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Ms Mira Dobovišek
Director
Center of Excellence in Finance
Cankarjeva 18
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SLOVENIA

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Dear Ms Dobovišek,

For the first time representatives of the Financial Supervision Commission attended a seminar organized by the Center of Excellence in Finance in the period of 12-14th September 2007. I would like to thank you, on behalf of three of our colleagues from the Legal Department, for organizing this excellent seminar on "How to Design Better Financial Regulation – Regulatory Impact Assessment: A Key Policy Analysis Tool Regulatory Impact Assessment". They highly appreciated the opportunity for participation in such high-quality training as well as the chance to meet prominent experts in the field.

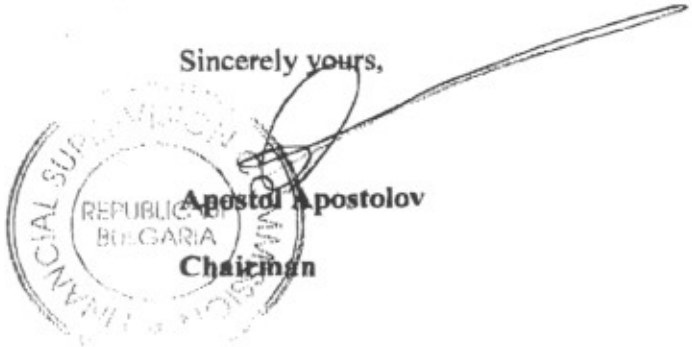
The Financial Supervision Commission is the non-banking financial services regulatory and supervisory body in Bulgaria, i.e. we regulate and supervise the capital market, insurance and pension funds. In view of the rapid developments in the sector of financial services, we face a real challenge in addressing the increasing needs for improvement of the staff qualifications and skills in the field of financial services. That is why I think that the opportunities for trainings provided by the Center for Excellence in Finance can help us in addressing to a large extent some of our specific needs for trainings.

Furthermore, in the course of the seminar training our colleagues learned also about additional activities of the CEF such as coordination and providing and technical assistance to and implementing donor projects with other financial institutions from the East South European region. We are very interested to understand if we can benefit from such initiatives through CEF in order to organize trainings and consultations in Bulgaria which could be

hosted by the Financial Supervision Commission and could cover a larger audience. Most of all, we will need assistance in identifying areas in which trainings could be provided, as well as in the finding and inviting of qualified experts who can provide in-country advice and topic-tailored trainings.

I hope that you will be interested to provide us with guidance on the above-mentioned matters and I am looking forward to a fruitful collaboration between our institutions on future occasions.

Sincerely yours,



Apostol Apostolov
Chairman

ANNEX

A Knowledge Transfer & Capacity-Building Program To Develop Financial Regulatory Impact Assessment Skills At the Bulgaria Financial Supervision Commission

Draft

Phase 0 – Why Market Failure and Cost-Benefit Analyses Matter in RIA

Time requirement: max [1.5] staff days*

Timeline	Event/Action	Background documents/Output	Time requirement (Full Time Equivalent days)
Mid October	➢ Convergence distributes to designated RIA experts a selected set of highly suggested readings about Regulatory Impact Assessment Possible material for distribution could be as follows: • FSA, *A Guide to Market Failure Analysis and High Level Cost Benefit Analysis*, November 2006; • FSA, *Cost-Benefit Analysis in Financial Regulation*, September 1999;		**Desk work (distance learning):** 1.0 FTE
Early November	➢ Convergence meets with designated experts and act as discussant of the material above Once designated RIA experts have gone through the material distributed, the aim of a follow up on-site meeting is to let participants discuss in depth and fix in a clearly and straightforward way the case for applying cost-benefit analysis to the policy making process.	Output: - Document prepared by participants containing the main issues tackled over the discussion	**Class work:** 0.5 FTE

Phase 1 – General Training on RIA

Time requirement: max [1] staff day*

Timeline	Event/Action	Background documents/Output	Nature of Activity & Time requirement (Full Time Equivalent days)
Early November	**Day 1 (RIA from a more organizational and methodological perspective)** • *Ms.Helen Carrier, Senior Economist, Department for Business, Enterprise and Regulatory Reform (BERR), UK Government*, Impact Assessment at Better Regulation Executive: how has the regulatory process been reshaped [by video-conference]*;* *[Allocated time: 1,5 hour]* • *Mr. Paul Gower, Senior Adviser, Oxera*, A framework for assessing the costs and benefits of financial regulation. Mr. Gower, will focus mainly on the following issues and will make participants exercise on them by also providing a good deal of case studies: - Market failure and regulatory failure analysis; - Assessment of costs of financial regulation; - Assessment of benefits of financial regulation; *[Allocated time: 5.5 hours]* Discussion, feedback and interventions are included into the sessions.	Background material: - Documents prepared by BERR and Oxera	**Class Work** 1.0 FTE

Phase 2 – Practicing RIA on an existing regulations

Time requirement: max [2] staff days*

Timeline	Event/Action	Background documents/Output	Nature of Activity & Time requirement (Full Time Equivalent days)
Mid November	**Day 1 (How to structure the RIA process; Practical application – Part 1)** • Part I: *Dr. Alexandra Berketi, Senior Officer, CESR,* Impact assessment guidelines of the 3L3 Committees *[Allocated time: 3 hours]* • Part II: *Mr. Stephen Dickinson, Senior Regulator, UK FSA;* MiFID transposition and implementation in the UK: RIA [by video-conference]*;* *[Allocated time: 1,5 hour]* • Part III: RIA methodology is applied to the following ongoing regulation by Bulgaria Financial Supervision Commission: - Markets in Financial Instruments Act, *promulgated in State Gazette, issue 52 from 29 June, 2007 in effect as of 1 Nov., 2007;* Part III exercise will be undertaken under the guidance and the supervision of a RIA expert from FSA. *[Allocated time: 2,5 hour]*	Background material: - Documents prepared by CESR and FSA Output: - Standardized draft RIA on FSC regulation prepared by participants	**Class Work** 1.0 FTE

	Day 2 (Practical application – Part I1) • Part I: Finalization of Day 1 Part III. *[Allocated time:2 hours]* • Part II: RIA methodology is applied to the following ongoing regulation by Bulgaria Financial Supervision Commission: - Ordinance no. 38 of 25 July, 2007 on the requirements to the activities of investment intermediaries, *in effect as of 1st November, 2007, issued by the Financial Supervision Commission, promulgated in SG, issue 67 from 17 August, 2007* Part III exercise will be undertaken under the guidance and the supervision of a RIA expert from FSA. *[Allocated time:5 hours]*	Output: - Standardized draft RIA on FSC regulation prepared by participants	**Class Work** 1.0 FTE

Phase 3 – Applying RIA to a draft regulation

Time requirement: max [5] staff days*

Timeline	Event/Action	Background documents/Output	Nature of Activity & Time requirement (Full Time Equivalent days)
Mid to End November	• Part I: International example of RIA on draft financial regulation:- *Mr. Velimir Šonje, Arhivanalitika General Manager* RIA and regulatory design of Securitization in Croatia *[Allocated time:2 hours]* • Part II: RIA methodology is applied to the following draft regulation by Bulgaria Financial Supervision Commission: - Draft Law on the Amendment of the Law on Special Investment Purposes Companies. Part II exercise will be undertaken under the guidance and the supervision of a *Mr. Velimir Šonje* *[Allocated time: 5 hour]*	Output: - Working document outlining main RIA content. *This document will be finalized with following deskwork conducted by participants themselves according to a plan shared with the instructor.*	**Class Work** 1.0 FTE *[additional homework:]* ***Desk Work*** *3.0 FTE*
End November	➢ Final presentation of the RIA exercise on the draft regulation to the FSC senior management Finalization and presentation of final RIA document, under the assistance of *Mr. Velimir Šonje, Arhivanalitika General Manager*	Output: - RIA Paper + RIA PPT presentation	**Desk Work** 1 FTE

(*)= in order to create an adequate "knowledge and operational critical mass" it would be advisable that RIA team is composed of 2-3 people. In order to make this program more flexible, overall FTEs required might be split among the members of the RIA Team.

Session 1

General introduction on RIA

and first practical application

Venue:

November 13-15, 2007

Financial Supervision Commission

Agenda

Seminar Objective:

Participants will learn and will be able to execute in their working experience the following items:

- **Familiarity with and some application of law and economics approach to policy design;**
- **Organization of the regulatory process along the prevailing EU practice;**
- **Analytical techniques to better engage in policy design;**
- **Beginning 'track record' based on international and local case studies.**

Setting the financial sector RIA stage

Session Objective:

Participants will learn the rationale underlying and driving the case for "Better Regulation" and RIA approach as well as how the RIA can be shaped along a systematic and standardized manner.

Chair: Riccardo Brogi, Convergence Program and South-East Europe Regional RIA Program Director

13:45 – 14:00 Registration of participants

14:00 – 14:15 Welcome address
Ms. Katerina Gigova, Chief legal expert, Legislative Department, FSC

14:15 – 14:45 Course introduction and Context (Better Regulation and Policy Dialogue through RIA)
Mr. Riccardo Brogi, Convergence Program

14:45 – 16:45 Illustration of Draft Impact Assessment Guidelines prepared by CESR-CEBS-CEIOPS
Dr. Alexandra Berketi, Senior Officer, CESR

16:45 – 17:00 *Coffee break*

17:00 – 17:20 Discussion, feedback and interventions

17:20 – 17:50 Reference material discussion with participants
Mr. Riccardo Brogi, Convergence Program

Participants will be invited to formulate questions on the following documents distributed in advance in order for them to have a better understanding of the RIA tool kits to be mastered:

- FSA, *A guide to market failure analysis and high level cost benefit analysis, November 2006;*
- FSA, *Cost benefit analysis in financial regulation*, September 1999;
- B. S. Bernanke, *Financial regulation and the invisible hand*, April 2007 (Speech);
- R. W. Ferguson Jr., *Financial regulation: seeking the middle way*, March 2006 (Speech).

17:50 – 18:00 Wrap up and end of session.

RIA from a methodological perspective

Session Objective:

Participants will get more familiar with IA approach by going through the key economic concepts used in RIA, in particular:

- **the main steps involved in the preparation of a market failure analysis;**
- **the methodologies that may be used for assessing costs and benefits in impact assessments;**
- **analysis of various case studies of financial sector impact assessments undertaken in the UK.**

Participants will also be briefed about an ongoing public-private dialogue initiative in Romania which makes use of RIA as a tool to promote financial sector modernization through the undertaking of micro-regulatory projects.

The day presentations will be given by the following Oxera experts: Dr. Leonie Bell, Managing Consultant, Dr. Paul Gower, Senior Adviser.

Chair: Mr. Luigi Passamonti, Head of Convergence Program, the World Bank
Alternate chair: Dr. Alexandra Berketi, Senior Officer, CESR

9:00 – 9:10	Welcome address *Mr. Apostol Apostolov, Chairman, Financial Supervision Commission*
9:10 – 9:20	Address in respect to the status of regulatory reform in Bulgaria and the importance for the institutionalization of the RIA *Mr. Florian Fichtl, Country Office, The World Bank Bulgaria*
9:20 – 10:30	Introduction and market failure analysis
10:30 – 11:00	*Coffee break*
11:00 – 12:30	Assessment of costs
12:30 – 13:30	*Lunch break*
13:30 – 14:00	How RIA-based consultations benefit policy design – The SPI Romania experience *Ms. Ramona Bratu, Director for Bank Products and Services, SPI Romania*
14:00 – 15:30	Assessment of benefits
15:30 – 16:00	*Coffee break*
16:00 – 17:15	Further issues and illustrations
17:15 – 17:30	Comments and final questions
17:30 – 17:45	Wrap up and end of session

International RIA case study and RIA practical application on an existing local regulation

Session Objective:

Participants will learn about an excerpt of how FSA has run RIA on MiFID and will experience a live RIA exercise on an already enacted FSC regulation

Chair: Ms. Ramona Bratu, Director of Bank Products and Services, SPI Romania
Alternate chair: Mr. Riccardo Brogi, Convergence Program

Facilitators:

- Mr. Stephen Dickinson, Senior Regulator, UK Financial Services Authority;
- Mr. Christian Winkler, Senior Regulator, UK Financial Services Authority;
- Ms. Ramona Bratu, Director for Bank Products and Services, SPI Romania;
- Mr. Riccardo Brogi, Convergence Program.

9:00 – 10:00 Impact assessment in practice: MiFID case study
Mr. Stephen Dickinson, Senior Regulator, UK Financial Services Authority

10:00 – 10:30 Discussion, feedback and interventions

10:30 – 11:00 *Coffee break*

Participants will practice the Impact Assessment process, step by step, using the IA Guidelines illustrated by CESR representative in the first day.

Participants will be divided into working groups (WGs), each supported by the respective facilitator who will provide assistance and guidance throughout the analytical exercise and will ensure that the plenary discussion takes place in a smooth manner.

The case study will focus on "best execution". This is covered in the following FSC regulations:
- Markets in Financial Instruments Act (promulgated in State Gazette, issue 52, effective of Nov 1 2007), Chapter 3, Division I
- Ordinance no. 38 of 25 July, 2007 on the requirements to the activities of investment intermediaries, in effect as of November 1, 2007, issued by the Financial Supervision Commission, promulgated in SG, issue 67 from 17 August, 2007, Chapter 2

11:00 – 12:30 Analytical RIA work (Part I)
Facilitators outline the case study. Working Groups are formed and the RIA application to FSC regulation starts as illustrated in the table which follows

12:30 – 13:30 *Lunch break*

13:30 – 15:00 Analytical RIA work (Part II)

15:00 – 16:30 Plenary discussion on IA exercises produced by groups

16:30 – 17:30 Homework assignments
FSA experts will give instructions to enable participants undertake RIA on parts of the following regulation: Ordinance no. 38 of 25 July, 2007 on the requirements to the activities of investment intermediaries, in effect as of November 1, 2007, issued by the Financial Supervision Commission, promulgated in SG, issue 67 from 17 August, 2007.

The case study will focus on Chapter 8 of the regulation, which covers "Internal Organisation, Internal Control, Risk Management and Internal Audit".

The whole desk work by multi-institutional WGs will be undertaken, remotely, under the guidance and support of FSA experts. The final RIA document will be presented in the next December session.

17:30 – 17:45 Wrap up and end of session

Steps of the RIA Process	Purpose of each RIA Step
1. Problem identification	To understand a market/regulatory failure analysis in order to establish whether or not there is an economic case at all for regulatory intervention
2. Development of "do nothing option"	To identify and state the status quo
3. Development of alternative policy options	To identify and state alternative policies and among them the "market solution" which consists in not intervening at all in the market and to rely on market forces alone to solve the problem
4. Definition of policy objectives	To identify the effects of policies. This will be useful to check whether the regulatory policy brings the market closer in line with organizational regulatory objectives
Analysis of impact	
5. Costs to users	To identify and state the costs borne by consumers under all options considered
6. Benefits to users	To identify and state the benefits yielded by consumers under all options considered
7. Costs to regulated firms and regulator	To identify and state the costs borne by regulator and regulated firms under all options considered
8. Benefits to regulated firms and regulator	To identify and state the benefits yielded by regulator and regulated firms under all options considered
Public consultation	
9. Arrangements of consultation process	To identify all main relevant stakeholders that should be consulted, outline some questions to be discussed in the consultation and choose the possible way(s) consultation process might be run

.

List of Participants

Title	Name	Last name	Position	Institution	E-mail
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Mr.	Boyan	Dombalov	Legal Expert	Bulgarian Financial Supervision Commission	dombalov_b@fsc.bg
Ms.	Tzveta	Grigorova	Chief Legal Expert	Bulgarian Financial Supervision Commission	grigorova_c@fsc.bg
Mr.	Evgeny	Jichev	Chief Secretary and Legal Counsel	Bulgarian Association of Asset Management Companies	evjichev@yahoo.com
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Mr.	Zhelju	Vasilev	Legal Expert	Bulgarian Financial Supervision Commission	vasilev_z@fsc.bg

Speaker Information

(Alphabetical order)

- Leonie BELL
  Managing Consultant, OXERA

Leonie specializes in the economics of the financial services sector and corporate finance.
Examples of her recent financial services work include an evaluation of the adequacy of investor compensation arrangements in EU Member States; analysis of investment restrictions for EU pension funds; developing a methodology for measuring the benefits of financial services regulation; analysis of the competitive position of the UK asset management industry; and a study of contractual and regulatory arrangements for custodian banks and depositaries in Europe. Leonie also works on a variety of finance issues in other industry sectors, including capital structure, asset valuation, cost of capital, and profitability, and for example conducted a study for the European Commission on the impact of golden shares held by governments in EU privatized companies. She has managed projects for the FSA, European Commission, European Asset Management Association, London Stock Exchange, Corporation of London, and other clients.

- Alexandra BERKETI
  Senior Officer, CESR

Alexandra Berketi is a Greek citizen and holds a Ph.D in Actuarial Science from Heriot-Watt University in the UK. She's a senior officer at the CESR Secretariat, in charge of the works of the EcoNet Group and a staff member at the Department of Research of the Hellenic Capital Market Commission. Alexandra has served as a research associate at the National Bank of Greece's Risk Management Division, specializing in model development for asset-liability management and has offered academic courses in financial economics in Heriot-Watt University and Cyprus University. Her current research interests involve financial regulation, regulatory impact assessment and monitoring alternative investment vehicles' risks.

- Ramona BRATU
  Director of Bank Products and Services, SPI Romania

Bringing to bear a long managerial experience in various Romanian banks (Unicredit Tiriac, Eximbank, Commercial Bank of Greece, Daewoo Bank and Dacia Felix Bank), Ramona has covered a variety of banking areas such as individual and corporate lending, trade finance, foreign loans and treasury.Ramona's distinctive contribution to the SPI Secretariat activities is her understanding of how laws and regulations affect the business processes and how the delivery of bank products and services could be improved through changes in regulations. After graduating from Academy of Economic Studies, Bucharest, Ramona is a PhD candidate at the same institution.

- Riccardo BROGI
  Senior Regulatory Economist, Convergence Program and South-East Europe Regional RIA Program Director

Riccardo Brogi brings to Convergence his pioneering experience in designing Regulatory Impact Assessment analyses at the Italian Banking Association where he applied Law and Economics methodology to all policy interventions he worked on. His main fields were as follows: insolvency law, real estate enforcement procedures, positive information sharing and credit bureau with privacy implications, corporate governance. He taught Economics of Financial Intermediaries as assistant at LUISS University in Rome. Riccardo holds a degree in Economics from the University of Florence and attended Microeconomics Summer course at London School of Economics and Political Science.

- Stephen DICKINSON
  Senior Regulator, UK Financial Services Authority

Stephen Dickinson has a BA (Hons) 1st Class in Politics, Philosophy and Economics and an MPhil in Economics both from Oxford University where he attended Pembroke College. Stephen joined the Royal Bank of Scotland in January 1992 where he worked in the Economics Office specialising in country risk analysis. In 2001 Stephen was seconded to the Regulatory Impact Unit (now called the Better Regulation Executive) of the Cabinet Office in UK central government where Stephen helped to set up a Business Regulation Team which aim was to go out to talk to businesses and identify and then help government departments address unnecessary regulatory burdens. On completion of the secondment in 2004 he left RBS to work in HM Treasury on an independent review of the actuarial profession before joining the FSA in June 2005 where Stephen works as an advisor to policy makers, ensuring that they use the disciplines of impact assessment appropriately. Latterly Stephen have also taken on a role dedicated to promoting these disciplines within financial regulators across Europe.

- Paul GOWER
  Senior Adviser, Oxera

Paul specialises in economics issues relating to financial regulation, company law, corporate governance and accounting reform. From 2004 until 2006, he was the Economic Adviser to the DTI's Corporate Law and Governance Directorate. He also provided economic input into regulatory impact assessments of policy initiatives and liaised with key stakeholders in both the public and private sectors. In addition, he was involved with a number of Better Regulation initiatives and was a member of a cross-Whitehall economists' group developing methodologies for the assessment of the cumulative impact of regulation. Between 2000 and 2003, he was an analyst for the Regulatory Strategy and Risk Division of the Financial Services Authority, assessing international developments in financial regulation and their implications for the UK. Paul has also lectured in economics, business analysis and financial regulation for the University of Brighton Business School and University of Sussex.

- Luigi PASSAMONTI
  The World Bank, Founder and Head of Convergence Program

Luigi Passamonti fought hard to build this program because he realized that authorities and bankers could achieve a great deal in terms of modernizing financial systems in many emerging and transition economies by joining forces with the help of an "honest broker" with a gift for analysis and compromise. This program is the fruit of a 25-year career in banking, strategy consulting, emerging market investments and public policy. With graduate studies in Economics in Brussels and Oxford, Luigi is married and has two children. He sails and hikes.

- Christian WINKLER
  Associate, UK Financial Services Authority

Christian Winkler has a Masters in Economics and a PhD in Economics from Nuremberg University in Germany. He is also a CFA charter holder. Christian joined MAN Aktiengesellschaft in Munich/Germany in 2002 where he worked in several roles in Corporate Finance. This included pension and asset management as well as the management of foreign exchange and interest rate risks. He was also involved in the implementation of new financial markets legislation, including e.g. the Market Abuse Directive. Christian joined the FSA in April 2007 where he works as an advisor to policy makers, ensuring that they use the disciplines of impact assessment appropriately.

DEAR COLLEGUES,

DEAR PARTICIPANTS,

First of all I would like to express our great pleasure in welcoming all of you and in hosting this Seminar here in Sofia.

I am also happy to have the opportunity to say a few words before starting this seminar as a participant in a previous workshop organized by the Convergence Program and Center of Excellence in Finance, which was held in Ljubljana in September this year. The topic of the workshop was very similar to the topic of our present seminar - "***How to design Better Financial regulation – Regulatory Impact Assessment: A Key Policy Analysis Tool***".

The main objectives of the seminar were to provide the participants with knowledge regarding:

- The application of law and economics approach to policy design;
- The organization of the regulatory process along the prevailing EU practice; and
- The Involvement of stakeholders for qualitative/quantitative IA.

Besides focusing on the different theoretical aspects of the RIA process the seminar was organized with the aim to enable the participants to use the knowledge gained from the training in their working experience in the future. By using the so-called ***"learning-by-doing" approach*** we had the chance to experience a live RIA exercise. We have gone through a selected range of case studies and divided in working groups we practiced the IA process, step by step, following the IA Guidelines, prepared for the needs of CESR-CEBS-CEIOPS.

We highly appreciated the opportunity for participation in such high-quality training as well as the chance to meet prominent experts in the area of IA.

Having in mind the rapid developments and very dynamic processes observed in the sector of financial services, the FSC as a financial regulator faces a real challenge in addressing the increasing needs for improvement of the staff qualifications and skills in the field of financial services and in particular in better regulating process. **I believe the better financial regulation is a common objective of the financial regulators on one hand and of all the market participants and stakeholders on the other hand.**

These were the reasons to consider the opportunities for training provided by the Convergence Program as really helpful to our efforts to address some of our specific needs of trainings in this area.

Through Convergence Program it became possible to invite well-qualified experts, who could provide topic-tailored trainings and consultation here, in Bulgaria and in this way to allow not just a small group of people but a larger audience to get advantage of their expertise, recommendations and advice.

In closing, I would like to wish you really interesting and very fruitful work during the whole seminar!

I hope that you will find the seminar as beneficial to your future work, as I found it.

THANK YOU VERY MUCH FOR YOUR ATTENTION!

Financial RIA Capacity Building Program in Bulgaria

Better Regulation and Policy Dialogue through RIA

Riccardo Brogi
Convergence Program
South-East Europe Regional RIA Program Director
Financial Supervision Commission
November 13, 2007

Quality of Regulation on International Agenda

• When: The first international standard on regulatory quality was produced in 1995;

• Why: evidence that quality of regulation has a causal-effect link with establishment of conditions for sustainable global economic growth.

Codifying Regulation Management

Objectives set by OECD's Recommendation were the following*:

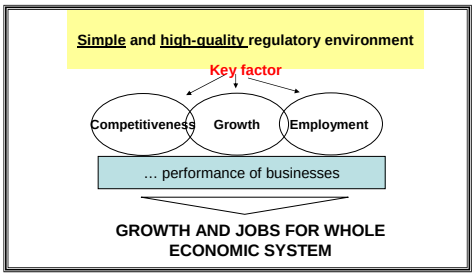
- To improve the quality of regulation;
- To support the development of more effective management of the regulatory system;
- To promote alternative instruments;
- To strengthen the effectiveness and legitimacy of the international regulatory system.

(*): OECD, *Recommendation Of the Council Of The OECD On Improving The Quality Of Government Regulation*, March 1995

European Commission's Commitment to Better Regulation

- Lisbon Strategy-> regulatory quality as key factor for growth and employment;
- 'Lisbon Strategy' renewal-> Better Regulation as main driver for competitiveness.

EU Approach to Better Regulation



Some EU Countries Engaged in High-Quality Regulation: Ireland

- "*Regulating Better*": Government White Paper aimed at enhancing competitiveness through the regulatory lever;
- How this can improve competitiveness?
  - Inappropriate regulation can produce adverse effects;
  - Public services not snarled up in red tape;
  - Businesses not to comply with unnecessary or unduly regulation.

Some EU Countries Engaged in High-Quality Regulation: the UK

• Better Regulation Executive (BRE): it works across government to support and challenge departments and regulators as they reduce and remove regulation;

• FSA and Treasury are strongly committed to assessing the benefits of regulation.

Some EU Countries Engaged in High-Quality Regulation: Denmark

• In 2002, the Danish Government set "The Danish Growth Strategy" mainly aimed at achieving a reduction of up to 25 percent of administrative burden faced by recipients;

• The underpinning reason was that Danish companies and citizens considered themselves hard hit by legislative and administrative regulation.

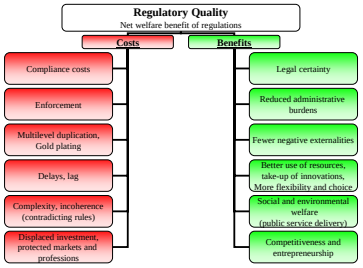
Some EU Countries Engaged in High-Quality Regulation: the Netherlands

• In 2003, Ministry of Finance took action for determining the administrative burden of businesses;

• "*In the last few decades, the Dutch system of rules has become increasingly complex (...). This hampers compliance and is unnecessarily time-consuming and expensive (…). The balance must be reinstated. This is why the Cabinet has declared tackling red tape and regulatory creep as one of its most important themes*"(*)

(*): Ministry of Finance/Interministerial Project Unit for Administrative Burdens (IPAL), *Reducing Administrative Burdens: Now Full Steam* Ahead, The Hague, June 2005

Costs and Benefits: Tipping the Scales for Better Regulation*



(*): Josef Konvitz, Head of OECD Regulatory Policy Division, *International Trends in Regulatory Reform*, ABI Conference on Better Regulation Rome, 14 March 2007.

Better Regulation Drives Growth

- A 25% reduction of administrative burden would yield a GDP increase of 1.4 to 1.8%;
- SEE countries can benefit above the average growth (Table 1 below).

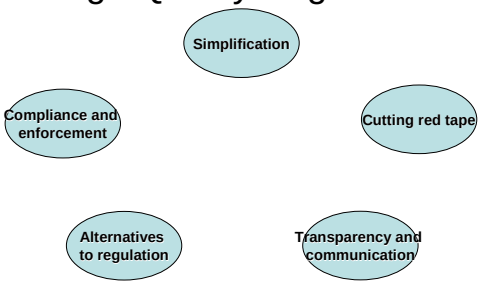
Table 1 - Reduction of administrative burdens and gains in labour efficiency (*)

Member State	Efficiency increase (%)
AT	2.2
BL[1]	1.1
CZ	1.6
DE	1.6
DK	0.8
ES	2.1
FI	0.7
FR	1.8
UK	0.6
GR	2.9
HU	3.5

Member State	Efficiency increase (%)
IE	1.1
IT	2.3
NL	1.6
PL	2.4
PT	1.9
RE[2]	3.3
SK	2.6
SI	1.6
SE	0.6
EU - 25[3]	1.6

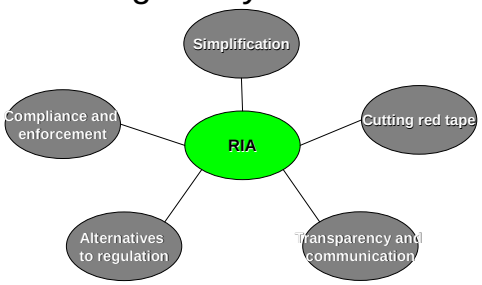
(*): European Commission, *Impact Assessment accompanying the "Action Programme for Reducing Administrative Burden in the European Union", 2007. (1): BL combines Belgium and Luxemburg. (2): Combines the Baltic member States, Malta and Cyprus. (3): EU-25 are GDP-weighted.*

The Virtuous Road Map to High-Quality Regulation*



(*): OECD-UE, *Conference on Regulatory Impact Assessment*, Ankara, April 2006.

Introducing Evaluation Culture in Regulatory Process



Added Value of RIA

- Impact assessment:

process of systematic analysis of the likely impacts of a proposed intervention by regulatory authorities as well as the range of its alternative feasible options;

- RIA is a policy analysis tool and an aid to decision-making (not a substitute for political judgment).

Regulation Makers and Recipients Sit at a Common Table

- Involvement of stakeholders is a key factor to increase regulatory quality;
- Consultation is inherently and strongly linked to RIA;
- Guiding Principles on dialogue on effective financial regulation, recently issued by Institute of International Finance(*).

(*): IIF, *Proposal for a Strategic Dialogue on Effective* Regulation, December 2006.

Valuable support for policy analysis

- RIA not necessarily provides clear-cut conclusions and recommendations;
- It offers a very helpful fact-based input;
- Effective communication tool for consultation with interested parties.

Thanks for your attention!

