition of when a natural or legal person is considered to own a financial instrument for the purposes of the definition of a short sale.

In relation to the net position in shares or sovereign debt, ESMA is expected to specify the concept of holding a position, the concept of a net short position, advise on the method of calculation of such a position including when different entities in a group have long or short positions or for fund management activities related to separate funds.

The advice will include specifications by ESMA of the cases in which a CDS transaction is considered to be hedging against a default risk or the risk of a decline of the value of the sovereign debt and the method of calculation of an uncovered position in a CDS.

ESMA was also asked to define the initial and incremental levels of the notification thresholds to apply for the reporting of net short positions in sovereign debt, and, to specify the parameters and methods for calculating the threshold of liquidity on sovereign debt for suspending restrictions on short sales of sovereign debt.

ESMA's advice was also sought on what constitutes a significant fall in value for financial instruments other than liquid shares taking into account the specificities of each class of financial instrument and the differences of volatility. Such falls of value of a financial instrument on a trading venue may allow the competent authority for that trading venue to prohibit or restrict short-selling of the financial instrument on that venue or otherwise to limit transactions on that trading venue in order to prevent a disorderly decline in its price.

Finally, ESMA is to provide technical advice on criteria and factors to be taken into account by NCAs and ESMA in determining when adverse events or developments arise. In such exceptional situations, NCAs or ESMA can use the emergency powers granted by the regulation.

NEXT STEPS

In order for the Commission to adopt the delegated acts and the implementing and regulatory technical standards proposed by ESMA by 1 November 2012, the date by when the Regulation shall apply, ESMA will have to meet very strict deadlines. To meet the delivery deadline of 31 March 2012, the timetable for preparing technical standards and developing the advice on all delegated acts, as well as the related public consultation, will need to be significantly compressed compared to normal ESMA practice.

Market Abuse Directive: ESMA reviews Member States' actual use of sanctions

ESMA's Review Panel, in 2010 began looking into the actual use by NCAs of sanctions concerning the two main offences of insider dealing and market manipulation defined by the Market Abuse Directive (MAD). The aim of this mapping exercise was to identify areas for further harmonisation in the implementation of EU markets regulation.

In cases where the powers are not completely in the hands of the NCAs, the relationship between the NCAs and Judicial Authorities (Courts and Public Prosecutors) was taken into account as well.⁴⁵ ESMA collected data from the authorities for all sanctions (administrative or criminal) taken during the three years covered by the mandate (2008 – 2010). The information received primarily covered data on insider trading and market abuse cases.

Special attention was paid to the work previously done on this issue by the Commission and within ESMA, including by the Review Panel.

As a result of ESMA's work in this area, on 23 February 2011, it provided an official response⁴⁶ to the Commission's Communication on 'reinforcing sanctioning regimes in the financial services sectors'⁴⁷ which proposed to overhaul the EU regime dealing with market abuse by i) introducing a regulation on insider dealing and market manipulation (market abuse)⁴⁸; and ii) introducing a directive on criminal sanctions for insider dealing and market manipulation.⁴⁹

NEXT STEPS

ESMA is due to publish the MAD sanctions report in early 2012.

ESMA issues Q&A on common operation of MAD: disclosure of inside information related to dividend policy

In 2011, ESMA prepared a Q&A with respect to the disclosure of inside information on dividend policy by issuers of shares which are used as the underlying of listed derivative contracts. ESMA reminded issuers that they should consider any relevant information related to dividend payments and policies as inside information, should this information be likely to have a significant effect on the price of either the issuer's shares or related derivatives or both. ESMA stated that the disclosure of this type of information should be done promptly, even when the proposals for any change on dividend policy, including dates and nature of the dividend, are still subject to further consideration or approval by the general shareholders meeting.

ESMA published this Q&A in order to provide market participants with its view on the correct application of the relevant section of MAD and to promote harmonisation in both detection and prevention of market abuse.

45. The Review Panel will not collect information directly from judicial authorities. Information will be collected through the RP members.

46. [ESMA/2011/64]

47. Reinforcing sanctioning regimes in the financial services sector COM(2010) 716 final: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0716:FIN:EN:PDF>

48. REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on insider dealing and market manipulation (market abuse) COM (2011) 651: http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2011_651_en.pdf

49. Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on criminal [COM (2011) 654]: http://ec.europa.eu/internal_market/securities/docs/abuse/COM_2011_654_en.pdf

3.4 European Investment Fund Legislation: UCITS and AIFMD

In 2011, ESMA detailed future rules for alternative investment fund managers⁵⁰ and put in place transitional arrangements for firms due to the late transposition of the UCITS IV Directive⁵¹. The Authority also contributed to the clarification of the categorisation of European money market⁵² funds and possible future rules for UCITS exchange-traded funds and structured UCITS⁵³. Regarding some types of structured UCITS, ESMA also put out guidelines on risk measurement and calculation of global exposure⁵⁴.

Both the UCITS and AIFM Directive aim at providing a comprehensive framework for the operation of firms engaging in collective investment management, including UCITS (Undertakings for Collective Investments in Transferable Securities), hedge or other types of alternative funds. They also provide for a framework in which non-EU based funds can operate on European markets. This aims at providing a level-playing-field to all funds and management companies active in the EU and in doing so ensuring the same level of investor protection exists across the Union. ESMA serves as standard setter, last year issuing advice, guidelines and recommendations in order to facilitate a uniform application of existing EU legislation in the field of collective investment schemes.

ESMA details future rules for alternative investment fund managers

In April 2009, the Commission adopted a proposal for a Directive on Alternative Investment Fund Managers (AIFMD) aimed at creating a comprehensive and effective regulatory and supervisory framework for alternative investment fund managers (AIFMs) at European level.

Following political agreement on the legislative text CESR received a provisional request from the Commission for technical advice on Level 2 measures concerning the future Directive. The request was provisional as at that time the AIFMD was still awaiting its final adoption. The final Directive⁵⁵ was published on 1 July 2011.

50. Final report - ESMA's technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (ESMA/2011/379): http://esma.europa.eu/system/files/2011_379.pdf

51. Practical arrangements for the late transposition of the UCITS IV Directive (ESMA/2011/342): http://esma.europa.eu/system/files/2011_342.pdf

52. Questions and Answers - A Common Definition of European Money Market Funds (ESMA/2011/273): http://esma.europa.eu/system/files/ESMA_273.pdf

53. Discussion paper - ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS (ESMA/2011/220): http://esma.europa.eu/system/files/2011_220.pdf

54. Final report - Guidelines to competent authorities and UCITS management companies on risk measurement and the calculation of global exposure for certain types of structured UCITS (ESMA/2011/112): http://esma.europa.eu/system/files/2011_112.pdf

55. Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010: <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0001:0073:EN:PDF>

Due to the significant number of implementing measures foreseen by the Directive, the provisional request was divided into four parts:

- Part I covers general provisions, authorisation and operating conditions;
- Part II relates to implementing measures regarding the depositary;
- Part III covers transparency requirements and leverage; and
- Part IV concerns implementing measures on supervision.

ESMA consulted on its draft advice in two stages. The first stage was the publication of a consultation paper in July covering Parts I to III of the Commission's request⁵⁶, followed by a second consultation paper in August that addressed Part IV of the request⁵⁷. ESMA received 104 and 49 responses to the two CPs respectively. There was a contribution from the Securities and Markets Stakeholder Group. Open hearings were also held on each of the two consultations which were attended by a broad range of external stakeholders. The final advice was submitted to the Commission on 16 November.

Improvements to investor protection and financial stability

The rules developed by ESMA will establish a comprehensive framework for alternative investment funds, their managers and depositaries. They are also designed to help achieve the AIFMD's objective of increased transparency and tackling systemic risk, ultimately contributing to sounder protection of investors. ESMA's advice covers four broad areas:

1. General provisions for managers, authorisation and operating conditions

The first part of the advice clarifies the operation of the thresholds that determine whether a manager is subject to the Directive. ESMA proposes to require AIFMs to have additional own funds and/or professional indemnity insurance to cover risks arising from professional negligence. Many of the rules in this section, such as on conflicts of interest, record keeping and organisational requirements are based on the equivalent provisions of the MiFID and UCITS frameworks.

2. Governance of AIFs' depositaries

This part of the advice sets out the framework governing depositaries of AIFs. Key issues include the criteria for assessing whether the prudential regulation and supervision applicable to a depositary established in a third country has the same effect as the provisions of the AIFMD. ESMA identified a number of criteria for this purpose, such as the independence of the relevant authority, the requirements on eligibility of entities wishing to act as depositary and the existence of sanctions in the case of breaches.

Another crucial point is the liability of depositaries, the first element of which relates to the circumstances in which a financial instrument held in custody should be considered as lost. This assessment is crucial in determining whether a depositary must subsequently return an asset. ESMA's advice proposes three conditions, at least one of which would have to be fulfilled in order for an asset to be considered lost. These are that a stated right of ownership of the AIF is to be unfounded because it either ceases to exist or never existed; the AIF has been permanently deprived of its right of ownership over the financial instruments; or the AIF is permanently unable to directly or indirectly dispose of the financial instruments. Another important concept which ESMA's advice aims to clarify relates to which events would constitute external events beyond the reasonable control of the depositary. Finally, the advice clarifies the objective reasons that would allow a depositary to contractually discharge its liability.

56. Consultation paper - ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive (ESMA/2011/209): http://esma.europa.eu/system/files/2011_209.pdf

57. Consultation paper - ESMA's draft technical advice to the European Commission on possible implementing measures of the Alternative Investment Fund Managers Directive in relation to supervision and third countries (ESMA/2011/270): http://esma.europa.eu/system/files/2011_270.pdf

3. Transparency requirements and leverage

One of the key objectives of the AIFMD is to help prevent the build-up of systemic risk. To help achieve this aim, ESMA's advice clarifies the definition of leverage, how it should be calculated and in what circumstances a competent authority should be able to impose limits on the leverage a particular AIFM may employ. ESMA considers it appropriate to prescribe two different calculation methodologies for the leverage (commitment and gross methods) as well as a further option (the advanced method) that can be used by managers on request and subject to certain criteria. The AIFMD also aims to increase transparency of AIFs and their managers. In this context, ESMA's advice specifies the form and content of information to be reported to NCAs and investors, as well as of the information to be included in the annual report.

4. Third-countries

With a view to ensuring the smooth functioning of the new requirements with respect to third-countries, the AIFMD puts in place an extensive framework regarding supervisory co-operation and exchange of information. ESMA's advice envisages that the arrangements between EU and non-EU authorities should take the form of written agreements allowing for exchange of information for both supervisory and enforcement purposes.

