CFA Institute | Centre for Financial Market Integrity

David Wright
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London, 9th April 2009

Dear Mr. Wright,

Response to the European Commission's "Communication for the spring European Council" - COM (2009) 114 final -

The CFA Institute Centre for Financial Market Integrity ("CFA Institute Centre") welcomes the opportunity to comment on the European Commission's Communication for the spring European Council, which addresses the supervisory and regulatory reforms that are going to reshape EU financial markets and set an important example for other leading jurisdictions globally.

The Financial Services Action Plan 2005-2010 aimed to create a single EU financial marketplace built around the principles of integration, openness, inclusiveness, competitiveness and economic efficiency.

This has been partially achieved. European financial markets became increasingly integrated and proved able to provide cheap capital for market actors. The Lamfalussy process achieved what was possible given the institutional mandates of its institutions.

The financial crisis has revealed failings in our regulatory and supervisory structures, which demand pan-European solutions that go beyond the scope of the Lamfalussy process and the work of the current three Level 3 committees. Even before the crisis broke out, it was becoming apparent that the current framework was falling short of the single market goal. The inconsistencies and omissions in scope and 'transposition' of the new MiFID, Market Abuse and Prospectus Directives highlight this issue. These problems cannot be solved on a national level alone. The Lamfalussy process and the existing Committees have "reached the limits of what is legally possible".

The aim of this new phase of financial regulation should be to repair the problems with the current system, such as incomplete integration and conflicting national laws, to strengthen stability, through sound supervision and exchange of information between supervisors, and to enhance investor protection.

Few things are as critical to the competitive position or proper functioning of the European financial market as restoring investor confidence. The correct regulatory approach is fundamental in this regard. Only with confidence restored can the European

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capital market be re-established as an efficient venue for the provision and trading of capital.

Overall, we believe that the proposals set out herein will help to produce a more coherent governance structure.

We attach our comments on the issues addressed by the Communication. Please do not hesitate to contact us, should you wish to discuss any of the points raised.

Yours faithfully,

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The CFA Institute Centre[1] is part of CFA Institute[2]. With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, London and Brussels, CFA Institute is a global, not-for-profit professional association of nearly 95,000 investment analysts, portfolio managers, investment advisers, and other investment professionals in 134 countries. Nearly 87,000 of these members are holders of the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 136 member societies in 57 countries and territories. In the European Union we have nearly 12,000 members affiliated with 20 country societies

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The Lamfalussy Process has given a valuable contribution to the development of a European financial services industry. The process has proven able to work towards a harmonization of investor protection rules throughout the EU, to lay the foundations for the development of increasingly integrated EU markets and to give representation to stakeholders. This dialogue should be retained during the coming restructuring of the EU financial regulatory and supervisory landscape.

However, even before the financial crisis, the process had become a victim of its own success. Developments made possible by the presence of a strong EU framework made the Lamfalussy approach less appropriate. This has only been confirmed and exacerbated by the events that reshaped global finance in recent months.

We value the defining principles of "better regulation" behind the Financial Services Action Plan - a bottom-up approach, open consultation, impact analysis, early and thorough participation of market professionals and consumer bodies plus national regulators. We would like to see these principles more thoroughly applied in the context of the new regulatory and supervisory framework.

With this vision, we support what the Commission has put forward and we sincerely appreciate some of the innovations proposed by the de Larosière Group.

The five key objectives identified by the Commission are as follows:

1. Supervisory framework:
   CFA Centre agrees that the structure and the role bestowed on the existing committees are not sufficient. The creation of a European System of Financial

[1] The CFA Institute Centre develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). It represents the views of investment professionals and investors before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and the transparency and integrity of global financial markets.

[2] CFA Institute is best known for developing and administrating the Chartered Financial Analyst curriculum and examinations and issuing the CFA Charter.

Supervision (ESFS) and the harmonization of supervisory structures at the national level are in line with what the CFA Centre has been advocating in recent years in order to promote financial market integrity and to do so in a more integrated EU marketplace.

Notwithstanding our general appreciation for the proposals of the Group, there is however a couple of points on which we would like to see further clarification.

In particular, we hope to see clearer decision-making processes within Colleges and quicker and more effective identification mechanisms for what constitutes a "systemically relevant" financial institution.

