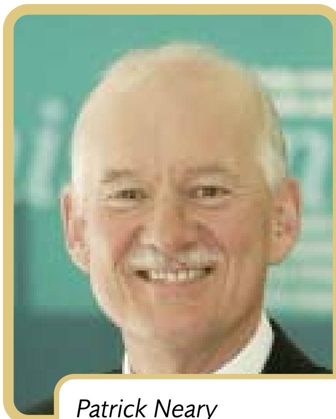
Financial Regulator
Rialtóir Airgeadais

Regulatory Connection

Issue 8
September 2006

Welcome from CEO



Patrick Neary

Welcome to the Autumn issue of Regulatory Connection. The next few months will see a period of implementation for the industry as many firms continue their work to embed the Consumer Protection Code in their organisations and prepare for the implementation of Minimum Competency Requirements from January 2007. Work is also continuing in the banking sector on preparations for the Capital Requirements Directive under Basle II and continues apace in reinsurance. See inside for updates.

The last few weeks have seen increased focus on the regulatory system following the International Monetary Fund (IMF) Financial System Stability Assessment and the publication of the Building on Success Report by the Department of the Taoiseach on the development of the international financial services industry in Ireland.

The Building on Success Report marks a very significant roadmap for the future development of the international financial services industry in Ireland. We at the Financial Regulator are particularly conscious of the need to operate an efficient, effective and impartial regime to encourage a competitive and expanding market of high reputation. The Financial Regulator is well equipped with the organisational structure and necessary expertise to facilitate, with appropriate regulation, the future growth and development of the international financial services industry in Ireland.

The approach being taken by the Financial Regulator has been underpinned by the recent IMF review. The IMF reported that good progress has been achieved in further strengthening the regulatory and supervisory framework and that a unified approach to risk with common elements across different sectors where appropriate, but differentiated where necessary is being put into practice well.

Work is currently underway on the Financial Regulator's strategy for 2007-2009. Due to be published in November, the strategy will guide us through our work over the next few years. This has been prepared in consultation with the industry and consumer panels whose feedback and comment we have welcomed.

Patrick Neary
Chief Executive

CONTENTS

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Challenges and Opportunities for Irish Firms under the MiFID

The purpose of replacing the original Investment Services Directive (ISD) with the Markets in Financial Instruments Directive (MiFID) was to provide secure access to the whole EU market for EU investment and asset management firms. From November 2007, Irish authorised firms will be free to do business with EU citizens, no matter where they are domiciled. Investors from across Europe will be able to invest on Irish markets and deal with Irish firms, confident that a common standard of regulation and market transparency applies across Europe.

Some Irish firms already do business elsewhere in the EU, under the ISD. They should find it easier to carry on that business and may seek to take advantage of the freedoms provided by the MiFID to extend their business. Existing firms that at present do business only in the Irish market may review their strategy to avail of the commercial advantages of operating in a much larger market. We may also see new Irish authorised firms enter the EU market to take advantage of the new freedoms. It is clear that MiFID compliant firms stand to gain a lot from the new framework as opportunities for business will grow, bearing in mind, however, that market efficiency is also set to increase through increased competition across the single market.

Availing of the advantages of the larger market does come with a cost for firms. The member states of the EU agreed to create a true single market in investments on the basis that all firms would be playing by the same rules. Thus, the MiFID specifies rules in a number of areas that must be fully observed in all member states. In Ireland, transparency and code of conduct requirements similar to those imposed by the MiFID already exist, but the Directive is quite specific on the precise rules to apply and the way they are to be enforced. This will require change in Ireland in the way firms and markets are regulated and the way firms organise compliance systems.

The maximum harmonisation of rules in the Directive is designed to ensure that individual member states cannot introduce barriers to their own market in the guise of extra prudential or consumer protection measures. This means that member states have few discretions in implementing the MiFID. It also means that, where it is necessary to interpret the provisions of the Directive, the European Commission, as the guardian of the laws of the EU, and the European Court of Justice, rather than individual member states, are the ultimate arbiters of what the Directive means.