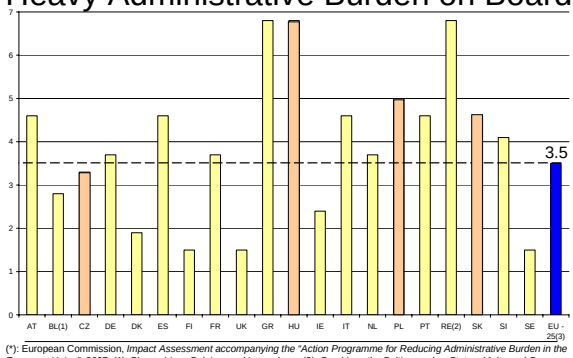
Annex

Regulatory Policy from OECD Angle*

- Regulatory quality is the driving principle behind reform today;
- Greater homogeneity across OECD countries for " good" regulation:
  - Quality regulation, not just de-regulation;
  - Incentive-based regulation in place of command-and-control.

(*): Josef Konvitz, Head of OECD Regulatory Policy Division, *International Trends in Regulatory Reform*, ABI Conference on Better Regulation Rome, 14 March 2007.

Heavy Administrative Burden on Board



(*): European Commission, *Impact Assessment accompanying the "Action Programme for Reducing Administrative Burden in the European Union", 2007. (1): BL combines Belgium and Luxemburg. (2): Combines the Baltic member States, Malta and Cyprus. (3): EU-25 are GDP-weighted.*

OECD Reference Checklist for Regulatory Decision-Making (1)

Question # 1 **Is the problem correctly defined?**	• Problem precisely stated; • Nature and magnitude; • Identification of incentives of affected entities.
Question # 2 **Is government action justified?**	• Evidence-based intervention; • Likely benefits and costs; • Alternative mechanisms for addressing the problem.
Question # 3 **Is regulation the best form of government action?**	• Informed comparison of policy instruments; • Regulatory/non-regulatory solution; • Early in the regulatory process.
Question # 4 **Is there a legal basis for regulation?**	• Explicit responsibility; • Consistency with higher-level regulations; • Certainty, proportionality and applicable procedural requirements.

Source: OECD, *Recommendation Of the Council Of The OECD On Improving The Quality Of Government Regulation*, March 1995

OECD Reference Checklist for Regulatory Decision-Making (2)

Question # 5 **What is the appropriate level of gov. for this action?**	• Most appropriate level should be chosen; • If multiple levels: effective coordination should be designed.
Question # 6 **Do the benefits of regulation justify the costs?**	• Total expected costs-benefits estimate; • Regulatory proposal/feasible alternatives; • Costs should be justified by benefits.
Question # 7 **Is the distribution of effects across society transparent?**	• Government intervention can affect distributive and equity values across social groups; • Distribution of regulatory costs/benefits should be made transparent.

Source: OECD, *Recommendation Of the Council Of The OECD On Improving The Quality Of Government Regulation*, March 1995

OECD Reference Checklist for Regulatory Decision-Making (3)

Question # 8 **Is the regulation clear, consistent, comprehensible and accessible to users?**	• Rules understood by likely users; • Clear text and structure.
Question # 9 **Had all interested parties had the opportunity to present their views?**	• Open and transparent regulatory process; • Effective and timely input from interested parties.
Question # 10 **How will compliance be achieved?**	• Assessment of incentives and institutions through which the regulation will take effect; • Design of responsive implementation strategies.

Source: OECD, *Recommendation Of the Council Of The OECD On Improving The Quality Of Government Regulation*, March 1995

Ireland - Chart of Regulatory Principles and Actions

1. NECESSITY	2. EFFECTIVENESS	3. PROPORTIONALITY	4. TRANSPARENCY	5. ACCOUNTABILITY	6. CONSISTENCY
We will require higher standards of evidence before regulating We will strengthen policy making and the quality of regulations through impact analysis, better training and awareness-raising and better quality data on which to base decisions. ***We will reduce red tape*** The burden of red tape will be reduced through customer service initiatives, IT-enabled improvements and Statute Law Revision. ***We will keep our regulatory institutions and framework under review*** The requirement for sectoral regulatory institutions will be regularly reviewed in the light of sectoral dynamics, competition, convergence and market change.	***We will target our new regulations more effectively*** The objectives of regulation will be stated clearly in explanatory guides. We will more frequently use regulation that sets out the goals to be achieved but which leaves maximum flexibility as to the means of achieving them. ***We will make sure that regulations can be adequately enforced and complied with*** We will frame regulations so that they achieve the greatest levels of compliance without excessive enforcement and compliance costs. ***We will ensure that existing regulations in key areas are still valid*** We will systematically review existing regulations governing key areas of the economy and society.	***We will regulate as lightly as possible given the circumstances, and use more alternatives*** We will promote the use of a wider range of alternatives by Government Departments/Offices. ***We will ensure that both the burden of complying and the penalty for not complying are fair*** Penalties in regulations will be more proportionate. We will also monitor the burden of compliance on business and SMEs. ***We will use Regulatory Impact Analysis appropriately when making regulations*** We will pilot and then mainstream a system of RIA in Government Departments and Offices.	***We will consult more widely before regulating*** Consultation processes will be improved and made more consistent across Government Departments and Offices. ***There will be greater clarity about Public Service Obligations*** We will ensure that Public Service Obligations are made more explicit when regulating, in terms of costs and service levels. ***Regulations will be straightforward, clear and accessible*** Regulations will be as straightforward, clear and accessible as possible, with guidance in plain language.	***We will strengthen accountability in the regulatory process*** Regulators and enforcement agencies should be clearly accountable to citizens, through the Houses of the Oireachtas and Government. ***We will improve appeals procedures*** There should be well publicised, accessible and equitable appeals procedures that balance rights of appeal with the need for speedy action, in a fair manner. Where regulatory decisions are referred to the courts, there are particular requirements of speed and expertise.	***We will ensure greater consistency across regulatory bodies*** As far as possible, there should be greater similarity in the remit, responsibilities, structure and approaches of regulatory institutions. ***We will ensure that regulations in particular sectors/areas are consistent*** Legislation in linked or connected areas will be consistent, and kept up to date and accessible through processes of simplification, consolidation and restatement.

Source: http://www.betterregulation.ie/upload/Regulating_Better_html/chartreg.html

Reference Documents and Web links

• Danish Government, *The Danish Growth Strategy*, August 2002;

• Dutch Cabinet letter 2005, *Reducing administrative burdens: now full steam ahead*, Ministry of Finance/Interministerial Project Unit for Administrative Burdens (IPAL), The Hague, June 2005;

• European Commission and Better Regulation: *http://ec.europa.eu/enterprise/regulation/better_regulation/index_en.htm*

• Ireland and Better Regulation: http://www.betterregulation.ie/

• UK and Better Regulation:

- http://www.cabinetoffice.gov.uk/regulation/index.asp;
- http://www.hm-treasury.gov.uk./documents/enterprise_and_productivity/better_regulation/ent_regulation_index.cfm ;
- http://www.fsa.gov.uk/pubs/other/better_regulation.pdf .

• OECD, *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, March 1995.

Reference Documents and Web links

• Danish Government, *The Danish Growth Strategy*, August 2002;

• Dutch Cabinet letter 2005, *Reducing administrative burdens: now full steam ahead*, Ministry of Finance/Interministerial Project Unit for Administrative Burdens (IPAL), The Hague, June 2005;

• European Commission and Better Regulation: *http://ec.europa.eu/enterprise/regulation/better_regulation/index_en.htm*

• Ireland and Better Regulation: http://www.betterregulation.ie/

• UK and Better Regulation:

- http://www.cabinetoffice.gov.uk/regulation/index.asp;
- http://www.hm-treasury.gov.uk./documents/enterprise_and_productivity/better_regulation/ent_regulation_index.cfm ;
- http://www.fsa.gov.uk/pubs/other/better_regulation.pdf .

• OECD, *Recommendation of the Council of the OECD on Improving the Quality of Government Regulation*, March 1995.

Impact Assessment Guidelines for EU Level 3 Committees

Financial Supervision Commission,
Sofia, 13 November 2007

Presentation by:
Dr Alexandra Berketi, Senior Officer, CESR

What is Impact Assessment ?

- IA is a method to assess the impact of regulatory / supervisory policies and practices.

- IA means doing in a systematic and transparent way what regulators/supervisors more or less always do when they design, implement and enforce policies.

Advantages of Impact Assessment

1. Better quality of policy making,
2. More transparent policy making,
3. Better communication with regulated/supervised firms (market participants).
4. More credible evidential basis for policy proposals

Current state of play among individual financial regulators / supervisors in the EU: Formal adoption of IA

EU Commission Impact Assessment Guidelines

Cover all types of regulatory policies in the EU,

wide range of types of impact (economic, social, environmental).

=> Too broad for financial services and markets regulation / supervision.

Unified IA framework for financial regulation / supervision in the EU

CESR (securities), CEBS (banking) and CEIOPS (pensions & insurance) are participating in a joint initiative to ensure that there is a common approach towards IA.

Developed IA framework in line with EU policy and OECD Guidelines.

The chronological order of the 3L3 IA guidelines' adoption

1. February 2007: 3L3 Committees adoption of draft guidelines

2. March 2007: Pilot Studies' inception

3. May-August 2007: IA guidelines on consultation

4. December 2007/January 2008: Target for adoption of final text

Unified IA framework for financial regulation / supervision in the EU

Future IA work will mainly concern:

- Level 3 work
- Revising level 2 policies
- Developing additional level 2 advice
- Level 1 work if requested by the Commission

The Lamfalussy Process

Final Report of the Committee of Wise Men on the Regulation of European Securities Markets", Feb 2001

Committees' Work at Level 3:

- Produce consistent guidelines for national regulations
- Issue joint interpretative recommendations and set common standards
- Compare and review regulatory practices
- Conduct peer reviews of regulation and regulatory practices in Member States

An example of a trigger point for applying IA at level 3 work:

Proposed measures are likely to have significant structural and cost implications

When the cost is insignificant there is no need for an IA

3L3 IA Working Methods

- Policy expert group
- 1-2 IA Experts (from Econet group) to provide monitoring and advice.
- Consultative Working Groups
- External technical assistance also possible.

Factors to be considered carefully when planning an IA

- ✓ Time
- ✓ Resources
- ✓ Significance of structural and cost implication of policy proposals

The 3 pillars of the IA framework

- Market Failure Analysis (to decide whether to intervene)
- Assessment of policy options (to decide how to intervene)
- Public consultation & review

The 3 pillars of the IA framework

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What is a Market Failure?

Financial markets sometimes fail to work efficiently and/or to produce an efficient outcome by themselves.

For example:

- Prices of goods and services do not reflect the true cost of production and consumption; or
- there are severe conflicts of interest between different market participants; or
- sellers are better informed than buyers etc.

Forms of Market Failure in financial markets

- Asymmetric information (e.g. insider trading);
- Externalities; (e.g. the failure of one market participant negatively affect others – US subprime loan market)
- Market power (e.g. market concentration, lack of competition, limited access by stock exchanges).

What is a Regulatory Failure?

Regulatory failure means an intervention whose economics costs were higher or economic benefits lower than was originally expected.

For example:

- Overregulation; or
- Era before the EU harmonised prospectus; etc.

Market Failure Analysis

A market failure analysis, should explain:

- what the problem is, and
- what evidence suggests that the problem is significant.

Moreover, MFA should clarify whether or not the problem can be solved (over time) **without a new regulatory policy**.

Sometimes, market mechanisms and market forces may solve or mitigate problems due to market failures.

The process of identifying MFA :

- Is the problem due to a market failure? (as described above)
- What is the evidence that establishes that the market failure is **significant**?
- Which **objective** – e.g. market integrity, market confidence, consumer protection, facilitating innovation, enhance competition - is threatened by the failure?
- Is there is a regulatory failure?
- Can the market be expected to solve the failure by itself in the foreseeable future?

MFA Example: Simplified Prospectus for Investors

Form of MFA :	Information Asymmetry
Significance of problem:	EU-impact
Evidence:	Technical, long document
	Costly & time consuming production
	Inconsistency of content among MS
	Unhelpful in comparing cross border products
Objective threatened:	Smooth functioning of single market
Regulatory Failure:	Yes

The 3 pillars of the IA framework

- Market Failure Analysis (to decide whether to intervene)
- Assessment of policy options (to decide how to intervene)
- Public consultation& review

Assessment of policy options in 5 steps

1. Problem identification.
2. Development of the main policy options.
3. Defining policy objectives.
4. Analysis of the positive and negative impacts of each policy option.
5. Comparison of options through their net impact and identification of the preferred policy option (s).

Key features of IA

- Wrong approach: using IA once the policy decisions have already been made, i.e. at the end of the policy making process.

- Correct approach: using IA right from the start when policy options are still open.

- => IA is a tool to help with the final policy decision (and neither a means to justify the decision ex post nor a substitute for decision making).

Technical considerations

- Keep the framework for analysis rigorous but practical
- Be consistent in treatment of data/issues
- Use previous IAs and existing economic literature – empirical and theoretical
- Consider other national IAs which may be relevant to your problem/country
- Don’t give up just because a lack of data prevents use of ideal methodology
- Use outsourcing if required but don’t outsource everything. Need to build centre of expertise (subject to resource constraints)

Key Features of IA

- IA is typically qualitative in nature.
- Sometimes it is possible and reasonable to complement the qualitative analysis by a quantitative analysis.
- Is a quantitative evaluation of the negative and positive impacts of regulatory / supervisory policies possible?

Key features of IA

- IA should be proportionate to the problem at hand and the policy chosen.
- Much of the time a *screening IA* is sufficient.

Screening IA

- Steps 1 – 5 on a principal basis or at a high level
- Informal consultation
- Brief report with recommendation for a full IA

IA Example: Simplified Prospectus for Investors

Brief Assessment of Standardisation of Past Performance

Benefits:

- Improves comparability of information between UCITS, potentially improving competition.
- Ensures information is available in a format which is less likely to be misunderstood by investors, reducing potential for mis-buying or selling.

Costs:

- There may be costs for firms where systems for providing past performance data need to be revised.
- Standardised layouts are likely to incur minor incremental costs for firms.
- Including past performance data may increase some investors' focus on information they are poorly equipped to use, leading to some mis-buying or selling over and against a document which excludes past performance data.

Source: Document CESR/07-669, p.44

The 3 pillars of the IA framework

- Market Failure Analysis (to decide whether to intervene)
- Assessment of policy options (to decide how to intervene)
- Public consultation & review

Public consultation & review

1. Consult on the draft policy proposal and the IA report which accompanies it.

2. Publish the responses received, give public feedback, revise policy proposals accordingly.

3. Once it is implemented and enforced, keep the policy under review as appropriate.

Tips for a Public consultation

1. Inform timely the stakeholders for the forthcoming consultation (e.g. press releases, targeted mails etc.)
2. Allow adequate time for consultation
3. Consult widely with market participants
4. Encourage involvement of consumer representatives'
5. Try to hear the voice of consumers themselves (e.g. behavioral studies/experiments)
6. Give clear and timely feedback to stakeholders
7. Do not necessarily believe what firms and consumer groups say – ask them!
8. Take seriously the efforts stakeholders make in order to provide data/info.

Consultation Example: Simplified Prospectus for Investors

- Consultation period Start: 17 October 2007
  End: 17 December 2007

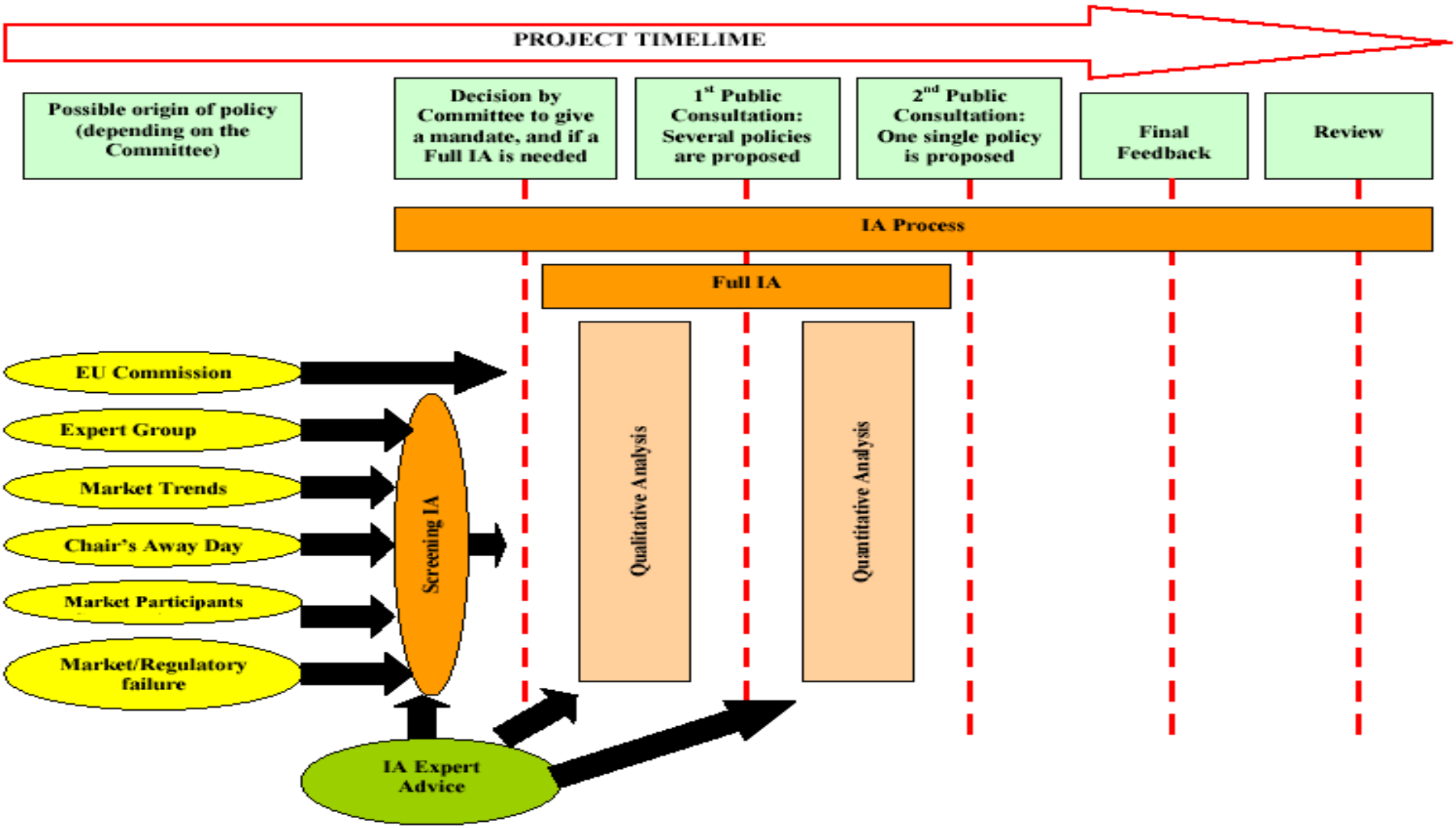
- Open hearing: 23 November 2007

- Press release directed to: From CESR to all its Members (national regulators) and to European institutions and associations.

  From CESR Members to their markets (investment firms, consumers, trade association etc).

Data source: Press Release CESR/07-688

Technical issue I: Indicative timeline for an IA Process



Technical issue II:

PRESENTATION OF THE IA REPORT

- summarise the work undertaken for the IA into a short report
- state any assumptions or uncertainties and knowledge gaps
- use simple and non-technical language
- put technical details or supporting documents in an appendix

Technical issue III: Indicative IA REPORTS:

Report 1: MARKET FAILURE ANALYSIS	
What is the problem? Is the issue identified likely to have an EU-wide impact on market participants/end users and on the smooth functioning of the single market?	
What evidence shows that the problem is significant?	
What regulatory objective is put at risk by the problem?	[Information about regulatory objectives can be found in section 1.5 of the Guidelines]
Is the problem due to market failure? What is the market failure?	[Information about market failure analysis can be found in section 1.3. of the Guidelines]
Is the problem due to regulatory/supervisory failure? What is the regulatory/supervisory failure?	[Information about regulatory failures can be found in section 1.4. of the Guidelines]
Is it or is it not likely that the problem will be solved over time without a new regulatory policy? Give reasons.	
Is the case for regulatory/supervisory action justified?	

Report 2: ASSESSMENT OF THE PROPOSED POLICIES

POLICY OPTIONS	SHORT TERM			LONG TERM			OVERALL NET EFFECT
	-TIVE Effects	+TIVE Effects	NET	-TIVE Effects	+TIVE Effects	NET	
Option-1							
Option-2							
Option-3							

Report 2a: ASSESSMENT OF EACH PROPOSED POLICY

BENEFITS & COSTS OPTION-1 etc.	QUALITATIVE DESCRIPTION	QUANTITATIVE DESCRIPTION	MONETARY VALUE
Benefits			
Direct costs			
Compliance costs			
Quantity of products offered			
Quality of products offered			
Variety of products offered			
Efficiency of competition			

Table-2

Report 2b: REGULATORY POLICY RESPONSE	
Policy option 1	
Operational objective	[Information about operational objectives can be found in section 1.8. of the Guidelines]
How would achieving the objective alleviate/eliminate the problem?	
Policy option 2	
Operational objective	
How would achieving the objective alleviate/eliminate the problem?	
Policy option 3	
Operational objective	
How would achieving the objective alleviate/eliminate the problem?	
Which policy option is the preferred one? Explain briefly.	

Report 3: CONSULTATION & REVIEW

Consultation period	**Start:**	**End:**
Participation	(low, medium, high)	
Summary of reactions received		
Feedback publication date		
Did the feedback result in a policy change? Explain briefly.		
Proposed review date (when appropriate)		

Committees' Pilot Studies

- CESR: Simplified Prospectus for UCITS– Key Investor Information
- CEBS: Work on Large Exposures
- CEIOPS: Aspects of Solvency II?

CESR's Pilot Study

- Main issues assessed: Information on past performance, information on risk, information on charges.

- First draft advice went on a 3M consultation till 17th December 2007

- CESR's Press release & Consultation paper: http://www.cesr.eu/index.php?page=home_details&id=239

3L3 IA Training Seminar

- The 3L3 Committees are currently developing a common training platform covering cross-sector issues.
- Joint training is considered at EU level as an important tool which can contribute to the development of a common supervisory culture by fostering convergence and cooperation between supervisory authorities on a cross-sector level.
- One of the first pilot seminars was on Impact Assessment and it took place on 17-19 October in Eltville, Germany.
- Next one in March 2008?

Consult your Internal Coordinator (Ms Nina Koltchakova)

Questions

?

Thank you

Dr Alexandra Berketi

Committee of European Securities Regulators (CESR)

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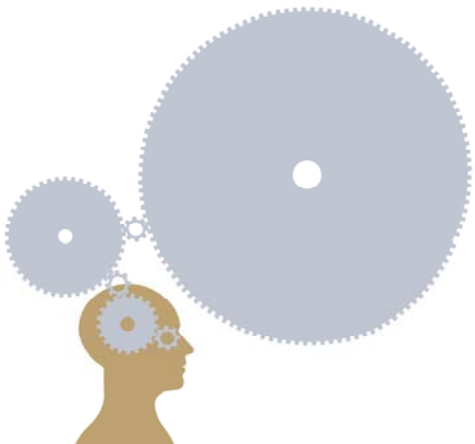
RIA from a methodological perspective

Session 1: Introduction and market failure analysis

Prepared for the
Bulgaria Financial Supervision Commission

Dr Leonie Bell
Dr Paul Gower



November 14th 2007

Overview

- introduction
- review of assumptions of well-functioning markets
- economic rationale for intervention
- the importance of impact assessments
- the importance of market outcomes
- market failure analysis in practice
- initial steps in preparing an impact assessment

Introduction

- policy making is about making informed choices
- the use of impact assessments help in the making of such choices
- creating impact assessments is not an exact science
- in an ideal world an impact assessment can identify whether there is a need for government intervention in the first place
- then it can help to identify the most appropriate form of intervention
- can also be used to undertake evaluation of existing policies

Review of assumptions of well-functioning markets

- important to be able to define a market
- a market is where individuals transact with each other in the specified product
- profit/utility maximisation is the key objective
- a well-functioning market is one in which an efficient allocation of resources is achieved
- based on assumptions of no asymmetries of information, prices reflecting all costs, including costs to third parties, and no excess profits

Economic rationale for intervention

- in reality, markets are not ‘perfect’ and may fail to achieve ‘efficiency’

- benefits of government intervention are improvements in market outcomes compared with a situation without intervention (eg, consumer choice, prices, costs of financial failure)

- with no intervention, adverse effects in the provision of financial services may arise from:
  - market failures
    - asymmetric information
    - market power
    - externalities
  - risks
    - operational
    - default
    - systemic
  - incentive problems

Importance of impact assessments

- impact assessments should be undertaken at the beginning of the policy-making process—not the end
- market failure analysis is vital at an early stage
- this can be used to justify government intervention but cannot identify the most appropriate intervention
- all potential government interventions should be considered including the ‘do nothing’ option
- the ‘do nothing’ option may still be appropriate even if market failures have been identified
- monitoring and evaluation plans need to be formulated

Market failure analysis in practice: asymmetric information

- two types of asymmetric information
  - hidden information prior to a transaction being completed
  - hidden action by one party after a transaction is completed

- with hidden information the seller will generally have more information than a buyer
  - purchased product may differ from buyer's expectations
  - price paid may not reflect underlying value of the product/service

- hidden action may arise in principal/agent relationships

- principal cannot costlessly observe the actions of the agent

Market failure analysis in practice: market power

- in a market where a single firm or firms have excessive market power
  - prices will be higher
  - output will be lower
- compare this with a well-functioning market
- may be collusion between firms
- market structure may be one of only a few firms
- market may be able to support only one firm due to high fixed costs and economies of scale (natural monopoly)

Market failure analysis in practice: externalities

- externalities arise when the production/consumption of a good or service affects welfare of other economic agents in addition to those consuming it

- such effects are not taken into consideration by the producers or suppliers of the good/service

- there is a mismatch between private and social costs and private and social benefits

- externalities can be positive or negative

Market failure analysis in practice: risks

- in financial services market, failures are linked directly to risks
- with little risk the potential detriment from a market failure would be low
  - information asymmetry not a problem if no risk of consumers losing money in event of firm default
  - externalities combined with default risk give rise to potential systemic failures in banking sector
- but risks alone cannot justify intervention
  - if product risks were understood they could be priced in terms of anticipated returns
- so, combination of market failures and risks is important

Market failure analysis in practice: incentive problems

- market failures are also linked with incentive problems in financial services

- asymmetric information might not be a problem if incentives of buyer and seller could be matched
  - need for a completely specified contract

- incentive misalignment heightens the negative impact of market failures

- particularly the case in retail financial services when products are provided on commission basis by intermediaries

Initial steps in preparing an impact assessment (I)

- beware: market failure alone may not be sufficient justification for intervention
- market failure, risks and incentive problems are all linked
- may also need to assess the impact on competition and distributional issues
- need to think about these market failures/risks/incentive effects in terms of adverse/unwanted outcomes
  - prices too high
  - costs too high
  - consumer choice is limited

Initial steps in preparing an impact assessment (II)

- need to identify effective policy options including ‘do nothing’
- start thinking about mechanisms that link policy options with correction of adverse/unwanted outcomes
  - importance of causal links
- start identifying high-level costs and benefits for each option
- specify the baseline
- determine what counterfactual you are going to use
- determine the time horizon you are going to use
- consider what evidence you will need to quantify costs and benefits

Concluding remarks

- impact assessments are a vital tool in policy-making process
- can be used to inform policy choices
- must be undertaken at early stage in policy-making process
- must be combined with market failure analysis and assessment of risks and incentive problems
- always think in terms of desired outcomes and how they can be measured

Oxera

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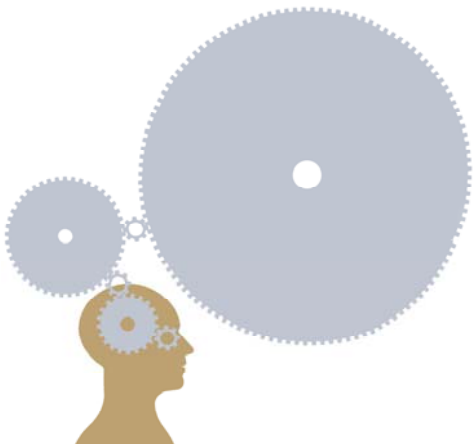


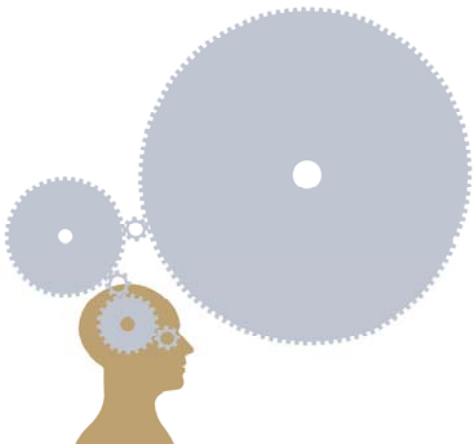
RIA from a methodological perspective

Session 2: Assessing the costs of financial regulation

Prepared for the
Bulgaria Financial Supervision Commission

Dr Leonie Bell
Dr Paul Gower

November 14th 2007



Overview

- importance of incremental costs
- estimation of direct operational costs
  - costs for the regulator
  - costs for firms (compliance)
  - costs for consumers
- analysis of administrative costs
- assessment of policy costs