When dealing with the supervision of cross-border institutions, the Report states that as far as these are concerned, "the ESFS should continue to rely heavily on the colleges of supervisors to be introduced by the revised Capital Requirements Directive[3] and the Solvency II directives" (Par 184). CFA Centre understands the political rationale behind this choice, the application of the subsidiarity principle, and the assumption that local regulators are often better placed to perform these tasks. At the same time we would prefer to see more centralisation of supervision for institutions that have become essentially supranational.

Without a clearer definition of institutions subject to these rules and of the working methods of such colleges, we risk a counter-productive and ineffective proliferation of structures that may reach unprecedented numbers, as a consequence of the expansion of the intra-EU activities of the main financial groups in the region. Moreover, the decision-making process described by the proposed new article 42a of the CRD would not only prove difficult to be implemented in a crisis situation, but would also leave excessively discretionary powers to the home supervisor. This becomes particularly worrisome in times where some member states have seen much of their banking system become a subsidiary of "foreign" financial institutions.

2. Fill the gaps in regulation:

   The removal of the persisting barriers to complete EU integration is probably the issue most thoroughly addressed by the de Larosière Report. We are supportive of the broad agenda set by the Group and of the need to move towards harmonised rules and powers.

   CFA Centre has been advocating for increased and substantial harmonisation of rules within the EU in most of its comment letters and policy proposals to the Commission and CESR, and has pointed out member states' best practices when dealing with national regulators. We will provide further details on specific points throughout this document.

   As for the proposed agenda of new Authorities (the three upgraded level 3 Committees)— i.e. the examination of intra EU differences and the proposition of

[3] http://ec.europa.eu/internal_market/bank/docs/regcapital/crd_proposal_en.pdf

new level 1 and 2 rules— again CFA Centre is supportive, provided that the committees will receive adequate authority, funding and human resources. This is crucial in order to enhance regulatory supervision and convergence.

There is a debate on the number of new Authorities[4]: 3, 2 or 1. We strongly support the intention to upgrade the three level 3 committees to pan-European: Banking, Insurance and Securities Authorities. Our rationale is that each area offers distinct services and commitments to the retail customer. Therefore it is most appropriate to regulate and supervise in line with the specific offering and commitment made by the service provider.

We offer the following explanation for our preference for three new authorities as opposed to a unitary structure. Banks offer a safe haven for customers to place their immediate cash, provide transaction services, and provide a home for precautionary deposits. Regulatory emphasis should be on the security of those funds and their access at short notice. In Insurance, customers make premium payments in return for a guaranteed payment on the occurrence of a prescribed event in the future. Here the emphasis should be on assuring the long-term guarantee, and making sure that the asset pool appropriately supports the guarantee (which differs materially from the bank pool). In the securities markets, investors purchase assets with no guaranteed return and are subject to varying degrees of risk. Here the principal concern should lie with the suitability of the products offered to customers. In addition the securities markets are 'the' forum for raising long-term capital; hence fairness, transparency and integrity are important characteristics in order support efficient capital-raising fora.

We have also observed that a unitary regulatory structure combining banks, insurance and securities under one umbrella produces complicated reporting structures with poorly defined responsibilities. We are concerned that these structures foster internal conflicts of interest, obscure accountability, and lead to sub-optimal solutions. Please refer to our remarks on short selling below. In this an example we cite failings in banking supervision leading to restrictions in the securities markets that in practice damage the price-formation process. This regulatory structure, in our opinion, did not address the underlying problem, which was bank-loan underwriting.

Moreover, a system modelled around three authorities, as opposed to one, would parallel the global regulatory framework that sees Basel Committee for Banking Supervision for banking, IOSCO for securities and International Association of Insurance Supervisors for insurance being at the core of a regulatory web centred on the Financial Stability Forum (FSF). Such a parallel will acquire additional importance with the possible reform of the FSF into the Financial Stability Board, as proposed by the London G20 Meeting.

However we are mindful that there is a significant degree of overlap in services offered by banks, insurance companies and asset managers/investment advisers,

[4] For example, the recent Turner Review published by the Financial Services Authority (UK) proposed the creation of a single European authority to replace the three existing level three committees.

most notably in 'substitutable' investment products. We recognise that robust horizontal structures are required between the three new authorities, for their optimal operation.

We are hopeful that there will be a strong consensus around this point, as it was in the Commission's intention even before the publication of the de Larosière Report.

3. Enhance European investors' confidence:
   As the leading voice representing investors, we are glad to see this as part of the top priorities. Restoring investors' confidence is paramount to restoring markets, especially in these times.