Implementation is underway in Ireland. The draft regulations implementing the Directive are available on the Department of Finance's website www.finance.gov.ie. The Financial Regulator has initiated a process of consultation by setting up a consultative forum with representatives of the firms and the Financial Regulator. The forum is setting up working groups to explore and agree possible approaches to the various issues that arise in relation to implementation of the MiFID. The Financial Regulator is also in direct contact with firms on specific issues they face.

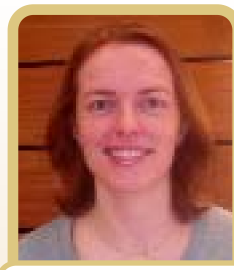
The Financial Regulator will assist the industry in understanding the requirements of the Directive and where appropriate, issue guidance. However, we will also emphasise the need for firms to do their due diligence and to come up with ways to comply with the Directive that are most suitable for their business and sector. Boards and Directors will have to make key decisions on the basis of their own evaluation of the requirements for their firm and will have to be ready to defend and explain those decisions. This approach gives firms the discretion to manage the costs of compliance while ensuring that the requirements are fully met with.

The effectiveness of implementation of the MiFID will of course be subject to constant evaluation by the industry and by individual regulators. Moreover, it will be subject to more formal evaluation by the EU Commission and by EU securities regulators as a group, gathered in the Committee of European Securities Regulators (CESR). The effectiveness of the MiFID regime will be judged for achievement of the twin objectives – a genuine single market and a genuine level playing field.

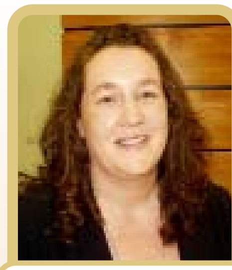
An update on the MiFID implementation process will feature in the next issue of Regulatory Connection.

Pictured at the Oracle/Irish Bankers Federation seminar on MiFID in June 2006: (L to R) Downey Keegan, Financial Regulator; John Moore, Department of Finance; JWG-IT; Eimer O'Rourke, Irish Bankers Federation

New Appointments at the Financial Regulator



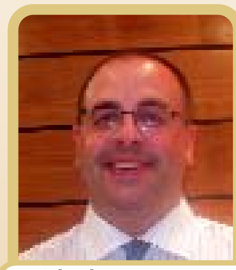
Colette Drinan
Deputy Head of Consumer Protection Codes



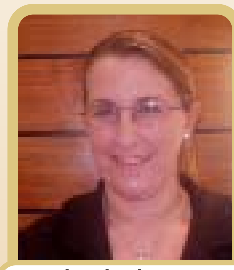
Karen O'Leary
Deputy Head of Consumer Information

Five new deputy heads have been appointed in recent weeks within the Financial Regulator.

An organisation chart outlining the management and departmental structure is available from www.financialregulator.ie/aboutus/orgchart.pdf



Michael Frazer
Deputy Head of Insurance Supervision



Sandra Shanley
Deputy Head of Markets Supervision

Fiona McMahon
Deputy Head of Financial Institutions & Funds Authorisation

Ireland Financial System Stability Assessment

The IMF published its Financial System Stability Assessment Update in July. This assessment followed on site visits to the Financial Regulator, industry bodies and individual financial institutions by the IMF in March of 2006.

The key macro-relevant findings of the report:

- The Irish financial sector has continued to perform well since its participation in the Financial Sector Assessment Programme (FSAP) in 2000. Financial soundness and market indicators are generally very strong.

- The outlook for the financial system is positive. That said, there are several macro-risks and challenges facing the authorities. As the housing market has boomed, household debt to GDP ratios have continued to rise, raising some concerns about credit risks. Further, a significant slowdown in economic growth, while seen as highly unlikely in the near term, would have adverse consequences for bank's non – performing loans. Stress test confirm, however, that the major financial institutions have adequate capital buffers to cover a range of shocks.