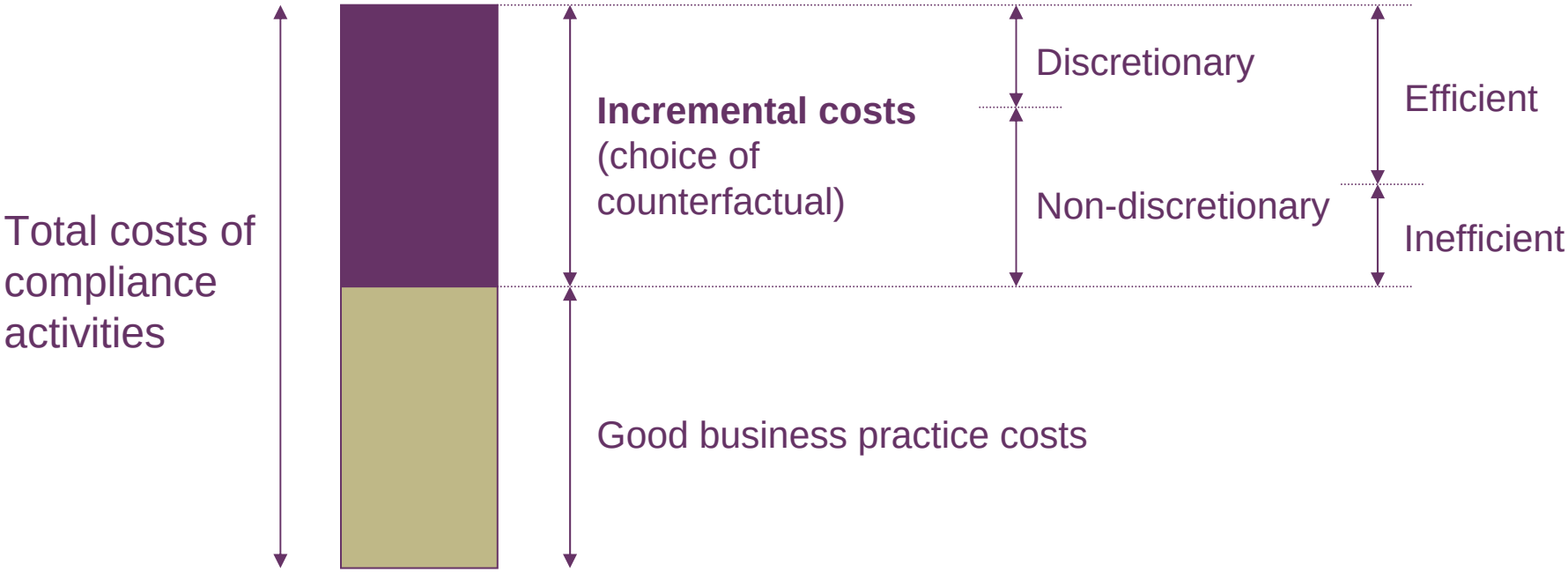
Introduction

- often believed that costs are easier to estimate than benefits
- may be the case, but problems can still emerge
  - methodology
  - measurement
- need to determine strong causal link between the intervention and the costs incurred
- need to identify incremental costs
- distinguish between direct and indirect costs
- one-off versus ongoing costs
- problems of survey and samples

Importance of incremental costs

- vital to determine how much additional cost is incurred by the intervention
- may be relatively easy for a firm to comply with new regulations by adapting systems currently in place
- some firms may already be adopting good business practices
  - could have lower incremental costs
  - important to identify these in survey/sample
- importance of counterfactual
- efficient versus inefficient compliance costs

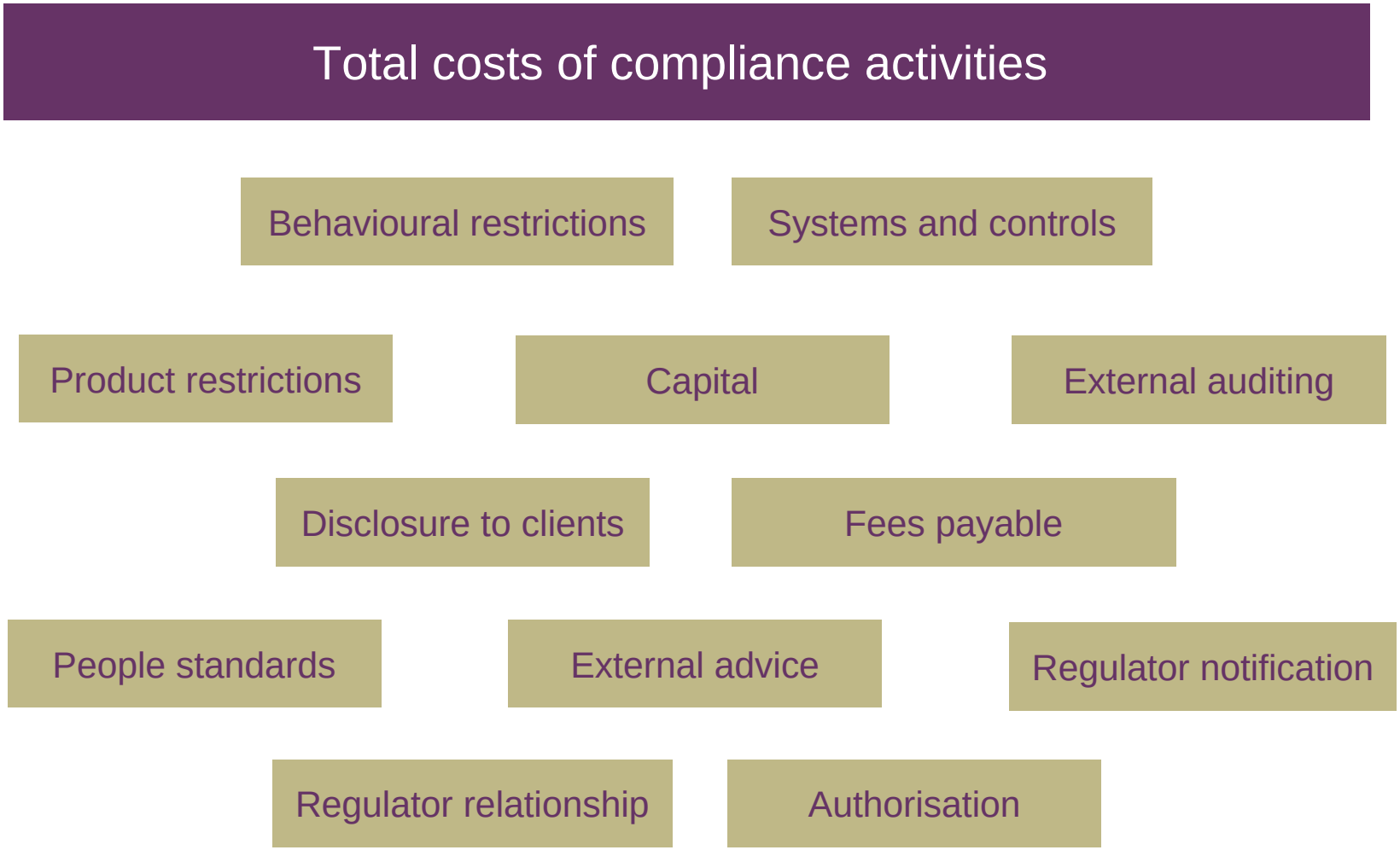
Relevant dimensions of cost



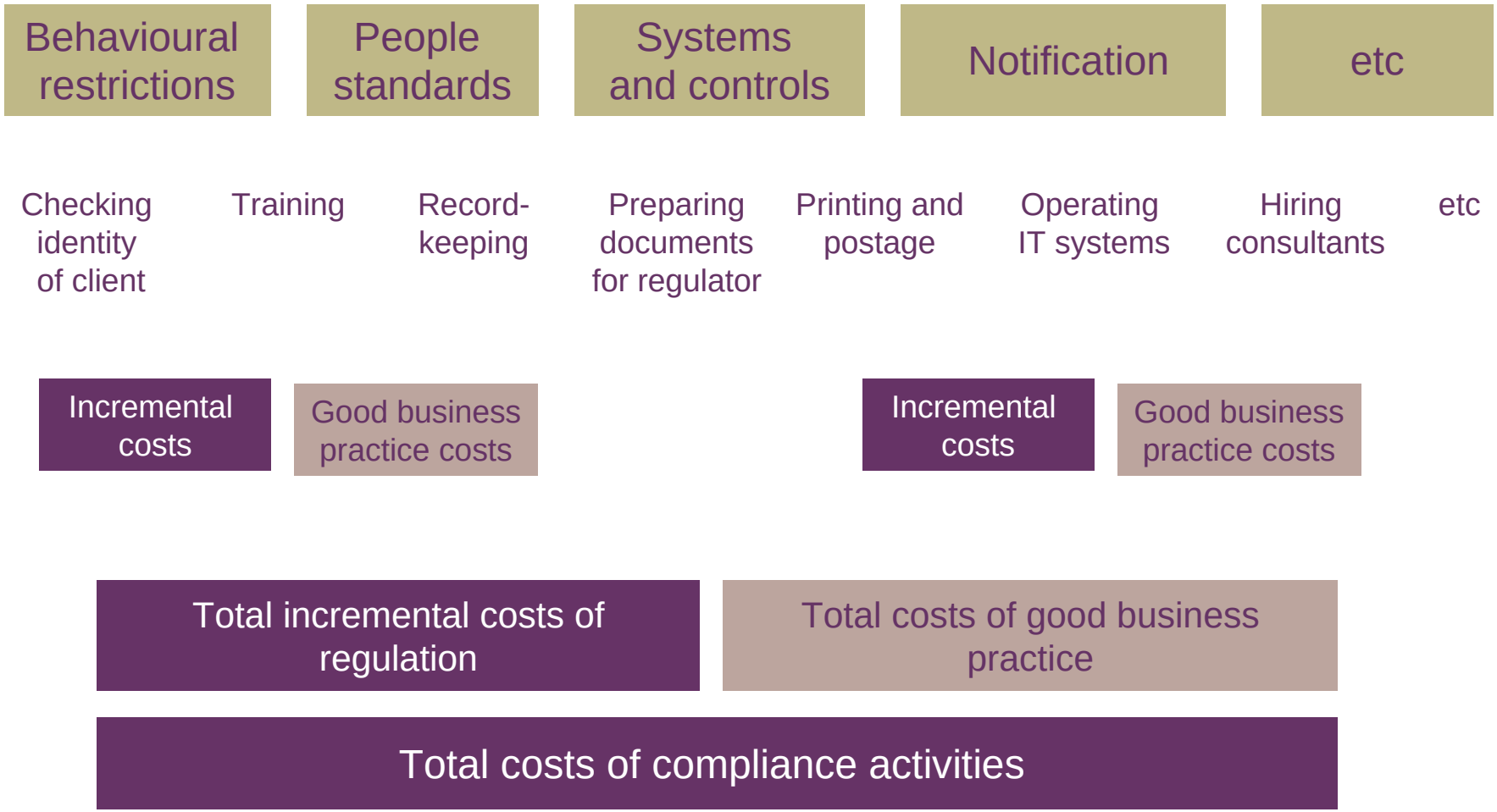
Costs for the regulator

- remember that the intervention itself may result in costs for the regulator
- may be necessary to establish additional monitoring facilities
- systems may need to be changed
- additional personnel and IT costs
- consider alternative forms of intervention
- can existing systems/agencies be adapted?

Costs for firms: compliance costs (I)



Costs for firms: compliance costs (II)



Costs for consumers

- compliance costs usually incurred by firms in financial services rather than consumers

- but remember that, ultimately, consumers may pay
  - costs for the regulator may be financed by higher taxes
  - regulatory fees may be passed on

- possible indirect effects on consumers
  - regulatory costs may restrict innovation
  - information requirements may impose transactions costs on consumers

Administrative costs

- subset of compliance costs but important in their own right
- refer to the need to comply with third-party information requirements to statutory bodies—government or regulatory agencies
- EU initiative to reduce these across Europe
- measured using Standard Cost Model
  - derived from time taken on a task and unit cost of task
- problems with determining incremental cost
  - information requirements may standardise market practice
- survey design very important
  - small company effects
- information for consumers?

Policy costs: indirect costs

- refer to ways in which a firm changes its behaviour or strategy in response to intervention
- wider economic impact
  - market development
  - product volumes/prices/services offered
  - innovation
- often overlap with compliance costs
  - high compliance costs create barriers to entry
  - may change supply of products
- first-/second-order effects of intervention

Costs of regulation in the UK: compliance costs

- study undertaken by Deloitte on behalf of the Financial Services Authority
- analysis of costs imposed by existing FSA regulations
- focus on three areas: corporate finance, institutional fund management, investment and pension advice for retail customers
- incremental costs highest for investment and pension advice
- wide distribution of costs within same sector
- little evidence that firms quantify and monitor compliance costs
- for retail investment firms, highest costs were regulatory fees, advising and selling, training and competency requirements
- most significant costs accounted for around 5% of total firm costs
- could not distinguish between efficient/inefficient response to regulation

Costs of regulation in the UK: administrative costs

- study undertaken by RealAssurance Risk Management on behalf of FSA
- used Standard Cost Model
- total administrative costs estimated at £600m per annum (€858m)
- most costs arose from a relatively small number of rules
  - top 20 rules accounted for over 85% of total cost
- highest costs incurred in anti-money laundering information provision
- study is interesting for its methodology

Costs of regulation in the UK: MiFID

- analysis undertaken by FSA of costs associated with MiFID
- survey sent to 263 firms—83 responses
- only 30 firms provided actual cost figures
- high variability of estimates—skewed distribution with significant outliers
- median estimates of one-off costs per firm
  - small: £10,350 (€14,800)
  - medium: £250,000 (€357,500)
  - large: £7,200,000 (€10,296,000)
- ongoing costs estimated at 10% of one-off costs

Concluding remarks

- cost estimates cannot be undertaken without cooperation of firms
- firms themselves may not be clear about cost impacts
- surveys/ongoing stakeholder involvement important
- all cost estimates are a matter of judgement
- need to consider firm size and cost impact
- incremental cost

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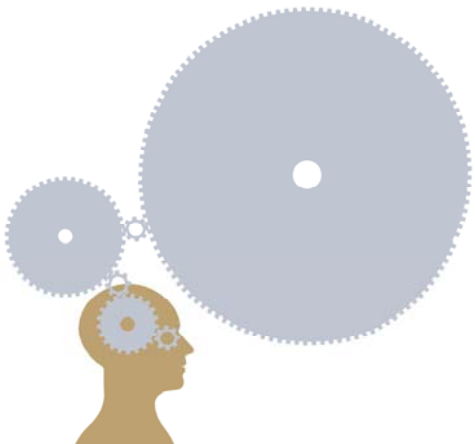


The SPI Romania Experience

RIA-Based Financial Modernization

Financial RIA Capacity Building in Bulgaria

Sofia, 14 November 2007

Ramona Bratu

Director for Bank Products and Services

SPI Romania

What is SPI Romania?

Romanian financial authorities and market participants established a partnership in September 2006 to provide focus and coordination to accelerate modernization of the Romanian financial sector.

Set-Up

- **SPI Committee**

  High-level direction and endorsement

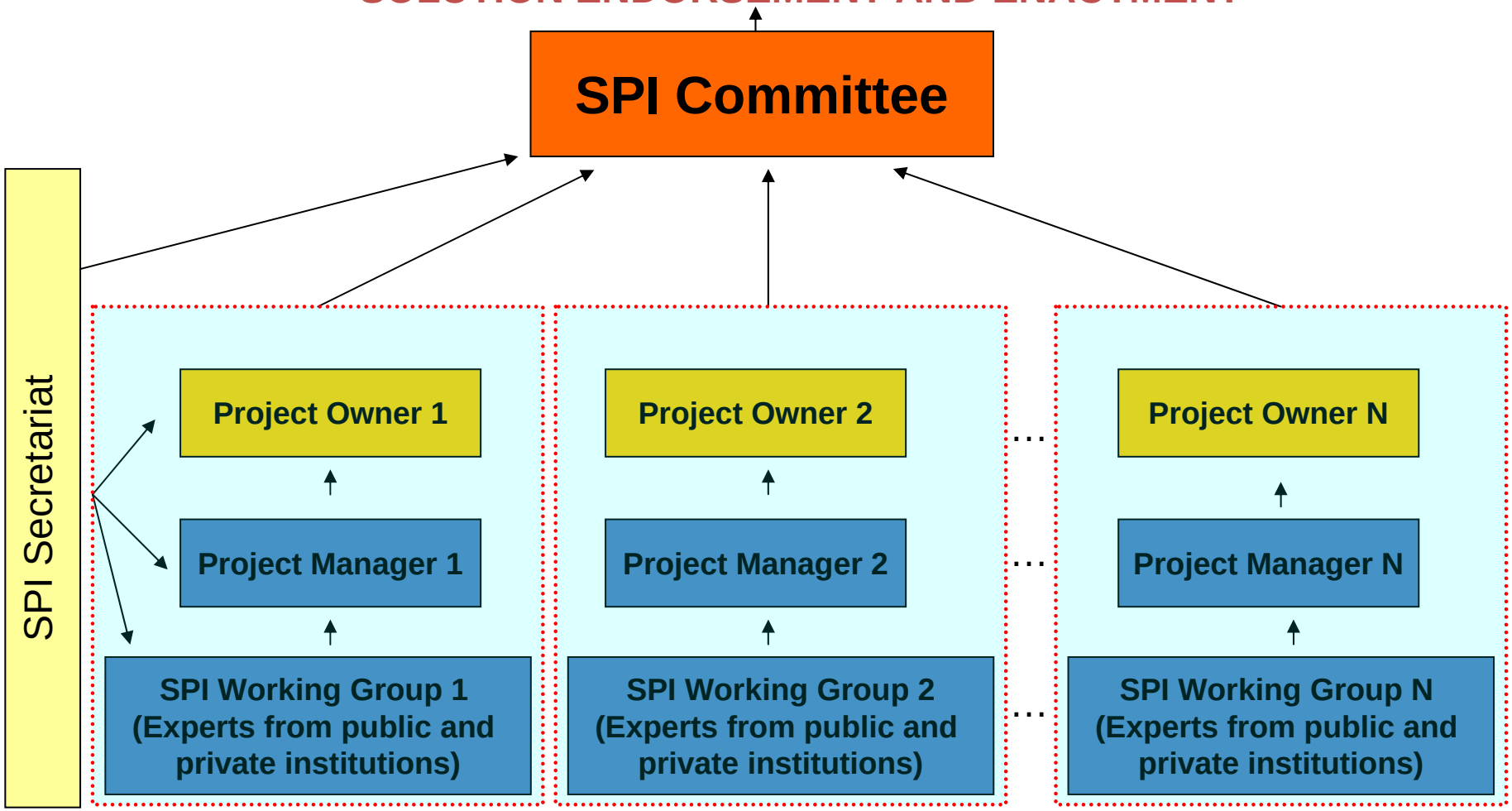
- **Public-Private Working Groups**

  Recommendations to SPI Committee based on RIA analyses and consultations

- **SPI Secretariat**

  Overall management and coordination

SOLUTION ENDORSEMENT AND ENACTMENT

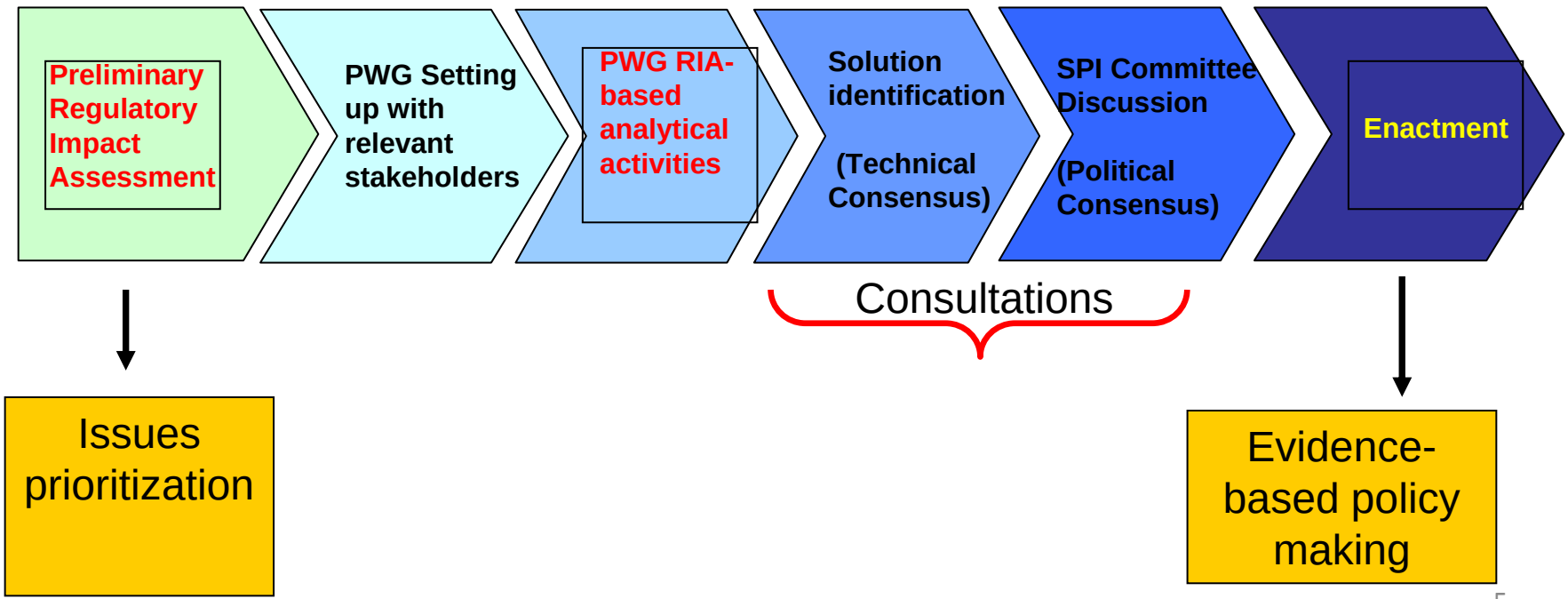


SOLUTION FINDING (Based on public-private consultations through RIA)

SPI Projects

- Relevant to <u>both</u> authorities and market participants;
- 2007 SPI Projects:
  - 15 projects mobilizing over 120 financial sector professionals
  - Examples of successfully completed SPI projects:
    - ✓ expansion of positive credit information sharing;
    - ✓ amendment of anti-money laundering legislation;
    - ✓ promoting the electronic processing of debit instruments;
    - ✓ bank ombudsman establishment;
    - ✓ IFRS provisioning;
    - ✓ rural lending;
    - ✓ bank security law, etc.

RIA and Consultations in the SPI process



Benefits of RIA in Policy Design (I)

AML Project

- RIA enabled the PWG to identify the detailed policy options that would rationalize the institutions' AML reporting system while preserving high AML standards;

Debit Instruments Project

- RIA outlined the large positive impact for users and financial intermediaries from the decrease of the banks' operational costs;

Benefits of RIA in Policy Design (II)

Rural Lending Project

- **RIA outlined the benefits for both public and private stakeholders and triggered the development of a mix (public-private) solution;**

Positive Information, Law on Goods Safety, Lending Databases, Ombudsman Projects

- **RIA outlined the impact on the stakeholders and helped at tailoring the solutions;**
  - **In some cases (Positive Information Reporting), RIA supported the development of industry self-regulatory options as an alternative to prescriptive regulations;**

Benefits of Consultations in Policy Design (I)

AML Project

- The regulatory solutions identified stroke a balance between high AML standards and the needs of the reporting institutions (including MEF) to have more efficient AML reporting system;

Debit Instruments Project

- The regulatory solutions were based on the consensus of the stakeholders, ensuring that the technical solution will be implemented smoothly;

Rural Lending Project

- The multi-stakeholder solution represents an efficient public-private institutional scheme, aimed at removing the current deadlock in the official actions for making the warrants-deposit certificates system operational;

Benefits of Consultations in Policy Design (II)

IFRS Provisioning Project

- The RIA consultations enabled an accurate determination of the potential impact of the new NBR regulations on the banks' financial statements and the state budget and allowed for the identification of the feasible fiscal treatment of provisions;

Other SPI Projects

- The regulatory / institutional solutions stroke a balance between the public and private interests and therefore facilitated a smooth and effective implementation;
- The consultations helped fine-tuning the regulation;
- The consultations helped basing solutions on established market participants practices.

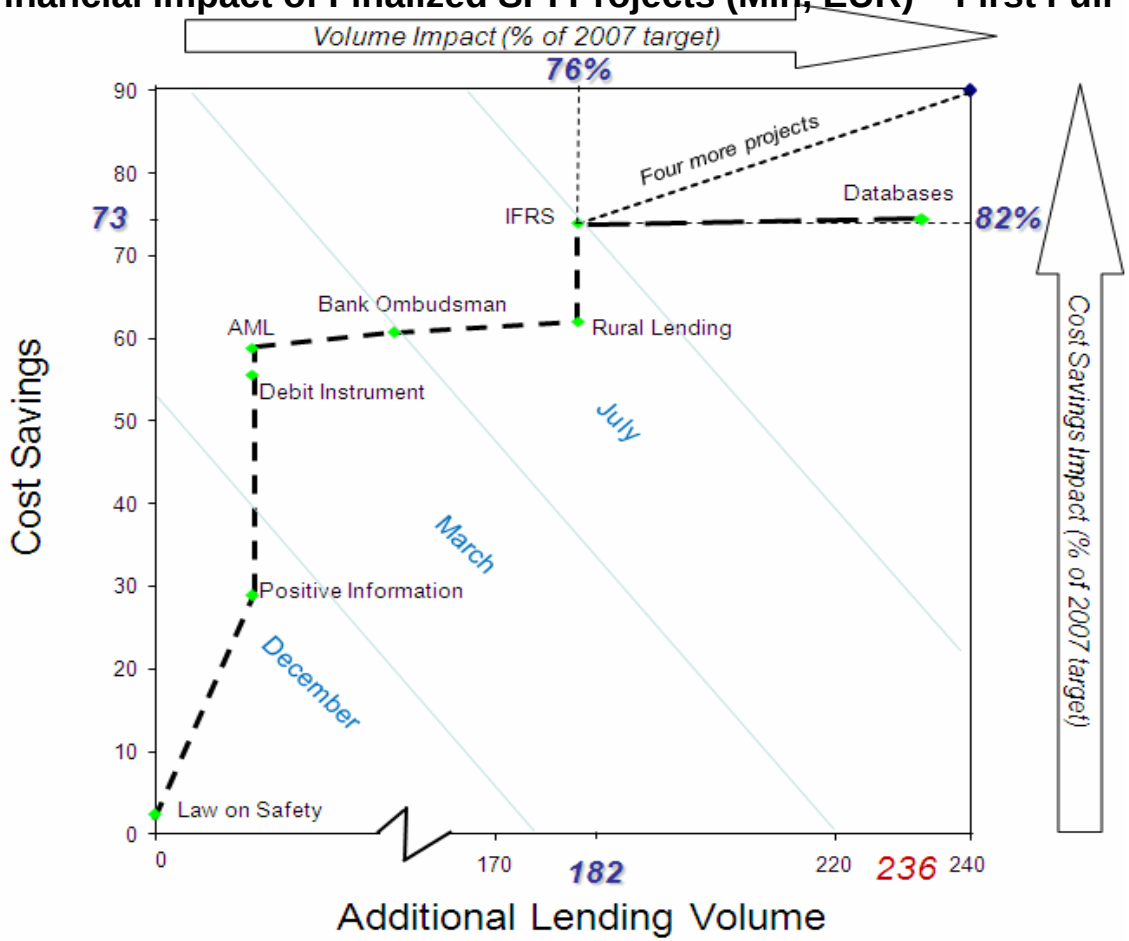
Conclusions

RIA-based consultations have been an useful policy design tool since they:

- ✓Strengthened the Romanian financial community's analytical culture and promoted evidence based policy making (in line with "better regulation" concept);
- ✓Enhanced public-private dialogue on financial sector modernization needs;
- ✓Enabled the identification of workable regulatory and institutional solutions.

A USEFUL RIA BY-PRODUCT!

Financial Impact of Finalized SPI Projects (Mln, EUR) – First Full Year



Final Message

South-East European countries need continued legislative and regulatory reforms for real convergence with the EU.

Modernization is driven by prudential and business considerations

- **RIA allows to assess proposals in an objective and neutral way**
  - **Focus: to achieve intended objectives & avoid unintended consequences**
- **A public-private analytical Secretariat can help launch RIA**
  - **It offers a well structured environment of carrying out projects and conducting the consultations.**

Prudential and Business Issues Generate A Large Modernization Program!

SPI Romania 2008 Program

ABI CRITERIA	European Central Bank CRITERIA				
	Asymmetric information	**Completeness of the market**	**Increased opportunities to engage in financial transactions**	**Reduced transaction costs**	**Increased competition**
Business development		1. Increasing bank lending under PPPs 2. Promoting refinancing through securitization 3. Green Banking	1.Development of Interbank Direct Debit 2. Standardization of the contractual framework for repo and derivative transactions 3. Securing down payments made by individuals for real estate projects 4. Facilitating structural lending 5. Supporting thermal rehabilitation of houses 6. Developing lending to municipalities		
Industry competitiveness	1.Database for risk rating the corporate clients 2.Centralized database for AML purposes		1.Improving access to and availability of the basic banking products 2. Electronic employment register and services	1.The banks' future contributions to RDGF 2.Improving account stopping regulation 3. Reducing the paper-based documents 4.Centralized tax roll 5. Facilitating bad debts recovery	Improving the payments framework
Industry reputation	Better information on saving products	1.Expanding Banking Mediator 2. Bank Code of Conduct 3. Ombudsman knowledge transfer	1.Standardizing the minimal information for basic bank products and services 2. Standardizing the advice on selected bank products and services 3. Enhancing Corporate Social Responsibility in the Banking Industry	1.Improving the quality of the education and professional training in the banking field 2. Improving cooperation framework on consumer protection	1.Enhancing financial consumer's protection 2. Responsible borrowing
	3	**6**	**11**	**7**	**3**

For more information see

www.spi-romania.eu

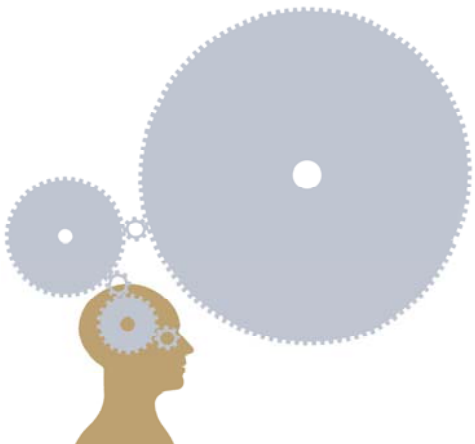
Thank you!