   There cannot be enhanced investors confidence without a strengthened EU financial market. As such, this objective calls for both increased harmonization of investor protection rules throughout the EU and for a clarification of the legal framework currently regulating retail financial products.

   We will analyse the shortcomings of this framework and recommend ways to improve it when analysing retail financial products.

4. Improving risk management in financial firms and aligning pay incentives with sustainable performance:
   We support this objective, as we are convinced that compensation for senior company executives and incentive structures for asset managers should be explicitly linked to long-term financial and operating performance.

   We also support shareowners' right to approve or reject any share-based compensation plan for management and directors and other plans that can potentially dilute shareowners' holdings.

   Finally, CFA Centre would like to point out to the Commission another key element in order to reach this strategic objective: the disclosure of the general formulas and performance metrics used to determine executive pay, as these are crucial to enable investors to decide whether they believe the incentives will lead to improved performance. We emphasise that these formulas should be simple as well as transparent. Further the premise should be that variable compensation is variable and not a mechanism of entitlement.

5. Ensure more effective sanctions against market wrongdoing:
   CFA Centre particularly welcomes the emphasis the Commission decided to put on this issue, by making of it one of the strategic objectives.

   Regulatory authorities must provide effective and consistent oversight and enforcement as part of the actions aimed to ensure market integrity and investor protection. In order to do so, national authorities need a harmonised range of enforcement/sanction mechanisms to enforce compliance with EU regulations and national laws and codes.

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This is the area in which the EU's efforts have not reached their potential. Currently, the different systems in place within the EU lack both teeth and consistency, in particular for what concerns market abuse. While understanding the institutional and legal reasons behind this failure, the CFA Centre does not see any more room to postpone essential and crucial reforms.

The unsuccessful framework in fact not only makes some of the provisions ineffective, but it may also contribute to the creation of a two-tiered financial market where insiders take advantage of regulatory arbitrage. This would have negative repercussions on both investor protection and on the effective functioning of the single market.

For these reasons, we strongly support Recommendation 19 of the Report, which calls for sanctions regimes that are sufficiently convergent, strict, and resulting in deterrence. We therefore look forward to receiving the concrete proposals the Commission will put forward by autumn 2009, and we urge the creation of mechanisms to involve national authorities at an early stage. In fact, here more than in other areas, the early support of national legislator is crucial, as sanctions and enforcement norms intersect with civil and criminal law.

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Prudential legal framework

- Credit Rating Agencies

The CFA Centre has been involved in the regulatory debate on Credit Rating Agencies (CRAs) reform since well before they became the focus of the policy debate, and has provided the market with an important contribution to this debate[5].

We are supportive of the need for reform of CRAs' role and business model. CFA Centre welcomes the proposals put forward by the Commission[6]. We do judge that some aspects of the proposals are too prescriptive on certain matters such as internal governance and restrictions on the ability of new firms to innovate when it came to CRAs registration. We refer in particular to the complex mechanism that saw CESR as an entry point for registration, with subsequent authorization by national regulators. Nevertheless, we support the Commission's overall efforts to improve the transparency requirements of the CRAs.

We are therefore extremely pleased to see most of our early recommendations on CRAs regulation being incorporated in the recommendations of the de Larosiere Report.

We hope that the Parliament and the Council will reduce the complexity of the registration mechanism, especially in light of both a deteriorating economic outlook that

[5] Please refer to the CRAs webpage of the Centre for a list of comment letters: http://www.cfainstitute.org/centre/topics/analysts/cra.html

[6] 2008/0217 (COD)

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calls for more consistent approaches and the de Larosière proposals. Ideally, a streamlined registration process would use a central community agency for the authorization of CRAs. Such a solution would not only be coherent with increasingly integrated EU capital markets, but also ensure that national regulators apply the rules in a harmonized fashion, and avoid regulatory conflicts and overlapping requirements which are likely to arise if the current regulation is not amended.

We are confident that the work already begun within the Parliament will be positively influenced by what is put forward in the Report, where Recommendation 3 asks for a strengthened CESR to be in charge of the registration and authorization of CRAs.

- MiFID

MiFID can be included among one of the achievements made possible by the Lamfalussy process, an achievement whose merits we noted in the introduction. Despite a fairly recent implementation, we are aware of the interest created by this directive even outside of the EU.