- Good progress has been achieved in further strengthening the regulatory and supervisory framework, in line with the 2000 recommendations of the FSAP. The strategy of creating a unified approach to risk with common elements across different sectors where appropriate, but differentiated where necessary is being put into practice well. Improvements could nonetheless be made to enhance some aspects of supervision, especially as regards more rigorous on-site supervision of insurance companies.

The full report is available from www.imf.org/external/pubs. The Financial Regulator will be reviewing the findings of the IMF Financial Sector Assessment Programme as it prepares its strategy for the next three years. The Central Bank will also publish its Financial Stability Report in November which reviews macro prudential risks in the Irish financial system.

News

Update on Minimum Competency Requirements

Consultation papers were issued in 2004 and 2006 seeking views in relation to the introduction of minimum competency requirements for the main sectors of the regulated financial services industry. Following consideration of the submissions and subsequent discussions with industry representative bodies and the main educational institutes active in this area, the Requirements were issued on 25 July. A Public Response was also issued, to provide additional clarification in a number of areas where concerns or uncertainty were evident in the submissions. The Requirements introduce a basic competency framework that is designed to establish minimum standards for the financial services industry. They will apply to individuals who provide advice on or sell retail financial products or who undertake certain specified activities. Specified activities include claims administration, reinsurance intermediation, management of accredited individuals and adjudicating on complaints. The requirements will be implemented on 1 January 2007 and are available on www.financialregulator.ie

Pictured at the launch of the Online Register of Qualified Financial Advisers (QFAs) in September are Mary O'Dea, Consumer Director and Bill Hannan, Chairman of the QFA Board. The Register of QFAs can be accessed at www.qfaboard.ie/register

Update on Consumer Protection Code

The Financial Regulator published the Consumer Protection Code on 25 July. This code represents the culmination of a detailed public consultation process that started in March 2004 and included the issue of three consultation papers, a Regulatory Impact Analysis and a Public Response to the submissions received.

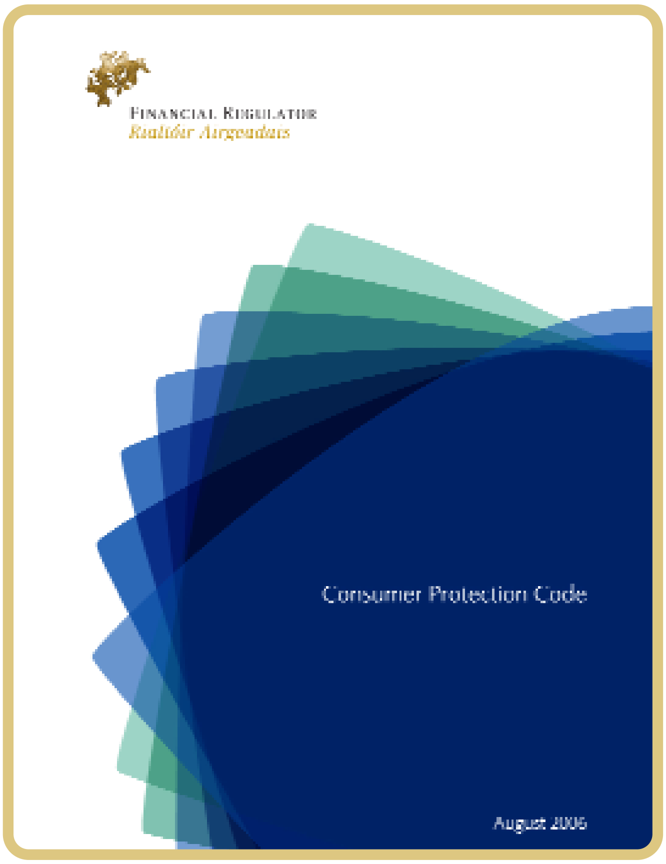
Our main focus with the code is to promote consumer focused behaviour, ensuring that people receive the same standard of fair treatment regardless of the type of financial services provider they deal with and the promotion of competiton by creating a level playing field. The Code is a legally binding document containing a set of general principles supplemented by more detailed rules.