RIA from a methodological perspective

Session 3: Assessing the benefits of financial regulation

Prepared for the
Bulgaria Financial Supervision Commission

Dr Leonie Bell
Dr Paul Gower



November 14th 2007

Overview

- introduction
- what benefits to measure?
  - identifying the relevant dimensions along which regulation can improve market outcomes
- how to measure the benefits?
  - framework and empirical methodologies
- illustration
- concluding remarks

Introduction

- potential benefits are the improvements in market outcomes that may result from regulation
  - through mitigation of market failures, risks and incentive problems

- benefits may arise to
  - consumers ('users' of financial services)
  - regulated firms ('producers' of financial services)
  - wider economy (parties outside the relevant market)

- measurement of actual benefits is complex
  - controlling for other changes affecting market outcomes
  - availability of data and empirical methodologies
  - monetary valuation of some benefits

Two parts of the measurement exercise

- what to measure?
  - improvements in market outcomes that result from regulation
- how to measure?
  - direct measurement of changes in market outcomes
  - indirect measurement using proxy metrics
    - focus on mechanisms through which regulation delivers better market outcomes
  - different empirical methodologies

Types of detrimental market outcomes for consumers

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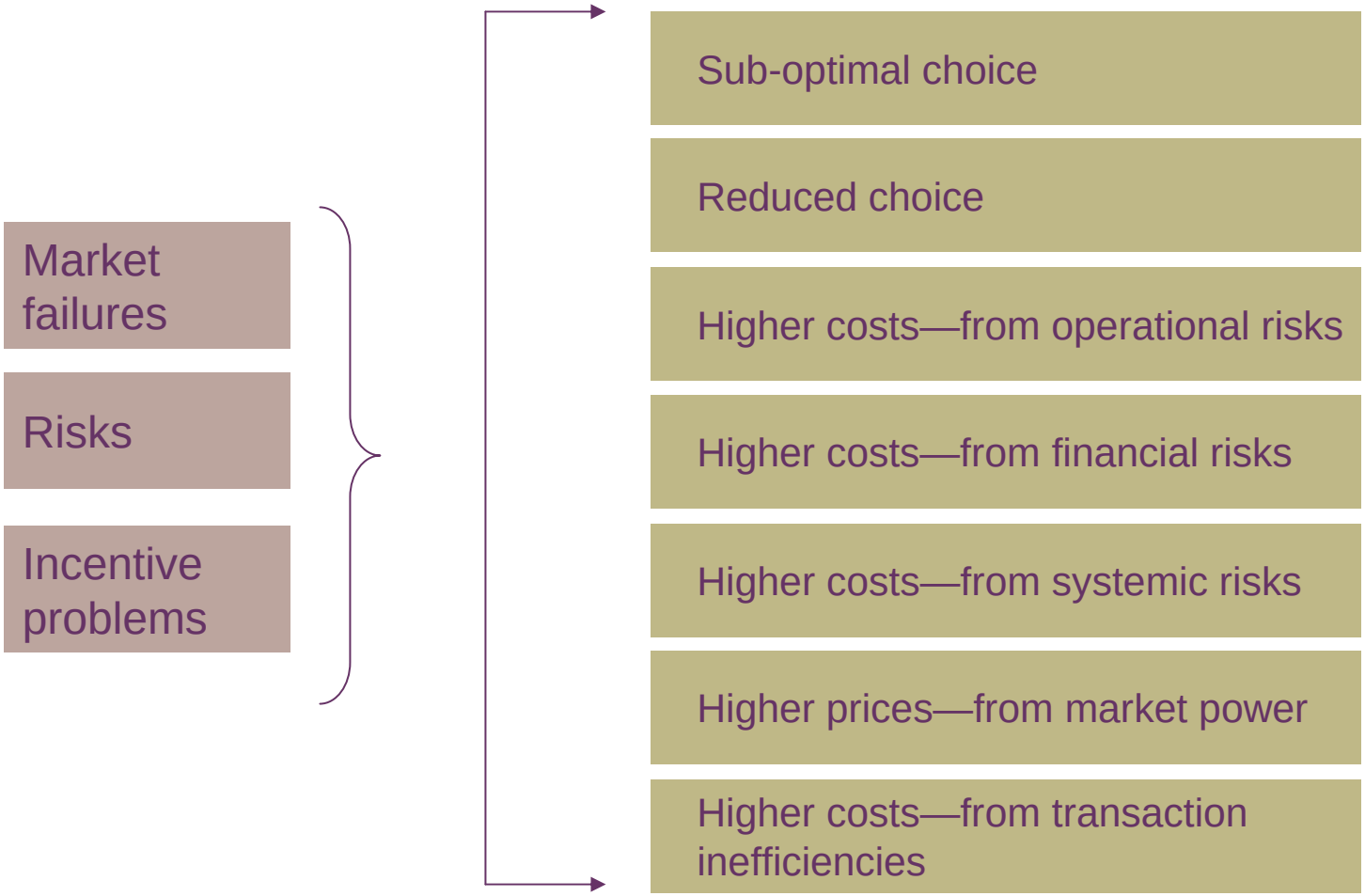


An efficient market may deliver outcomes that are considered 'unfair' from a public policy point of view

Direct measurement of consumer benefits

Type of detrimental market outcome that regulation may improve	Relevant measure of benefit is the **value that consumers derive from …**
Sub-optimal choice	better choice (more optimal fit between what consumers buy and what they need)
Reduced choice	increased choice (wider availability of what consumers need)
Higher costs—operational risks	reduction of losses or other costs associated with operational failure
Higher costs—financial risks	reduction of losses or other costs associated with firm default
Higher costs—systemic risks	reduction of losses or other costs associated with systemic failure
Higher prices—market power	reduction in excessive prices
Higher costs—transaction inefficiencies	reduction in transaction costs, including search costs
Financial exclusion	improved access to financial services

Direct measurement: empirical techniques

- before-and-after comparisons
  - event-study methodology
  - market models used by competition/industrial economists
  - econometric techniques to test for structural breaks
- quantifying total detriment before regulation is introduced
  - upper bound of benefits
- consumer surveys to gather subjective evidence
  - including stated-preference/willingness-to-pay surveys
- benchmarking
  - including international comparisons

Direct measurement: limitations

- ex ante impact assessment
  - change in market outcome cannot be observed
- data requirements
  - how to control for other influences on market outcomes
- measurability of relevant metrics of market outcome
  - quantification of reductions in market prices or lower transaction costs is possible
  - techniques have also been developed to quantify changes in operational or financial risks
  - but how to measure
    - improvements in consumer purchase decisions?
    - reductions in risk of systemic failure?
    - better access to financial services?

Indirect measurement of benefits (I)

- benefits measurement should aim to directly quantify improvements in market outcomes
- but where direct measurement is difficult or not possible, apply indirect measurement technique
  - use proxy metrics which are themselves good and robust indicators of the changes in market outcomes
  - this provides important substitute (and complementary) information about the benefits of regulation

Illustration: disclosure rule

- how to measure benefits of a disclosure rule aimed at improving optimality of consumer purchase decisions?
- direct measurement is difficult, particularly for ex ante assessments
- indirect measurement using proxy metrics
  - survey of consumers to ask about degree of information problem
    - information they seek or have access to
    - degree to which consumers make use of information
  - comparison of current and future information provided by firms
  - number of complaints by consumers about 'mis-bought' products
  - revealed preference—how many consumers have adjusted purchase decisions following introduction of rule (or ex ante, how many would switch)?
  - etc

Indirect measurement of benefits (II)

Oxera

	Illustration
Identify the market outcome that regulation is seeking to improve	Disclosure rule intended to benefit consumer purchase decisions
↓	
Identify the mechanisms by which regulation delivers the improvement	More information leads to better purchase decisions
↓	
Identify and measure the corresponding proxy metrics	Degree of information provision by firms
↓	
Validate the link between the proxy and market outcome	Test whether consumers use/ understand information and adjust their decisions

Identifying proxy metrics

- ‘unpack’ mechanisms by which regulation is expected to improve market outcomes
  - measure improvements along the process
  - indicators of market failure, risks and incentives
- firm-level data
  - infer impact for end-consumer from changes at intermediary level
- past interventions
  - proxy impact of new rule by impact of previous, similar rule
- but always validate that the proxy is a robust indicator for changes in ultimate market outcomes
  - importance of chain of causal links

Testing for other (unintended) impacts

- the same rule can have an impact
  - via more than one chain of causal links
  - on more than one dimension of market outcome
  - that is not intended (positive and negative)
    - changes in market outcomes reflect net benefits

- hence, important to check the complete set of causal links
  - repeat measurement if impact plausible and significant

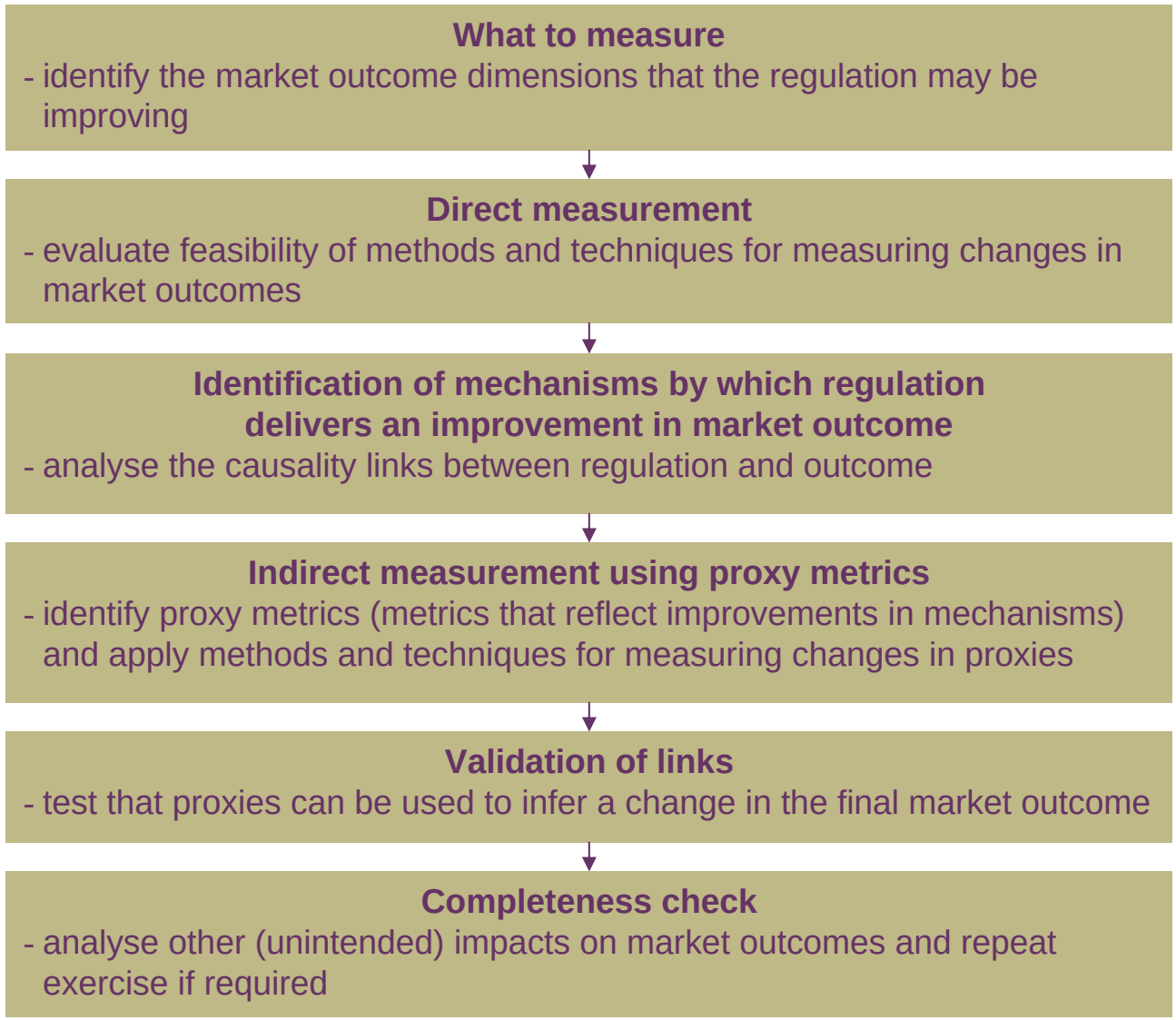
Concluding remarks

- benefits measurement is complex
- direct and indirect approaches
  - market outcomes
  - mechanisms through which regulation delivers improvements in market outcomes

    $\Rightarrow$ systematic measurement of market impacts

    $\Rightarrow$ important for policy formulation

Summary of measurement framework



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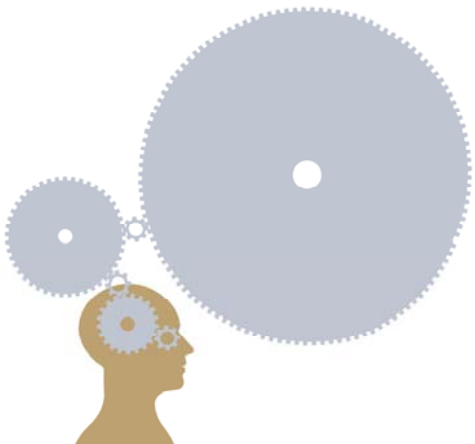

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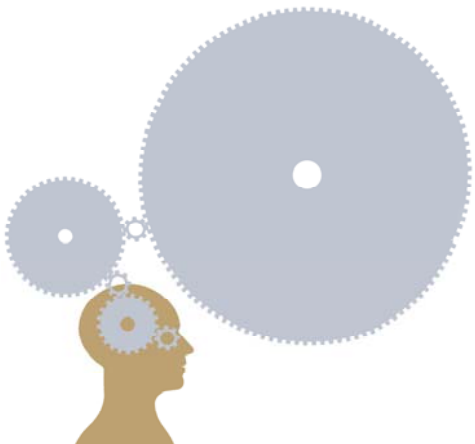
RIA from a methodological perspective

Session 4: Further issues and case studies

Prepared for the
Bulgaria Financial Supervision Commission

Dr Leonie Bell
Dr Paul Gower



November 14th 2007

Overview

- consideration of further issues
  - net present value
  - discount rates
  - distributional effects
  - risk and sensitivity analysis
  - monitoring and evaluation plans
- case studies
  - assessment of the benefits of the FSA of suitability letter
  - the Companies Act 2006 RIA
  - the overall impact of MiFID

Further issues

- costs and benefits may arise in the future and at different times
  - important to consider how these can be restated to current values
  - what discount rate should be used?
- intervention may not affect all groups in the same way
  - look at distributional effects
  - redistribution may be a desired outcome
  - may be differences even within broadly similar groups
- risk and sensitivity analysis must be undertaken
  - what could affect the desired outcomes of intervention?
  - how may outcomes change with changes in external environment?
- monitoring and evaluation vital to assess impact
  - post-implementation reviews
  - further cost–benefit analysis—ex post

Assessment of the benefits of the FSA suitability letter (I)

- UK conduct-of-business rules required financial advisers to provide a letter to a customer explaining why a particular recommendation had been made
- expected market outcome: improve optimality of consumer purchase decisions
- direct measurement of this proved difficult, but potential methodology for calculating damage from less suitable products was developed
- indirect measure—establish chain of causal links
  - consumer changes purchase decision
  - firm changes advice offered
  - subsequent transaction costs change

Assessment of the benefits of the FSA suitability letter (II)

- possible to estimate additional costs for regulators in the absence of a suitability letter
  - these appeared to be relatively small
- additional route was to consider the reduction in costs that firms would incur if suitability letter requirement were removed
- then estimate frequency with which transactions resulting in less suitable product would need to be stopped in order to offset these cost savings
- identify product pairs, initial investments and nature of mis-selling
- results showed that a relatively small proportion of unsuitable recommendations would need to be changed as a result of a letter to incur overall net benefits
  - for large transactions, could be as low as 1–2%

The Companies Act 2006 RIA (I)

- Companies Act 2006 was an attempt to update and amend company legislation in the UK—not new legislation as such
- company law
  - provides a corporate vehicle to enable individuals to collaborate in business
  - legal structure for financing of companies
  - sets rules for company boards and shareholders
  - establishes rules for decision-making
- in absence of company law, adverse market outcomes would arise due to
  - asymmetric information
  - externalities
  - market power

The Companies Act 2006 RIA (II)

- what were desired market outcomes from amending company law?
  - lower cost of capital
  - reduction in transactions costs
- RIA concentrated on the latter
- compliance costs arising from new legislation found to be small: £10m–£20m (€14.3m–€28.6m)
- benefits from reduction in costs to business much larger: £160m–£340m (€229m–€486m)
- large range due to uncertainty
- no attempt to estimate benefits to shareholders
  - would have needed assessment of required risk premium

The overall impact of MiFID (I)

- MiFID major part of EU Financial Services Action Plan (FSAP)
- internal FSA study to estimate costs to UK firms (referred to in session 2)
- study undertaken by Europe Economics to estimate benefits to the UK
- quantification of both costs and benefits acknowledged to be very difficult
- first-round effects: beneficial market outcome seen in terms of reduction in firm transaction costs
- second-round effects: take the form of reduction in cost of equity leading to higher GDP

The overall impact of MiFID (II)

- methodology for assessing benefits based on assessment of four scenarios
  - limited effect from MiFID
  - MiFID has minor effect
  - MiFID is a substantial contributor to impact of FSAP
  - MiFID achieves wholesale financial market integration
- key first-round effects include
  - reduced compliance costs
  - reduced operating costs
  - improved access to new markets
  - improved functioning of markets
- not all benefits could be estimated
- conservative assumptions yielded first-round benefits of around £200m per annum (€286m)
- additional second-round effects of £240m (€343m)

Concluding remarks

- nobody says impact assessments are easy!
- remember to establish clear causal links for costs and benefits
- think in terms of expected market outcomes
- consider variety of measurement approaches
- beware of spurious accuracy—use ranges of estimates
- need to be realistic about limitations of analysis

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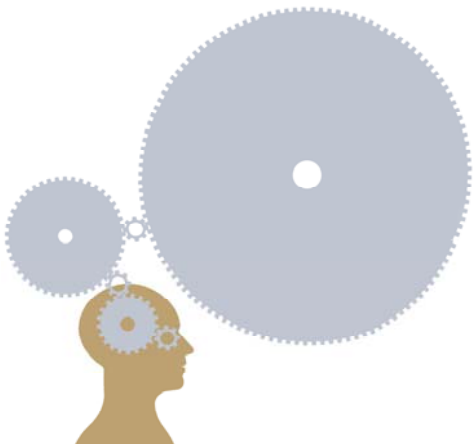

Financial RIA Capacity Building Program in Bulgaria

Impact assessment in practice: MiFID case study

Stephen Dickinson

Economics of Financial Regulation Department

UK Financial Services Authority

Financial Supervision Commission

Sofia, 15 November 2007

Overview

- Background - on FSA and MiFID
- Assessing the impact of MiFID
- Case study – benefits of MiFID
- Case study - overall costs of MiFID
- Concluding remarks

Background – the FSA

- **The Financial Services Authority (FSA) is responsible for regulating the UK's financial markets**
- **We authorise and regulate nearly 30,000 firms and are paid for by fees levied from the industry (2007 FY budget c£300m)**
- **We have four statutory objectives:**
  - Market confidence
  - Consumer protection
  - Consumer awareness
  - Financial crime
- **FSMA (2000), which established the FSA, includes explicit requirements relating to CBA and consultation**
  - Quantification of costs; analysis of benefits
  - CBA must be published as an annex to a consultation paper that seeks stakeholder reaction to proposed rule change(s)

Background - MiFID

- **A key part of FSAP**
- **Replaces Investment Services Directive (ISD) – why?**
  - Innovation
  - Regulatory barriers
- **Introduces EU-wide requirements**

  - eg on investment advice, operation of MTFs and services relating to commodity derivatives
- **Passporting**

Assessing the impact of MiFID (1)

- **FSA approach to impact assessment (IA)**
  - Legal requirements to consult and conduct CBA
  - Use of MFA and HLCBA embedded institutionally to decide whether or not to intervene (where there is discretion)
  - Independent team to ensure IA is conducted to high standard – generates appropriate incentives
  - Formal accountability mechanisms ensure stakeholder involvement both formally and informally
  - Methods of data gathering - use of consultants etc

Assessing the impact of MiFID (2)

- In the case of MiFID, focus was on CBA only – no discretion
- First step was to identify population of affected firms (UK authorised firms only)
- Europe Economics employed to consider the overall benefits of MiFID
- Cost information gathered in a series of individual consultation exercises
- “Overall impact of MiFID” consultation paper published in November 2006
- Issues of super-equivalence and timing

Benefits of MiFID (1)

- Europe Economics employed to quantify, where possible, the benefits of MiFID
- Direct effects distinguished from “second round” effects
- Direct benefit of up to £200m p.a. due to compliance and transaction cost savings to firms – achieved immediately
- Second round benefits of £240m p.a. to end-users from increased competition and innovation due to deepening of capital markets (contingent on achieving direct benefits) – emerge over time
- Possible third round effects relating to increased long-term sustainable growth rate

Benefits of MiFID (2)

- **Four scenarios**
  - Limited effect
  - Non-regulatory factors dominate
  - Contributor to FSAP
  - Key measure
- **Scale of benefits depends on assumptions about:**
  - Existing level of capital market integration (in the UK)
  - Pooling of liquidity in equity markets
  - Scope for greater substitutability between shares and of barriers to cross-border trading
  - Nature of implementation in other member states
- **So scenario 2 deemed most appropriate**

Benefits of MiFID (3)

- **Sources of first round benefits:**
  - Reduced authorisation costs
  - ***Reduced compliance costs - £100m p.a.***
  - Reduced costs of establishing “market reputation”
  - Reduced operating costs
  - ***Improved market access due to passporting – small but material increase in supply***
  - Lower prices due to best execution and transparency requirements
  - Improved functioning of markets
  - ***Reduced transaction costs due to aggregation effects - £100m-£1bn***
  - ***Increased competition in publication of firms’ data - £2m-£20m***

Benefits of MiFID (4)

- **Sources of second round benefits:**
  - **Deeper, more liquid, more sophisticated capital markets**
  - **Broader range of available risk-return trade-offs**
  - **Reduced diversification costs**
  - **Better risk hedging**
  - **Increased ability of market participants to diversify**

Benefits of MiFID (5)

- **Benefits from reduced compliance costs**
  - Questionnaire used
  - Main driver reduced need to produce multiple compliance systems for multiple regulators
  - Scale of benefit depends on assumption about firms' number of non-UK EU business involvements and extent of associated additional compliance costs
  - Earlier Europe Economics study indicated scale of total UK financial sector compliance costs at 1.5% of operating costs

Benefits of MiFID (6)

- **Benefits from reduced compliance costs**
  - Operating costs assumed to = £70bn
  - Total compliance costs = 1.5%
  - Cost saving of one third assumed
  - Saving only applicable to MiFID firms (15% of financial services industry)
  - Assume passporting to 2 other member states
  - So benefit = £70bn*0.015*1/3*0.15*2 = £105m

Benefits of MiFID (7)

- **Benefits from aggregation**
  - Modelling used
  - Assumption that main scope for scale economies is in segregated equity markets
  - Benefits accrue as creation of an effective single EU exchange increases liquidity and reduces bid-ask spreads
  - Data on turnover for major EU exchanges analysed to model implications and quantify impact of changes in spreads
  - Scenario 2 assumes only 10% of improvement attributable solely to MiFID (£100m but could be £1b under different assumptions)

Costs of MiFID (1)

- **Various elements of MiFID provisions considered separately in a series of consultations but EE surveyed too (bottom up versus top down approach)**
- **One-off costs estimated at £877m to £1.17b**
- **Ongoing costs of £88m to £117m p.a.**
- **Costs driven mainly by:**
  - Client categorisation
  - Best execution
  - Appropriateness test
  - Systems changes due to markets transparency provisions

Costs of MiFID (2)

- **Survey evidence revealed that some firms had budgeted for MiFID but others hadn't**
- **For latter firms (over half of those surveyed) three scenarios considered:**
  - Firms that learn from first-movers so incur lower than industry average costs
  - Firms that incur higher than average costs in order to catch up
  - Firms incurring average costs
- **Scenario 3 assumed but questionable assumption**

Costs of MiFID (3)

- **Firm population stratified into small, medium and large by no. of employees**
  - Small = 100 or fewer
  - Medium = 100 to 5000
  - Large = 5000 and over
- **Distribution of firms by size assumed on basis of survey and FSA data (75:20:5)**
- **Estimates of cost per firm estimated**
- **Median or mean?**

Costs of MiFID (4)

- One-off versus ongoing costs
- Former most important for large firms because they can more easily absorb compliance internal audit and risk control costs given extent of existing functions
- But large firms can't avoid large costs of changes to IT systems
- Small firms hard to contact and generally suggested large on-going costs as well as one-off costs
- Day three exercise will consider specific MiFID provisions on best execution

Costs of MiFID (5)

- **MiFID provisions on best execution**
  - High level principle: firms must take all reasonable steps to obtain best possible result for their clients (taking account of price, costs, speed, likelihood of execution, settlement procedures, order size)
  - More detailed requirements: firms must establish "execution arrangements" and an "execution policy" (eg information on choice of venues or entities) and disclose arrangements to clients (who must give consent)
  - Firms must monitor and (annually) review effectiveness of execution processes
  - Firms must also notify clients of process changes and, at client request, demonstrate compliance with execution policy

Costs of MiFID (6)

- **MiFID provisions on best execution**
  - Benefits: nature and scale of market failure (retail v professional investors)
  - Benefits: nature of competition effects
  - Costs: compliance costs driven by formulation of execution policy; client consent requirements; execution arrangements; record keeping requirements; and demonstrating compliance with execution policy
  - Costs: scope for negative market impacts

Concluding remarks

- A very challenging exercise
- Very resource intensive for all involved
- Anticipating firm behaviour in the face of change – difficult but important
- Work of Europe Economics introduces interesting ways of thinking about benefits
- Use of existing studies important
- Use of scenarios – helps to identify significance of assumptions made
- Why bother if you have to do it anyway?

Questions…

…are very welcome

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Financial Supervision *Mr. Boyan Dombalov*	Financial Supervision Commission *Ms. Tzveta Grigorova*
Financial Supervision Commission *Ms. Vesela Todorova*	Association of Banks in Bulgaria *Ms. Irina Kazandjieva*
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Financial Supervision Commission *Mr. Zhelju Vasilev*	Ministry of finance *Ms. Denitza Markova*

RIA Class exercise

Excerpts of regulations to practice RIA

- Markets in Financial Instrument Act, Chapter 3, Division I;
- Requirements to the activities of investment intermediaries, Chapter 2.