The Directive has acted as a catalyst for evolution, resulting in a proliferation of new multilateral trading facilities, dark pools, and systematic internalisers. As such, the Directive has greatly enhanced competition for equity trading. At the same time, greater competition has created a number of challenges for market participants, as liquidity fragments across trading venues. The loss of transparency as trades have moved to these alternative trading venues has created particular concerns for market participants and regulators, alike.

For this reason, we will shortly conduct a survey of our EU membership in order to know practitioners' views on the first months of MiFID. This survey will focus in particular on the consequences of fragmentation for price formation and market efficiency; on best execution requirements – costs and measurement implications; on the impact on transparency of pre- and post-trade reporting obligations; and on the impact of dark pools. One area we are keen to investigate relates to interest in a widely available consolidated tape, so that market participants gain full awareness of market activity at one point.

We hope that our input will be of value to the Commission during the forthcoming review of MiFID and to the EU regulatory community in general.

- Transparency Directive

The Transparency Directive (TD) is crucial for the modernisation and for the further integration of EU financial markets, as it affects other legal instruments in the fields of corporate governance/company law and in the field of securities. The TD is a minimum requirements directive: this has led, apart from different transpositions into national law, to Member States building different disclosure requirements on top of what was required by the Directive itself.

We understand that higher disclosure requirements may have been kept in place with investors' protection in mind. However, fragmented EU markets can jeopardise investor protection and lead to higher costs. Hence, we see a need for further harmonization in this field, particularly in the area of quarterly reporting. We are not convinced that continuous disclosure regimes, which leave the judgement of a material event in the hands of companies and advisers, best serves the investor's interest.

For what concerns instead different implementation of the Directive, we feel that particular attention needs to be given to reporting mechanisms. CFA Centre has long favoured a central reporting mechanism at the EU level, and maintains that changes in the TD would be the easiest and most effective way to achieve if not regulatory convergence at the EU level, then at least regulatory harmonization among member states.

Full access to the relevant market information is a cornerstone of competitiveness and market integrity. As a consequence, the EU should create uniform market data facilities to collect, store, and share relevant information between Member States regulators and market participants all over the EU. This is why we favour the creation of a central repository at the EU level. Such an instrument would eliminate the need for complex legal structures directing cooperation among regulators, and would standardize the format for data collection and distribution. It would also make collection, submission, and review of relevant market data easier for regulators with the added benefit of making such information immediately available across all markets and all member states.

- Market Abuse Directive

The Market Abuse regime is fundamental to promoting integrity in financial markets. We put our efforts in ensuring that the investors' community was heard on this matter through our contributions to CESR[7]. The importance we placed on this stream of level 2 work was reflected in our decision to create a European Working Group[8] composed of investment professionals, whose members represent several member states. We hope that our suggestions, aimed at ensuring higher levels of transparency and integrity, will be incorporated in CESR's final guidance.

On a more general level, here again the main issue is the lack of harmonization in the implementation of the Directive. There are a number of conflicts between jurisdictions and supervisor. Whereas some jurisdictions have imposed burdensome regulatory requirements, others have not even taken proper care in the transposition of the Directive into national law. Reporting thresholds also differ significantly, as we point out in other parts of this statement.

However, among the most divergent practices is the management of rumours. This problem acquires additional importance in the light of the current market conditions, which have produced an increasing number of issues related to rights and corporate

[7] http://www.cfainstitute.org/centre/topics/comment/2008/pdf/080814.pdf ; http://www.cfainstitute.org/centre/topics/comment/2009/pdf/090109.pdf

[8] We are in the process of forming a European Investors Working Group, which will be distinct from the European Working Group.

bonds. In this context the management of rumours becomes a top priority in order to guarantee financial market integrity and investor protection.

As the easiest and most effective way to approach this problem, CFA Centre has recommended in earlier consultations alternative ways to manage insider lists and the introduction of clearer mechanisms for the identification of rumours, such as quantitative tools based on a combination of share price movements and trade volumes analysis.

This could not only alleviate uncertainty but also could be the first step towards a harmonization of national approaches, as it provides Member States with a simple and non-discriminatory mechanism for rumours identification. We urge adoption in the final set of guidance that will be issued by CESR.

We hope that the Review of the Directive will reflect these concerns, and will extend harmonization not only to sanction and enforcement but also to the tools applied by national authorities to monitor market activity.