The Code came into effect on 1 August 2006. The general principles and existing provisions carried forward from the previous codes and handbooks became effective on that date. While a bedding down period is to be expected, we felt that some new provisions were capable of coming sooner than others as the level of staff training and system changes required for their implementation was not significant. Therefore the following came into place on 31 August 2006:

- the prohibition on making the sale of one product contingent on the purchasing of another product;
- the requirement that a consumer must positively indicate acceptance of any optional extras for which there is a charge;
- application of changes in interest rates;
- the prohibition on unsolicited pre-approved credit;
- the requirement to advise consumers who are thinking of surrendering certain life assurances policy before they mature of the existence of a secondary market, where they may get a higher amount for their policy; and
- the requirement for warning statements in certain advertisements must be included in all advertisements created after 31 August 2006.

We expect firms to take immediate steps towards implementing the other new requirements in the Code. We recognise that this is a significant undertaking and in monitoring compliance with the Code, we will take account of the time needed to make the necessary changes to systems, procedures and documents and to train relevant staff.

The Handbook for Investment and Stockbroking Firms, the Code of Conduct for the Investment Business Services of Credit Institutions and Advertising Requirements applicable to Credit Institutions continue to apply to these regulated entities when providing services covered by EU Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments until 1 November 2007 (commonly referred to as MiFID). These are all available on our website.



The prudential requirements contained in the Handbook for Authorised Advisors and the Handbook for Restricted Intermediaries are now available in a consolidated Handbook of Prudential Requirements for Authorised Advisors and Restricted Intermediaries on our website and continue to apply.

The following requirements were withdrawn with effect from 1 August 2006

- Handbook for Authorised Advisors
- Handbook for Restricted Intermediaries
- Interim Code of Practice for Mortgage Intermediaries
- Interim Code of Practice for Insurance Undertakings
- Code of Conduct for Deposit Agents
- Code of Practice for Credit Institutions

The Code is available on the Financial Regulator's website at www.financialregulator.ie. Any queries on the Code should be directed to code@financialregulator.ie.

Credit Institutions - Requirements for the Management of Liquidity Risk

The new liquidity requirements for credit institutions were issued in July 2006. The requirements seek to enhance the current qualitative requirements and amend the current quantitative requirements on liquidity as set out in Section 6 of the Licensing and Supervision Requirements and Standards of 1995.

The quantitative requirements involve a forward looking mismatch approach to liquidity management under which cash flows are assigned to relevant time bands, replacing the current stock approach. The new requirements reflect the use of improved techniques to measure and manage liquidity risk.

A six month parallel run of the existing stock approach and the proposed mismatch approach will commence in January 2007 with compliance with all of the qualitative and quantitative requirements under the new framework to commence with effect from July 2007.

Annual management fees within authorised collective investment schemes

In June 2006 the Financial Regulator issued a consultation paper to request feedback on a proposal to allow retail collective investment schemes ("CIS") calculate their annual management fees based on initial issue price per share. In particular, the Financial Regulator sought specific information on any global trends in relation to annual management fee calculations, and the ability of investors to understand and compare charging structures across CIS.

On the basis of the information provided to the consultation, the Financial Regulator will permit retail CIS charge the annual management fee calculated based on the initial issue price, subject to the following:

- The CIS is a structured product which, through investment in financial derivative instruments, provide for a specific return (for example, a guaranteed return or an element of capital protection) based on the performance of a particular index or underlying basket of assets provides a pre-defined return to investors.

- The fee charged is a percentage of the initial issue price per share, i.e. it will be adjusted to take account of dealing activity in the CIS.

- The prospectus of the CIS will disclose the fee paying arrangement and provide a clear warning that the fee is fixed and not subject to the performance of the CIS.