NEXT STEPS

The Commission will prepare the required implementing measures in the first half of 2012 taking into account ESMA's advice. The Commission aims to adopt the measures by July 2012 i.e. one year ahead of the transposition deadline of the AIFMD. In parallel with the development of the implementing measures, ESMA will take forward a number of AIFMD work streams including the regulatory technical standards under Article 4(4) of the Directive, as well as ESMA guidelines on remuneration and the advanced method for calculation of leverage. ESMA plans to publish consultation documents on these work streams by Q2 2012.

ESMA issues guidelines on risk measurement and calculation of global exposure for certain types of structured UCITS

On 14 April 2011, ESMA published its final report on Guidelines on Risk Measurement and the Calculation of Global Exposure for certain type of structured UCITS⁵⁸. The guidelines supplement those guidelines published by ESMA in 2010 on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS⁵⁹.

Structured UCITS offer investors a predefined payoff depending on different scenarios based on the value of the underlying assets. The purpose of the guidelines is to allow, for certain types of structured UCITS, an optional regime for the calculation of the global exposure. The specific approach adopted by ESMA consists of the calculation, for each scenario to which investors can be exposed at any one time, of the global exposure using the commitment approach. Under this approach, each scenario must comply at all times with the 100% global exposure limit.

58. *Guidelines on Risk Measurement and the Calculation of Global Exposure for certain type of structured UCITS* [ESMA/2011/112]: http://esma.europa.eu/system/files/2011_112.pdf

59. *Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS* [ESMA/10-788]: http://esma.europa.eu/system/files/10_788.pdf

ESMA considers that the scope of this alternative approach must be clearly defined. Therefore, a list of all the criteria with which structured UCITS should comply in order to be able to benefit from this specific approach is set out in the guidelines. These include that the investor only be exposed to one payoff profile at any time during the life of the UCITS, the UCITS has a maturity not exceeding nine years and that the UCITS does not accept new subscriptions from the public after the initial marketing period.

ESMA puts in place transitional arrangements for the late transposition of the UCITS IV Directive

The deadline for the transposition of the UCITS IV Directive was 1 July 2011. However, most Member States appeared unable to fully transpose the Directive and its implementing measures by that date. This could have led to complications for both NCAs and market participants, particularly with respect to the cross-border mechanisms envisaged by the Directive.

Therefore ESMA decided to address the situation at an operational level in order to minimise, as far as possible, the impact on industry and investors caused by the lack of transposition. ESMA set out practical arrangements in an Opinion published in October⁶⁰.

The opinion published by ESMA sets out the different issues that may arise from the late transposition of the Directive and, where possible, identifies practical solutions. The issues identified concern the cross-border mechanisms that have been changed or introduced by the Directive, namely the marketing and management company passports, cross-border fund mergers and master-feeder structures.

ESMA publishes Q&A on its definition of European money market funds

On 25 August 2011, ESMA published a Q&A on ESMA's guidelines on a Common Definition of European Money Market Funds⁶¹. The purpose of this Q&A is to promote common supervisory approaches and practices in the application of the guidelines developed by ESMA by providing responses to questions posed by NCAs and the general public. The document aims to assist NCAs in ensuring that in their supervisory activities converge along the lines of the responses adopted by ESMA. The answers also help management companies by providing clarity on the content of ESMA's guidelines.

Areas covered by the Q&A include ESMA's expectations regarding a management company's internal ratings process, the treatment of non-rated instruments and the calculation of both the weighted average life and weighted average maturity of the fund.

ESMA seeks views on future rules for UCITS exchange-traded funds and structured UCITS

Following a review of the current regulatory regime applicable to UCITS Exchange-Traded Funds (ETFs) and structured UCITS, ESMA considered that the existing requirements were not sufficient to take account of the specific features and risks associated with these types of fund. ESMA began working on guidelines applicable to UCITS ETFs and structured UCITS, as well as examining possible measures to mitigate the risk that particularly complex products are made available to retail investors. To achieve this goal, ESMA published a discussion paper on 21 July 2011 setting out proposed policy options on guidelines for UCITS ETFs and structured UCITS⁶², in the following areas:

60. *Opinion - Practical arrangements for the late transposition of the UCITS IV Directive (ESMA/2011/342)*: http://esma.europa.eu/system/files/2011_342.pdf

61. *Questions and Answers - A Common Definition of European Money Market Funds (ESMA/2011/273)*: http://esma.europa.eu/system/files/2011_273.pdf

62. *Discussion paper - ESMA's policy orientations on guidelines for UCITS Exchange-Traded Funds and Structured UCITS (ESMA/2011/220)*: http://esma.europa.eu/system/files/2011_220.pdf

- **UCITS ETFs should carry an identifier** in their name and in their fund rules, prospectus and marketing material, which identifies them as an exchange-traded fund;
- **Index-tracking features need to be described** - the prospectus of index-tracking ETFs should contain a clear and comprehensive description of the index to be tracked and the mechanism used to gain exposure to the index;
- **More disclosure for synthetic ETFs** - the information provided to investors in the prospectus of synthetic ETFs should at least include information on the underlying of the investment portfolio or index, the type of collateral which may be received from the counterparty and the risk of counterparty default and the effect on investors' returns;
- **Rules for securities lending activities and collateral** - for securities lending activities, collateral received should comply with the criteria for OTC transactions set out in ESMA's Guidelines on Risk Measurement and Calculation of Global Exposure and Counterparty Risk for UCITS⁶³. Investors should be informed about the policy in relation to collateral e.g. permitted types of collateral and the level of collateral required by the UCITS);
- **Disclosure of main risks of actively-managed ETFs** - investors should be clearly informed of the fact that the fund is actively managed. There should also be disclosure of the main sources of risk arising from the investment strategy;
- **Disclosure of the leverage policy when used by ETFs** (The prospectus of leveraged ETFs should disclose the leverage policy and the risks associated with it, as well as a description of how the daily calculation of leverage impacts on investors' returns over the medium to long term);
- **Secondary market investors** (possibility to require UCITS ETFs to give all investors, including those who acquire units on the secondary market, the right to redeem their units directly from the UCITS); and
- **Structured UCITS** guidelines should be developed with regard to total return swaps and strategy indices.

ESMA received 65 responses to the discussion paper by the deadline of 22 September 2011.

NEXT STEPS

ESMA will take into account all the responses received and will be finalising the guidelines in the second quarter of 2012.

63. *Guidelines - Risk Measurement and the Calculation of Global Exposure and Counterparty Risk for UCITS (ESMA/10-788)*: http://esma.europa.eu/system/files/10_788.pdf

3.5 European Market Infrastructure Regulation (EMIR)

In 2011, ESMA started preparing the technical standards it is supposed to issue regarding the upcoming EMIR Regulation⁶⁴. This included preparatory work for the new responsibilities ESMA is supposed to receive in setting standards, participating in the supervision of CCPs but also for its role in supervising trade repositories. In addition, ESMA continued its work on Target 2 Securities⁶⁵ and also provided input in the Commission work on the CSD Regulation⁶⁶.

The financial crisis laid bare shortcomings in the field of securities clearing and OTC derivatives trading, identifying a need for central counterparty clearing (CCP) and a stronger role for trade repositories (TRs), due to the risks OTC derivatives might inherit with regards to financial stability and integrity. The Commission therefore started putting together a tailored European regulation that will cover these three areas: OTC derivatives, CCPs and TRs. The so-called EMIR text aims at contributing to financial stability by bringing clearing obligations to products where no such requirements exist and by strengthening the oversight of CCPs and TRs. ESMA will be given a key role as European standard setter in the definition of what kind of derivatives should be centrally cleared, on the supervision of TRs, and in participating in the NCAs' supervision of CCPs.

ESMA starts preparing technical standards for EMIR

At the end of 2011, the EU Regulation on OTC Derivatives, Central Counterparties (CCPs) and Trade Repositories (EMIR) was still awaiting its final adoption. However, while awaiting the finalisation of the Regulation, ESMA had already conducted intensive preliminary work on the draft technical standards it has to develop. In particular, ESMA set up three dedicated task forces under its Post-Trading Standing Committee (PTSC) to develop the relevant draft technical standards for EMIR:

1. OTC Derivatives Task Force;
2. CCP Requirements Task Force; and
3. Trade Repositories Task Force.

Depending on the level of development of the different parts of EMIR, the task forces have started outlining the content of the different technical standards, i.e. the draft legal provisions that ESMA will need to submit to the Commission following EMIR's adoption. The task forces conducted:

- i) a survey on CCPs;
- ii) worked on a request for input to the ESMA Post-Trading Consultative Working Group;
- iii) the consultation of the relevant authorities on their needs concerning data maintained by trade repositories and met existing trade repositories to ensure clear understanding on their current services; and
- iv) the preparation of a draft discussion paper.

64. Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on OTC derivatives, central counterparties and trade repositories (COM(2010) 484 final): <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0484:FIN:EN:PDF>

65. See page 63 of report.

66. http://ec.europa.eu/internal_market/consultations/docs/2011/csd/consultation_csd_en.pdf

Joint work with ESCB, EU and national supervisory authorities

There are joint Task Forces in place which are comprised of representatives of the other two ESAs and members of the European System of Central Banks (ESCB). Their aim is to develop technical standards including in the task force on CCP requirements. As the ESAs must develop the joint standard on risk mitigation techniques for non-centrally cleared transactions, EBA and EIOPA staff are following the work of the ESMA OTC derivatives task force while ESMA staff participate in the work of the relevant EBA drafting team.

Public consultations to start in early 2012

In the absence of a stable version of the primary legislation (EMIR), ESMA could not publicly consult on any aspect of the forthcoming draft technical standards in 2011. However, ESMA has issued a discussion paper for public consultation in early 2012, as soon as the text of EMIR had been agreed.

In letters sent to the European Parliament, Council and Commission, ESMA raised the importance of having sufficient time to develop high quality and sound draft technical standards, of which an essential component will be proper consultation of the relevant stakeholders. ESMA recommended that the deadline for the delivery of technical standards and guidelines should be postponed, and differentiated between provisions that are necessary to comply with the G20 commitment on OTC derivatives and those that are not.

ESMA's preparatory work in 2011, looked at the following areas for which ESMA will develop technical standards in 2012, once the final EMIR text is adopted:

Standards on central clearing obligation for OTC derivatives

ESMA is required to draft technical standards on assessing which OTC derivatives should be subject to central clearing. These would include the criteria to be used for the assessment of the eligibility of the OTC derivative contracts subject to this clearing obligation, the procedure for the notifications of the class of derivatives from the NCAs to ESMA in a so-called bottom-up approach and the timeframe for application of the clearing obligation. ESMA will also need to develop draft technical standards setting out the details to be included in its public register.