* * *

Markets in Financial Instruments Act

Promulgated SG, issue 52 from 29 June, 2007 in effect as of 1 Nov., 2007

TITLE ONE
GENERAL PROVISIONS

Chapter Three
REQUIREMENTS TO THE INVESTMENT INTERMEDIARIES' ACTIVITIES
Division I
Relations with Clients

Art. 27. (1) The investment intermediary shall carry out the services and activities under Art. 5 para 2 and 3 for client account on the basis of a written contract with the client.
(2) In the performance of the services and activities under Art. 5 para 2 and 3, the investment intermediary shall act honestly, fairly and professionally, with due diligence and in accordance with the best interests of its clients, and shall also inform them of the risks associated with transactions with financial instruments.
(3) The investment intermediary shall inform its clients about the existing system for compensation of investors in financial instruments, including about its scope and about the guaranteed amount of the client's assets, and on request shall provide data about the conditions and procedure of compensation.
(4) The information which the investment intermediary provides to its clients, as well as to potential clients, including in its advertising materials and the public statements of the members of the intermediary's management and supervisory bodies and of the persons, working under a contract for it, must be understandable, correct and clear and not to be misleading. The advertising materials of the investment intermediary must clearly be indicated as such.
(5) The investment intermediary shall provide in an appropriate manner and in compliance with para 4, the following information to its clients or to potential clients:
1. data about the investment intermediary and about the services offered by it, including whether it pursues business or concludes transactions with financial instruments for its account;
2. the financial instruments, subject of the provided by the intermediary investment services and the proposed investment strategies;
3. warning about the risks associated with investments in the instruments under item 2 or in relation to specific investment strategies;
4. the venues for the transactions' execution;
5. the types of expenses for the client and their amount;
6. other circumstances, as laid down in an ordinance.
(6) The information under para 5 shall be provided to the client in a way, allowing him to understand the nature and risks of the investment service and the offered specific financial instrument, ensuring the taking subsequently of informed investment decision. This information may be provided in a standardized form.
(7) The investment intermediary must supply to its clients enough information on the provided service, including on the expenses about the transactions and services, provided for the client's account, where applicable.
Art. 28. (1) In the performance of services under Art. 5 para 2 item 4 and 5, the investment intermediary shall require from the client, respectively from the potential client, information regarding his financial possibilities, investment objectives, knowledge, and experience relevant to the services under Art. 5 para 2 item 4 and readiness to risk, as well as to update this information. The investment intermediary shall not have the right to execute the services under Art. 5 para2 item 4 and 5 for a client, who has not provided the information under sentence one.
(2) In the provision of the services under para 1 the investment intermediary shall be guided by the received under para 1 information.
(3) Upon the provision of investment services, other than those indicated in para 1, the investment intermediary shall ask the client, respectively the potential client, to provide information regarding his knowledge and experience relevant to the provided services, as well as to update this information.
(4) On the basis of the information under para 3 the investment intermediary shall assess whether the offered investment service is appropriate for the client, respectively for the potential client. The investment intermediary shall notify the client, respectively the potential client in writing, in case that on the basis of the received under para 3 information it decides that the offered investment service will not be appropriate for the client.
(5) In case that the client, respectively the potential client, fails to provide the information under para 3, or the provided information is insufficient to make the estimate under para 4, the investment intermediary shall inform the client in writing that it cannot estimate whether the offered investment service is appropriate for it.
(6) An investment intermediary, providing investment services under Art. 5 para 2 item 1 and/or 2, may provide such services to a client, without the latter having supplied the information under para 3, if:
1. subject of the services are shares, which have been admitted to trading on a regulated market, or on an equivalent market of a third country, according a list of the European

Commission, bonds or other forms of securitized debt, with the exception of such bonds or other debt securities that underlie a derivative instrument, money market instruments, units of collective investment schemes and other non-complex financial instruments;
2. the service is provided at the initiative of the client or of a potential client;
3. the client or the potential client has been informed in writing that the investment intermediary will not comply with the obligations under para 4;
4. the investment intermediary complies with the requirements for treatment of conflict of interests.
(7) The requirements under para 1-6 shall not apply when the investment service is offered as part of a financial product, which is regulated by *acquis communautaire* or by common European standards in relation to credit institutions or consumer credits with regard to risk assessment of clients and/or requirements to information providing.
Art. 29. (1) When performing the services and activities under Art. 5 para 2 and 3, the investment intermediary shall take all necessary steps to identify potential conflicts of interests between:
1. the investment intermediary, including the persons under Art. 11 para 2 and 5, all other persons who work under a contract for it, and the linked to it by control persons, on one side, and its clients, on the other side;
2. its individual clients;

(2) In case that in spite of the applying of the rules under Art. 24 para 2, a risk to client interests continues to exist, the investment intermediary may not carry out activities for client account, if it has not informed the client about the general nature and/or sources of the potential conflicts of interest.
Art. 30. (1) The investment intermediary shall execute client orders in the best interest of the client. The investment intermediary shall have fulfilled this duty of its, if it has made reasonable efforts to establish the best for the client price according the conditions of the order, amount of costs, likeliness of performance, as well as all other circumstances concerning the order fulfillment. In case of specific instructions on the client's side, the investment intermediary must fulfill the order following these instructions.
(2) An investment intermediary shall accept, update and inform its clients about the policy for client orders execution, ensuring fulfillment of the obligations under para 1, as well as about any substantial changes in this policy.
(3) The policy under para 2 includes information of the venues for the client orders execution (type of financial instrument), the advantages and shortcomings of any execution venue (according the volume, price and execution costs) and venues where the intermediary may achieve best execution. The execution policy shall include at least the venues of execution which allow the investment intermediary to obtain continuously the best possible results for the execution of its clients' orders.
(4) An investment intermediary may not execute orders for client account unless they have given their preliminary consent for the followed by the intermediary policy.
(5) An investment intermediary must perform the client orders in conformity with the adopted execution policy and to inform in due time the client about any changes in such policy.
(6) Where the policy for order execution envisages a possibility client orders to be also executed outside of a regulated market or MTF, the orders may be executed in such way only provided the clients of the intermediary have been preliminarily informed and have given an express assent for that.
(7) On client's request, the investment intermediary shall prove that it has fulfilled the orders in compliance with the declared policy under para 2.
(8) The investment intermediary shall monitor the effectiveness of the policy for order execution, and in the cases where possible, shall remove the established by it irregularities.

The investment intermediary shall conduct regular inspections whether the included in the execution policy venues ensure the best execution of the clients' orders, as well as whether any changes in this relation are needed.
Art. 31. (1) An investment intermediary carrying out investment services under Art. 5 para 2 item 1, 2 and 3 may enter into transactions with eligible counterparties, without it having to comply with the requirements under Art. 27 para 4 and 7, Art. 28, 30 and Art. 33 para 2 with respect to the specific transactions or the relevant ancillary service directly related to these transactions.
(2) Any entity specified as an eligible counterparty under this Act, may expressly request not to be considered such in whole, or for a concrete transaction.
Art. 32. (1) An investment intermediary carrying out investment services under Art. 5 para 2 item 2, or ancillary services for the account of a third person, according an order by another intermediary, shall be entitled to receive the information about the third person gathered by such intermediary.
(2) The investment intermediary by whose order the services under para 1 are performed, shall bear responsibility for the completeness and correctness of the provided information.
(3) An investment intermediary performing investment services under Art. 5 para 2 shall be entitled to receive and to refer to the recommendations, provided to a third party by the other intermediary in respect to the service.
(4) The investment intermediary on whose orders the services under para 3 are performed shall bear responsibility for the correctness of the recommendations provided to the client.
(5) The investment intermediary under para 1 and 3 shall be responsible for the execution of the order under which a transaction has been entered into on the basis of the received information and recommendations under para 1 and 3.
(6) An investment intermediary may not transfer the performance of investment and ancillary services for client account to another intermediary, as well as the performance of material operational functions to a third person, if thus the realization of an efficient internal control, or the possibility of the Commission to exercise its supervisory functions will be frustrated.
(7) The cases where the investment intermediary may transfer material operational functions and the performance of investment services for client account to another intermediary shall be laid down in an ordinance.
Art. 33. (1) An investment intermediary shall enter in a special register in the sequence of their receiving all orders of its clients.
(2) An investment intermediary must execute immediately, fairly and accurately the received client orders, including to observe the sequence of receiving of identical orders.
(3) The register under para 1 shall be kept on paper and magnetic media.
(4) With regard to every transaction shall be written down the name or business name of the parties to it, time of entering into, as well as other data as laid down in an ordinance.
(5) The investment intermediary shall register in the relevant register, in the sequence of their entering, the transactions with financial instruments not later than at the end of the working day.
(6) An investment intermediary shall maintain records of all transactions, services and activities carried out by it, which are to allow the Commission and the deputy chairman in the exercising of their supervisory functions under this Act and its implementing instruments, to establish that the investment intermediary fulfills the envisaged in the Act and its implementing instruments obligations in relation to the clients and the potential clients.
Art. 34. (1) An investment intermediary shall segregate its financial instruments and cash from those of its clients. The investment intermediary shall not be liable to its creditors with the financial instruments and cash of its clients, as well as with securities which are underlying in respect to depository receipts.

(2) An investment intermediary may not keep with itself the cash of its clients.
(3) An investment intermediary shall deposit the cash of its clients in:
1. a central bank;
2. a credit institution;
3. bank, licensed in a third country;
4. collective investment scheme that has been authorized to pursue activity according Council Directive 85/611/EEC or undertaking for collective investment, which is subject to control by the competent supervisory authority in a Member State, provided it meets the following conditions:
a) its major investment objective is to maintain certain average net asset value (net profit) or net asset value equal to the capital attracted from investors plus profit;
b) it invests the raised pecuniary funds exclusively in money market instruments with highest possible credit rating, awarded by a credit rating agency, whose maturity or residual term till maturity is not more than 397 days, or in instruments with fixed yield, close to that of the preceding instruments, or in instruments whose average residual term till maturity is 60 days; it may additionally invest pecuniary funds in bank deposits;
c) ensures liquidity on the same day or settlement on the next day.
(4) An investment intermediary may deposit the pecuniary funds of its clients in the entities under para 3, with which it is a related person, only if the clients have given written assent for that.
(5) The investment intermediary shall safeguard the financial instruments of its clients in a depository institution on client accounts under the investment intermediary's account or on accounts opened under the account of a third parson on conditions and according a procedure as laid down in an ordinance.
(6) An investment intermediary shall regularly inform its clients about the balances and operations on the cash accounts and about financial instruments which it keeps and about the conditions of the contracts for their safeguarding.
(7) Except for the cases laid down in an ordinance, the investment intermediary shall not have the right to use:
1. for its account the cash and financial instruments of its clients;
2. for the account of its client the cash or financial instruments of other clients;
3. for account of a client its own cash or financial instruments.
(8) The safekeeping and registration of government securities, issued on the internal market shall be carried out under the conditions and procedure, provided for in the National Debt Act and its implementing instruments. .
Art. 35. (1) In the performance of its activities the investment intermediary shall keep the trade secret of its clients as well as their trade prestige.
(2) The members of the management and supervisory bodies of the investment intermediary, the persons working under a contract for an investment intermediary may not divulge, unless authorized for it, and use for the benefit of themselves or of other persons, facts and circumstances, relating to the balances and operations under the accounts for financial instruments and for cash of the investment intermediary's clients, as well as all other facts and circumstances constituting trade secret, which have come to their knowledge in the fulfillment of their official and professional obligations.
(3) All persons under para 2, upon taking up office or beginning activity as an investment intermediary shall sign a declaration that they shall keep the secret under para 2.
(4) The provision of para 2 shall also apply in the cases where the indicated persons are not in office or their activity was terminated.
(5) Beside to the Commission, the deputy chairman and authorized officials from the Commission's administration, or to a regulated market of which it is a member, for the

purposes their control activities and within the order for an inspection, the investment intermediary may give information under para 2 only:
1. with the consent of its client, or
2. by court decision issued under the conditions and procedure of para 6 and 7.
(6) The court may rule disclosure of the information under para 2 on the request of:
1. the prosecutor – in case of availability of data for perpetrated crime;
2. the Minister of Finance or authorized by him official – in the cases of Art. 143 para 4 of the Tax and Social Security Procedure Code;
3. the director of the territorial directorate of the National Revenue Agency, where:
a) evidence is presented that the inspected person has frustrated the carrying out of an audit or inspection or does not keep the required records, as well as if there is material incompleteness therein;
b) by an act of a competent government authority the occurrence of an accidental event has been established, that resulted in destruction of the inspected person's reporting documentation;
4. The Committee for establishment of property acquired from criminal activity and the directors of its territorial divisions.
5. The Director of the Agency for State Financial Inspection where by an act of a body of the Agency it has been established that:
a) the management of the inspected organization or entity frustrates the carrying out of financial inspection;
b) no accounting records are kept in the inspected organization or entity or they are incomplete or untrustworthy;
c) there are data about shortages or crimes;
d) the levying of distraint on bank accounts is necessary for the securing of established during financial inspections receivables;
e) by an act of a government authority the occurrence of an accidental event has been established, that resulted in the destruction of reporting documentation of the inspected organization or person;
6. the Director of Customs Agency and the directors of the regional customs divisions, where:
a) by an act of the customs authorities it has been established that the inspected person has frustrated the carrying out of customs inspection and does not keep the necessary records, as well as when they are incomplete or untrustworthy;
b) by an act of the customs authorities customs violations have been established;
c) the levying of distraint on bank accounts is necessary for the securing of established by the customs authorities receivables, collected by them, as well as for the securing of fines, legal interests, etc.;
d) by an act of a government authority the occurrence of an accidental event has been established, that resulted in the destruction of the reporting documentation of the inspected by the customs bodies site.
7. the Director of the National Police Service of the Ministry of Interior – for the purpose of enquiry on instituted criminal proceedings;
8. the Director of the National Security Service to the Ministry of Interior – when this is necessary for protection of the national security.
(7) The regional judge shall rule on the petition with a reasoned decision in a closed session not later than 24 hours of its receiving, setting the time-limit for disclosure of the information under para 2. The decision of the court shall not be subject to appeal.
(8) On written request of the Director of the National Investigation Service, of National Security Service or National Police Service, the investment intermediaries shall provide

information about the cash and movements under the accounts of companies having over 50 per cent of state and/or municipal participation.
(9) If there are data about organized criminal activity or about money laundering, the Prosecutor General, or an authorized by him Deputy, may demand from the investment intermediaries to provide the information under para 2.
Art. 36. (1) The investment intermediary shall provide a possibility for its professional clients under Division I of the Appendix to use a higher degree of protection, which is provided to unprofessional clients. The investment intermediary shall inform the professional client under Division I of the Appendix before the beginning of the investment services provision, that on the basis of the received from the client information he is considered a professional client and with regard to him shall be applied the rules for professional clients, unless the investment intermediary and the client do not agree otherwise.
(2) The investment intermediary shall inform the professional client under Division I of the Appendix that he is entitled to ask for amendment to the conditions of the contract with the purpose of securing higher degree of protection for the client.
(3) The investment intermediary ensures a higher degree of protection for a client under Division I of the Appendix on his request, where the client estimates that he cannot rightly assess and manage the risks, associated with investment in financial instruments.
(4) The higher degree of protection under para 3 shall be provided on the grounds of a written agreement between the investment intermediary and the client under Division I of the Appendix, which shall explicitly state the specific services, activities, transactions, financial instruments or other financial products, in relation to which a higher degree of protection will be ensured to the client.
(5) The higher degree of protection under para 3 shall ensure to the client under Division I of the Appendix that he shall not be considered as a professional client for the purposes of the applicable regime to the investment intermediary's operation.
Art. 37. (1) Clients, other than those under Division I of the Appendix, including government authorities and private individual investors, may request in respect to them not to apply the rules of pursing business of investment intermediaries, which ensure a higher degree of client protection.
(2) An investment intermediary may treat a client under para 1 as a professional client, if the criteria under item 1 of Division II of the Appendix exist and the procedure under item 2 of Division II of the Appendix has been complied with. It shall not be considered that a client for whom the conditions under sentence one are complied with, possesses the knowledge and experience as the clients under Division I of the Appendix.
(3) The investment intermediary shall not apply the relevant rules which ensure a higher degree of client protection, only if on the basis of its evaluation of the experience, skills and knowledge of the client, a reasoned conclusion may be drawn that according the nature of the transactions and services which the client intends to use or enter into, the client may take independent investment decisions and to assess the risks associated with them.
(4) The evaluation under para 3 may be done according the conditions and procedure of evaluation, envisaged for the persons, who manage the activities of the investment intermediaries, insurers or credit institutions according the *acquis communautaire.* In cases where the client under para 2 does not have an independent management body, subject to evaluation shall be the person who has the right to conclude on his own transactions for the account of a legal entity.
(5) In cases when a client of the investment intermediary has been specified as a professional client on the basis of a procedure and in accordance with criteria, analogous to those under Division II of the Appendix, this Article shall not apply.

(6) An investment intermediary shall apply appropriate written internal procedures and policies for specifying the clients as professional clients.
(7) The clients of an investment intermediary that have been specified as professional clients according Art. 1 – 6 shall inform the investment intermediary of any change in the data that served as a ground for their specifying as professional clients.
(8) In the cases where the investment intermediary in the course of the pursued by it business finds out that a client defined as a professional according Art. 1-6, has ceased to meet the conditions under item 1 of Division II from the Appendix, on which it has been specified as a professional client, the investment intermediary shall take the necessary measures to apply a higher degree of protection with respect to such client according the internal procedures and policies of item 6.

ORDINANCE No. 38 OF 25 JULY, 2007 ON THE REQUIREMENTS TO THE ACTIVITIES OF INVESTMENT INTERMEDIARIES

In effect as of 1st November, 2007, issued by the Financial Supervision Commission
Promulgated SG, issue 67 from 17 August, 2007

Chapter Two
RELATIONSHIPS WITH CLIENTS
Art. 2. (1) When performing investment services and investment activities for client account, the investment intermediary shall act in a honest, fair and efficient manner and as a professional in accordance with the best interests of its clients.
(2) An investment intermediary shall treat its clients equally.
(3) An investment intermediary shall conclude transactions in financial instruments for client account on the best possible conditions and where making efforts to achieve the best possible performance according the order submitted by the client. When executing an order given by a non-professional client, the best possible performance of such order shall be determined by the total amount of the transaction, including the price of the financial instrument and the expenses related to the performance. The expenses related to the performance shall include all expenses that are directly related to the execution of the order, including fees for the execution venue, clearing and settlement fees, as well as other fees and remunerations payable to third parties, bound with the execution of the order.
(4) To achieve best possible performance, in the cases where there is more than one competitive execution venues of an order in relation to financial instruments and in making assessment and comparison of the results that may be achieved for a non-professional client where executing the order on each of the execution venues, specified under the intermediary's policy for performance of orders which are suitable for its execution, the intermediary's commission fees and the expenses incurred in connection with the execution of the order on each of the possible venues shall be taken into consideration.
(5) An investment intermediary shall not have the right to specify and collect commission fees in ways which obviously divide unfairly the different execution venues.
(6) In compliance with its obligation of achieving best result for the client, an investment intermediary shall execute its clients' orders at its earliest convenience, unless this would obviously be to the clients' disadvantage.

Art. 3. (1) When and investment intermediary manages a portfolio, it shall comply with the obligation to act in accordance with the client's best interest when it gives orders for execution to another person of taken by the intermediary decisions for trade with financial instruments for the account of its clients.
(2) When the investment intermediary carries out the activity under Art. 5 para 2 item 1 of the Markets in Financial Instruments Act (MFIA) and transmits to other persons orders of its clients for execution, it shall act according the client's best interest.
(3) For the fulfillment of the obligations under para 1 and 2 the investment intermediary shall:
1. make all reasonable efforts to achieve the best result for its clients, accounting for the factors according Art. 30 para 1 of the MFIA; the relevant significance of any of these factors shall be determined according the criteria under Art. 5, and for the non-professional clients – also according the requirements of Art. 2 para 3 and 4; the investment intermediary will have fulfilled its obligation under para 1 and 2 and shall not be obligated to meet the requirement under sentence one, when it follows special instructions of the client in the fulfillment of the order or transmits the order for execution to another person;

2. adopt and apply policy which ensures compliance with the requirements under item 1; the policy must indicate in relation to every class of financial instruments the persons to whom the investment intermediary gives the orders or to whom it transmits the orders for execution; the persons to whom the investment intermediary gives or transmits an order for execution must have the necessary arrangement and mechanisms, which are to ensure that the investment intermediary shall fulfill its obligations under this article, giving or transmitting client orders for execution to these persons;

3. provide to the clients appropriate information about the pursued by it policy under item 2;

4. continuously monitor for the efficiency of the policy under item 2, including also for the quality of performance by the persons under item 2 and where necessary, take actions for removal of the established irregularities;

5. make inspection of the policy under item 2 once yearly, as well as upon any substantial change which may affect the intermediary's ability to ensure best results for its clients.

(4) Paragraphs 1 – 3 shall not apply when the investment intermediary manages client portfolio and/or receives and transmits orders and simultaneously executes the received orders or the decisions for conclusion of transactions in the portfolio management. In these cases Art. 30 of the MFIA shall apply.

Art. 4. The investment intermediary shall once yearly perform an inspection of the policy for execution of orders of customers under Art. 30 para 2 of the MFIA and the arrangements for order execution.
(2) The inspection under para 1 shall be conducted also upon any substantial change that may interfere with the intermediary's ability continuously to provide the best possible results for the execution of client orders when using the execution venues which have been included in the order execution policy.

(3) The investment intermediary shall submit to its non-professional clients within an appropriate term, prior to commencing to perform services, including execution of orders for their account, the following information on the order execution policy:

1. description of the relevant significance of the factors for execution under Art. 30 of the MFIA, determined by the investment intermediary in consistence with the criteria under Art. 5 para 1, or the method by which the investment intermediary defines the relevant significance of these factors;

2. a list of the execution venues, on which the intermediary largely relies for achievement of best execution of client orders;

3. a clear and explicit warning stating that all specific instructions of the client may prevent the intermediary to take the necessary actions for achieving the best possible result in client orders execution, where pursuing the policy of order execution, for that part of the order to which the specific instructions relate;

(4) The information under para. 3 shall be provided to the client on a durable medium. The information under para 3 may also be provided by means of the web site, when it does not satisfy the requirements for a durable medium, if the conditions under Art. 15 para 2 have been met.

Art. 5. (1) In the execution of client orders, the investment intermediary shall take into account the relevant significance of the factors for execution under Art. 30 para 1 of the MFIA according the following criteria:
1. the characteristics of the client, including whether its has been defined as a non-professional or professional client;
2. the characteristics of the client order;
3. the characteristics of the financial instruments subject of the order;
4. the characteristics of the execution venues, to which the order may be directed for execution.

(2) An investment intermediary will have fulfilled its obligation to act for the achievement of the best result for its clients, if it has fulfilled the order or a specific aspect of the order, following special instructions by the client.

Art. 6 An investment intermediary which provides investment advice to a client or manages a portfolio, shall conclude a contract with and investment advisor.

Art. 7. (1) The information which the investment intermediary provides to its clients, including in its advertising materials and public statements of the intermediary's members of the management and the control bodies and of the persons working under a contract for it, shall be understandable, accurate, clear and not to be misleading.
(2) An investment intermediary shall ensure that the information under para 1 which it provides to non-professional clients or potential non-professional clients or disseminated in a way whereby it may reach such clients shall satisfy the following conditions:

1. it contains indication of the investment intermediary's business name;
2. it is accurate and does not underline potential benefits of a given investment service or financial instrument, without simultaneously indicating clearly and at a prominent place the relevant risks;
3. it is sufficient and presented in a understandable way for the customary members of the group to which it has been addressed or is likely to reach;
4. it does not conceal, omit or undervalue important messages, statements or warnings.

(3) Where the information under para 2 contains a comparison between investment or ancillary services, financial instruments or persons providing investment or ancillary services, it shall meet the following terms and conditions:

1. the comparison has to be purposeful and presented in a fair and balanced manner;
2. to indicate the sources of information used for the comparison;
3. to include the main facts and assumptions used to prepare the comparison.

(4) Where the information under para 2 contains indication of previous profitability of a financial instrument, financial index or investment service, such information shall meet the following terms and conditions:

1. the indication of the previous profitability may not constitute the most essential part of the information;

2. the information shall include appropriate data about the profitability over the preceding 5 years; when the period during which the financial instrument has been offered, or the financial index has been formed, or the investment service has been offered is longer or shorter than 5 years, shall be presented data on the profitability of that period; in any case the data on the profitability shall be based on a full period of 12 months;

3. to specify the period, to which the information relates, and its source;

4. to contain an explicit warning that the data relate to a past period and these are not a reliable indicator for future performance;

5. in the cases where the indication contains data and values in a currency other than the currency of the Member State where the client's seat or place of residence is located, the currency shall be clearly indicated and it shall have an express warning that the profitability may be decreased or increased as a result of change in the exchange rates;

6. where profitability is specified as a total, shall be specified the amount of the commissions, fees and other expenses for the client.

(5) Where the information under para 2 contains or relates to simulated past profitability, it shall meet the following requirements:

1. to relate to financial instrument or financial index;

2. the simulated past profitability to be based on actual past profitability of one or more financial instruments or indices which are the same or which are underlying asset for the financial instruments for which profitability has been simulated;

3. for the actual past profitability under item 2, the requirements under para. 4, items 1-3, 5 and 6 to have been complied with;

4. to contain an explicit warning that the data are based on simulated profitability and that the information is not a certain index of future profitability.

(6) Where the information under para 2 contains information on future profitability, it shall meet the following requirements:

1. not be based or refer to simulated previous profitability;
2. to be based on well-grounded assumptions, supported by objective data and facts;
3. where profitability is specified as a total, the amount of the commissions, fees and other expenses for clients shall be specified;
4. to contain an explicit warning that these forecasts are not a certain index of future profitability.

(7) Where the information under para 2 relates to levying of certain type of tax, it shall contain the specification that the taxation depends on the concrete circumstances, related to the client and may be changed in the future.

(8) The information under para 2 may not include the name of the Commission or of another competent authority in order to be explicitly stated or otherwise indicated that the authority has confirmed or approved the products or the services offered by the investment intermediary.

(9) The provided to the clients information, advertising materials and public statements by the persons working under a contract for the investment intermediary are to be preliminarily approved by a person with the Internal Control Department.

(10) The Commission may request from the investment intermediary to submit evidence of the authenticity of the facts contained in the information provided to clients, the advertising materials and public statements of the members of the management and control bodies of the intermediary and of the persons working under a contract for it.

Art. 8. (1) An investment intermediary shall provide in due time, before a non-professional client or potential non-professional client to be bound by virtue of a contract with the investment intermediary for the provision of investment or ancillary services, the following information:

1. the conditions of the relevant contract;
2. information under Art. 9, having bearing to the contract or to the investment or ancillary service provided.

(2) Within an appropriate term before the beginning of the provision of investment or ancillary service to a non-professional client, the investment intermediary shall provide the client, or the potential client with the information under Art. 9, 10, 18 and 32.

(3) In an appropriate term prior to providing an investment or ancillary service to a professional client, the investment intermediary shall provide the client, or the potential client, with the information under Art. 32 paras. 3 and 4.

(4) The information under paras. 1-3 shall be provided to the client on a durable medium or on the investment intermediary's web site, where this does not constitute a durable medium, while observing the requirements under Art. 15, para. 2.

(5) An investment intermediary shall ensure the conformity of the information which is contained in its advertising materials and the public statements of the members of the intermediary's management and control bodies and of the persons working under a contract for it, to the information which it provides to the clients when performing investment and ancillary services.

(6) The investment intermediary shall notify in due time the client of any substantial change in the circumstances under Art. 9, 10, 18 and 32 which have bearing on the offered service to the client. The notification shall be done on a durable medium, if the information to which it relates, has been provided on a durable medium to the client.

(7) Where advertising materials or public statements by the members of the investment intermediary's management and control bodies or by the persons working under a contract for it contain an offer or an invitation indicated in para 8, and specify the method of reply or the form, in which the reply of the client is to be provided, they have to contain such part of the information under Art. 9, 10, 18 and 34 which is proportionate to the offer or the invitation.

(8) Paragraph 7 shall apply to advertising materials or public statements by the members of the investment intermediary's management and control bodies or by persons working under a contract for it, which contain proposals and invitations of the following type:

1. an offer for conclusion of a contract, with the subject of financial instrument or an investment or ancillary service with any person who replies to the notification;

2. an invitation to each person who replies to the notification to make a proposal for conclusion of a contract, with the subject of financial instrument or an investment or ancillary service.

(9) In cases where a potential non-professional client must acquaint himself with documents containing the information under Art. 9, 10, 18 and 32, in order to reply to the proposal or invitation contained in the advertising materials or the public statements, para 7 shall not apply.

Art. 9. (1) An investment intermediary shall provide non-professional clients and potential non-professional clients with the following general information, if applicable:

1. the business name and address of the investment intermediary, as well as telephone and/or other information for contact with the investment intermediary;
2. the languages in which the client may communicate and keep correspondence with the investment intermediary and to receive documents and other information by the intermediary;

3. the ways of communication which are used between the investment intermediary and its clients, including where applicable, the ways of forwarding and acceptance of orders;

4. explicit indication that the investment intermediary is licensed by the Commission, as well as indication of the name and address of the authority who has issued the license;

5. the type, the periodicity and the deadline for submitting the reports and the confirmations to a client in connection with the investment services and activities performed;

6. a concise description of the steps that the intermediary undertakes in order to guarantee the client financial instruments or cash, in the cases where the intermediary holds such for the client, including a concise description of any relevant investor compensation or deposit guarantee schemes in which the investment intermediary participates in relation to its operation in a Member State;

7. a description, which may also be in a summarized form, of the policy for handling conflicts of interest under Art. 75 para 1 item 4 applied by the investment intermediary;

8. additional detailed information on the handling of conflicts of interest policy; the information shall be provided upon request by the client on a durable medium, or on the investment intermediary's website where this does not constitute providing on a durable medium, while observing the requirements set under Art. 15, para. 2.

(2) In the cases where the investment intermediary manages an individual portfolio of a client, the intermediary shall apply an appropriate method for assessment and comparison as a generally accepted benchmark, based on the client's investment purposes and the types of financial instruments included in the client portfolio, in such a manner that the client making use of the service may assess the performance of the service by the investment intermediary.

(3) In the cases where the investment intermediary offers to a non-professional client, or to a potential non-professional client, the service of portfolio management, the intermediary shall, apart from the information under para. 1, provide the client also with the following information where applicable:

1. information about the method and periodicity of assessing the financial instruments in the client portfolio;

2. details of each delegation of the management of all or a part of the financial instruments and/or money in a client portfolio;

3. characteristics and information on each benchmark by which the portfolio management results shall be assessed;

4. the types of financial instruments which may be included in a client portfolio and the types of transactions which may be concluded with them, any restrictions inclusive;

5. the management objectives, the risk level contained in the assessment of the person managing the portfolio, as well as all specific restrictions of that assessment.

Art. 10. (1) The investment intermediary shall provide the client and the potential client with a general description of the financial instruments and the associated with them risks. The description has to be conformed to the client's type (professional and non-professional) and shall meet the following requirements:

1. to contain detailed description of the type and the characteristics of the specific financial instrument and of the specific risks associated with it;
2. the information under item 1 is to allow the client to take informed investment decision.

(2) The description of the risk shall include the following elements, insofar as applicable for the specific type of financial instrument, the status and level of knowledge of the client:

1. indication of the risks associated with the specific type of financial instruments, including explanation of the leverage and its consequences and the risk of losing the whole investment made;

2. the volatility of the financial instruments' price and all market restrictions pertaining to these instruments;

3. the circumstance that the investor may undertake as a result of transactions in financial instruments, financial and other additional liabilities, including unforeseen liabilities that are additional to the expenses for the instruments' acquisition;

4. all margin requirements or similar liabilities applicable to the instruments of this type.

(3) The Deputy Chairman in charge of Investment Activity Supervision Division, hereinafter referred to as "deputy chairman", may specify the contents of the risk description under para. 1 and 2.

(4) Where the financial instruments are subject of public offering carried out on the grounds of a published prospectus in compliance with the provisions of Directive 2003/71EC of the European Parliament and of the Council on prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Directive 2003/71/EC); the investment intermediary shall inform the non-professional client and the potential non-professional client of the place where the prospectus is accessible for the public..

(5) In the cases where the risks associated with a financial instrument consisting of two or more different financial instruments or services, are likely to be higher than the risks related to any of its components, the investment intermediary shall submit and adequate description of the financial instrument's components and of the way in which their interaction enhances the risks.

(6) In the cases where the financial instruments include a guarantee by a third person, the investment intermediary shall provide a non-professional client and a potential non-professional client with sufficient data on the guarantor and the guarantee, which shall allow the client to make an objective assessment of the guarantee.