Consultations

The following consultations have been recently published on www.financialregulator.ie

Financial Regulator Service Protocol Consultation Process

The Financial Regulator is developing a Service Protocol which will outline the nature and quality of service which stakeholders can expect from the Financial Regulator. The Service Protocol will also set out:

- The responsibilities of stakeholders when interacting with the Financial Regulator;
- Timescales for principal interactions with stakeholders;
- Qualitative issues (such as whether they are treated in a professional and courteous manner), and
- It will also include a complaints mechanism.

The protocol will benefit the public, industry and staff of the Financial Regulator and benefits will include:

- Compliance Officers will be aware of the time the Financial Regulator needs to authorise a new financial service provider or process an amendment to it;
- Consumers will know the timescale for answering a query, and
- Industry will have a better understanding of the inspection process.

The Financial Regulator is adopting a consultative approach to the development of a Service Protocol. Workshops are being organised with representatives from across the industry. These workshops are mainly focusing on the following issues: authorisation, inspection, communication and how we consult publicly.

To help us help you, we would welcome your views on the following:

1. What are the three most important service issues, in order of importance, that the Financial Regulator should address in the service protocol?
2. For each of these items and where an improvement in service delivery would be beneficial how does it need to be improved?
3. What are the responsibilities of stakeholders in assisting the Financial Regulator in achieving an improvement in service?

The closing date for submissions is **30 October 2006.** Please e-mail your suggestions to Dermot.leahy@financialregulator.ie. The results of this survey will be published in the next issue of Regulatory Connection.

CP 20 - Transitional Requirements for Life Reinsurance Undertakings

The Financial Regulator has decided to engage in a limited consultation before the transitional requirements for Life Reinsurance Undertakings are finalised. In carrying out a limited consultation we do not intend to alter the fundamental structure of the proposed requirements. We will actively seek the views of the industry through this process. In addition, these documents will be sent to industry representative bodies and Consultative Panels and published on our website. The term 'limited' does not preclude, however, any other interested party from submitting their views to the Financial Regulator.

Comments are welcome on this consultation paper by **29 September 2006,** and should be forwarded to reinsurance@financialregulator.ie

Pictured at the Insurance Institute Industry Leaders Conference (L to R) Michael Brennan, President, The Insurance Institute of Ireland; Mary Fulton, Partner, Deloitte; Cormac McCarthy, Group Chief Executive Officer, Ulster Bank Group and Patrick Neary, Chief Executive, Financial Regulator who spoke at the event

CP 21 - Run-Off of Reinsurance Undertakings

As the reinsurance sector in Ireland moves to formal regulation, it is intended that the run-off of Reinsurance Undertakings will be subject to regulatory oversight. This paper provides draft guidance to the sector on the Financial Regulator's proposals in relation to the run-off of Reinsurance Undertakings. Comments are welcome on this consultation report by **29 September 2006,** and should be forwarded to reinsurance@financialregulator.ie

Other Consultations

A consultation will shortly be published on the Capital Requirements Directive. The revised Fit and Proper framework is also being finalised and requirements will be published on our website in the coming weeks.

EU News

CEBS

Questionnaire on Commodity Firms and Commodities Business

CEBS members preparing for a plenary meeting in London.

CEBS received a call for advice from the European Commission on prudential treatment of commodities business. The advice will form part of the Commission's review of commodities business under the Capital Requirements Directive (CRD) that requires the Commission to consider the question of an appropriate prudential regime for firms carrying out business in relation to commodities derivatives and certain other derivatives contracts. In order to consult with a sufficiently broad spectrum of firms of all sizes, CEBS has published a questionnaire on current industry practices and thinking in relation to the measurement and management of commodity risk. The main focus of the questionnaire is on the measurement and management of commodities business risk for internal purposes. Questions are also asked about industry's experience of the current regulatory framework and how a potential future regulatory regime would affect commodity firms and commodities business.