Standards on exemption from the clearing obligation

ESMA also needs to develop draft technical standards related to aspects of the exemptions from the clearing obligation. These concern the intra-group exemption, the setting of the clearing threshold below which non-financials would not be subject to the clearing obligation, the regular review of this clearing threshold, and determination of non-financials' OTC derivative activity directly related to commercial activity or treasury financing activity for which the clearing obligation does not apply.

Risk mitigation techniques in case of non-CCP clearing of OTC derivatives

ESMA conducted preliminary work on developing draft technical standards specifying risk mitigation techniques to apply when the OTC derivative contracts would not be cleared by a CCP. These standards would specify the maximum time lag for confirmation, market conditions preventing marking-to-market or criteria for using marking-to-model, reconciliation, dispute resolution and the level of collateral and capital.

ESMA needs to draft ten standards on central counterparties

According to the draft EMIR proposal, ESMA would have to develop the following technical standards:

1. Organisational requirements

These draft technical standards need to specify organisational requirements that market participants will have to follow. This will include issues such as:

- a) governance arrangements;
- b) compliance policy and procedures;
- c) information technology systems;
- d) reporting lines;
- e) remuneration policy;
- f) disclosure of rules and governance arrangements; and
- g) audits.

2. Record keeping - these will indicate the details of the records that a CCP should maintain in order to meet the EMIR requirements.

3. Business continuity - technical standards indicating the minimum content of the business continuity policy and disaster recovery plan and the requirements a CCP should specify.

4. Margins - these will define:

- a) the appropriate percentage above the minimum 99 per cent confidence interval that margins are required to cover for the different financial instruments;
- b) the liquidation period; and
- c) the look-back period, i.e. the period over which the appropriate percentage should be covered, which is necessary to properly calibrate the model.

5. Default fund - these will specify the framework for the definition of the extreme but plausible conditions a default fund should withstand.

6. Liquidity risk controls - these will specify the framework for managing liquidity risk. EMIR requires CCPS to have sound liquidity risk controls in place in order to maintain at all times sufficient liquidity.

7. Default waterfall - to specify the appropriate level of own funds that CCPs should dedicate to be used in a default situation before the resources of the non-defaulting clearing members can be mutualised, i.e. so called 'skin in the game'.

8. Collateral requirements - these RTS will define the type of collateral that can be considered highly liquid. ESMA is also required to define the conditions under which commercial bank guarantees may be accepted as collateral.

9. Investment policy - these RTS on investment policy need to define highly liquid financial instruments with minimal market and credit risk.

10. Review of models, stress testing and back testing - these RTS need to specify:

- a) the types of tests to be undertaken for different classes of financial instruments and portfolios;
- b) the involvement of clearing members or other parties in the tests;
- c) the frequency of tests;
- d) the time horizons of tests; and
- e) the key information a CCP shall publicly disclose on its risk management model and assumptions adopted to perform its stress tests.

Standards on reports to trade repositories, their authorisation and access to data

ESMA is required to draft RTS indicating details and type of reports to Trade Repositories (TR) for different classes of derivatives. These should include at least data on counterparties; beneficiary; main characteristics of the contract, including at least type, underlying, maturity and notional. ESMA must also draft an Implementing Technical Standard (ITS) on the format and frequency of reports for the different classes of derivatives.

ESMA is required to draft RTS on the details to be included in the application for registration to ESMA and on the format of the application for registration to ESMA. It must also draft technical standards on the information elements (and frequency) to be provided to the public and certain authorities listed under the same article, including ESMA, supervisors of counterparties, and supervisors of CCPs, relevant ESCB Members and ACER.

NEXT STEPS

At the time this report is published, ESMA will have issued a consultation paper, including the legal text, an explanation of such text and the cost-benefit analysis. This consultation paper is expected to be issued in the summer of 2012, having in mind the deadline for ESMA to submit the technical standards for Commission endorsement.

ESMA prepares for its direct responsibilities under EMIR

The 2011 Work Programme included the preparatory work for ESMA's direct powers under EMIR where it was assumed it would receive direct responsibilities. ESMA started preparing in 2011 for the following expected direct responsibilities:

ESMA's role in determining the clearing obligation for OTC derivatives

In order to determine the classes of derivatives that will be subject to the clearing obligation, EMIR provides for a bottom-up and a top-down approach.

Bottom-up approach

In the bottom-up approach, the national competent authority notifies ESMA when it authorises a CCP to clear a class of OTC derivatives. ESMA shall then assess the information received and gathered, consult and prepare draft technical standards setting out the clearing obligations and its framework.

Top-down approach

In the top-down approach, ESMA, on its own initiative and in consultation with the ESRB, identifies the classes of derivatives which should be subject to the clearing obligation but where no CCP is authorised to clear them.

Generally, ESMA would need to set up and maintain a public register where classes of derivatives subject to the clearing obligation would be identified with related information such as effective date, authorised CCPs, and other information.

ESMA's role in the supervisory colleges for CCPs

ESMA's exact role within the college of NCAs to be formed to supervise CCPs and in their authorisation was still subject to negotiation at the end of 2011. However, what it is expected is that, at a minimum, ESMA will participate in all colleges for CCPs with a general co-ordination function.

ESMA recognition of third-country CCPs

Third-country trade repositories will be able to provide services to entities established in the European Union only if recognised by ESMA. ESMA is therefore expected to:

1. verify that the CCP is subject to an equivalent regime and co-operate with the Commission for the adoption of an equivalence decision;
2. establish the relevant co-operation arrangements with the third country NCAs;
3. consult the relevant authorities within the Union;
4. assess the application of the third country CCP; and
5. take a decision on the recognition.

Registration and supervision of trade repositories

According to the EMIR draft, ESMA will be responsible for receiving and assessing the applications for the registration of trade repositories in the EU, and applications for recognition of third-country trade repositories. It is also expected to supervise EU TRs and enter into co-operation arrangements with third-country NCAs for the monitoring of the activities of recognised TRs, and in particular for ensuring access to data for the relevant EU authorities. To support this ESMA launched internal working groups to assess IT, staff and internal procedure needs, assuming these duties will take effect from 2013.

On the authorisation procedure, ESMA will continue its efforts to:

1. implement the standards on registration e.g. creating a registration form or platform for registration;
2. ensure staffing resources to receive, assess and take a decision on the registration;
3. process any notifications by authorised TRs on material changes to the conditions for registration; and
4. assess all the conditions for the recognition of third-country trade repositories, which will comprise:
 - a) **Equivalence** - the European Commission adopts implementing acts on the equivalence of a third country TR's legal and supervisory arrangements so that the TRs in such jurisdiction comply with rules equivalent to EMIR;
 - b) **International agreement** between the Union and the third-country on mutual access to and exchange of third country TR-held information;
 - c) **Co-operation arrangement** between ESMA and the third-country competent authority for supervisory co-ordination of the relevant third country trade repository; and
 - d) **Recognition** - ESMA receives applications for recognition from the relevant third country TRs and takes a decision.

Direct reporting to ESMA

Transactions that cannot be recorded by authorised trade repositories may have to be reported directly to ESMA.

NEXT STEPS

In 2012, ESMA will start recruiting the relevant staff in preparation for these new responsibilities. It will also start developing the relevant IT tools and procedures necessary to manage the processes described above.

Target 2 Securities and securities regulators

2011 was a cornerstone for the Target-2-Securities (T2S) project which aims at establishing a single platform for securities settlement in Europe. Indeed, the framework agreement prepared by the ECB and negotiated with the central securities depositories (CSDs) was approved by the ECB Governing Council.

ESMA has actively participated in the development of the T2S project, ensuring co-ordination with the NCAs, conducting analysis, and providing comments and detailed feedback on the Framework Agreement drafts to the Eurosystem. This input was conducted in two different streams set out below:

ESMA performs joint pre-assessment of T2S against the ESCB-CESR

Recommendations

ESMA considered it important to contribute to the development of the T2S project by communicating at an early stage its views on the impact of T2S on the current supervision and regulation of CSDs, settlement and best ways forward in a multilateral clearing environment. ESMA conducted a pre-assessment of T2S against the ESCB-CESR Recommendations on Securities Settlement Systems⁶⁷, published in 2009. The conclusions of the joint pre-assessment were communicated to the T2S Programme Board in August. When the development phase is finished and T2S services are launched, an assessment of the impact of T2S against the relevant provisions at that date will be necessary.

ESMA reviews T2S Framework Agreement

In 2011, ESMA in co-operation with the ECB (T2S Programme Board), worked on the scope of the preparation of the T2S Framework Agreement and co-ordinated the preliminary supervisory review of drafts of the Agreement with the NCAs for the CSDs outsourcing to T2S. ESMA also conducted analysis of drafts of the T2S Framework Agreement in order to provide preliminary supervisory comments to the ECB before completion of the T2S Framework Agreement.

⁶⁷. CESR-ESCB recommendations for securities settlement systems and recommendations for central counterparties in the European Union, published in 2009 (CESR/09-446).

ESMA inputs to Commission work on CSD Regulation

In 2011, ESMA continued to follow the Commission working group on the future legislation on central securities depositories (CSDs) and settlement, providing its input to the process, in line with its previous advice provided in 2010. ESMA provided its contribution to the Commission, including a specific contribution on settlement discipline.

The main lines of the advice were:

- i) the need to specify the rationale and implications on the stability of settlement systems if an exemption to government debt management offices was granted;
- ii) fine-tuning of the definitions of settlement function and suggestion to leave the definition of a securities settlement system as under the Settlement Finality Directive (SFD);
- iii) support for the introduction of a grandfathering clause, provided that a clear deadline for authorisation under the new regime is included;
- iv) support for the alignment to ESCB-ESMA Recommendation 14 on access and interoperability, according to which refusal to grant access should only be based on risk grounds;
- v) suggestion to analyse and introduce possible harmonisation of certain aspects of company law for the effective removal of barrier 9 on the free location of issuance;
- vi) suggestions on several definitions of risk types, such as settlement risk vs. liquidity risk; delays; pre-settlement risk; custody risk; systemic risk;
- vii) recommendation that the new legislation should mandate the offering of a securities lending service, either centrally or bilaterally;
- viii) support for harmonisation of settlement cycles, although not limiting the provision to CSDs which are not always setting the cycles;
- ix) the need to effectively harmonise the moment of entry of transfer orders and the moment of irrevocability of transfer orders, in particular in view of the potential impact that this might have on T2S.