Art. 11. The liabilities under Art. 10 shall not apply with regard to units and shares of collective investment schemes in the cases when the investment intermediary provides the information contained in the short-form prospectus according Art. 28 of Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (Directive 85/611/EEC).

Art. 12. (1) An investment intermediary shall notify all its clients of the conditions and criteria, according which the investment intermediary determines them as professional or non-professional, as well as of the circumstances under which they may be defined as an eligible counterparty. The clients shall be also notified on a durable medium of their right to request to be categorized in a different way, as well as of the restrictions imposed on their protection in the case of different categorization.

(2) The investment intermediary shall define a client to be professional, non-professional or an eligible counterparty in compliance with the criteria established in the Markets in Financial Instrument Act (MFIA).

(3) The investment intermediary on its own initiative or on the client's request may:

1. specify as professional or non-professional a client who in other cases would be defined as eligible counterparty within the sense of § 1 item 29 of the MFIA;

2. specify as non-professional a client, who is considered as a professional client within the meaning of Division I of the Appendix to the MFIA.

(4) Where a person defined as an eligible counterparty requests not to be treated as such and the investment intermediary consents, that person shall be treated as a professional client, unless the person has explicitly requested to be treated as a non-professional client.

(5) In the cases where an eligible counterparty expressly requests to be treated as a non-professional client, Art. 36 para 2 – 5 of the MFIA shall apply accordingly.

Art. 13. (1) The investment intermediary may not:

1. perform transactions for client's account in volume or with frequency, at prices or with given counterparty, for which according to the circumstances it may be assumed that they are performed exclusively in the investment intermediary's interest;
2. to buy for its own account financial instruments for which its client gave a purchase order, and to sell them to the client at a price higher than the price at which it bought them;
3. to perform for its own or for a third party's account activities with client's funds and financial instruments for which it has not been authorized by the client;
4. to sell for its own account or for a third party's account financial instruments which the investment intermediary or its client does not own, unless under the conditions and procedure established by an Ordinance;
5. to participate in the performance, including in the capacity of a registration agent, of concealed purchases or sales of financial instruments;
6. to receive a part or the whole benefit if the investment intermediary has concluded and executed the transaction under terms and conditions that are more favorable than those established by the client;
7. to perform activities otherwise which jeopardizes the interests of the intermediary's clients or the integrity of the market in financial instruments.

(2) The prohibition under para. 1, item 3 shall not apply to transactions, for the performance of which the client has given explicit orders on his own initiative.

(3) The prohibition under para. 1, item 4 shall also relate to the members of the management and control bodies of the investment intermediary, to the persons who manage its operation, as well as for all persons who work for it under a contract, as well as to related persons.

Art. 14. (1) The investment intermediary shall not have the right in connection with the provision of investment or ancillary services to a client, to pay, respectively provide, and to receive remuneration, commission or non-monetary benefit, apart from:

1. remuneration, commission or non-monetary benefit paid or provided by or to the client or his representative;

2. remuneration, commission or non-monetary benefit paid or provided by or to a third person or his representative where the following conditions exist:

a) the existence, nature and amount of the remuneration, commission or the non-monetary benefit shall be indicated to the client clearly, in an accessible way, accurately and understandably prior to providing the relevant investment or ancillary service, and where the amount may not be established, the method of its calculation shall be indicated;

b) the payment, respectively the provision of the remuneration, commission or non-monetary benefit, shall be with a view to enhancing the quality of the service and does not violate the obligation of the investment intermediary to act in the best interest of the client;

3. relevant fees that provide or are necessary with a view to providing the investment services, such as expenses for trustee services, settlement and currency exchange fees, legal services fees and public fees, and which in their nature do not result in the arising of a conflict with the investment intermediary's obligation to act honestly, fairly and professionally to the best interest of the client.

(2) It shall be considered that the investment intermediary has fulfilled its obligation under para 1 item 2 letter "a" where it:

a) presents the material conditions of the contracts concerning the remuneration, commission or the non-monetary benefit in a summarized form;
b) provides detailed information about the remuneration, commission or the non-monetary benefit on the client's request; and
c) the provision of the information according this paragraph is honest, fair and in the client's interest.

Art. 15. (1) In the cases where, pursuant to this Ordinance, information is required to be provided to the client on a durable medium, the investment intermediary shall provide information on paper or otherwise, while observing the following requirements:

1. the provision of the information in that way is appropriate with a view to the existing or future relations with the client;
2. the client has expressly preferred that way of information supply over its provision on paper.

(2) Where information is provided to clients through the intermediary's website and it is not addressed to a specific client, the information shall meet the following conditions:

1. the provision of the information in that manner is appropriate with a view to the existing or future relations with the client;

2. the client has expressly agreed with that manner of information provision;

3. the client has been notified via electronic means of the intermediary's website address and where exactly on it the information may be found;

4. the information is up-to-date;

5. the information to be continuously accessible by the client on the intermediary's website for a period of time that is usually necessary for the clients to acquaint themselves with it.

(3) The provision of information by electronic means of communication shall be treated as appropriate with a view to the existing or future relations with the client, if data exist that the client has a regular access to internet. It shall be considered that the client has a regular access to internet, if he provides an e-mail address for the needs of the established relations with the investment intermediary.

Art. 16. (1) The members of the investment intermediary's management and controlling bodies and the persons who manage the operation of the investment intermediary, as well as the members of the control body, where applicable, shall be responsible for the realization of the investment intermediary's operation in compliance with the requirements of the MFIA and its implementing instruments.

Art. 17. (1) An investment intermediary shall adopt, apply and maintain appropriate rules for the prevention of the performance of the following actions by a person who works under a contract for the investment intermediary and who participates in the performance of activities which may give rise to conflict of interests, or who due to the realized by such person activities for the investment intermediary has an access to inside information within the meaning of the Law on Measures against Market Abuse with Financial Instruments (LMMAFI), or to some other confidential information about clients or transactions with or for clients:
1. conclusion of a personal transaction which meets some of the following conditions:
a) its execution by that person is prohibited by the LMMAFI;

b) it is connected with abuse or unlawful disclosure of confidential information;

c) its execution is in contradiction with, or may result in contradiction with an obligation of the investment intermediary according the MFIA or its implementing instruments;

2. the provision of advice or rendering of assistance, outside of the usual performance by the person of activities for the investment intermediary, to another person to conclude a transaction with financial instruments, which if it were a personal transaction of the person who works under a contract for the investment intermediary, would be prohibited according Art. 36 para 3 item 1 and Art. 42 para 3 item 1 and 2;

3. disclosure outside of the usual performed by such person activity for the investment intermediary of information or opinion of another person, provided that the person who works under a contract for the investment intermediary, knows or it may reasonably be assumed to know that as a result of such disclosure the person will perform or is likely to perform some of the following activities:

a) to conclude a transaction in financial instruments, which, if it would be a personal transaction of the person who works under a contract for the investment intermediary, would be prohibited according Art. 36 para 3 item 1 and Art. 44 para 3 item 1 and 2;
b) to provide advice or to render assistance to another person in concluding a transaction under letter 'a'.

(2) The rules under para. 1 shall ensure that:

1. every person who works for the investment intermediary is acquainted with the restrictions in the conclusion of personal transactions and the measures adopted by the investment intermediary about the personal transactions and the disclosure of information according para 1;
2. the investment intermediary is informed in due time of any personal transaction concluded by the persons who work for the investment intermediary, by notification or otherwise, allowing the investment intermediary to establish the conclusion of such transactions;

3. records are kept of the personal transactions of which the investment intermediary has been informed or which have been established by it, including authorizations or prohibitions in relation to such transactions.

(3) In the cases where there is a contract concluded between the investment intermediary and a third person for the assignment of the performance of an activity to that third person, the contract must include an obligation of that person to keep a register of personal transactions, concluded by persons under para. 1, and to provide such information to the investment intermediary upon its request.

(4) The requirements under para 1 and 2 shall not apply to personal transactions that meet any of the following conditions:

1. personal transactions concluded when managing an individual portfolio, if there is no preceding the conclusion of the transaction exchange of information in relation to the transaction between the person carrying out the management, and the person who works under a contract for the investment intermediary, or another person for whose account the transaction is concluded;

2. personal transactions having as a subject units of undertakings for collective investment or units of undertakings for collective investment, which are subject to supervision according the legislation of a Member State, requiring level of risk spreading in their assets, equivalent to that with the collective investment schemes, if the person who works under a contract for the investment intermediary, or another person for whose account the transaction is concluded, does not participate in the management of that undertaking.

Art. 18. (1) The investment intermediary shall provide its non-professional clients and the potential non-professional clients, with the following information on the expenses and fees related to the transactions, so far as applicable:

1. the total price which shall be paid by the client in connection with the financial instrument or the investment or ancillary service provided, including all remunerations, commissions, fees and expenses, as well as all taxes payable through the investment intermediary; in case that the exact price may not be specified, the basis for its calculation shall be indicated in a way, where the client may check and confirm the latter;
2. in the case where any part of the total price under items 1 has to be paid in a foreign currency or the equivalence of that currency, the currency of payment, exchange rate and the currency conversion expenses shall be specified;
3. notification of the possibility other expenses to arise as well, including taxes, related to the transactions in financial instruments or investment services provided, which are not paid through the intermediary or have not been imposed by it.
4. the rules and methods of payment or some other fulfillment.

(2) The obligation under para. 1 shall not apply with regard to units and shares of collective investment schemes, if the investment intermediary provides the client with the information, contained in the short-form prospectus according Art. 28 of Directive 85/611/EEC.

RIA Class exercise

Excerpts of regulations to practice RIA

- Markets in Financial Instrument Act, Chapter 3, Division I;
- Requirements to the activities of investment intermediaries, Chapter 2.

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Markets in Financial Instruments Act

Promulgated SG, issue 52 from 29 June, 2007 in effect as of 1 Nov., 2007

TITLE ONE
GENERAL PROVISIONS

Chapter Three
REQUIREMENTS TO THE INVESTMENT INTERMEDIARIES' ACTIVITIES
Division I
Relations with Clients

Art. 27. (1) The investment intermediary shall carry out the services and activities under Art. 5 para 2 and 3 for client account on the basis of a written contract with the client.
(2) In the performance of the services and activities under Art. 5 para 2 and 3, the investment intermediary shall act honestly, fairly and professionally, with due diligence and in accordance with the best interests of its clients, and shall also inform them of the risks associated with transactions with financial instruments.
(3) The investment intermediary shall inform its clients about the existing system for compensation of investors in financial instruments, including about its scope and about the guaranteed amount of the client's assets, and on request shall provide data about the conditions and procedure of compensation.
(4) The information which the investment intermediary provides to its clients, as well as to potential clients, including in its advertising materials and the public statements of the members of the intermediary's management and supervisory bodies and of the persons, working under a contract for it, must be understandable, correct and clear and not to be misleading. The advertising materials of the investment intermediary must clearly be indicated as such.
(5) The investment intermediary shall provide in an appropriate manner and in compliance with para 4, the following information to its clients or to potential clients:
1. data about the investment intermediary and about the services offered by it, including whether it pursues business or concludes transactions with financial instruments for its account;
2. the financial instruments, subject of the provided by the intermediary investment services and the proposed investment strategies;
3. warning about the risks associated with investments in the instruments under item 2 or in relation to specific investment strategies;
4. the venues for the transactions' execution;
5. the types of expenses for the client and their amount;
6. other circumstances, as laid down in an ordinance.
(6) The information under para 5 shall be provided to the client in a way, allowing him to understand the nature and risks of the investment service and the offered specific financial instrument, ensuring the taking subsequently of informed investment decision. This information may be provided in a standardized form.
(7) The investment intermediary must supply to its clients enough information on the provided service, including on the expenses about the transactions and services, provided for the client's account, where applicable.
Art. 28. (1) In the performance of services under Art. 5 para 2 item 4 and 5, the investment intermediary shall require from the client, respectively from the potential client, information regarding his financial possibilities, investment objectives, knowledge, and experience relevant to the services under Art. 5 para 2 item 4 and readiness to risk, as well as to update this information. The investment intermediary shall not have the right to execute the services under Art. 5 para2 item 4 and 5 for a client, who has not provided the information under sentence one.
(2) In the provision of the services under para 1 the investment intermediary shall be guided by the received under para 1 information.
(3) Upon the provision of investment services, other than those indicated in para 1, the investment intermediary shall ask the client, respectively the potential client, to provide information regarding his knowledge and experience relevant to the provided services, as well as to update this information.
(4) On the basis of the information under para 3 the investment intermediary shall assess whether the offered investment service is appropriate for the client, respectively for the potential client. The investment intermediary shall notify the client, respectively the potential client in writing, in case that on the basis of the received under para 3 information it decides that the offered investment service will not be appropriate for the client.
(5) In case that the client, respectively the potential client, fails to provide the information under para 3, or the provided information is insufficient to make the estimate under para 4, the investment intermediary shall inform the client in writing that it cannot estimate whether the offered investment service is appropriate for it.
(6) An investment intermediary, providing investment services under Art. 5 para 2 item 1 and/or 2, may provide such services to a client, without the latter having supplied the information under para 3, if:
1. subject of the services are shares, which have been admitted to trading on a regulated market, or on an equivalent market of a third country, according a list of the European

Commission, bonds or other forms of securitized debt, with the exception of such bonds or other debt securities that underlie a derivative instrument, money market instruments, units of collective investment schemes and other non-complex financial instruments;
2. the service is provided at the initiative of the client or of a potential client;
3. the client or the potential client has been informed in writing that the investment intermediary will not comply with the obligations under para 4;
4. the investment intermediary complies with the requirements for treatment of conflict of interests.
(7) The requirements under para 1-6 shall not apply when the investment service is offered as part of a financial product, which is regulated by *acquis communautaire* or by common European standards in relation to credit institutions or consumer credits with regard to risk assessment of clients and/or requirements to information providing.
Art. 29. (1) When performing the services and activities under Art. 5 para 2 and 3, the investment intermediary shall take all necessary steps to identify potential conflicts of interests between:
1. the investment intermediary, including the persons under Art. 11 para 2 and 5, all other persons who work under a contract for it, and the linked to it by control persons, on one side, and its clients, on the other side;
2. its individual clients;

(2) In case that in spite of the applying of the rules under Art. 24 para 2, a risk to client interests continues to exist, the investment intermediary may not carry out activities for client account, if it has not informed the client about the general nature and/or sources of the potential conflicts of interest.
Art. 30. (1) The investment intermediary shall execute client orders in the best interest of the client. The investment intermediary shall have fulfilled this duty of its, if it has made reasonable efforts to establish the best for the client price according the conditions of the order, amount of costs, likeliness of performance, as well as all other circumstances concerning the order fulfillment. In case of specific instructions on the client's side, the investment intermediary must fulfill the order following these instructions.
(2) An investment intermediary shall accept, update and inform its clients about the policy for client orders execution, ensuring fulfillment of the obligations under para 1, as well as about any substantial changes in this policy.
(3) The policy under para 2 includes information of the venues for the client orders execution (type of financial instrument), the advantages and shortcomings of any execution venue (according the volume, price and execution costs) and venues where the intermediary may achieve best execution. The execution policy shall include at least the venues of execution which allow the investment intermediary to obtain continuously the best possible results for the execution of its clients' orders.
(4) An investment intermediary may not execute orders for client account unless they have given their preliminary consent for the followed by the intermediary policy.
(5) An investment intermediary must perform the client orders in conformity with the adopted execution policy and to inform in due time the client about any changes in such policy.
(6) Where the policy for order execution envisages a possibility client orders to be also executed outside of a regulated market or MTF, the orders may be executed in such way only provided the clients of the intermediary have been preliminarily informed and have given an express assent for that.
(7) On client's request, the investment intermediary shall prove that it has fulfilled the orders in compliance with the declared policy under para 2.
(8) The investment intermediary shall monitor the effectiveness of the policy for order execution, and in the cases where possible, shall remove the established by it irregularities.

The investment intermediary shall conduct regular inspections whether the included in the execution policy venues ensure the best execution of the clients' orders, as well as whether any changes in this relation are needed.
Art. 31. (1) An investment intermediary carrying out investment services under Art. 5 para 2 item 1, 2 and 3 may enter into transactions with eligible counterparties, without it having to comply with the requirements under Art. 27 para 4 and 7, Art. 28, 30 and Art. 33 para 2 with respect to the specific transactions or the relevant ancillary service directly related to these transactions.
(2) Any entity specified as an eligible counterparty under this Act, may expressly request not to be considered such in whole, or for a concrete transaction.
Art. 32. (1) An investment intermediary carrying out investment services under Art. 5 para 2 item 2, or ancillary services for the account of a third person, according an order by another intermediary, shall be entitled to receive the information about the third person gathered by such intermediary.
(2) The investment intermediary by whose order the services under para 1 are performed, shall bear responsibility for the completeness and correctness of the provided information.
(3) An investment intermediary performing investment services under Art. 5 para 2 shall be entitled to receive and to refer to the recommendations, provided to a third party by the other intermediary in respect to the service.
(4) The investment intermediary on whose orders the services under para 3 are performed shall bear responsibility for the correctness of the recommendations provided to the client.
(5) The investment intermediary under para 1 and 3 shall be responsible for the execution of the order under which a transaction has been entered into on the basis of the received information and recommendations under para 1 and 3.
(6) An investment intermediary may not transfer the performance of investment and ancillary services for client account to another intermediary, as well as the performance of material operational functions to a third person, if thus the realization of an efficient internal control, or the possibility of the Commission to exercise its supervisory functions will be frustrated.
(7) The cases where the investment intermediary may transfer material operational functions and the performance of investment services for client account to another intermediary shall be laid down in an ordinance.
Art. 33. (1) An investment intermediary shall enter in a special register in the sequence of their receiving all orders of its clients.
(2) An investment intermediary must execute immediately, fairly and accurately the received client orders, including to observe the sequence of receiving of identical orders.
(3) The register under para 1 shall be kept on paper and magnetic media.
(4) With regard to every transaction shall be written down the name or business name of the parties to it, time of entering into, as well as other data as laid down in an ordinance.
(5) The investment intermediary shall register in the relevant register, in the sequence of their entering, the transactions with financial instruments not later than at the end of the working day.
(6) An investment intermediary shall maintain records of all transactions, services and activities carried out by it, which are to allow the Commission and the deputy chairman in the exercising of their supervisory functions under this Act and its implementing instruments, to establish that the investment intermediary fulfills the envisaged in the Act and its implementing instruments obligations in relation to the clients and the potential clients.
Art. 34. (1) An investment intermediary shall segregate its financial instruments and cash from those of its clients. The investment intermediary shall not be liable to its creditors with the financial instruments and cash of its clients, as well as with securities which are underlying in respect to depository receipts.

(2) An investment intermediary may not keep with itself the cash of its clients.
(3) An investment intermediary shall deposit the cash of its clients in:
1. a central bank;
2. a credit institution;
3. bank, licensed in a third country;
4. collective investment scheme that has been authorized to pursue activity according Council Directive 85/611/EEC or undertaking for collective investment, which is subject to control by the competent supervisory authority in a Member State, provided it meets the following conditions:
a) its major investment objective is to maintain certain average net asset value (net profit) or net asset value equal to the capital attracted from investors plus profit;
b) it invests the raised pecuniary funds exclusively in money market instruments with highest possible credit rating, awarded by a credit rating agency, whose maturity or residual term till maturity is not more than 397 days, or in instruments with fixed yield, close to that of the preceding instruments, or in instruments whose average residual term till maturity is 60 days; it may additionally invest pecuniary funds in bank deposits;
c) ensures liquidity on the same day or settlement on the next day.
(4) An investment intermediary may deposit the pecuniary funds of its clients in the entities under para 3, with which it is a related person, only if the clients have given written assent for that.
(5) The investment intermediary shall safeguard the financial instruments of its clients in a depository institution on client accounts under the investment intermediary's account or on accounts opened under the account of a third parson on conditions and according a procedure as laid down in an ordinance.
(6) An investment intermediary shall regularly inform its clients about the balances and operations on the cash accounts and about financial instruments which it keeps and about the conditions of the contracts for their safeguarding.
(7) Except for the cases laid down in an ordinance, the investment intermediary shall not have the right to use:
1. for its account the cash and financial instruments of its clients;
2. for the account of its client the cash or financial instruments of other clients;
3. for account of a client its own cash or financial instruments.
(8) The safekeeping and registration of government securities, issued on the internal market shall be carried out under the conditions and procedure, provided for in the National Debt Act and its implementing instruments. .
Art. 35. (1) In the performance of its activities the investment intermediary shall keep the trade secret of its clients as well as their trade prestige.
(2) The members of the management and supervisory bodies of the investment intermediary, the persons working under a contract for an investment intermediary may not divulge, unless authorized for it, and use for the benefit of themselves or of other persons, facts and circumstances, relating to the balances and operations under the accounts for financial instruments and for cash of the investment intermediary's clients, as well as all other facts and circumstances constituting trade secret, which have come to their knowledge in the fulfillment of their official and professional obligations.
(3) All persons under para 2, upon taking up office or beginning activity as an investment intermediary shall sign a declaration that they shall keep the secret under para 2.
(4) The provision of para 2 shall also apply in the cases where the indicated persons are not in office or their activity was terminated.
(5) Beside to the Commission, the deputy chairman and authorized officials from the Commission's administration, or to a regulated market of which it is a member, for the

purposes their control activities and within the order for an inspection, the investment intermediary may give information under para 2 only:
1. with the consent of its client, or
2. by court decision issued under the conditions and procedure of para 6 and 7.
(6) The court may rule disclosure of the information under para 2 on the request of:
1. the prosecutor – in case of availability of data for perpetrated crime;
2. the Minister of Finance or authorized by him official – in the cases of Art. 143 para 4 of the Tax and Social Security Procedure Code;
3. the director of the territorial directorate of the National Revenue Agency, where:
a) evidence is presented that the inspected person has frustrated the carrying out of an audit or inspection or does not keep the required records, as well as if there is material incompleteness therein;
b) by an act of a competent government authority the occurrence of an accidental event has been established, that resulted in destruction of the inspected person's reporting documentation;
4. The Committee for establishment of property acquired from criminal activity and the directors of its territorial divisions.
5. The Director of the Agency for State Financial Inspection where by an act of a body of the Agency it has been established that:
a) the management of the inspected organization or entity frustrates the carrying out of financial inspection;
b) no accounting records are kept in the inspected organization or entity or they are incomplete or untrustworthy;
c) there are data about shortages or crimes;
d) the levying of distraint on bank accounts is necessary for the securing of established during financial inspections receivables;
e) by an act of a government authority the occurrence of an accidental event has been established, that resulted in the destruction of reporting documentation of the inspected organization or person;
6. the Director of Customs Agency and the directors of the regional customs divisions, where:
a) by an act of the customs authorities it has been established that the inspected person has frustrated the carrying out of customs inspection and does not keep the necessary records, as well as when they are incomplete or untrustworthy;
b) by an act of the customs authorities customs violations have been established;
c) the levying of distraint on bank accounts is necessary for the securing of established by the customs authorities receivables, collected by them, as well as for the securing of fines, legal interests, etc.;
d) by an act of a government authority the occurrence of an accidental event has been established, that resulted in the destruction of the reporting documentation of the inspected by the customs bodies site.
7. the Director of the National Police Service of the Ministry of Interior – for the purpose of enquiry on instituted criminal proceedings;
8. the Director of the National Security Service to the Ministry of Interior – when this is necessary for protection of the national security.
(7) The regional judge shall rule on the petition with a reasoned decision in a closed session not later than 24 hours of its receiving, setting the time-limit for disclosure of the information under para 2. The decision of the court shall not be subject to appeal.
(8) On written request of the Director of the National Investigation Service, of National Security Service or National Police Service, the investment intermediaries shall provide

information about the cash and movements under the accounts of companies having over 50 per cent of state and/or municipal participation.
(9) If there are data about organized criminal activity or about money laundering, the Prosecutor General, or an authorized by him Deputy, may demand from the investment intermediaries to provide the information under para 2.
Art. 36. (1) The investment intermediary shall provide a possibility for its professional clients under Division I of the Appendix to use a higher degree of protection, which is provided to unprofessional clients. The investment intermediary shall inform the professional client under Division I of the Appendix before the beginning of the investment services provision, that on the basis of the received from the client information he is considered a professional client and with regard to him shall be applied the rules for professional clients, unless the investment intermediary and the client do not agree otherwise.
(2) The investment intermediary shall inform the professional client under Division I of the Appendix that he is entitled to ask for amendment to the conditions of the contract with the purpose of securing higher degree of protection for the client.
(3) The investment intermediary ensures a higher degree of protection for a client under Division I of the Appendix on his request, where the client estimates that he cannot rightly assess and manage the risks, associated with investment in financial instruments.
(4) The higher degree of protection under para 3 shall be provided on the grounds of a written agreement between the investment intermediary and the client under Division I of the Appendix, which shall explicitly state the specific services, activities, transactions, financial instruments or other financial products, in relation to which a higher degree of protection will be ensured to the client.
(5) The higher degree of protection under para 3 shall ensure to the client under Division I of the Appendix that he shall not be considered as a professional client for the purposes of the applicable regime to the investment intermediary's operation.
Art. 37. (1) Clients, other than those under Division I of the Appendix, including government authorities and private individual investors, may request in respect to them not to apply the rules of pursing business of investment intermediaries, which ensure a higher degree of client protection.
(2) An investment intermediary may treat a client under para 1 as a professional client, if the criteria under item 1 of Division II of the Appendix exist and the procedure under item 2 of Division II of the Appendix has been complied with. It shall not be considered that a client for whom the conditions under sentence one are complied with, possesses the knowledge and experience as the clients under Division I of the Appendix.
(3) The investment intermediary shall not apply the relevant rules which ensure a higher degree of client protection, only if on the basis of its evaluation of the experience, skills and knowledge of the client, a reasoned conclusion may be drawn that according the nature of the transactions and services which the client intends to use or enter into, the client may take independent investment decisions and to assess the risks associated with them.
(4) The evaluation under para 3 may be done according the conditions and procedure of evaluation, envisaged for the persons, who manage the activities of the investment intermediaries, insurers or credit institutions according the *acquis communautaire.* In cases where the client under para 2 does not have an independent management body, subject to evaluation shall be the person who has the right to conclude on his own transactions for the account of a legal entity.
(5) In cases when a client of the investment intermediary has been specified as a professional client on the basis of a procedure and in accordance with criteria, analogous to those under Division II of the Appendix, this Article shall not apply.

(6) An investment intermediary shall apply appropriate written internal procedures and policies for specifying the clients as professional clients.
(7) The clients of an investment intermediary that have been specified as professional clients according Art. 1 – 6 shall inform the investment intermediary of any change in the data that served as a ground for their specifying as professional clients.
(8) In the cases where the investment intermediary in the course of the pursued by it business finds out that a client defined as a professional according Art. 1-6, has ceased to meet the conditions under item 1 of Division II from the Appendix, on which it has been specified as a professional client, the investment intermediary shall take the necessary measures to apply a higher degree of protection with respect to such client according the internal procedures and policies of item 6.

ORDINANCE No. 38 OF 25 JULY, 2007 ON THE REQUIREMENTS TO THE ACTIVITIES OF INVESTMENT INTERMEDIARIES

In effect as of 1st November, 2007, issued by the Financial Supervision Commission
Promulgated SG, issue 67 from 17 August, 2007

Chapter Two
RELATIONSHIPS WITH CLIENTS
Art. 2. (1) When performing investment services and investment activities for client account, the investment intermediary shall act in a honest, fair and efficient manner and as a professional in accordance with the best interests of its clients.
(2) An investment intermediary shall treat its clients equally.
(3) An investment intermediary shall conclude transactions in financial instruments for client account on the best possible conditions and where making efforts to achieve the best possible performance according the order submitted by the client. When executing an order given by a non-professional client, the best possible performance of such order shall be determined by the total amount of the transaction, including the price of the financial instrument and the expenses related to the performance. The expenses related to the performance shall include all expenses that are directly related to the execution of the order, including fees for the execution venue, clearing and settlement fees, as well as other fees and remunerations payable to third parties, bound with the execution of the order.
(4) To achieve best possible performance, in the cases where there is more than one competitive execution venues of an order in relation to financial instruments and in making assessment and comparison of the results that may be achieved for a non-professional client where executing the order on each of the execution venues, specified under the intermediary's policy for performance of orders which are suitable for its execution, the intermediary's commission fees and the expenses incurred in connection with the execution of the order on each of the possible venues shall be taken into consideration.
(5) An investment intermediary shall not have the right to specify and collect commission fees in ways which obviously divide unfairly the different execution venues.
(6) In compliance with its obligation of achieving best result for the client, an investment intermediary shall execute its clients' orders at its earliest convenience, unless this would obviously be to the clients' disadvantage.

Art. 3. (1) When and investment intermediary manages a portfolio, it shall comply with the obligation to act in accordance with the client's best interest when it gives orders for execution to another person of taken by the intermediary decisions for trade with financial instruments for the account of its clients.
(2) When the investment intermediary carries out the activity under Art. 5 para 2 item 1 of the Markets in Financial Instruments Act (MFIA) and transmits to other persons orders of its clients for execution, it shall act according the client's best interest.
(3) For the fulfillment of the obligations under para 1 and 2 the investment intermediary shall:
1. make all reasonable efforts to achieve the best result for its clients, accounting for the factors according Art. 30 para 1 of the MFIA; the relevant significance of any of these factors shall be determined according the criteria under Art. 5, and for the non-professional clients – also according the requirements of Art. 2 para 3 and 4; the investment intermediary will have fulfilled its obligation under para 1 and 2 and shall not be obligated to meet the requirement under sentence one, when it follows special instructions of the client in the fulfillment of the order or transmits the order for execution to another person;

2. adopt and apply policy which ensures compliance with the requirements under item 1; the policy must indicate in relation to every class of financial instruments the persons to whom the investment intermediary gives the orders or to whom it transmits the orders for execution; the persons to whom the investment intermediary gives or transmits an order for execution must have the necessary arrangement and mechanisms, which are to ensure that the investment intermediary shall fulfill its obligations under this article, giving or transmitting client orders for execution to these persons;

3. provide to the clients appropriate information about the pursued by it policy under item 2;

4. continuously monitor for the efficiency of the policy under item 2, including also for the quality of performance by the persons under item 2 and where necessary, take actions for removal of the established irregularities;

5. make inspection of the policy under item 2 once yearly, as well as upon any substantial change which may affect the intermediary's ability to ensure best results for its clients.