- Hedge Funds

The financial crisis has brought increasing attention to the role played by hedge funds in financial markets. Hedge funds perform a very useful role in providing liquidity and in the price formation process, and do not represent a systemic risk as such. However, a systemic risk is represented by the extent to which hedge funds employ leverage in their investment portfolios.

We are aware of the difficulties experienced in some regulatory fora when trying to establish a common definition of what constitutes a hedge fund. We consider the following four elements to be the key distinguishing characteristics of hedge funds: investment objective, legal structure, fee structure, and the investment instruments used.

Hedge funds have a common objective to generate absolute returns. The principal legal structures for hedge funds are limited partnerships, limited liability corporations, or offshore corporations. The fee structure typically comprises a management fee and an incentive fee, and may also include a high water mark. With regards to investment instruments, hedge funds may invest in over-the-counter derivatives, engage in short-selling techniques, and employ leverage, not to mention more traditional debt, equity, and derivatives instruments. Typically, the more exotic of these instruments and techniques are outside the eligible investment parameters for traditional long-only collective investment schemes. We believe that these defining characteristics should be taken into account whenever drafting legislation that may have repercussions on the investment management industry.

For what concerns the new regulations to be applied to the industry, the primary facilitator of hedge fund leverage is typically the prime broker. For this reason we believe that an ‘indirect approach’ of regulating and monitoring hedge fund exposures and aggregate leverage via the prudential oversight of and requirements on prime brokers and other hedge fund service providers can be effective. This, supplemented by registration

of hedge fund managers and adoption of investor-focused codes of conducts, would be preferred to an approach that would place new capital requirements on hedge funds.

We strongly oppose the imposition of capital requirements on hedge funds, as this would be not only prove costly from a supervisory perspective but would also be likely futile. If such an initiative were to be adopted in Europe but not in other key international jurisdictions, it would offer easy opportunities for regulatory arbitrage.

As a consequence, CFA Centre believes that an indirect approach regulating leverage, complemented with a fine-tuned regulation on banking, securities, and insurance sectors that provide hedge funds with access to local markets, would be the most effective way to minimise systemic impact while at the same time controlling the risk they pose to investors.

These systemic measures should be complemented by an increased attention for ethical and professional standards. As part of this, we favour the announced measures aimed at improving transparency and risk management in the industry.

The systemic impact and the risk posed to investors could be minimised thanks to increased disclosure. Clear, relevant, and timely disclosures are essential for investors to have sufficient information on which to base their decision-making process, and to maintain confidence in the hedge fund industry. Recent scandals only serve to highlight this fact. In this context, hedge funds should adopt transparency measures as part of a formal and workable self-regulatory code of conduct for the sector, such as the CFA Institute Centre's Asset Manager Code of Professional Conduct[9].

For what concerns risk management, we are fully supportive of efforts to improve risk management processes and procedures for managing hedge fund assets. Again, this would be best achieved through industry-wide adherence to an accepted code of conduct based on best market practices.

- Investment Funds

Recent scandals have highlighted the need for improved transparency in the investment fund management industry. We share this concern with the Commission and the de Larosière Group.

However, when the Group calls for "tighter supervisory control" over depositaries and custodians (Recommendation 9), we tend to disagree. CFA Centre does not see the need for "tighter" controls, but rather for a clarification of responsibilities.

What we believe is of paramount importance is to raise the standards of responsibilities for custodians. This is the key function and the area that showed the main deficiencies during the crisis' escalation and the related unfolding of several frauds.

[9] http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2004.n4.4008

Depositaries should adhere to the highest ethical and professional standards and enjoy a harmonised regulatory framework at the EU level. Review of the role and responsibilities of custodians, as they have ultimate controls on clients' money, is therefore what we see as the top priority in this area.

- Short selling

The uncoordinated measures adopted within the EU in the wave of short-selling bans last autumn is a prime example of the evident and strong need for more coordination not only in supervisory laws but also (and increasingly so in light of the current crisis) in day-to-day oversight of markets. The emergency rules on short selling were introduced to bring order to disorderly markets and curb market abuse in financial service stocks. With the benefit of hindsight it appears that investor behaviour was rationally interpreting the changing fortunes of the financial sector and we are unaware of any cases of market abuse that materially affected security prices. In our opinion the focus of regulator attention should have been directed at banking supervision in this instance and enforcement against abusive activity by the individual.