CEBS is equally interested in getting feedback from larger and smaller institutions, and both from institutions that are part of a financial group and that are not part of such a group. The aim is to gain a full and deep understanding of industry analysis, policies, practices and procedures. The questionnaire is available on CEBS' website www.c-ebs.org/Advice/Q commodities.pdf. The responses will be published unless otherwise requested by the respondents. Comments should be sent to CFCB@c-ebs.org by **20 October 2006.**

Report on Industry Practices on Large Exposures

CEBS has published a final report on industry practices for the measurement and management of large exposures, including the use of credit risk mitigation (CRM) to manage large exposures. The report also provides feedback on the industry's views on the current regulatory environment. The report responds to a Call for Advice issued by the European Commission in December 2005, in which CEBS was invited to carry out a number of pieces of work to inform the Commission's review of the Large Exposures rules in the Capital Requirements Directive. The information collected in this report together with the CEBS report on supervisory practices published in April 2006 should contribute to the assessment of whether revisions in the current rules are warranted. In this respect, CEBS is studying the fundamental prudential principles underlying a large exposures regime and the degree to which credit risk management techniques (including the use of credit risk mitigation) should be included in large exposures rules. For more information on, please use the following link: www.c-ebs.org/Advice/advice.htm.

Informal Joint Assessment of Three External Credit Assessment Institutions

Competent supervisory authorities across Europe have reached a shared view on the Fitch Ratings, Standard & Poor's Ratings Services, and Moody's Investors Service eligibility for regulatory capital purposes and on the mapping of their credit assessments.

As required by the Capital Requirements Directive (CRD), competent authorities have considered whether the methodologies of the three external credit assessment institutions (ECAIs) meet the requirements of objectivity, independence, ongoing review and transparency and that their ratings meet the requirements of credibility and transparency. Furthermore they have considered which of the risk weights should be attached to their ratings (the 'mapping').

Competent authorities have based their assessment on the guidelines published by the Committee of European Banking Supervisors (CEBS). They have adopted a single joint approach to the assessment of those rating agencies, as recommended in the guidelines. The guidelines aim to reduce administrative burden and ensure a level playing field for institutions that use ECAIs ratings for the purposes of the Standardised Approach and the Securitisation Ratings Based Approach to determine the risk weights of their credit exposures. The agreement is without prejudice to any applications - current or future - that may be received from other ECAI applicants. They will also be considered on their merits in line with the CRD and on the basis of the CEBS guidelines. For more information on mapping, please use the following link: www.c-ebs.org/Press/04082006b.pdf.

CESR

CESR changes its profile and starts operational tasks to deliver effective supervisory convergence in the EU

Following successful finalisation of the legislative and regulatory phase of the Financial Services Action Plan (FSAP), the Committee of European Securities Regulators (CESR) has decided to shift its priorities to more operational tasks so as to deliver effective supervisory convergence across the EU. This policy orientation was confirmed in the Commission's White Paper (White Paper on Financial Services Policy 2005-2010, December 2005) and by the recent ECOFIN Conclusions of 5 May 2006 (8500/06). The EU Institutions and CESR recognise that the continued success of the FSAP is now dependent upon an intensification of supervisory convergence. CESR has responded with a number of changes to the way that it now works in order to become more operational in nature and to function as a cohesive network of supervisors who act in a convergent manner. The key rationale of the change in CESR's profile is developed in its recent supervisory convergence report to the FSC (Ref. CESR/06-259b). Available from www.cesr.eu

CESR publishes joint responses to commonly asked questions on prospectuses

CESR recently published a guide for market participants which establishes a convergent response from all EU securities supervisors to commonly asked questions on the day-to-day application of the EU legislation regarding the preparation of prospectuses (Ref. CESR/06-296d). The purpose of this guide is to provide market participants with greater certainty and quick answers to their most common queries.

This 'Q and A' guide that CESR members have developed focuses on responses to queries that are likely to have an EU-wide impact on market participants or end users, and therefore on the smooth functioning of the Single Market. Some of the agreements aim at facilitating the correct functioning of cross-border offers (for example, information from the issuers to host competent authorities or passport of the supplements). The rest are responses to questions on the application of the legislation that have been arising frequently in most Member States (for example, how to treat employee share option schemes, free offers or offers of convertible or exchangeable securities).