NEXT STEPS

The publication of the formal proposal of legislation on CSDs and settlement in 2012 will be a key step in post-trading harmonisation and the completion of the European internal market. ESMA stands ready to draft technical standards in order to complement certain aspects of the proposed legislation to enable harmonisation and co-ordination of settlement and its infrastructures in the EU in tandem with operational harmonisation of settlement.

ESMA advances mapping system for settlement discipline and fails

Post-trading infrastructures have been largely stable during the volatile market conditions from 2007 to the present. Following the work started in 2009 by ESMA, the Authority progressed in creating a mapping system for settlement fails in the EU, for the benefit of regulators and in the context of ESMA's role on financial stability and systemic risk monitoring and mitigation.

During 2011, ESMA focused on the possible impact of the market turmoil on settlement discipline, notably a potential increase in settlement fails (non-delivery of securities at settlement date) due to high volumes, price volatility and liquidity strain. ESMA collected and monitored relevant data from national authorities and settlement systems (see below). Through this exercise, ESMA identified divergent national regimes, notably differences on basic terms such as definition of a settlement fail. These divergences do not enable true data comparability and it is therefore challenging to produce sound analytical evidence on the number of fails and their causes.

ESMA proposes improvements on settlement discipline to Commission

ESMA proposed to the Commission to address, in the context of the legislation on CSDs and settlement, the key issue of settlement discipline and fully supported the need for harmonisation in this regard, particularly in clarifying the reasons, apart from short-selling, that may exist for fails, such as operational failures, including human error.

An advice was sent to the Commission early in 2011, complemented with a follow-up advice in the second semester ahead of the Commission's publication of the formal legislative proposal. The advice covered:

- i) the definition of settlement fail;
- ii) the scope;
- iii) ex-ante measures, such as pre-matching, early matching or early settlement, splitting a failed settlement instruction in two instructions, re-instructing and promoting Straight Through Processing (STP);
- iv) ex-post measures such as introduction of penalties, buy-in and cash compensation procedures; and
- v) monitoring through a harmonised reporting mechanism.

ESMA also suggested that some measures could be complemented by technical standards, particularly in order to ensure proper enforcement and consistency at the European level, with supplementary benefits for settlement efficiency.

ESMA launches pan-EU monitoring of settlement fails

In support of maintaining market confidence ESMA has considered the need to have pan-EU details on settlement fails. This need did not result from any particular concern over increased fail levels but rather from the aim to help establish a pan-EU monitoring scheme. ESMA has already started preliminary work in harmonising the existing procedures in measuring settlement fails. It is currently monitoring settlement fails and designing the relevant decision-making process to take action, when needed.

Settlement fails are considered to be the failure of a counterparty of a financial transaction to deliver the financial instruments or to ensure the availability of cash to enable receipt of the financial instruments on the contractual settlement date, also possibly affecting third parties.

Although ESMA concluded from the preliminary data that there is no current EU-wide peak or trend in settlement fails that may require regulatory action, there is a need to monitor fails to assist in preventing a major market disruption. In extreme cases, peaks or certain trends in fails in a number of jurisdictions and affecting certain financial institutions could have a domino-effect. In such cases the possible resulting widespread failures could increase systemic risk. That would likely be the case particularly where the institutions being affected are themselves of a systemic nature. Settlement fails are therefore being monitored at the national and the pan-European level as they serve as early warning of potential difficulties. The monitoring system is however being tested and is still very preliminary due to the current disparities among EU markets and local rules.

ESMA co-ordinates with regulators outside the EU on post-trade topics

ESMA maintains an intensive dialogue with third-country authorities responsible for regulating derivatives markets and post-trading market infrastructures. In 2011 ESMA had on-going dialogue with the U.S. Securities Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission (CFTC) on the rules implementing the Dodd-Frank Act and their possible effects for European market participants and market infrastructures, as well as the possible effects of EMIR and relevant technical standards on US entities. The dialogue, conducted together with the Commission, focused mainly on:

- i) registration in the US of Swap Dealers and Major Swap Participants;
- ii) registration and recognition of third country CCPs; and
- iii) registration and recognition of third-country trade repositories and access to data by relevant authorities.

Similar issues related to the cross-border effects of the implementation of derivatives reforms in different jurisdictions were also discussed bilaterally with other authorities from non-EU countries. These were the main focus of a meeting of leaders and senior representatives of the authorities responsible for the regulation of the OTC derivatives markets in Canada, the European Union, Hong Kong, Japan, Singapore and the United States on 9 December at ESMA.

ESMA also actively contributed to the work of the following international fora which are ensuring international consistency across regulatory standards related to derivatives markets and post-trading market infrastructures. The standards of these fora will be taken into account in the drafting of technical standards under EMIR:

- CPSS-IOSCO Steering Group for the definition of Principles for Financial Market Infrastructures;
- CPSS-IOSCO Task Force for the definition of OTC derivatives data reporting and aggregation requirements;
- IOSCO Task Force on OTC Derivatives (report on mandatory clearing);
- OTC Derivatives Regulators Forum; and
- The Financial Stability Board (for the establishment and use of a global LEI and its compatibility with the regulatory requirements for trade repositories and other transaction reporting mechanisms.)

ESMA also participated in the regulatory initiatives aiming at the creation of a global Legal Entity Identifier (LEI).

3.6 Promoting consistent application of International Financial Reporting Standards

In 2011, ESMA contributed to the development of International Financial Reporting Standards by working with the relevant standard setters such as the IASB or IFRS IC⁶⁸. The Authority issued an opinion on the correct treatment of Greek debt⁶⁹, and generally on financial reporting in times of crisis; it facilitated co-operation of IFRS enforcement authorities in the EU and advanced its assessment of the equivalence of third-countries' accounting standards⁷⁰.

International reporting standards are important as they provide investors with a clear and transparent view of the financial situation of a company. Financial reporting standards lay out the common rules on how companies have to report on their performance. Having comparable and enforced rules is key for providing transparency and protection to investors. ESMA's role is to input to the developments of the standards as the European markets regulator, comprising a network of national enforcers of financial information.

Financial reporting in times of crisis

The financial crisis has had a major impact on the financial position and performance of publicly traded companies, particularly those in the financial sector. As a result of sovereign debt developments and the increased market interest in this area, ESMA focused its attention on the impact of those developments on the accounting practices of listed companies in Europe, and financial institutions in particular, with respect to their exposures to sovereign debt.

On 28 July 2011, ESMA issued a statement⁷¹ stressing the need for enhanced transparency and the importance of applying the relevant International Financial Reporting Standards (IFRS). ESMA also encouraged issuers to provide information on their exposures to sovereign debt on a country-by-country basis in their financial statements. Following that, ESMA conducted, together with NCAs, a pan-EU fact-finding exercise on the accounting treatment of Greek sovereign debt in the half-year financial statements based on a sample of more than 50 financial institutions listed on EU regulated markets. This exercise revealed some diverging practices across banks and countries.

68. ESMA comment letters are available here: <http://esma.europa.eu/page/Comment-letters>

69. Public statement on sovereign debt in IFRS financial statements (ESMA/2011/397): http://esma.europa.eu/system/files/2011_397.pdf

70. <http://esma.europa.eu/page/Corporate-reporting-policy>

71. Public statement - ESMA Statement on disclosures related to sovereign debt to be included in IFRS financial statements (ESMA/2011/226): http://esma.europa.eu/system/files/2011_226.pdf

In order to promote consistent application in the year-end IFRS financial statements, ESMA published a second statement⁷² in November 2012 containing two sections:

- one section discusses accounting issues related to sovereign debt in IFRS annual financial statements ending 31 December 2011 and highlights elements that should be considered by issuers and their auditors in relation to exposure to sovereign debt when preparing their financial statements for the upcoming year-end; and
- the second section is an ESMA Opinion on Accounting for Exposure to Greek Sovereign Debt – Considerations with respect to IFRS Interim Financial Statements for Accounting Periods ended on 30 June 2011. The opinion provides a summary of the outcome of the fact-finding exercise performed by ESMA together with elements that should have been considered by issuers and their auditors as part of the IFRS interim financial statements for periods ended 30 June 2011.

NEXT STEPS

ESMA will publish in 2012 a review of the accounting practices with respect to exposure to sovereign debt in the 2011 year-end IFRS financial statements.

ESMA facilitates co-operation on IFRS enforcement

The European Enforcers' Co-ordination Session (EECS) is a forum organised by ESMA in which all EU national enforcers of financial information meet to exchange views and discuss experiences of IFRS enforcement. A key function of EECS lies in analysing and discussing decisions taken by independent EU national enforcers in respect of financial statements published by issuers with securities traded on a regulated market and who prepare their financial statements in accordance with IFRS. The objective of these meetings is to share and compare practical experience in the fields of accounting and enforcement in order to achieve harmonisation and co-ordination of future decisions. Another objective is to identify issues which are not covered by financial reporting standards or which may be open to conflicting interpretations for referral to standard-setting or interpretative bodies such as IASB and IFRS IC.

Sovereign debt exposure in focus

A total of eight regular meetings were organised in 2011 and two specific meetings took place with IFRS Interpretation Committee members. A particular focus was on reviewing and analysing the accounting practices of exposure to sovereign debt in the IFRS interim financial statements, based on which preparatory work for year-end accounts review was performed.

In 2011, ESMA published an activity report on the IFRS enforcement activities in the EU⁷³. The document provides an overview of the monitoring and enforcement structures as well as processes and level of co-ordination of such activities as a consequence of the crisis. It also reports on the main areas of focus, either because of their significance when reporting during the economic crisis or because of the complexity of the transactions.

72. Public statement on sovereign debt in IFRS financial statements (ESMA/2011/397): http://esma.europa.eu/system/files/2011_397.pdf

73. Press release - European enforcers see good level of IFRS application in 2010 (ESMA/2011/354): http://esma.europa.eu/system/files/2011_354.pdf

ESMA regularly publishes extracts from its database of enforcement cases. Publication of enforcement decisions aims to inform market participants about which accounting treatments EU national enforcers may consider as complying with IFRS, e.g. whether the treatments are considered as being within the accepted range of those permitted by the standards or interpretations. In publishing these decisions ESMA contributes to a consistent application of IFRS in the European Union. Two case extracts were published in 2011.