The CFA Institute Centre firmly believes that short selling is a valuable investment activity that enables markets to quickly and accurately adjust securities prices to reflect investor opinions about valuations. Accordingly, we remain opposed to measures designed to restrict short selling or specific controls that would contribute to the erosion of liquidity in financial markets.

However, market efficiency could be improved through greater transparency regarding short selling activity. For example, if not already implemented in an EU jurisdiction, firms should identify short sales on trade tickets, and exchanges should publish aggregate short interest data ideally in real time or in a consolidated form at the end of the trading day.

Finally, disclosure thresholds for short sales (for example, 0.25% of economic interest in some EU jurisdictions) are disproportionate relative to the claims and benefits of short and long positions of similar sizes. This asymmetry not only discriminates against the interests of short sellers, but also is detrimental to the efficiency of the price-formation process and in the end of market transparency itself.

Some key jurisdictions in the EU are currently consulting market participants in order to amend the rules adopted in a crisis and codify them more in detail; these should be discouraged for the reasons stated above.

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Retail financial services

The expansion and integration of the market for retail financial services within the EU has prompted increased regulatory attention to the field. This resulted in the adaptation of EU law through MiFID, and the UCITS, Prospectus, Life Insurance, Insurance Mediation, and E-Commerce directives. Despite this, structured securities, investment funds, unit-linked

life, insurance policies and structured term deposits are currently subject to different disclosure and distribution rules under European law.

CFA Centre considers it essential to strive for coherence between these frameworks, in particular by ensuring that a set of fundamental principles are respected in each case. These include a high level of transparency on performance, costs and risks; responsible selling practices; effective management and disclosure of conflicts of interest; and fair and especially comparable marketing materials. We believe there is a need for a greater degree of horizontal harmonisation and, above all, comparability.

On top of the inconsistencies existing between product ranges, every product category is regulated by several legal instruments. Some products, such as unit-linked life insurance products, are regulated by as many as five different directives (Life Insurance, Solvency, Insurance Mediation, E-Commerce or Distance Marketing). Adding to this are the cultural differences still shaping many of the investment decisions of EU citizens, and the patchy and not always homogeneous transposition of these directives into national law. Ultimately, this provides an indication of the complexity of the current legal framework in this market, which does not make the goals of investor protection or market transparency easy.

A recent survey of our EU membership[10] highlighted some of the inconsistencies of the regulatory framework. In particular the results obtained from our members involved in the management, marketing, and selling of investment products to retail customers confirmed that there are consistency problems with this framework, and portrayed a further deterioration of this context due to the current crisis.

The survey found that 49% of the respondents believe that material differences in the regulatory requirements governing mandatory disclosures and conduct of business negatively affect the advice/sales process. In particular, the aspects of the sales process to retail customers that are most negatively affected by regulatory differences were seen as the identification/explanation of the investment proposition (49%), followed by the costs associated with the investment (46%), the range of probable risk-reward outcomes (41%) and the selection of investment options most suitable for individual investors (44%).

Our EU membership also indicated in their responses that this already intricate situation has been further complicated by the current crisis. The picture has deteriorated in the recent market turmoil due to the sharp increase in liquidity risk (80%), investment risk (55%) and counterparty risk (63%). Recent developments also have prompted investment advisers to re-evaluate the suitability of certain investment products for retail/mass affluent clients, including specifically the suitability of hedge funds (61%), funds of hedge funds (60%), retail structured products (56%), real estate funds (32%) and equity funds (24%).

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[10] The survey was conducted from 20 January-30 January, 2009, among CFA Institute members in the European Union. 1.027 members responded to the survey. For results based on samples of this size, the margin of error is ±2.9 percentage points at the 95 percent confidence level. The value of this survey stems from the fact that questions relating to retail investment products were only asked of respondents indicating they are involved in the management, marketing, and selling of investment products to retail/mass affluent customers.

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The responses identify a series of concrete issues that need to be addressed. Most of them relate to the complexity of the EU legal framework and to its transposition into national law. As a consequence, the key objectives should be horizontal harmonization and the comparability of the integrated directives in national law across Member States.

We suggest focusing first on the need for clear disclosures. As we have already pointed out, we see a risk that disclosures for structured products and unit-linked life policies are at present too opaque, particularly for as it relates to risk measures and past performance.

We welcomed the work on identifying Key Investor Information or Key Information Document (KII or KID) for UCITS, and we participated actively to the related policy debate. We think that this work could form the basis, with appropriate adjustments, for improved disclosures about other product categories. This is true, in particular, for structured and complex products whose risk measure indicators have proven unable to convey the right information to investors.