(4) Paragraphs 1 – 3 shall not apply when the investment intermediary manages client portfolio and/or receives and transmits orders and simultaneously executes the received orders or the decisions for conclusion of transactions in the portfolio management. In these cases Art. 30 of the MFIA shall apply.

Art. 4. The investment intermediary shall once yearly perform an inspection of the policy for execution of orders of customers under Art. 30 para 2 of the MFIA and the arrangements for order execution.
(2) The inspection under para 1 shall be conducted also upon any substantial change that may interfere with the intermediary's ability continuously to provide the best possible results for the execution of client orders when using the execution venues which have been included in the order execution policy.

(3) The investment intermediary shall submit to its non-professional clients within an appropriate term, prior to commencing to perform services, including execution of orders for their account, the following information on the order execution policy:

1. description of the relevant significance of the factors for execution under Art. 30 of the MFIA, determined by the investment intermediary in consistence with the criteria under Art. 5 para 1, or the method by which the investment intermediary defines the relevant significance of these factors;

2. a list of the execution venues, on which the intermediary largely relies for achievement of best execution of client orders;

3. a clear and explicit warning stating that all specific instructions of the client may prevent the intermediary to take the necessary actions for achieving the best possible result in client orders execution, where pursuing the policy of order execution, for that part of the order to which the specific instructions relate;

(4) The information under para. 3 shall be provided to the client on a durable medium. The information under para 3 may also be provided by means of the web site, when it does not satisfy the requirements for a durable medium, if the conditions under Art. 15 para 2 have been met.

Art. 5. (1) In the execution of client orders, the investment intermediary shall take into account the relevant significance of the factors for execution under Art. 30 para 1 of the MFIA according the following criteria:
1. the characteristics of the client, including whether its has been defined as a non-professional or professional client;
2. the characteristics of the client order;
3. the characteristics of the financial instruments subject of the order;
4. the characteristics of the execution venues, to which the order may be directed for execution.

(2) An investment intermediary will have fulfilled its obligation to act for the achievement of the best result for its clients, if it has fulfilled the order or a specific aspect of the order, following special instructions by the client.

Art. 6 An investment intermediary which provides investment advice to a client or manages a portfolio, shall conclude a contract with and investment advisor.

Art. 7. (1) The information which the investment intermediary provides to its clients, including in its advertising materials and public statements of the intermediary's members of the management and the control bodies and of the persons working under a contract for it, shall be understandable, accurate, clear and not to be misleading.
(2) An investment intermediary shall ensure that the information under para 1 which it provides to non-professional clients or potential non-professional clients or disseminated in a way whereby it may reach such clients shall satisfy the following conditions:

1. it contains indication of the investment intermediary's business name;
2. it is accurate and does not underline potential benefits of a given investment service or financial instrument, without simultaneously indicating clearly and at a prominent place the relevant risks;
3. it is sufficient and presented in a understandable way for the customary members of the group to which it has been addressed or is likely to reach;
4. it does not conceal, omit or undervalue important messages, statements or warnings.

(3) Where the information under para 2 contains a comparison between investment or ancillary services, financial instruments or persons providing investment or ancillary services, it shall meet the following terms and conditions:

1. the comparison has to be purposeful and presented in a fair and balanced manner;
2. to indicate the sources of information used for the comparison;
3. to include the main facts and assumptions used to prepare the comparison.

(4) Where the information under para 2 contains indication of previous profitability of a financial instrument, financial index or investment service, such information shall meet the following terms and conditions:

1. the indication of the previous profitability may not constitute the most essential part of the information;

2. the information shall include appropriate data about the profitability over the preceding 5 years; when the period during which the financial instrument has been offered, or the financial index has been formed, or the investment service has been offered is longer or shorter than 5 years, shall be presented data on the profitability of that period; in any case the data on the profitability shall be based on a full period of 12 months;

3. to specify the period, to which the information relates, and its source;

4. to contain an explicit warning that the data relate to a past period and these are not a reliable indicator for future performance;

5. in the cases where the indication contains data and values in a currency other than the currency of the Member State where the client's seat or place of residence is located, the currency shall be clearly indicated and it shall have an express warning that the profitability may be decreased or increased as a result of change in the exchange rates;

6. where profitability is specified as a total, shall be specified the amount of the commissions, fees and other expenses for the client.

(5) Where the information under para 2 contains or relates to simulated past profitability, it shall meet the following requirements:

1. to relate to financial instrument or financial index;

2. the simulated past profitability to be based on actual past profitability of one or more financial instruments or indices which are the same or which are underlying asset for the financial instruments for which profitability has been simulated;

3. for the actual past profitability under item 2, the requirements under para. 4, items 1-3, 5 and 6 to have been complied with;

4. to contain an explicit warning that the data are based on simulated profitability and that the information is not a certain index of future profitability.

(6) Where the information under para 2 contains information on future profitability, it shall meet the following requirements:

1. not be based or refer to simulated previous profitability;
2. to be based on well-grounded assumptions, supported by objective data and facts;
3. where profitability is specified as a total, the amount of the commissions, fees and other expenses for clients shall be specified;
4. to contain an explicit warning that these forecasts are not a certain index of future profitability.

(7) Where the information under para 2 relates to levying of certain type of tax, it shall contain the specification that the taxation depends on the concrete circumstances, related to the client and may be changed in the future.

(8) The information under para 2 may not include the name of the Commission or of another competent authority in order to be explicitly stated or otherwise indicated that the authority has confirmed or approved the products or the services offered by the investment intermediary.

(9) The provided to the clients information, advertising materials and public statements by the persons working under a contract for the investment intermediary are to be preliminarily approved by a person with the Internal Control Department.

(10) The Commission may request from the investment intermediary to submit evidence of the authenticity of the facts contained in the information provided to clients, the advertising materials and public statements of the members of the management and control bodies of the intermediary and of the persons working under a contract for it.

Art. 8. (1) An investment intermediary shall provide in due time, before a non-professional client or potential non-professional client to be bound by virtue of a contract with the investment intermediary for the provision of investment or ancillary services, the following information:

1. the conditions of the relevant contract;
2. information under Art. 9, having bearing to the contract or to the investment or ancillary service provided.

(2) Within an appropriate term before the beginning of the provision of investment or ancillary service to a non-professional client, the investment intermediary shall provide the client, or the potential client with the information under Art. 9, 10, 18 and 32.

(3) In an appropriate term prior to providing an investment or ancillary service to a professional client, the investment intermediary shall provide the client, or the potential client, with the information under Art. 32 paras. 3 and 4.

(4) The information under paras. 1-3 shall be provided to the client on a durable medium or on the investment intermediary's web site, where this does not constitute a durable medium, while observing the requirements under Art. 15, para. 2.

(5) An investment intermediary shall ensure the conformity of the information which is contained in its advertising materials and the public statements of the members of the intermediary's management and control bodies and of the persons working under a contract for it, to the information which it provides to the clients when performing investment and ancillary services.

(6) The investment intermediary shall notify in due time the client of any substantial change in the circumstances under Art. 9, 10, 18 and 32 which have bearing on the offered service to the client. The notification shall be done on a durable medium, if the information to which it relates, has been provided on a durable medium to the client.

(7) Where advertising materials or public statements by the members of the investment intermediary's management and control bodies or by the persons working under a contract for it contain an offer or an invitation indicated in para 8, and specify the method of reply or the form, in which the reply of the client is to be provided, they have to contain such part of the information under Art. 9, 10, 18 and 34 which is proportionate to the offer or the invitation.

(8) Paragraph 7 shall apply to advertising materials or public statements by the members of the investment intermediary's management and control bodies or by persons working under a contract for it, which contain proposals and invitations of the following type:

1. an offer for conclusion of a contract, with the subject of financial instrument or an investment or ancillary service with any person who replies to the notification;

2. an invitation to each person who replies to the notification to make a proposal for conclusion of a contract, with the subject of financial instrument or an investment or ancillary service.

(9) In cases where a potential non-professional client must acquaint himself with documents containing the information under Art. 9, 10, 18 and 32, in order to reply to the proposal or invitation contained in the advertising materials or the public statements, para 7 shall not apply.

Art. 9. (1) An investment intermediary shall provide non-professional clients and potential non-professional clients with the following general information, if applicable:

1. the business name and address of the investment intermediary, as well as telephone and/or other information for contact with the investment intermediary;
2. the languages in which the client may communicate and keep correspondence with the investment intermediary and to receive documents and other information by the intermediary;

3. the ways of communication which are used between the investment intermediary and its clients, including where applicable, the ways of forwarding and acceptance of orders;

4. explicit indication that the investment intermediary is licensed by the Commission, as well as indication of the name and address of the authority who has issued the license;

5. the type, the periodicity and the deadline for submitting the reports and the confirmations to a client in connection with the investment services and activities performed;

6. a concise description of the steps that the intermediary undertakes in order to guarantee the client financial instruments or cash, in the cases where the intermediary holds such for the client, including a concise description of any relevant investor compensation or deposit guarantee schemes in which the investment intermediary participates in relation to its operation in a Member State;

7. a description, which may also be in a summarized form, of the policy for handling conflicts of interest under Art. 75 para 1 item 4 applied by the investment intermediary;

8. additional detailed information on the handling of conflicts of interest policy; the information shall be provided upon request by the client on a durable medium, or on the investment intermediary's website where this does not constitute providing on a durable medium, while observing the requirements set under Art. 15, para. 2.

(2) In the cases where the investment intermediary manages an individual portfolio of a client, the intermediary shall apply an appropriate method for assessment and comparison as a generally accepted benchmark, based on the client's investment purposes and the types of financial instruments included in the client portfolio, in such a manner that the client making use of the service may assess the performance of the service by the investment intermediary.

(3) In the cases where the investment intermediary offers to a non-professional client, or to a potential non-professional client, the service of portfolio management, the intermediary shall, apart from the information under para. 1, provide the client also with the following information where applicable:

1. information about the method and periodicity of assessing the financial instruments in the client portfolio;

2. details of each delegation of the management of all or a part of the financial instruments and/or money in a client portfolio;

3. characteristics and information on each benchmark by which the portfolio management results shall be assessed;

4. the types of financial instruments which may be included in a client portfolio and the types of transactions which may be concluded with them, any restrictions inclusive;

5. the management objectives, the risk level contained in the assessment of the person managing the portfolio, as well as all specific restrictions of that assessment.

Art. 10. (1) The investment intermediary shall provide the client and the potential client with a general description of the financial instruments and the associated with them risks. The description has to be conformed to the client's type (professional and non-professional) and shall meet the following requirements:

1. to contain detailed description of the type and the characteristics of the specific financial instrument and of the specific risks associated with it;
2. the information under item 1 is to allow the client to take informed investment decision.

(2) The description of the risk shall include the following elements, insofar as applicable for the specific type of financial instrument, the status and level of knowledge of the client:

1. indication of the risks associated with the specific type of financial instruments, including explanation of the leverage and its consequences and the risk of losing the whole investment made;

2. the volatility of the financial instruments' price and all market restrictions pertaining to these instruments;

3. the circumstance that the investor may undertake as a result of transactions in financial instruments, financial and other additional liabilities, including unforeseen liabilities that are additional to the expenses for the instruments' acquisition;

4. all margin requirements or similar liabilities applicable to the instruments of this type.

(3) The Deputy Chairman in charge of Investment Activity Supervision Division, hereinafter referred to as "deputy chairman", may specify the contents of the risk description under para. 1 and 2.

(4) Where the financial instruments are subject of public offering carried out on the grounds of a published prospectus in compliance with the provisions of Directive 2003/71EC of the European Parliament and of the Council on prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Directive 2003/71/EC); the investment intermediary shall inform the non-professional client and the potential non-professional client of the place where the prospectus is accessible for the public..

(5) In the cases where the risks associated with a financial instrument consisting of two or more different financial instruments or services, are likely to be higher than the risks related to any of its components, the investment intermediary shall submit and adequate description of the financial instrument's components and of the way in which their interaction enhances the risks.

(6) In the cases where the financial instruments include a guarantee by a third person, the investment intermediary shall provide a non-professional client and a potential non-professional client with sufficient data on the guarantor and the guarantee, which shall allow the client to make an objective assessment of the guarantee.

Art. 11. The liabilities under Art. 10 shall not apply with regard to units and shares of collective investment schemes in the cases when the investment intermediary provides the information contained in the short-form prospectus according Art. 28 of Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (Directive 85/611/EEC).

Art. 12. (1) An investment intermediary shall notify all its clients of the conditions and criteria, according which the investment intermediary determines them as professional or non-professional, as well as of the circumstances under which they may be defined as an eligible counterparty. The clients shall be also notified on a durable medium of their right to request to be categorized in a different way, as well as of the restrictions imposed on their protection in the case of different categorization.

(2) The investment intermediary shall define a client to be professional, non-professional or an eligible counterparty in compliance with the criteria established in the Markets in Financial Instrument Act (MFIA).

(3) The investment intermediary on its own initiative or on the client's request may:

1. specify as professional or non-professional a client who in other cases would be defined as eligible counterparty within the sense of § 1 item 29 of the MFIA;

2. specify as non-professional a client, who is considered as a professional client within the meaning of Division I of the Appendix to the MFIA.

(4) Where a person defined as an eligible counterparty requests not to be treated as such and the investment intermediary consents, that person shall be treated as a professional client, unless the person has explicitly requested to be treated as a non-professional client.

(5) In the cases where an eligible counterparty expressly requests to be treated as a non-professional client, Art. 36 para 2 – 5 of the MFIA shall apply accordingly.

Art. 13. (1) The investment intermediary may not:

1. perform transactions for client's account in volume or with frequency, at prices or with given counterparty, for which according to the circumstances it may be assumed that they are performed exclusively in the investment intermediary's interest;
2. to buy for its own account financial instruments for which its client gave a purchase order, and to sell them to the client at a price higher than the price at which it bought them;
3. to perform for its own or for a third party's account activities with client's funds and financial instruments for which it has not been authorized by the client;
4. to sell for its own account or for a third party's account financial instruments which the investment intermediary or its client does not own, unless under the conditions and procedure established by an Ordinance;
5. to participate in the performance, including in the capacity of a registration agent, of concealed purchases or sales of financial instruments;
6. to receive a part or the whole benefit if the investment intermediary has concluded and executed the transaction under terms and conditions that are more favorable than those established by the client;
7. to perform activities otherwise which jeopardizes the interests of the intermediary's clients or the integrity of the market in financial instruments.

(2) The prohibition under para. 1, item 3 shall not apply to transactions, for the performance of which the client has given explicit orders on his own initiative.

(3) The prohibition under para. 1, item 4 shall also relate to the members of the management and control bodies of the investment intermediary, to the persons who manage its operation, as well as for all persons who work for it under a contract, as well as to related persons.

Art. 14. (1) The investment intermediary shall not have the right in connection with the provision of investment or ancillary services to a client, to pay, respectively provide, and to receive remuneration, commission or non-monetary benefit, apart from:

1. remuneration, commission or non-monetary benefit paid or provided by or to the client or his representative;

2. remuneration, commission or non-monetary benefit paid or provided by or to a third person or his representative where the following conditions exist:

a) the existence, nature and amount of the remuneration, commission or the non-monetary benefit shall be indicated to the client clearly, in an accessible way, accurately and understandably prior to providing the relevant investment or ancillary service, and where the amount may not be established, the method of its calculation shall be indicated;

b) the payment, respectively the provision of the remuneration, commission or non-monetary benefit, shall be with a view to enhancing the quality of the service and does not violate the obligation of the investment intermediary to act in the best interest of the client;

3. relevant fees that provide or are necessary with a view to providing the investment services, such as expenses for trustee services, settlement and currency exchange fees, legal services fees and public fees, and which in their nature do not result in the arising of a conflict with the investment intermediary's obligation to act honestly, fairly and professionally to the best interest of the client.

(2) It shall be considered that the investment intermediary has fulfilled its obligation under para 1 item 2 letter "a" where it:

a) presents the material conditions of the contracts concerning the remuneration, commission or the non-monetary benefit in a summarized form;
b) provides detailed information about the remuneration, commission or the non-monetary benefit on the client's request; and
c) the provision of the information according this paragraph is honest, fair and in the client's interest.

Art. 15. (1) In the cases where, pursuant to this Ordinance, information is required to be provided to the client on a durable medium, the investment intermediary shall provide information on paper or otherwise, while observing the following requirements:

1. the provision of the information in that way is appropriate with a view to the existing or future relations with the client;
2. the client has expressly preferred that way of information supply over its provision on paper.

(2) Where information is provided to clients through the intermediary's website and it is not addressed to a specific client, the information shall meet the following conditions:

1. the provision of the information in that manner is appropriate with a view to the existing or future relations with the client;

2. the client has expressly agreed with that manner of information provision;

3. the client has been notified via electronic means of the intermediary's website address and where exactly on it the information may be found;

4. the information is up-to-date;

5. the information to be continuously accessible by the client on the intermediary's website for a period of time that is usually necessary for the clients to acquaint themselves with it.

(3) The provision of information by electronic means of communication shall be treated as appropriate with a view to the existing or future relations with the client, if data exist that the client has a regular access to internet. It shall be considered that the client has a regular access to internet, if he provides an e-mail address for the needs of the established relations with the investment intermediary.

Art. 16. (1) The members of the investment intermediary's management and controlling bodies and the persons who manage the operation of the investment intermediary, as well as the members of the control body, where applicable, shall be responsible for the realization of the investment intermediary's operation in compliance with the requirements of the MFIA and its implementing instruments.

Art. 17. (1) An investment intermediary shall adopt, apply and maintain appropriate rules for the prevention of the performance of the following actions by a person who works under a contract for the investment intermediary and who participates in the performance of activities which may give rise to conflict of interests, or who due to the realized by such person activities for the investment intermediary has an access to inside information within the meaning of the Law on Measures against Market Abuse with Financial Instruments (LMMAFI), or to some other confidential information about clients or transactions with or for clients:
1. conclusion of a personal transaction which meets some of the following conditions:
a) its execution by that person is prohibited by the LMMAFI;

b) it is connected with abuse or unlawful disclosure of confidential information;

c) its execution is in contradiction with, or may result in contradiction with an obligation of the investment intermediary according the MFIA or its implementing instruments;

2. the provision of advice or rendering of assistance, outside of the usual performance by the person of activities for the investment intermediary, to another person to conclude a transaction with financial instruments, which if it were a personal transaction of the person who works under a contract for the investment intermediary, would be prohibited according Art. 36 para 3 item 1 and Art. 42 para 3 item 1 and 2;

3. disclosure outside of the usual performed by such person activity for the investment intermediary of information or opinion of another person, provided that the person who works under a contract for the investment intermediary, knows or it may reasonably be assumed to know that as a result of such disclosure the person will perform or is likely to perform some of the following activities:

a) to conclude a transaction in financial instruments, which, if it would be a personal transaction of the person who works under a contract for the investment intermediary, would be prohibited according Art. 36 para 3 item 1 and Art. 44 para 3 item 1 and 2;
b) to provide advice or to render assistance to another person in concluding a transaction under letter 'a'.

(2) The rules under para. 1 shall ensure that:

1. every person who works for the investment intermediary is acquainted with the restrictions in the conclusion of personal transactions and the measures adopted by the investment intermediary about the personal transactions and the disclosure of information according para 1;
2. the investment intermediary is informed in due time of any personal transaction concluded by the persons who work for the investment intermediary, by notification or otherwise, allowing the investment intermediary to establish the conclusion of such transactions;

3. records are kept of the personal transactions of which the investment intermediary has been informed or which have been established by it, including authorizations or prohibitions in relation to such transactions.

(3) In the cases where there is a contract concluded between the investment intermediary and a third person for the assignment of the performance of an activity to that third person, the contract must include an obligation of that person to keep a register of personal transactions, concluded by persons under para. 1, and to provide such information to the investment intermediary upon its request.

(4) The requirements under para 1 and 2 shall not apply to personal transactions that meet any of the following conditions:

1. personal transactions concluded when managing an individual portfolio, if there is no preceding the conclusion of the transaction exchange of information in relation to the transaction between the person carrying out the management, and the person who works under a contract for the investment intermediary, or another person for whose account the transaction is concluded;

2. personal transactions having as a subject units of undertakings for collective investment or units of undertakings for collective investment, which are subject to supervision according the legislation of a Member State, requiring level of risk spreading in their assets, equivalent to that with the collective investment schemes, if the person who works under a contract for the investment intermediary, or another person for whose account the transaction is concluded, does not participate in the management of that undertaking.

Art. 18. (1) The investment intermediary shall provide its non-professional clients and the potential non-professional clients, with the following information on the expenses and fees related to the transactions, so far as applicable:

1. the total price which shall be paid by the client in connection with the financial instrument or the investment or ancillary service provided, including all remunerations, commissions, fees and expenses, as well as all taxes payable through the investment intermediary; in case that the exact price may not be specified, the basis for its calculation shall be indicated in a way, where the client may check and confirm the latter;
2. in the case where any part of the total price under items 1 has to be paid in a foreign currency or the equivalence of that currency, the currency of payment, exchange rate and the currency conversion expenses shall be specified;
3. notification of the possibility other expenses to arise as well, including taxes, related to the transactions in financial instruments or investment services provided, which are not paid through the intermediary or have not been imposed by it.
4. the rules and methods of payment or some other fulfillment.

(2) The obligation under para. 1 shall not apply with regard to units and shares of collective investment schemes, if the investment intermediary provides the client with the information, contained in the short-form prospectus according Art. 28 of Directive 85/611/EEC.

RIA Class Exercise: "Best Execution"

Sofia, 15 November 2007

Parts of regulation considered for RIA analysis:

1) Markets in Financial Instruments Act issued by FSC, *Chapter 3, Division I;*
2) Ordinance on the requirements to the activities of investment intermediaries, issued by the FSC, Chapter 2.

(*)= The current template is based on Draft Impact Assessment Guidelines prepared by CESR, CEBS, CEIOPS

Table Of Content

CESR RIA Steps

1: Identification of the problem;
2: Definition of policy goals:
3: Development of “do nothing option”;
4: Development of alternative policy options;
5: Costs to users;
6: Benefits to users;
7: Costs to regulated firms;
8: Benefits to regulated firms.

Step 1 – Identification of the problem (1)

i) Was there a significant market failure and/or regulatory failure and what was its nature?

WG1	Market failure: Not applicable because we are obliged to transpose MiFID. Possible regulatory failure regarding best execution requirements.
WG2	Yes, there is asymmetric information as broker/investment intermediary has more info on where (at which market), at what prices and with what broker fee he can execute an offer than his client. This gives him an advantage and places the retail customer in an unfavorable position

ii) If no intervention or further intervention would have taken place, would the market have corrected the failure by itself in the short term?

WG1	Not applicable. It will be an intervention. We are obliged to implement MiFID best execution requirements
WG2	Not applicable

Step 1 – Identification of the problem (3)

iv) What is the evidence that establishes that the market/regulatory failure is **significant**?

WG1	Best execution policy is important for the investor protection in new big competitive EU environment. Bulgarian capital market is in the process of development now. There is no tradition in following such policy.

v) Which **objective** – e.g. market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition - is threatened by the failure?

WG1	Providing of such requirements will improve the investors' confidence in the market and facilitate the introduction of new products on it. Enhance competition with regard to different market venues – regulated markets, MTF, systematic internalisers, OTC Markets.

Step 2 – Definition of policy goals (1)

i) **General goals** (*examples include a- financial stability, b- the proper functioning of markets, and c- consumer protection)*

WG1	Protection of investors; market efficiency
WG2	The financial stability is the principal aim of the general financial policy, which includes the other two over mentioned columns of the market's shape as whole. It could be defined as the "bottom of the financial market's edifice". It's scope is also to contribute for the economic growth and for reaching a high rate of employment on national level.

ii) **Specific goals** [*examples (which link respectively to the general objective examples above) include a- capital adequacy provisions that align the economic and regulatory capital of banks and investment firms, b- disclosure regimes, and c- conduct of business rules*]

WG1	Better organization of the execution; more information for the clients reducing the number of uncompetitive trades; increasing investors' understanding of the pricing process and their confidence to trade; Improved access to pricing information would improve investor protection against poor execution.
WG2	The specific goals are such type of aims, connected to or deriving from the principles, on which the market policy is built. The most important of them are to conserve the equilibrium between costs and benefits through developing responsible lending practices and trying to avoid the hyper indebtedness of the intermediaries. In regard to the clients, the Bulgarian legislation doesn't divide them in categories, except when it concerns the due explanation of the eventual risks from the part of the intermediaries to the non-professional clients and the additional information, which they are obliged to transmit to them.

Step 2 – Definition of policy goals (2)

iii) **Operational goals** [*examples (which link respectively to the specific objective examples above) include a- specific rules relating to the use of credit evaluation models, b- rules on the publication of prospectuses, and c- rules setting out specific terms of business requirements*]

WG1	Rules regarding the adoption and the review of the execution policy and the procedures for client information and obtaining clients' consent

WG2	The principal operational goal is incarnated in the requirement of the Art. 30 of the home Markets in Financial Instruments Act, regarding the transformation of the due diligence rule in a norm, defending the best interest of the clients. It is meant to be fulfilled after the intermediary has done its best for recommending the suitable financial instrument for the client and after having made reasonable efforts for establishing the best price for him.

Step 3 – Development of “do nothing option”

i) Please illustrate how the option to “do nothing” would have looked like?

WG1	This option means no adoption of such requirements. Thus the firms bear no direct costs to comply with the new requirements and so the clients bear no additional indirect costs. \the option has no new costs and this is its main benefit\. Research is necessary to determine whether this option is useful, especially whether there are practices for identification of the client's needs and the client's information about it \the second being rather unlikely\.The results of research have shown that: capital markets are very competitive; the best execution policy approach is inconsistent with the practice; the application of best execution policy would be based on the erroneous premise that there is a continuously executable price available from a predominant source of liquidity in capital markets; it would be not possible to monitor the following of the best execution policy in any meaningful way; the application of best execution policy would stop their innovative individual initiatives and affect the competitiveness; costs for investors would be increased without any sufficient benefits; for many less liquid instruments, best execution policy standards would not be available; it would be difficult to achieve MiFID’s requirements for best execution in the OTC markets, because the character of OTC markets means that there is limited pre-trade information available, unlike on regulated markets.
WG2	The Bulgarian investment intermediaries took care for the interests of their clients in accordance with the existing legislation in the period until the 1 of November 2007, when the Markets in Financial Instruments Act entered into force, which contented the same rules concerning the protection of the clients’ interests. In regard to the option “do nothing”, if the FSC hadn’t transposed the principles of the “best execution” in the Bulgarian legislation, the interests of the clients wouldn’t have been protected in sufficient grade and there might have been observed an asymmetric impact, by which some of the clients would have been treated not equally and at the same time the diminishing of the operating costs for clients’ servicing from the part of the investment intermediaries, should have been considered as benefit for them.

Step 4 – Development of alternative policy options (1)

i) Please illustrate the option that has been implemented in the Regulation

WG1	Best execution policy and its content is provided in our new Law on Markets in Financial Instruments which come in force from 1st November 2007. The new policy rules must be inserted in a document and to be presented to the clients in an appropriate way – to be published on the web site and/or in a printed brochure.

Step 4 – Development of alternative policy options (2)

ii) In case that option(s) additional to that one implemented in the Regulation were considered, please illustrate the alternative policy option(s)

WG1	1. Investment firms should formulate policy in written document and to publish it. 2. Arrangements for its implementation – for the best execution of the client order it should be assumed the best possible price and the time needed for the execution. In connection with this investment firms need one of the follows: •big and well trained staff to observe all market venues; •computer software program which generate all this information and give on screen all prices in different market venues and evaluates the best opportunities for the execution. 3. To inform clients by web site or in a written brochure, paper etc. 4. Client consent – by clause in the contract or specific declaration which should be signed by client. 5. Review of the effectiveness – by internal or external audit. And establishment of special discussion (chat) forum on the web site providing feed back of the policy effectiveness. Free Hot line. 6. Monitoring of the effectiveness – frequency of the monitoring which has to be done depends on the market share of the firm, turn over of the firm, number of transactions, clients for the certain period. 7. Demonstration of best execution – to provide client with comparative data about the other possible results that could be achieved on the other market venues

Step 5 – Analysis of impacts (Users)

i) **Costs to users/consumers** (Please think about the incremental costs incurred by customers after the regulation was enacted in comparison with the baseline before the enactment)

WG1	• Direct/compliance/indirect costs: Higher commissions for clients, because of the costs of the firm to assure best execution; Indirect – if the firm choose to use computer program with access on it by internet it will increase the expenses of the retail clients
WG2	• Direct/compliance/indirect costs: • One-off - Clients' costs for expressing consent on the best execution policy • Increase in transaction costs, passed on to retail clients due to increase in companies' costs

Step 6 – Analysis of impacts (Users)

i) **Benefits to users/consumers** (Please think about the incremental benefits obtained by consumers after the regulation was enacted in comparison with the baseline before the enactment)

WG1	• Clients are better informed; • Facilitate investment decision making; • Broader access to different market venues; • Increase of clients' confidence; • Better net financial results.
WG2	- Reducing asymmetric information; - Reducing transaction fees due to national and cross-border competition; - Long term – improving retail clients' approval and trust in the financial market; - Access to more markets and a larger variety of services - brokers will enter many markets to give clients more choice; - Increased markets, CSDs, CCPs competition and reduction of their fees, usually passed on to clients; - Less asymmetric information – increasing number of transactions; - Customer tailored best execution policies/solutions.