As the Prospectus Directive will have been in place for a year, it now seems an appropriate juncture for CESR to undertake an assessment of its practical functioning. To this end, CESR is currently working on an analysis of the impact that the Directive is having on the EU markets and is seeking to identify any practical day-to-day difficulties encountered with the passport and other relevant provisions of the Prospectus Directive. CESR will seek input from market participants through an open hearing that will take place in Paris before the end of 2006, the date for this will be announced on CESR's website www.cesr.eu in the news section.

CEIOPS

Update from CEIOPS

CEIOPS continues its work on the Solvency II project. The European Commission requested further advice ("post-third wave") on key aspects of CEIOPS' Advice which were not fully elaborated and/or defined and thus require additional input. In line with this request CEIOPS released for public consultation its Consultation Paper No. 13 on Draft Advice to the European Commission in the framework of the Solvency II project on insurance undertakings Internal Risk and Capital Assessment requirements, supervisors' evaluation procedures and harmonised supervisors' powers and tools and Consultation Paper No. 14 Draft Advice to the European Commission in the framework of the Solvency II project on sub group supervision, diversification effects, cooperation with third countries and issues related to the MCR and the SCR".

In addition CEIOPS is working on further consultation papers covering key Pillar I aspects such as technical provisions, capital requirements, risk mitigation tools and eligible elements to cover capital requirements as well as Pillar II issues such as reinsurance, safety measures (limits on assets and diversification requirements) and internal models - use test.

On 7 September CEIOPS held a public hearing in addition to the procedure for written public consultation that was open until 12 September 2006. The aim of this public hearing was to give all stakeholders the opportunity of direct dialogue with CEIOPS' representatives in commenting on Consultation Papers Nos. 13 and 14, as well as other outstanding issues of the Solvency II project, especially in the light of the short written consultation period which was set for these Consultation Papers. CEIOPS will take into consideration all useful input in any revision of the drafts as well as in developing further work.

CEIOPS Conference 2006

Building on the achievements of the 2005 conference, CEIOPS intends to continue its open dialogue in line with the Lamfalussy process, through public consideration of CEIOPS' achievements to date and stakeholders' views on the future development of its role, tools and plans.

The prime purpose of the CEIOPS Conference 2006 is to increase the transparency of CEIOPS' work and progress and to strengthen communications with the industry and all interested parties in order to help it react better to stakeholders' demands.

The Conference, which takes place on November 14th in Frankfurt, will again host high-level speakers, offering the benefit of their expertise. The main topics for discussion will be covered in four panel sessions and will relate to the progress of the Solvency II Project, the implementation of Pension Funds' supervisory regime, the management and supervision of operational risk, and the enhancement of consumer protection.

Time will again be reserved for questions and inter-active discussion, which can continue informally between presentations, together with personal networking.

Further details can be obtained at www.ceiops-conference.org

Recently Published on www.financialregulator.ie

- Annual Report for 2005
- Minimum Competency Requirements
- Consumer Protection Code
- Guidance Note on Voluntary Reporting
- Chief Executive Speech at World Credit Unions Conference
- Chief Executive Speech at Insurance Institute Conference

New consumer publications published on www.itsyourmoney.ie

- Savings and Investments Made Easy
- Pensions Made Easy
- Your Choices at Retirement
- Motor Insurance Cost Survey Issue 7
- Stockbrokers Cost Survey Issue 1
- Car Finance Cost Survey Issue 2
- Third Level Student Current Account Cost Survey Issue 3
- Credit Card Cost Survey Issue 5

Pictured at the launch of the IBF Business Account Switching Code: Eimer O'Rourke, Head of Member Services - Retail, Irish Bankers Federation; Mary O'Dea, Consumer Director, Financial Regulator; Patricia Callan, Director, Small Firms Association

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