ESMA undertakes revision of enforcement standards

In 2004 CESR, published two standards on the enforcement of financial information. After six years of experience with enforcement of IFRS, ESMA decided to review the enforcement standards in 2010. A preparatory fact-finding exercise was organised to better understand European enforcement, the outcome, together with identified possible improvements to the enforcement of IFRS in Europe, will form the basis for ESMA's continuing work on the revision of the guidance on European enforcement.

Enforcers review application of IFRS 8 – operating segments

In 2011, based on the experience gained through the EECS, ESMA decided to include as one of its working priorities a post-implementation review of the application of IFRS. This initiative covered issues that were identified in 2010 regarding the application of IFRS 8 – Operating Segments, and which were submitted in a formal letter to the IASB.

In November 2011, ESMA published the 'Enforcers' Review of the Application of IFRS 8 – Operating Segments'⁷⁴, which provided an overview on the application of IFRS 8 requirements by European issuers and indicated those areas which pose significant challenges either to preparers, investors and/or enforcers. One of the areas mentioned in the report regarding aggregation of operating segments was considered by the IASB as a matter to be included in the 2012 annual amendments to IFRS.

In addition, the report aims to provide the European Commission with some of the information requested by the European Parliament with regards to the potential deficiencies identified in the Parliament's motion, such as the level of change in the geographical information communicated by companies or measures used for reporting entity's performance.

ESMA consults on materiality in financial reporting

A recurring theme which is part of the co-ordination of IFRS enforcement is the apparently differing views regarding the practical application of the concept of materiality amongst preparers, auditors, possible users of financial reports and, in some instances, accounting enforcers. Considering the role and impact of materiality in financial reporting, a working group was established in 2010 to work on materiality issues. Following this preparatory work, ESMA prepared a consultation paper in 2011 analysing and identifying common principles related to establishing materiality as understood under IFRS⁷⁵. The aim of the consultation paper, published on 25 November 2011, is to seek comments from interested parties on their understanding of various aspects of materiality in an effort to contribute to a consistent application of this important concept in financial reporting.

74. *Final report - Review of European enforcers on the implementation of IFRS 8 (ESMA/2011/372)*: http://esma.europa.eu/system/files/2011_372.pdf

75. *Consultation paper - Considerations of materiality in financial reporting (ESMA/2011/373)*: http://esma.europa.eu/system/files/2011_373.pdf

ESMA holds seminar on IFRS enforcement

In December 2011, ESMA invited accounting enforcers from around the globe to discuss IFRS enforcement. Accounting enforcers from around 30 countries attended the meeting, together with representatives from international standard-setting bodies such as Hans Hoogervorst, Chair of the IASB, and Arnold Schilder, Chair of International Auditing and Assurance Standards Board (IAASB). The European Commission and IOSCO also participated. Organising such a seminar reflects ESMA's strong commitment to strengthen the dialogue with third-country IFRS enforcers with a view to enhance global co-operation and consistent application of IFRS.

Throughout the year ESMA, in its efforts to contribute to the quality of financial reporting under IFRS on a global basis, maintained its active dialogue with third-country authorities which have adopted or are in the process of adopting IFRS, such as the US SEC and the Japanese FSA.

ESMA contributes to the development of IFRS

IFRS have greatly contributed to further harmonising the presentation of financial information in European markets. The development of IFRS in a consistent and logical manner is key to protecting investors and ensuring the integrity of markets through preserving transparent reporting. ESMA continues to monitor developments in IFRS proposed by the IASB and the IFRS Interpretations Committee, and respond to calls for market input by submitting the views of European securities regulators and enforcers of accounting information.

In this capacity, ESMA regularly provides comment letters to the IASB and EFRAG with the aim of contributing to the standard-setting and endorsement process within Europe.

In 2011, ESMA commented on the following issues:

- Request for Views on Effective Date and Transition Methods;
- ED Hedge Accounting;
- Supplementary Document on the ED Financial Instruments: Amortised Cost and Impairment;
- ED Offsetting Financial Assets with Financial Liabilities;
- EFRAG DP Effects of Accounting Standards;
- The IFRS Interpretations Committee's tentative agenda decisions (issues related to IFRS 8 – Operating Segments);
- ED Improvements to IFRSs;
- ED Mandatory Effective Date of IFRS 9 – Financial Instruments: Classification and Measurement;
- EFRAG's draft response to the IFRS Interpretations Committee on the Committee's September 2011 tentative agenda decisions (related to IAS 12 – Income Tax); and
- 2011 IASB Agenda Consultation;

Throughout the year, ESMA also provided comments to the IFRS Foundation, the legal entity under which the IASB operates, on:

- The IFRS Foundation's review of the operational efficiency and effectiveness of the IFRS Interpretations Committee; and
- The IFRS Foundation response to the consultation regarding IFRS as the global standard: setting a strategy for the Foundation's Second Decade

ESMA participates actively in the review of the governance framework around the IFRS Foundation and, in particular, in the high level Working Group that was set up by the IFRS Foundation Monitoring Board undertaking a review of the IFRS Foundation. This included a review of the composition of the Monitoring Board, to which ESMA contributed.

External contributions to accounting

ESMA participates in the European Commission's Accounting Regulatory Committee (ARC) and in EFRAG's monthly Technical Expert Group (TEG) meetings as observer. ESMA was also granted an observer seat at EFRAG's Supervisory Board and its working group on accounting for insurance contracts and financial instruments. Such roles allow ESMA to feed its views directly into the process of developing accounting standards for endorsement in the EU.

Throughout 2011, ESMA participated actively in the outreach activities organised by the IASB and EFRAG on the ongoing financial reporting projects and is also a member of the IFRS Advisory Council.

ESMA contribution on audit issues

ESMA operates a working group on audit, responsible for the preparation of responses to consultations launched by the European Commission and to the IAASB on audit related projects. As part of this process, the group in 2011 sent its contribution to the IAASB in relation to the following projects:

- IAASB Discussion Paper – The Evolving Nature of Financial Reporting: Disclosure and Its Audit Implications⁷⁶; and
- Consultation Paper Enhancing the Value of Auditor Reporting: Exploring Options for Change⁷⁷.

In November 2011, the Commission adopted and published the Proposal for a Regulation on the quality of audits of public-interest entities and Proposal for a Directive to enhance the single market for statutory audits. The proposed legislation includes significant changes to the European audit legal framework. One of these refers to an enhancement of the European supervision of the audit sector and proposes to give ESMA responsibilities in the following areas: preparation of regulatory technical standards, co-ordination of the auditor supervision activities and set-up of a European Quality Certificate.

Pan-European access to financial information

The Transparency Directive (TD) requires each Member State to have at least one Officially Appointed Mechanism for the central storage of regulated information (OAM). Every time an issuer discloses information, the information is required to be filed with the OAM of the home Member State.

CESR in 2010 provided the Commission with a report on the Development of Pan-European Access to Financial Information Disclosed by Listed Entities. The report explained how the usefulness of OAMs could be enhanced and looked into the creation of a European central access point of all the information stored in the 29 different national databases. The report formed the basis for the proposals to amend the TD that were put forward by the Commission in 2011⁷⁸. According to this proposal, ESMA is expected to develop draft regulatory technical standards that set technical requirements regarding access to regulated information at the EU level.

In addition, ESMA actively monitored the European and global developments in the area and participated in the IFRS Annual Taxonomy Convention organised by the IFRS Foundation. ESMA is also a member of the XBRL Advisory Council of the IFRS Foundation.

76. [ESMA/2011/122]

77. [ESMA/2011/353]

78. [COM(2011)283]

Equivalence of third-countries' accounting standards

In December 2007, the Commission published the Regulation (EC) 1569/2007⁷⁹ establishing a mechanism for the determination of equivalence of accounting standards applied by third-country issuers of securities pursuant to Directives 2003/71/EC⁸⁰ and 2004/109/EC (Commission Regulation on the Mechanism)⁸¹. This Regulation established the conditions under which Generally Applied Accounting Principles (GAAP) of a third-country can be considered equivalent to IFRS, or more precisely European IFRS. From 2008 to 2010, CESR, provided advice to the Commission on the equivalence in relation to certain countries' GAAPs.

In June 2010, CESR received a specific mandate from the Commission to provide an update on the adoption or convergence programmes in several countries, namely India and China. In January 2011, ESMA met with representatives of the relevant authorities from India and China in charge of the program convergence and the enforcement of financial information. ESMA prepared a report on each country identifying elements important for the assessment of the process of convergence such as: evolutions in the process of convergence of the standards, enforcement experience, involvement in IASB process of issuance of standards and co-operation with third parties.

The final decision on granting permanent equivalence is due to be made public after approval by the European Parliament.



ESMA premises, Paris-France

79. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2007:340:0066:0068:en:PDF>

80. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:345:0064:0064:EN:PDF>

81. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2004:390:0038:0038:EN:PDF>

3.7 Corporate Finance: Prospectus, Transparency and Takeover Bids Directive

In 2011, ESMA started looking into the service provided by proxy advisors relating to corporate governance⁸² and in order to foster regulatory consistency, discussed with NCAs takeover bid cases in the EU⁸³. Regarding investment prospectuses, the Authority advised the Commission on its plans to amend the current Prospectus Directive⁸⁴ and reviewed NCAs' use of regulatory good practices⁸⁵. ESMA also continued to look into several issues relating the Transparency Directive, including the actual use of NCAs' use of options, discretions and more stringent requirements⁸⁶.

Firms listed on a EU regulated market have to comply with rules on corporate finance, which aim at providing investor with easy to access understandable information in order to take informed investment decisions. The European Prospectus, Transparency and Takeover Bids Directives (PD, TD and TOD) provide the rules to achieve this. The PD and TD define the key information any investment provider has to provide to investors, and the TOD holds provisions for disclosure in a case where company takeovers take place. ESMA works on those Directives as standard setter and co-ordinator at an EU-level which ensures the same level of investor protection and product transparency exists no matter where an investment decision might be taken.

ESMA analyses EU proxy advisors industry

Proxy Advisors provide advice to (generally institutional) investors and asset management firms on their voting policy and strategy. This advice can take a variety of forms, for example, corporate governance advice, research on the financial impact of their investment, and specific vote recommendations based on an analysis of the issuer and the advisor's own or investor's voting policies and guidelines. Larger advisors may also provide voting services such as voting platforms, enabling investors to conveniently execute their votes through these services.

In February 2011, ESMA decided to undertake an evaluation of the European proxy advisory industry, to be performed by the Corporate Governance Advisory Group of the Corporate Finance Standing Committee (CFSC). The responses from the different questionnaires sent to proxy advisors, issuers and investors were received and analysed. Following this fact-finding work ESMA noted that the proxy advisory industry within Europe is, or is expected to be growing in prominence and investors are, or are expected to be, increasingly using proxy advisor services.