As we expect this area will need regulatory attention in the coming months, we welcome the forthcoming consultations on the KID. As stated in a previous response to CESR[11], the CFA Centre believes the KID should be short, and only contain information that improves investors' decision-making process. As such, generic and explanatory information should be transferred 'sign posted' to a separate "knowledge base" document (for example accessible on the web). This would make more informative content available to investors, while at the same time complementing the Commission's effort to promote the strengthening of financial education[12]. In fact the knowledge base document could include simple and detailed explanations to generic ideas, terms, and concepts linked to each section of the KID.

We appreciate the focus being placed on the strengthening of the effectiveness of safeguards during the marketing, selling and recommending steps, and on the delivery of clear comparable pre-contractual information to investors. Harmonization of legal instruments and comparability between different products is essential.

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Financial Market Infrastructure

- Over-the-Counter derivatives markets

The financial crisis has brought many to question the systemic impact of derivatives trading and to analyse possible solutions to these supposed risks. Much of the focus has been over credit default swaps (CDS) and on the potential use for price manipulation, especially following the Lehman Brothers collapse.

[11] http://www.cfainstitute.org/centre/topics/comment/2007/pdf/cesr_response.pdf

[12] Commission Communication, Volume 2, Annex I.

We agree that there is little or no price discovery in some of these markets, which contributes to serious concerns about valuations. Moreover, up to now, the lack of a central clearinghouse for trades in this market raises concerns about the potential default of a significant counterparty and the potential impact upon trade settlement. For these reasons, we are sympathetic towards efforts aimed at achieving improved transparency and standardization of certain OTC markets, in particular those for CDSs.

However, CFA Centre urges caution against attempting to standardize and place all OTC derivatives instruments on trading markets. This is because many of these instruments are bespoke contracts between two consenting parties, and thus tailored to meet the specific needs of each set of counterparties. Notwithstanding the benefits of standardisation, investors should be able to continue to benefit from customised contracts in order to manage their idiosyncratic risks.

Accordingly, we urge the Commission not only to differentiate between those derivatives that have already achieved a certain level of standardisation or that create systemic risks due to the magnitude of their use, but also to enter in technical talks with the industry to achieve the level of harmonization requested for these specific instruments.

We urge EU regulators to continue engaging in exploratory talks with the industry in order to give adequate consideration to the industry initiatives that have emerged in response to the Commission's intentions. We look forward to learning more about the joint industry/Commission talks concerning the establishment of a CDS central clearing platform, which is to be established by 31 July.

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International Regulatory Dialogue

International cooperation in financial regulatory affairs is of the utmost importance. As we have noted twice in this policy paper, regulatory arbitrage is a risk that needs to be considered when defining regulatory impact. The degree of international coordination, or lack thereof, can be crucial in this domain.

Unfortunately, despite the deeper integration existing within the EU and the increasingly outward-looking approach of other jurisdictions, the promising regulatory dialogues initiated in recent years have been partially interrupted due to the financial crisis. The CFA Centre believes that it is particularly in this moment that regulators, especially those in Europe and North America, need to increase the breadth and depth of their cooperation.

We understand the need for the de Larosiere Report and for the Commission communication to focus on macro- as well as micro-supervision. Macroeconomic surveillance and crisis prevention should form one of the components of an integrated and effective global financial structure. However, the mechanisms identified by the de Larosière Report would require lengthy, cumbersome and politically sensitive negotiations between too many actors.

We therefore urge regulators and the European Commission in particular, to address international regulatory failures in the areas where solutions are easiest and where implementation is quickest. Successful steps in this direction could boost negotiations in supranational organizations such as the Basel Committee, the Financial Stability Forum, IOSCO, and others.

We refer in particular to mutual recognition in the field of securities and of market abuse. This would prove to be an area where regulatory convergence and implementation could proceed without increasing the legal burden on market actors and without relying on a difficult and long reform process of the legal structures of the main international structures in the field. Such an action in the field of securities would be extremely beneficial in order to increase consumers' choice, facilitate the general functioning of US and EU financial markets, and enhance liquidity.

Even where technical differences exist, such as among the Market Abuse regimes in the US and in the EU, the underlying principles and the goals of the regulations do not differ substantially. Here, and in every similar situation, the formal acceptance of the principles of mutual recognition and home supervision might be a big step in the right direction.