82. <http://esma.europa.eu/page/Corporate-Finance-SC>

83. http://esma.europa.eu/system/files/Takeover_bids_Directive.pdf

84. ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU [ESMA/2011/444]: <http://esma.europa.eu/system/files/2011-444.pdf>

85. <http://esma.europa.eu/page/Review-Panel-Documents>

86. Report - Mapping of the Transparency Directive [ESMA/2011/194]: http://esma.europa.eu/system/files/2011_194.pdf

NEXT STEPS

In March 2012, ESMA will publish its discussion paper on proxy advisor seeking market participants' views. ESMA expects to publish a feedback statement in Q4 2012 which will summarise the responses received and will state ESMA's view on whether there is a need for policy action in this area.

ESMA advises Commission on amending the Prospectus Directive

On 24 November 2010, the European Parliament and the Council adopted a proposal for amending the Prospectus Directive⁸⁷. On 20 January 2011, the Commission requested ESMA to provide technical advice on possible delegated acts concerning the Prospectus Directive as amended by Directive 2010/73/EU. The objectives of the Amending Prospectus Directive are:

- 1) increasing efficiency in the prospectus regime;
- 2) reducing administrative burdens for companies when raising capital in the European securities markets, and
- 3) enhancing investor protection.

When providing this advice ESMA was to consider areas which would benefit from further convergence and uniform practices in order to maintain a high level of investor protection and consistent application of the prospectus regime, as well as consider if certain requirements were to be changed in order to alleviate burdens on issuers.

ESMA focused on three sections in the first part of the Mandate covering the format of the final terms to a base prospectus, the format of the summary of the prospectus and the detailed content and specific form of the key information to be included in the summary. It also examined the proportionate disclosure regime proposed to be introduced for some pre-emptive offers of equity securities, offers by SMEs and issuers with reduced market capitalization, and offers of non-equity securities.

ESMA published a consultation paper⁸⁸ on 15 June 2011 requesting market participants' views on its mandate. ESMA delivered the first part of its Technical Advice on the first three sections on 4 October 2011. The advice covered the following issues:

1. Format of the final terms to a base prospectus

ESMA determined which information should be included in a base prospectus at the time of its approval, and the information to be included in the final terms. In essence, this distinction was drawn to ensure that all information which needs to be approved by a competent authority due to its significance to the investor's assessment of an investment decision is included in the base prospectus, and that only information that is not known at the time of the approval of the base prospectus is included in final terms and only when such information does not need to be approved by a competent authority.

2. Restriction of the replication of securities notes items in the final terms

The items of a securities note schedule and its building blocks which are already known at the time of the approval of the base prospectus, and therefore determined by the base prospectus, cannot be reproduced in the final terms.

3. Role of the final with regard to information in the base prospectus

The Final Terms are not allowed to amend or replace any information contained in the base prospectus.

87. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2003:345:0064:0064:EN:PDF>

88. Consultation paper - ESMA's technical advice on possible delegated acts concerning the Prospectus Directive as amended by the Directive 2010/73/EU [ESMA/2011/141]: http://esma.europa.eu/system/files/11_141.pdf

4. Indices composed by the issuer

Proprietary indices should be detailed in the base prospectus. ESMA is of the opinion that the length and comprehensibility of index descriptions are not necessarily connected as issuers can annex index descriptions to a base prospectus.

5. Combination of the summary of the base prospectus and the final terms

A summary for the individual issue shall be annexed to the final terms, because the summary contains key information for investors and this treatment ensures comparability of the summaries. The summary shall form part of the final terms.

6. Additional information

Even though article 5(4) of the Amending Prospectus Directive provides that final terms shall contain only information that relates to the securities note, ESMA is of the opinion that the final terms may also contain, on a voluntary basis, information which might be useful to investors. This 'Additional Information' should however be limited.

7. Supplement to the base prospectus

According to ESMA's advice, the final terms are not allowed to amend or replace any information contained in the base prospectus. All the information that is not allowed to be included in the final terms, requires the approval of a supplement or a new prospectus. Information can be included by way of a supplement, only if it may be considered as significant pursuant to article 16 of the Prospectus Directive.

8. Format and detailed content of the key information to be included in the summary

A modular approach should be followed so that the information (securities notes, registration documents and building blocks) is checked to establish whether they should be considered as key information and therefore included in the summary. Five main sections have been established (A-Introduction and warnings, B-Issuer and any guarantor, C-Securities, D-Risks and E-Offer) together with the sub-items that have been considered as key elements. The order of the sections have been established as mandatory as it allows comparison of summaries of similar products by ensuring that equivalent information always appears in the same position of the summary.

9. Proportionate disclosure regime for right issues, SMEs and small caps offers and offers of non equity issues

Rights issues: after the analysis of the Prospectus Regulation new Annexes to the Prospectus Regulation for equity securities have been developed on the basis of the information that could be eliminated from offers relating to rights issues of shares of the same class that are already admitted to trading on a regulated market or an MTF considering what information items are easily accessible to investors as already required by other Directives (Transparency Directive and the Market Abuse Directive). The most significant issue is the reduction of the historical financial information to one year.

Offers by SME's and issuers with reduced market capitalisation: due to their higher risk profile the information that could be omitted is not particularly extensive, the most relevant one being the reduction of the historical financial information to 2 years (equity securities) and 1 year (debt securities). This regime should not be applied when they first seek admission to trading in a regulated market.

NEXT STEPS

The Commission is under an obligation to adopt the delegated acts by 1 July 2012 (18 months after the entry into force of the Amending Directive) in relation to sections 3.1 and 3.2 covered by the first part of the Mandate. Due to the need to provide market participants with legal clarity by 1 July 2012 (when the Amended Directive applies) and in light of the importance of the areas covered in the remaining areas of the Technical Advices, the delegated acts dealing with these matters should be published in the Official Journal of the EU by 1st of July 2012.

ESMA started work on the second part of the mandate which covers the consent to use a prospectus in a retail cascade and the review of the provisions of the Prospectus Regulation with regard to information on taxes withheld at source, index composed by the issuer, profit forecasts and estimates and audited historical financial information. In December 2011, ESMA released a consultation paper on these issues.

The third part of the Mandate will commence in 2012 and covers a comparative table recording the liability regimes applied by the Member States in relation to the Prospectus Directive and the disclosure requirements for convertible bonds. The work on criteria to be applied in assessing the equivalence of a third-country financial market is postponed due to the on-going review of the Transparency Directive, Market Abuse Directive and MiFID. The delivery date on the disclosure requirements for convertible bonds is end of 2012.

ESMA is working on several issues related to the Transparency Directive

In 2011, ESMA has been working on several issues relating to the Transparency Directive, one of which is empty voting. Empty voting happens e.g. when securities are lent to investors which then use the securities lent to vote in the company's shareholders' meetings. A small task force consisting of a number of NCAs explored whether there is a need for further ESMA work in the area of empty voting.

ESMA issued a call for evidence on September 14, with a consultation period running until 25 November 2011, to collect information and evidence on the extent to which empty voting exist in practice, the effects of such practices and the need for regulatory action.

In addition, the Commission published its proposals relating to the revision of the Transparency Directive in October 2011, which encompasses further ESMA work in different areas.

NEXT STEPS

ESMA will prepare a feedback statement on the empty voting issue looking at possible next steps.

EU regulators discuss takeover bids cases

The Takeover Bids Directive (TOBD) aims to ensure a level playing field in Europe for companies launching takeover bids and seeks to ensure transparent and fair treatment of investors. Some of ESMA's Board Members do not themselves regulate takeovers so ESMA has formed a network to ensure an interface exists allowing takeover regulators to exchange information and harmonise views, in order to facilitate convergence in Europe.

In 2011, ESMA organised meetings with representatives from the relevant EU takeover regulatory authorities to discuss their experiences and the Takeover Bids Network met twice in the course of 2011. There were discussions on issues regarding the operation of the takeover bids regime in Europe as well as on the fact-finding exercise currently being undertaken by a law firm on the operation of the Directive on behalf of the Commission.

ESMA reviews implementation of Prospectus Directive's good practices

Following the completion of ESMA's mapping of the use by NCAs of the Prospectus Directive's options and discretions in 2010, ESMA, in November 2010, decided on a set of six good practices to be followed and implemented by NCAs in the process of approving investment prospectuses. NCAs were given a period for implementation of these good practices and another period for gaining experience in applying them.

As agreed, when setting up these good practice standards, ESMA began a peer review of the application of the good practices six months after their approval. A self-assessment, by NCAs, followed in autumn 2011.

NEXT STEPS

The PD good practices peer review report will be finalised and published in early 2012.

Transparency Directive – options, discretions and 'more stringent requirements'

In 2010, ESMA started mapping the options, discretions and gold plating provisions under the Transparency Directive (TD)⁸⁹ and its implementing Level 2 Directive.⁹⁰ The work was started in order to ascertain the extent to which Member States introduced options, discretions, additional requirements and/or more stringent rules in their national legislation, as authorised for in TD and its implementing measures. The aim of such mappings is to identify areas in the implementation of EU securities legislation where a higher level of convergence can be achieved.

ESMA's report on the TD options, discretions and gold-plating, was published on 7 July 2011.⁹¹

89. Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC.

90. Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market.

91. Report - Mapping of the Transparency Directive (ESMA/2011/194): http://esma.europa.eu/system/files/2011_194.pdf

ESMA'S WORK PROGRAMME FOR 2012

04

ESMA's Work Programme for 2012 was developed setting out the key future priorities stemming from different regulatory mandates.

4.1 ESMA's key objectives and priorities in 2012

While 2011 was a transitional year in terms of ESMA becoming operational and gearing up for its new responsibilities, 2012 will be the first full year of delivery against ESMA's objectives. The work programme sets out the goals and deliverables for the second year of operations.

ESMA will start the year 2012 in a better position staffing wise and with a new organisational structure that will support the delivery of this work programme. In addition, 2012 will be a key year for ESMA, due to the following four challenges:

1. The introduction of new, and the overhaul of existing, legislation will be a key challenge for ESMA. The year ahead will see the finalisation and implementation of new directives and regulations on short-selling, EMIR, and AIFMD.
2. ESMA will continue to develop technical standards and advice to build a single rulebook for Europe. While it will provide advice and support on legislation being introduced and debated by Council and Parliament, particularly on MiFID/MiFIR, ESMA will also continue to promote supervisory convergence and work to avoid regulatory arbitrage.
3. ESMA will fully exercise its supervisory duties for the first time as the focus for CRAs moves from registration to effective supervision.
4. In order to enable ESMA to deliver on its demanding 2012 work programme, it will need to substantially increase its staffing and budget. Staff numbers are expected to grow from 75 in 2011 to 101 by the close of 2012, and the budget from €16.9 to €20.2 million. Funding will also be generated from CRAs' fee contributions.

ESMA's 2012 Work Programme

ESMA's detailed Work Programme for 2012 can be viewed on ESMA's website.

 [http:// esma.europa.eu/system/files/2012-275.pdf](http://esma.europa.eu/system/files/2012-275.pdf)



ANNEXES

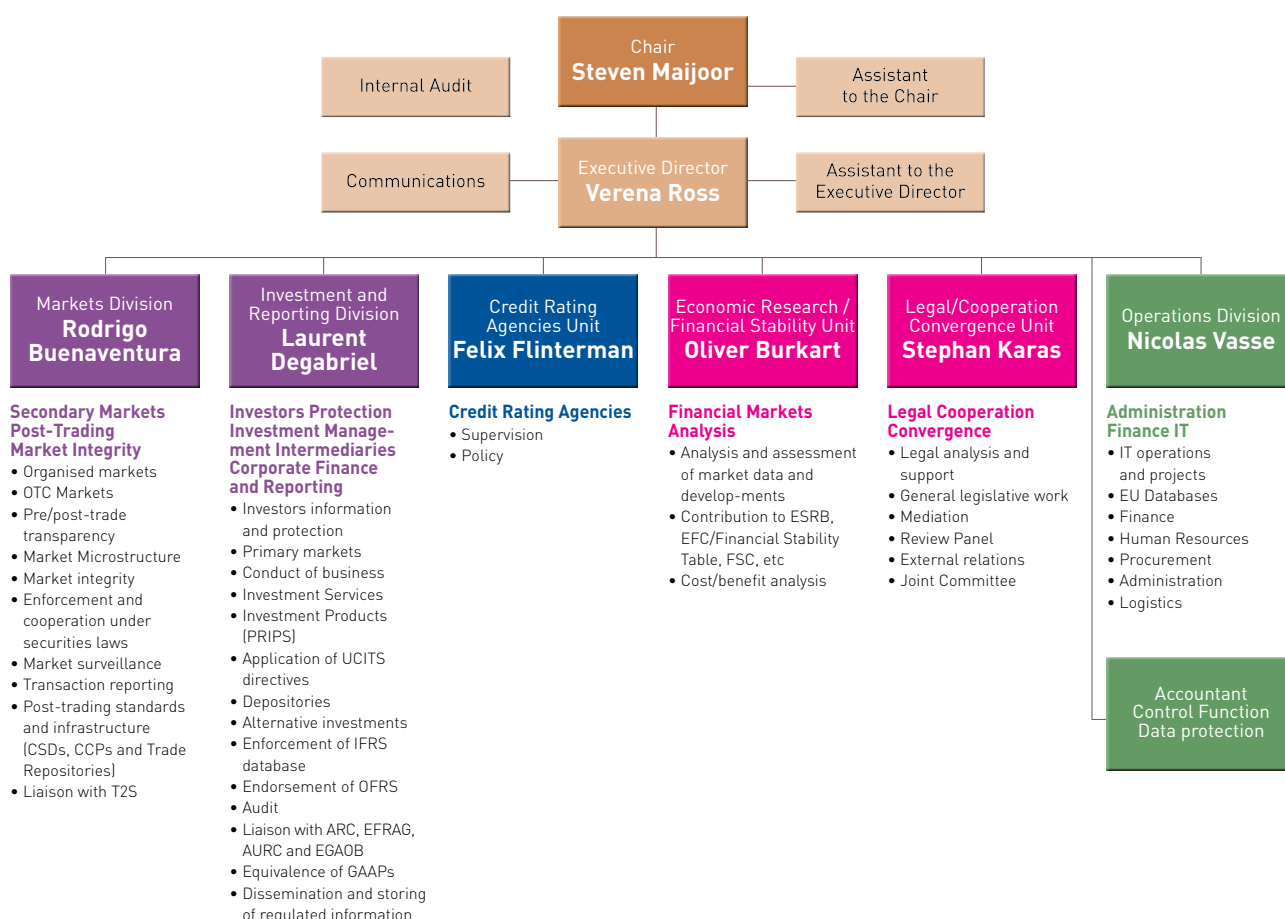
05

- The organisation and structure of ESMA
- 2011 financial statements
- List of commonly used abbreviations
- Other disclosure

A The organisation and structure of ESMA

ESMA is divided into six Divisions/Units, dealing with securities markets, investment management and reporting, CRAs, economic research, legal and co-operation and operational issues. The Authority is chaired by its Chairman, Steven Maijoor, while Verena Ross, Executive Director, is responsible for its day-to-day management. The Chair and Executive Director are supported by the Communications and Audit & Accounting Teams and by their Personal Assistants. The detailed organogram can be viewed below:

The organigramme of ESMA



ESMA's standing committees, working groups and task forces

As well as being comprised of Divisions and Units, much of the Authority's technical work is conducted through standing committees (SC), working groups and task forces, panels and networks, which draw together senior experts from NCAs. The different ESMA groups are established either on a permanent basis or limited in time, depending on the issues handled and the mandate given. The groups are chaired by senior representatives of NCAs and supported by ESMA staff which act as rapporteurs. A table of ESMA's SCs and their task below:

Name of SC	Mandate	CHAIR
Secondary Markets Standing Committee	Work on structure, transparency and efficiency of secondary markets for financial instruments, incl. trading platforms OTC markets (such as regulated markets, MTFs, systematic internalisers and other platforms). Develop technical standards and guidelines, elaborating advice to the Commission related to the MiFID.	Martin Wheatley, FSA, United Kingdom
Investment Management Standing Committee	Work on issues relating to collective investment management, covering both harmonised and non-harmonised investment funds. Develop technical standards, elaborating advice to the Commission, or developing guidelines and recommendations relating to UCITS and AIFMD.	Giuseppe Vegas, CONSOB, Italy
Post-trading Standing Committee	Work relating to clearing and settlement of transactions in Financial instruments. Develop technical standards, elaborating advice to the Commission, or developing guidelines and recommendations relating to EMIR.	Jean-Pierre Jouyet, AMF, France
Credit Rating Agencies Technical Committee	Assist ESMA in the tasks relating to CRAs Promoting convergence in the application of the CRA Regulation and enhancing legal certainty for market participants. Prepare technical standards and common guidelines. Co-ordinate with other international organisations and third-country regulators that are performing activities in relation to CRAs.	Verena Ross, ESMA
Corporate Finance Standing Committee	Work relating to the Prospectus Directive, corporate governance, and major shareholding disclosures under the Transparency Directive. Develop technical advice and guidance, standards on the provisions of the above Directives. In the area of corporate governance, respond to areas which relate to the securities laws in the EU.	Ronald Gerritse, AFM, Netherlands
Corporate reporting Standing Committee	Work on issues relating to accounting, audit, periodic reporting and storage of regulated information. Co-ordinate the activities of national enforcers from the European Economic Area (EEA) relating to the enforcement of compliance with IFRS. Foster operational co-operation between EU and non-EU regulators.	Julie Galbo, FSA, Denmark
ESMA-Pol Standing Committee	Work on issues relating to market surveillance, enforcement of securities laws, facilitation of co-operation of national authorities and exchange information in market abuse investigations. Develop technical standards, elaborating advice to the Commission or developing guidelines and recommendations on issues relating to the integrity of markets or issues such as market abuse or short-selling.	Konstantinos Botopoulos, HSC, Greece
Investor Protection and Intermediaries Standing Committee	Deal with regulatory issues related to the provision of investment services and activities by investment firms and credit institutions. Particular regard is made to investor protection, including the conduct of business rules, distribution of investment products, investment advice and suitability. Develop and provide technical advice to the Commission, and for preparing technical standards, guidelines and recommendations relating to the provisions of MiFID applicable to investment services and activities.	Jean-Paul Servais, FSMA, Belgium
Financial Innovation Standing Committee	Achieve a co-ordinated approach to the regulatory and supervisory treatment of new or innovative financial activities. Identify risks to investor protection, and to financial stability, in the financial innovation area; and then to produce a risk mitigation strategy.	Anneli Tuominen, FSA, Finland
Review Panel	Contribute to supervisory convergence through supporting the consistent and timely implementation of Community legislation in the EU. Conduct peer reviews and mapping exercises. Review the implementation of EU legislation and ESMA standards and guidelines.	Jean Guill, CSSF, Luxembourg
Committee of Economic and Markets' Analysis	Financial markets monitoring and analysis. Identification, monitoring, and assessment of trends, potential risks and vulnerabilities in financial markets across borders and sectors, including a thorough focus on financial innovations and incentives related to market practices both at wholesale and retail level.	Carlos Alves, CMVM, Portugal

Other groups, boards and task forces

There are a number of other groups, networks and task forces falling outside the permanent structures which are currently undertaking work on important issues these include the Commodities Task Force, to provide analysis and advice on commodities related issues, along with a number of collaborative groups formed with other organisations in order to respond to special mandates.

ESMA's Boards and its composition



The Management Board of ESMA

Members of the ESMA Management Board

Member	Authority	Country
Karl-Burkhard Caspari	BaFin	Germany
Raul Malmstein	FSA	Estonia
Fernando Restoy	CNMV	Spain
Jean Guill	CSSF	Luxembourg
Kurt Pribil	FMA	Austria
Carlos Tavares	CMVM	Portugal
Martin Wheatley	FSA	United Kingdom



Members and Observers of ESMA's Board of Supervisors

Members of the ESMA Board of Supervisors

Member	Authority	Country
Jean Paul Servais	FSMA	Belgium
Stoyan Mavrodiiev	FSC	Bulgaria
Pavel Hollmann	National Bank	Czech Republic
Julie Galbo	Finanstilsynet	Denmark
Karl-Burkhard Caspari	Bafin	Germany
Raul Malmstein	FSA	Estonia
Konstantinos Botopoulos	CMC	Greece
Fernando Restoy	CNMV	Spain
Jean-Pierre Jouyet	AMF	France
Matthew Elderfield	Central Bank	Ireland
Giuseppe Vegas	Consob	Italy
Demetra Kalogerou	CySEC	Cyprus
Kristaps Žakulis	FCMC	Latvia
Vilius Šapoka	Central Bank	Lithuania
Jean Guill	CSSF	Luxembourg
Károly Szász	PSZAF	Hungary
Andre Camilleri	FSA	Malta
Ronald Gerritse	AFM	Netherlands
Kurt Pribil	FMA	Austria
Marek Szuszkiewicz	KNF	Poland
Carlos Tavares	CMVM	Portugal
Gabriela Anghelache	CNVM	Romania
Damjan Zugelj	SMA	Slovenia
Ivan Barri	National Bank	Slovak Republic
Anneli Tuominen	FIN-FSA	Finland
Martin Andersson	Finansinspektionen	Sweden
Martin Wheatley	FSA	United Kingdom

Observers to the Board

Name	Authority	Country
Unnar Gunnarsdóttir	FI	Iceland
Mario Gassner	FMA	Liechtenstein
Eirik Bunæs	Finanstilsynet	Norway
Adam Farkas	European Banking Authority	
Carlos Montalvo	European Insurance and Occupational Pensions Authority	
Francesco Mazzaferro	European Systemic Risk Board	
Jonathan Faull	EU Commission	

B 2011 financial statements

The annual accounts of ESMA have been established in accordance with the Financial Regulation of ESMA as adopted by ESMA's Board of Supervisors and Management. The "Framework Financial Regulation" Commission Regulation (EC, EURATOM) No 652/2008 of July 2008 amending Regulation (EC, EURATOM) No 2343/2002 on the framework Financial Regulation for the bodies referred to in Article 185 of Council Regulation (EC, EURATOM) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Communities.

The accounting rules, methods and guidelines are those as adopted and provided by the Accountant of the European Commission.

Esma-balance sheet - Assets (in Euros)

ASSETS	31.12.2011	01.01.2011
A. NON CURRENT ASSETS		
FIXED ASSETS	1.697.900,60	363.303,00
Intangible fixed assets	616.291,43	
Tangible fixed assets	1.081.609,17	
Land and buildings	614.607,26	
Plant and equipment	625,00	
Computer hardware	246.120,81	
Furniture and vehicles	163.662,10	
Other fixtures and fittings	56.594,00	
LONG TERM RECEIVABLES	69.845,14	69.845,14
TOTAL NON CURRENT ASSETS	1.767.745,74	433.148,14
B. CURRENT ASSETS		
SHORT-TERM RECEIVABLES		
Current receivables	1.117.407,39	838.003,44
Sundry receivables	8.886,52	
Other		
Deferred charges	71.434,10	
CASH AND CASH EQUIVALENTS	6.325.318,37	2.014.966,60
TOTAL CURRENT ASSETS	7.523.046,38	2.852.970,04
TOTAL ASSETS	9.290.792,12	3.286.118,18

Esma-balance sheet - Liabilities (in Euros)

LIABILITIES	31.12.2011	01.01.2011
A. CAPITAL	2.122.190,73	363.303,00
Fixed Assets transferred from CESR (preceding organisation)		363.303,00
Accumulated surplus/deficit	0,00	
Economic result of the year - profit+/-loss-	2.122.190,73	
B. MINORITY INTERESTS	0,00	0,00
C. NON CURRENT LIABILITIES	0,00	0,00
TOTAL NON CURRENT LIABILITIES	2.122.190,73	363.303,00
D. CURRENT LIABILITIES	7.168.601,39	2.922.815,18
Provisions for risks and charges	318.379,81	0,00
Accounts payable	6.850.221,58	
Net funds for reimbursement to CESR members		1.174.741,31
Advance payments received by CESR in 2010 on 2011 ESMA contributions		701.154,78
Payables to MS NCAs	960.956,08	
Current & Sundry payables suppliers	199.731,62	1.046.919,09
Other		
Accrued charges	1.232.289,06	
Surplus pre-financing EC	4.457.244,82	
TOTAL CURRENT LIABILITIES	7.168.601,39	2.922.815,18
TOTAL LIABILITIES	9.290.792,12	3.286.118,18

Economic outturn account (in Euros)

	2011
Recovery of expenses	91.217,77
Revenues from administrative operations	422.954,16
Fixed assets related revenue (fixed assets from 2010)	363.303,00
Other administrative revenue	59.651,16
Operating revenue - Contributions	12.503.955,18
Contributions MS NCAs	9.862.735,96
Contribution EC	2.326.755,18
Contribution observers NCAs	314.464,04
Other operating revenue	5.340,69
Other	5.340,69
TOTAL OPERATING REVENUE	13.023.467,77
Administrative expenses	-10.657.153,06
Staff expenses	-6.285.311,34
Fixed asset related expenses	-219.958,62
Other administrative expenses	-4.151.883,10
Operational expenses	-220.769,84
Other operational expenses	-220.769,84
TOTAL OPERATING EXPENSES	-10.877.922,90
SURPLUS/(DEFICIT) FROM OPERATING ACTIVITIES	2.145.544,87
Financial revenues	0,00
Financial expenses	-23.354,14
SURPLUS/ (DEFICIT) FROM NON OPERATING ACTIVITIES	-23.354,14
SURPLUS/(DEFICIT) FROM ORDINARY ACTIVITIES	2.122.190,73
SURPLUS/(DEFICIT) FROM EXTRAORDINARY ITEMS	0,00
ECONOMIC RESULT OF THE YEAR	2.122.190,73

Cash flow table (indirect method) (in Euros)

	2011
Cash Flows from ordinary activities	
Surplus/(deficit) from ordinary activities	2.122.190,73
Operating activities	
Adjustments	
Amortization (intangible fixed assets)	+ 74.695,08
Depreciation (tangible fixed assets)	+ 413.912,61
Increase/(decrease) in Provisions for risks and liabilities	318.379,81
Increase/(decrease) in Value reduction for doubtful debts	0,00
(Increase)/decrease in Stock	0,00
(Increase)/decrease in Long term Pre-financing	0,00
(Increase)/decrease in Short term Pre-financing	0,00
(Increase)/decrease in Long term Receivables	-69.845,14
(Increase)/decrease in Short term Receivables	-1.197.728,01
(Increase)/decrease in Receivables related to consolidated EC entities	0,00
Increase/(decrease) in Other Long term liabilities	0,00
Increase/(decrease) in Accounts payable	2.359.002,32
Increase/(decrease) in Liabilities related to consolidated EC entities	4.491.219,26
(Gains)/losses on sale of Property, plant and equipment	
NET CASH FLOW FROM OPERATING ACTIVITIES	8.511.826,66
Cash Flows from investing activities	
Increase of tangible and intangible fixed assets (-)	-2.186.508,29
Proceeds from tangible and intangible fixed assets (+)	0,00
NET CASH FLOW FROM INVESTING ACTIVITIES	-2.186.508,29
Cash flow from CECA specific transactions	
(Increase)/decrease in Other Investments (281000)	0,00
(Increase)/decrease in Long term Loans (290000)	0,00
(Increase)/decrease in Short term Investments (501000)	0,00
Increase/(decrease) in Long term Financial Liabilities (170000)	0,00
Increase/(decrease) in Short term Financial Liabilities (430000)	0,00
Other CECA	
NET CASH FLOW FROM CECA SPECIFIC TRANSACTIONS	0,00
Increase/(decrease) in Employee benefits	0,00
Net increase/(decrease) in cash and cash equivalents	6.325.318,37
Cash and cash equivalents at the beginning of the period	
Cash and cash equivalents at the end of the period	6.325.318,37

C List of Commonly Used Abbreviations

AII	Alternative Instrument Identifier
AIFMD	Alternative Fund Managers Directive
AMLTF	Anti-Money Laundering Task Force
ARC	Accounting Regulatory Committee
AUM	Assets under Management
AuRC	Auditing Regulatory Committee
CCP	Central Counterparty Clearing
CDS	Credit Default Swaps
CDO	Collateralized Debt Obligations
CEMA	Standing Committee for Market and Economic Analysis
CEREP	Central Ratings Repository
CFTC	Commodity Futures Trading Commission
Commission	European Commission
CRAs	Credit Rating Agencies
CSD	Central Securities Depositories
EBA	European Banking Authority
ECB	European Central Bank
ECON	Economic and Monetary Affairs Committee of the European Parliament
EEA	European Economic Area
EECS	European Enforcers' Co-ordination Sessions
EFC	Economic and Financial Committee
EFRAG	European Financial Reporting Advisory Group
EIOPA	European Insurance and Occupational Pensions Authority
EMIR	European Market Infrastructure Regulation
EP	European Parliament
ESAs	European Supervisory Authorities
ESC	European Securities Committee
ESCB	European System of Central Banks
ESFS	European System of Financial Supervision
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
EU	European Union
FASB	Financial Accounting Standards Board
FCD	Financial Conglomerates Directive
FICOD	Financial Conglomerates Directive
FSB	Financial Stability Board
FSC	Financial Services Committee
GAAP	Generally Accepted Accounting Principles
IA	Impact Assessment
IAASB	International Auditing and Assurance Standards Board
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFRSF	International Financial Reporting Standards Foundation
IFRS IC	International Financial Reporting Standards Interpretations Committee
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering

IT	Information Technology
MAD	Market Abuse Directive
M&A	Mergers and Acquisitions
MiFID	Markets in Financial Instruments Directive
MoU	Memorandum of Understanding
MTF	Multilateral Trading Facility
NCA s	National Competent Authorities
OTC	Over-The-Counter
Q&A	Questions and Answers
SEC	Securities and Exchange Commission
SLD	Securities Law Directive
SMSG	Securities Markets Stakeholder Group
TD	Transparency Directive
TOD	Takeover Bids Directive
TREM	Transaction Reporting Exchange Mechanism
UCITS	Undertakings for Collective Investment in Transferable Securities (Directive)
US	United States

D Other disclosure

Agreements with third countries

Article 33(3) of the ESMA Regulation requires ESMA to set out the administrative arrangements agreed upon with international organisations or administrations in third countries and the assistance provided in preparing equivalence decisions.

For 2011, these were:

1. ESMA establishes co-operation with the Israeli FSA on:

 [http:// esma.europa.eu/system/files/11_82.pdf](http://esma.europa.eu/system/files/11_82.pdf)

2. ESMA and the Japanese FSA establishing co-operation for credit rating agencies:

 [http:// esma.europa.eu/system/files/2011_170.pdf](http://esma.europa.eu/system/files/2011_170.pdf)

Access to information

Pursuant to Article 17(1) of the Access Regulation, a report shall be annexed to ESMA's annual report including: (a) the number of cases in which ESMA refused to grant access to documents; (b) the reasons for such refusals; and (c) the number of sensitive documents not recorded in the register.

For 2011, no requests were received.



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