Step 7 – Analysis of impacts (Regulated firms)

i) **Costs to regulated firms** (Please think about the incremental costs incurred by regulated firms after the regulation was enacted in comparison with the baseline before the enactment)

WG1	• Direct/compliance/indirect costs: staff and personal training, IT systems, software programs • For preparation of policy - costs for external consultants or internal audit systems • Behavior restrictions; • One-off/on-going costs: to buy software/ salaries of the staff, subscriptions of updating software

Step 7 – Analysis of impacts (Regulated firms)

i) **Costs to regulated firms** (Please think about the incremental costs incurred by regulated firms after the regulation was enacted in comparison with the baseline before the enactment)

WG2	• Direct/compliance/indirect costs: • New procedures and policies • Employing new staff members to follow best execution rules • Wages or fees for external consultants • On-going - Reporting of information to the commission costs • On-going - Informing and getting client's consent on the Investment intermediary's policy •Costs to get quotes compare them and execute at the best price. •On-going annual monitoring costs •On-going – providing clients with information /demonstration of how the policy is being executed (by request)
	• One-off/on-going costs: • One-off and ongoing costs for accessing several markets to give clients a choice • One-off costs – buying and upgrading computer systems or software

Step 8 – Analysis of impacts (Regulated firms)

i) **Benefits to regulated firms** (Please think about the incremental benefits obtained by regulated firms after the regulation was enacted in comparison with the baseline before the enactment)

WG1	• Increase good will reputation of the regulated firm; • More clients will be interested of services provided by firm; • Costs of transactions will be reduced; • More optimal fit between what consumers buy and what they need.
WG2	•Improving competition between brokers and investment intermediaries– national, cross border; • Long term – improving retail clients' approval and trust in the financial market and thus – the number of investors; • Reducing prices and fees – increase in amount invested in the market; • Reducing prices and fees– increase in the number of investors.

Working Group Members

Working Group #1

WG Coordinator
Financial Supervision Commission *Ms. Petya Nikiforova*
Bulgarian National Bank *Mr. Georgi Petkov*
Financial Supervision Commission *Ms. Broyana Dimitrova*
Financial Supervision Commission *Mr. Boyan Dombalov*
Financial Supervision Commission *Ms. Vesela Todorova*
Central Depository AD *Ms. Nadia Daskalova*
Bulgarian Association of Asset Management Companies *Mr. Evgeny Jichev*
Financial Supervision Commission *Mr. Nursen Murad*
Bulgarian National Bank *Mr. Lyubomir Mirchev*
Financial Supervision Commission *Mr. Zhelju Vasilev*

Working Group #2

WG Coordinator
Financial Supervision Commission *Ms. Valentina Stefanova*
Financial Supervision Commission *Ms. Lidiya Valchovska*
Bulgarian Stock Exchange- Sofia *Mr. Ivo Stankov*
Financial Supervision Commission *Ms. Tzveta Grigorova*
Association of Banks in Bulgaria *Ms. Irina Kazandjieva*
Financial Supervision Commission *Mr. Julian Razpopov*
Financial Supervision Commission *Ms. Suzana Kapsazova*
Financial Supervision Commission *Mr. Vladimir Karamfilov*
Financial Supervision Commission *Mr. Damyan Staykov*
Ministry of finance *Ms. Denitza Markova*

Impact assessment in practice – Homework
Internal Control, Risk Management and Internal Audit

Stephen Dickinson / Christian Winkler

Economics of Financial Regulation Department

UK Financial Services Authority

Objectives of this homework

This homework should enable you to:

- **Carry out an impact assessment including the consultation of stakeholders;**
- **Study a regulatory problem from an impact assessment perspective;**
- **Discover the insights into the problem that impact assessments can give;**
- **Understand how those insights can help in the choice of regulatory solutions.**

The problem

As part of MiFID the FSC implemented the following regulation:
Ordinance no. 38 of 25 July, 2007 on the requirements to the activities of investment intermediaries, in effect as November 1, 2007, issued by the Financial Supervision Commission, promulgated in SG, issue 67 from 17 August, 2007.

The homework will focus on Chapter 8, Sections 2-4 of the regulation, which covers

- Internal Control (Section 2),
- Risk Management (Section 3) and
- Internal Audit (Section 4).

What are your tasks?

- Please prepare an impact assessment for the three main obligations stated above.

- Does FSC's MiFID implementation go beyond the requirements of the original MiFID directive (i.e. is super-equivalent).
  → If yes, please specify if the super-equivalent rules are beneficial.

- The groups are asked to support their analysis with relevant data. In order to achieve this, the groups have to identify the main relevant stakeholders and carry out a consultation with these stakeholders.

Hints on completion of the Impact Assessment

- The IA Guidelines (particularly the first three annexes) contain various hints and suggestions to help you ask the right sort of questions.

- Your task is an IA that deals with the implementation of an EU directive

  → Market / regulatory failure analysis is not required in this case.

  But: thinking about and defining the relevant market / regulatory failures may also be useful in these cases. This may help you defining the costs and benefits of implementing the directive.

Session 1

General introduction on RIA and first practical application

November 13-15, 2007

AGGREGATE RESULTS OF THE EVALUATION

Total participating institutions:		**8**
Total respondent institutions:		**7**
Total participants:		**21**
Total respondents:		**14**
Responding rate	**- institutions:**	**87%**
	- participants:	**67%**

Please rate the session

Aggregate feedback:
Average Rating: 3.7 out of 4 (92.5%).

Did the session disappoint, meet, or exceed your expectations?

Aggregate feedback:

Option	#	%
Disappoint	0	0%
Meet	9	64%
Exceeded	5	36%
	14	100%

What did you like best about the session and how would you compare it to other workshops you have attended?

- Well organized, with useful information, some of the information was given seveeral times; I wish there were more details on the estimation of benefits, especially more indicators and relations;
- The topic was new for me and it was interesting for me to learn more things on this issue;
- The division in 2 groups on day 3 liked me most because we had the opportunity to discuss concrete topics;
- The practical approach and examples from day-to-day work;
- The speakers and the possibility to discuss their practical experience;
- For me the best part of the session was that one about cost of the regulatory impact - link between the regulatory provision and cost they incur;
- It's my first participation in workshops;
- I liked the practical part as in many of the workshops I have attended before were more theory covering;
- The combination between theory and practice;
- I consider the seminar as very useful due to the practical exercises;
- Well structured session. Many examples. The case study however should have focused on more hot regulations, e.g. Ordinance n. 16 of FSC;
- It was very useful. All aspects were clearly explained by the lecturers;
- Dialogue with the lecturers, informal approach, clear and practical oriented presentations with many examples;

- Practical exercise was very interesting and it shows the way how we should work on this aims.

Do you recommend more workshops or training on this topic?

- Yes, especially when ex-post analysis on MIFID implementation should be done;
- Regarding the current situation and the organization the current workshops and training were quite beneficial;
- No, I think already a lot of useful information was given;
- Yes, further training will be necessary in terms of acquainting other participants with the topics disussed and follow-up studies and refinement of knowledge for current traienees;
- Yes;
- Yes, IA method is very useful for my and FSC future effective work;
- Yes, because this topic is very important for all participants in financial market;
- Yes, but after some time, when there are more concretee steps towards IA in the supervisory institutions;
- If the RIA become a part of FSC strategy it would be useful to envisage other workshops;
- Yes, if RIA becomes obligatory for regulatory authrorities;
- Yes, RIA is going to be mostly valuable as an approach for solving problems improving BSE rules and regulations;
- Yes, they must be organized because there are related with practise and current conditions.

Which Authorities/Institutions, other than those already represented in this session, should join future RIA sessions?

- Any institution with regulatory obligations;
- Considering the topic of the seminar, the participants from the represented institutions were well selected;
- Stakeholders -- probably consumer protection authorities (NGOs);
- Representatives of the Bulgarian Association of licensed investment intermediaries;
- Association of Investment Intermediaries;
- Senior management;
- Association of Investment firm.

Will, in your opinion, RIA implementation in your country improve the quality of regulatory activities?

Aggregate feedback:

Option	#	%
Yes, a lot	8	57%
Perhaps	6	43%
No impact whatsoever	0	0%
	14	100%

Do you think RIA awareness should be improved among your superiors and colleagues?

Aggregate feedback:

Option	#	%
Yes	12	86%
No	1	7%
	13	93%

Do you think that Bulgaria financial sector modernization could be enhanced through a program similar to SPI Romania?

Aggregate feedback:

Option	#	%
Yes	9	75%
No	1	8%
No reply	2	17%
	12	100%
2 qualitative replies: 1) At the moment it is difficult for me to estimate this; 2) Perhaps.		

Session 2

RIA on local financial regulations

– Consultation Process and Final Presentation drafting –

Venue:

December 19-20, 2007

Financial Supervision Commission

Agenda

Seminar Objective:

Following the IA analysis and the preparation of the consultation questionnaire phases already completed, participants will practice the following aspects of the RIA process:

- Use of written answers from stakeholders taking part in the consultation process to lay the ground for the live consultation process;
- How a consultation meeting ought to be prepared in order to extract as much information as possible;
- How to run a consultation meeting and reach a fruitful interaction with stakeholders;
- How use the feedback from consultation process in view of preparing a draft document summarizing main findings and policy recommendations.

WG participants

WG # 1	***WG Coordinator*** Financial Supervision Commission *Ms. Petya Nikiforova*	Bulgarian National Bank *Mr. Georgi Petkov*	Financial Supervision Commission *Ms. Broyana Dimitrova*	Financial Supervision Commission *Mr. Boyan Dombalov*	Financial Supervision Commission *Ms. Vesela Todorova*	Central Depository AD *Ms. Nadia Daskalova*	Bulgarian Association of Asset Management Companies *Mr. Evgeny Jichev*	Financial Supervision Commission *Mr. Nursen Murad*	Bulgarian National Bank *Mr. Lyubomir Mirchev*	Financial Supervision Commission *Mr. Zhelju Vasilev*

WG # 2	***WG Coordinator*** Financial Supervision Commission *Ms. Valentina Stefanova*	Financial Supervision Commission *Ms. Lidiya Valchovska*	Bulgarian Stock Exchange-Sofia *Mr. Ivo Stankov*	Financial Supervision Commission *Ms. Tzveta Grigorova*	Association of Banks in Bulgaria *Ms. Irina Kazandjieva*	Financial Supervision Commission *Mr. Julian Razpopov*	Financial Supervision Commission *Ms. Suzana Kapsazova*	Financial Supervision Commission *Mr. Vladimir Karamfilov*	Financial Supervision Commission *Mr. Damyan Staykov*	Ministry of finance *Ms. Denitza Markova*

Consulted stakeholders

- Bulgaria Association of Asset Management Companies;
- Association of Banks in Bulgaria;
- Investment intermediary “ Somon;
- Investment intermediary "Somoni FB";
- Investment intermediary "Beta corp";
- Investment intermediary "STS Finance";
- Investment intermediary "Elana trading".

Regulations

- Requirements to the activities on investment intermediaries, Chapter 8, Section II (Internal Control)-> assigned to Working Group 1;
- Requirements to the activities on investment intermediaries, Chapter 8, Section III (Risk Management) and Section IV (Internal Audit) -> assigned to Working Group 2.

Consolidating written answers by consulted stakeholders and preparing the consultation meeting

Session Objective:
Participants will learn how to use written feedback from consulted stakeholders to prepare for the consultation meeting.

Morning session:

Participants discuss feedback to consultation questionnaire, if necessary with identified stakeholders [1]*

Deliverable: "Summary of Questionnaire Results"

Facilitator: Riccardo Brogi, Convergence Program and South-East Europe Regional RIA Program Director

9:30 – 9:35 Session introduction

9:35 – 11:00 WG1 – Regulatory section on "internal control"

11:00 – 11:15 Coffee break

11:15 – 12:45 WG2 – Regulatory sections on "Risk management and internal audit"

12:45 – 14:30 *Lunch break*

Afternoon session: *Preparation of the consultation meeting* (consulted stakeholders are welcome to attend)

Deliverable: "Policy Options – Consultation Document"

Facilitator: Christian Winkler, Senior Regulator, UK Financial Services Authority;
Co-facilitator: Riccardo Brogi

14:30 – 16:00 WG1 – Regulatory section on "internal control"

16:00 – 17:15 *Coffee break*

17:15 – 18:45 WG2 – Regulatory sections on "Risk management and internal audit"

[1] The structure of morning session exercise is based on the agreed action plan as per Annex 1. In case the work run by the WGs prior to the 2-day seminar undergoes some postponement, the information gathering phase might require also the active participation of the identified stakeholders.

Thursday December 20, 2007

Live consultation meeting and drafting of Final Presentation document

Session Objective:

Participants will practice the following:

- **a live consultation meeting and learn how to run this in such a way to make it as meaningful as possible in relation to the consultation process purpose;**
- **How to gather all consultation feedback and prepare a document bringing the main findings and some policy recommendations for policy analysis.**

Facilitator: Christian Winkler
Co-facilitator: Riccardo Brogi

Morning session: *All participants and consulted stakeholders gather for the consultation meeting*

9:00 – 9:10 Session introduction

9:10 – 10:45 WG1 Plenary consultation meeting: Regulatory section on "internal control"

10:45 – 11:00 *Coffee break*

11:00 – 12:30 WG2 Plenary consultation meeting: Regulatory sections on "Risk management and internal audit"

12:30 – 14:00 *Lunch break*

Afternoon session: *Preparation of draft Final Presentation document*

Deliverable: "Summary of Consultation Feedback"

14:00 – 15:30 The 2 WGs work separately to systematize the consultation feedback obtained to come up with the main findings

15:30 – 16:00 Plenary discussion on the main findings identified

- 15:30 – 15:45 WG1 presents its findings and WG2 acts as discussant
- 15:45 – 16:00 WG2 presents its findings and WG1 acts as discussant

16:00 – 16:15 *Coffee break*

Deliverable: "Draft Policy Recommendations"

16:15 – 17:45 The 2 WGs work separately to refine main findings and start drafting policy recommendations

17:45 – 18:00 Wrap up and end of session

Annex

Program-critical activity

Time line	Actions
Nov 30	➢ WG1 and WG2 fill in the ***Impact Assessment Analysis Document*** on the FSC Regulation on requirements to the activities of investment intermediaries; ➢ Coordinators of WG1 and WG2 send the documents to FSA (**Christian.Winkler@fsa.gov.uk**, and **.Stephen.Dickinson@fsa.gov.uk**) and Convergence **(rbrogi@worldbank.org).** *Each WG Coordinator prepares the minutes of the meeting highlighting the main parts (i.e. criticalities and agreed aspects faced by each respective WG in dealing with this achievement)* ➢ WG1 and WG2 identify the stakeholders to be involved in the consultation process and invite them to fill questionnaire by December 18 and attend December 20 consultation session
Dec 7	➢ FSA sends comments on ***Impact Assessment Analysis Document*** to WG1 and WG2.
Dec 12	➢ WG1 and WG2 update the FSC ***Impact Assessment Analysis Document*** on the basis of the FSA comments they have received. ➢ WG1 and WG2 complete the draft ***Consultation Questionnaire***; ➢ Coordinators of WG1 and WG2 send the respective drafts to Convergence for review.
Dec 14	➢ Convergence prepares its comments on the 2 draft ***Consultation Questionnaires*** and share them with FSA; ➢ Convergence sends comments to the 2 WGs.
Dec 17 (morning)	➢ WG Coordinators send the aggregate Consultation Questionnaire to the identified stakeholders
Dec 18 (afternoon)	➢ Stakeholders send their written answers to WG coordinators for discussion on the following day.
Dec 19 (morning) 10:00 - 12:30	➢ **Working session in Sofia – Meeting to aggregate the Questionnaire Results:** WG1and WG2, together with Convergence, prepare the ***Summary of Questionnaire results***.
Dec 19 (afternoon) 15:30 - 18:00	➢ **Working session in Sofia – Preparation of consultation meeting:** Under the guidance of Convergence/FSA, WG1, WG2 prepare the live consultation meeting based on the Questionnaire already circulated
Dec 20 (morning) 9:00 - !2:30	➢ **Working session in Sofia – Consultation meeting**: WG1 and WG2, under the guidance of Convergence/FSA run a live consultation meeting based on the Questionnaire already circulated,
Dec 20 (afternoon) 14:00 – 18:00	➢ **Working session in Sofia –Drafting of Final Presentation document**: on the basis of the previous actions, WG1 and WG2 work on the preparation of a Draft Final Presentation document, which should include the main findings of the exercise and some policy Recommendations.
Mid January 2008	➢ **Final Presentation to authorities**: WG1 and WG2 illustrate the Final Presentation to management from FSC and other authorities.

Financial RIA Capacity Building Program in Bulgaria

RIA homework exercise

Excerpts of regulation to practice RIA

WG 1

Requirements to the activities of investment intermediaries,
Chapter 8 Section 2

ORDINANCE No. 38 OF 25 JULY, 2007 ON THE REQUIREMENTS TO THE ACTIVITIES OF INVESTMENT INTERMEDIARIES

In effect as of 1st November, 2007, issued by the Financial Supervision Commission
Promulgated SG, issue 67 from 17 August, 2007

Chapter Eight
INTERNAL ORGANISATION, INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

Section II
Internal Control

Art. 76. (1) An investment intermediary shall have an internal control department, which operates independently and:
1. exercises an ongoing control over and assesses the adequacy and efficiency of the measures and procedures under Art. 75 para 1, as well as the actions taken for removal of the inconsistencies in the investment intermediary's operation with the requirements of the MFIA and its implementing instruments;

2. provides advice and assists the persons responsible for the performed by the investment intermediary services and activities, with the purpose of ensuring their realization in compliance with the requirements of the MFIA and its implementing instruments;
3. executes other functions, assigned to it pursuant to the Ordinance and the rules under Art. 80.

(2) The internal control shall be established and realized in accordance with the nature, scale and the complexity of the investment intermediary's activities, as well as with the type and scope of the performed investment services and activities.

(3) The officials from the internal control department must satisfy the requirements under Art. 3, item 1 - 6 from Ordinance № 7 in 2003 on the requirements which must be met by natural persons who directly execute transactions in securities and provide investment advice on securities under a contract and also the procedure for acquisition and revocation of the right to carry out such activities and to possess the required for the performance of the assigned to them functions skills, knowledge and experience.

(4) An official from the internal control department shall be present at the registered office and in any branch or office, in which contracts under Art. 24, para 1 are concluded and orders are accepted.

(5) The way of fixing the labor remuneration and all additional payments to the persons from the internal control department must not create preconditions for non-objective performance of the functions of those persons.

(6) The officials from the internal control department shall be entitled to full access to the whole needed information and to all documents, related to the exercising of the control under para 1.

(7) The members of the management and supervisory bodies of the investment intermediary and all other persons who work under a contract for the investment intermediary are under the obligation to assist the officials from the internal control department in the exercising of their functions.

(8) The head of the internal control department shall conduct an instruction of the officials from the department upon their appointment, as well as regularly, by the 15th day of the month, following every quarter. In such case the head of the internal control department shall draw up a document, whereby he/she shall verify the carrying out of the instruction.

Art. 77. (1) The head of the internal control department shall be appointed, report to and dismissed on conditions and under a procedure according the investment intermediary's basic instruments.

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(3) The person in charge of the internal control department may not be a member of the management or supervisory bodies, broker, investment adviser or some other person, to whom the operating management of the investment intermediary has been entrusted or who participates in the execution of activities or separate actions, over which control is exercised. The preceding sentence shall also apply to all officials from the internal control department.

Art. 78. (1) At the end of every business week the internal control department shall make an inspection of the accepted orders, documents, presented or drawn up in relation thereto, the confirmations to clients given under Art. 45 and the payments made, as well as of the transactions which the members of its management and control bodies, and the persons working under a contract for the investment intermediary, have concluded for their account through the investment intermediary, respectively of the provided information under Art. 17 para 2 item 2 during that week, for compliance with the provisions of the MFIA and its implementing instruments.

(2) At the end of each month the internal control department shall conduct an inspection of the operations under every managed by the investment intermediary portfolio, and the reports submitted to the clients, during the relevant month, for compliance with the provisions of the MFIA and its implementing instruments.

(3) The internal control department shall also carry out other inspections for compliance of the investment intermediary's operation with the provisions of the MFIA and its implementing instruments.

(4) In the conducting of inspections under para 1 - 3, a protocol shall ce drawn up indicating the concrete contracts and orders, subject of inspection, as well as the established irregularities and the directions given according Art. 76 para 1 item 2.

(5) Within 3 business days after the inspection's carrying out, the protocol shall be submitted to the person in charge of the internal control department, who shall acquaint himself with the findings therein and approve it, or direct the performance of additional actions.

Art. 79. (1) The person in charge of the internal control department shall prepare and present to the management body, as well as to the supervisory body, if any, of the investment intermediary by the 3rd day of every month a report on the inspections carried out by the internal control department during the preceding month. To the report shall be attached the protocols of the inspections carried out.

(2) The report according para 1 shall state the irregularities established and the measures undertaken for their elimination, and the adoption of new measures by the management body shall be proposed. The report shall also contain an assessment of the internal organization and internal control system acting in the investment intermediary, including the rules under Art. 75 para 1 and Art. 80, with a view to their ability to ensure the lawful functioning of the investment intermediary and the timely establishment of performance of activity in violation of the statutory requirements, as well as proposals to the management body for the adoption of amendments to the rules under Art. 75 para 1 and Art. 80, in case that they do not ensure to a sufficient extent the fulfillment of those requirements.
(3) The investment intermediary's management body shall inform within 3 business days of receiving the report under para 1, the Commission about the irregularities established by the internal control department, described therein, and about the undertaken in relation to them measures.

Art. 80. (1) The management body of the investment intermediary shall adopt internal control rules, as well as policies and procedures for the establishment of any risk of default on the investment intermediary's obligations under the MFIA and its implementing instruments and the related risks and adequate measures and procedures for the minimization of these risks, appropriate to the pursued by the investment intermediary business.:

(2) The management body of the investment intermediary on a yearly basis, by 31st of January shall review and assess the rules, policies and procedures under para 1 with the purpose of ensuring the lawful, efficient and reliable functioning of the internal control department, and in case of deficiencies and/or need of the internal control improvement, shall adopt amendments and supplements to the rules. Regardless of the requirement of the preceding sentence, the management body shall adopt amendments and supplements to the rules, policies and procedures according to para 1 whenever the necessity of it is established.

Art. 81. (1) An investment intermediary, by decision of the management body, may not apply in its activities the requirements under Art. 76, para 5 and/or Art. 77 para 3, if they are not needed with a view to the scale and complexity of its activities and the type and scope of the performed investment services and activities and non-compliance with them does not create jeopardy for the lawful, efficient and reliable exercising of the internal control in the investment intermediary.

(2) The investment intermediary shall latest on the next business day after taking the decision under para 1 notify the deputy chairman of that decision, producing evidence for compliance with the conditions under para 1.

(3) On the basis of the notification under para 2 the deputy chairman shall make an assessment of the compliance with the conditions under para 1, and may direct in writing to the investment intermediary to continue to apply in its activities the requirements under Art. 76 para 5 and/or Art. 77 para 3 if those conditions were not complied with. Direction under the preceding sentence may be given after the receiving of the notification under para 2, or upon receiving additional data, on the basis of which the conclusion can be made that the conditions under para 1 were not complied with.

Financial RIA Capacity Building Program in Bulgaria

RIA homework exercise

Excerpts of regulation to practice RIA

WG 2

Requirements to the activities of investment intermediaries,
Chapter 8 Sections 3-4

ORDINANCE No. 38 OF 25 JULY, 2007 ON THE REQUIREMENTS TO THE ACTIVITIES OF INVESTMENT INTERMEDIARIES

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Chapter Eight
INTERNAL ORGANISATION, INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

Section III
Risk Management

Art. 82. (1) The management body of the investment intermediary shall adopt and apply rules for risk management, adequate to the pursued by the investment intermediary business, which shall:
1. contain policy and procedures which identify the risks relating to the investment intermediary's activities, procedures and systems, as well as to the tolerated by the investment intermediary level of risk, if such can be established;

2. contain effective procedures and measures to manage the risks associated with the investment intermediary's activities, procedures and systems in accordance with the tolerated by the investment intermediary admissible level of risk;

3. include mechanisms for exercising control over the adequacy and efficiency of the policy and procedures under item 1 and over compliance by the investment intermediary and the persons who work under a contract for the investment intermediary, with the procedures and measures under item 2;

4. include mechanisms for control over the adequacy and effectiveness of the measures taken to address such deficiencies and inconsistencies in the policy and procedures under item 1 and the procedures and measures under item 2, including the impossibility for their observance by the persons.

(2) The management body of an investment intermediary shall at least once in a quarter review and assess the rules under para 1, and in case of deficiencies and/or need of improvement of the risk management, shall adopt amendments and settlements to the rules. Regardless of the requirements according the preceding sentence, the management body shall adopt amendments and supplements to the rules under para 1 whenever the need of that is established.

(3) An investment intermediary where applicable and in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business, shall have a risk management department, which operates independently and applies the policy and procedures under para 1.

(4) The risk management department shall prepare and present to the management body, as well as to the supervisory body, if any, of the investment intermediary by the 10th day of every month a report on the department's activities in the preceding month, in which it shall indicate the established deficiencies and inconsistencies in the policy and the procedures under para 1 item 1 and the procedures and measures under para 1 item 2, as well as the measures taken for their elimination.

(5) An investment intermediary may not establish a risk management department according para 3 if the maintenance of such is not appropriate in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business and may prove at any time that the policy and procedures established according para 1 satisfy the requirements of para 1 and are effective.

(6) In the case under para 5, on request of the deputy chairman, the investment intermediary shall submit evidence of the availability of the conditions under para 5. The deputy chairman may order the investment intermediary to establish a risk management department according para 3, if the conditions of para 5 were not complied with.

Section IV
Internal Audit

Art. 83. (1) An investment intermediary, where applicable and in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business, shall set up and maintain an internal audit department, which functions separately and independently from the other departments and activities and examines and evaluates the adequacy and effectiveness of the adopted by the investment intermediary internal rules and the established systems of internal organization, internal control, information storage and processing, accounting, etc.
(2) To the persons from the internal audit department shall apply accordingly the requirements under Art. 76 para 3 and Art. 77 para 3, and for the person in charge of the department – the requirements under Art. 77 para 2.
(3) The person in charge of the internal audit department shall adopt a plan for conducting the audits under para 1 and shall ensure its observance.

(4) After conducting an audit in consistence with the plan according para 3, the person in charge of the internal audit department may give recommendations for removal of the established deficiencies and inconsistencies. In the cases under the preceding sentence, the department shall check the undertaken in compliance with them actions and the applied measures and shall verify their fulfillment.

(5) The internal audit department shall prepare and present to management body, as well as to the supervisory body, if any, of the investment intermediary by the 10th day of every month, a report on the department's activities for the preceding month, where it shall indicate the established deficiencies and inconsistencies, as well as the measures taken for their removal.

(6) An investment intermediary may not set up an internal audit department, or it may consists of one person only, if the maintenance of such according para 1-3 is not appropriate and

proportionate in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities.

(7) In the case under para 6, on request of the deputy chairman, the investment intermediary shall submit evidence of the availability of the conditions under para 6. The deputy chairman may order the investment intermediary to set up an internal audit department, if the existence of such is needed in view of the nature, scale and complexity of the investment intermediary's business and the nature and range of the performed investment services and activities.

(8) The management body of an investment intermediary shall on an annual basis, by 31st January, review and assess the operation of the internal audit department and shall undertake appropriate measures if it is necessary to improve its activities. Regardless of the requirement under the preceding sentence, the management body shall take appropriate measures to improve the internal audit whenever the need of that is established.

Evaluation Form
Aggregate Results

SESSION 2
RIA ON LOCAL REGULATIONS

I – Desk work (mid November to mid December, 2007)
II – Seminar: consultation process and final presentation drafting (December 19-20, 2007)

Total participants:		**18 (approx)**
Total respondents:		**12**
Responding rate	**- participants:**	**67%**

Desk work part

Question 1 – How do you rate the instructions and support received from the facilitators, through the WG coordinators, in preparing for this session?

a. Good	82%
b. Average	18%
c. Less that average	0%
d. Bad	0%
	100%

(To be answered by the WG coordinators)
How do you rate the instructions and support received from the facilitators in preparing for this session?

a. Good	60%
b. Average	40%
c. Less that average	0%
d. Bad	0%
	100%

Question 2. – How do you rate the usefulness of the workflow so far?

	Average rating
Regulatory Impact Assessment Analysis Document (RIAAD) Template	3.8 out of 4 (95.5%)
Iterations between the WG and facilitators in filling in RIAAD	3.6 out of 4 (90.0%)
Consultation Questionnaire Template	3.7 out of 4 (93.2%)
Iterations between the WG and facilitators in filling in Consultation Questionnaire	3.6 out of 4 (90.0%)

Question 3. – In the future, how important could it be to prepare the following document in a class setting, as opposed to desk-based work?

A. IA Template

a. Important	67%
b. Not quite so important	33%
c. Relatively unimportant	0%
	100%

B. Questionnaire

a. Important	75%
b. Not quite so important	25%
c. Relatively unimportant	0%
	100%

Question 4. – How much time did you devote to preparing the documents

A. IA Template

a. Less than one working day	36%
b. between 1 and 2 days	45%
c. More than 2 working days	18%
	100%

B. Questionnaire

a. Less than 4 working hours	27%
b. between 4 and 8 working hours	64%
c. More than 8 working hours	9%
	100%

Question 5. – What is the ideal time to devote to desk-based preparation?

A. IA Template

a. Less than one working day	33%
b. between 1 and 2 working days	59%
c. More than 2 working days	8%
	100%

B. Questionnaire

a. Less than 4 working hours	8%
b. between 4 and 8 working hours	75%
c. More than 8 working hours	17%
	100%

2-day workshop

Question 6 – Please rate the session Average Rating: 3.6 out of 4 (90.0%)

Question 7 – What did you like best about the session and how would you compare it to other workshops you have attended?

- The interaction between participant and the exchange of the point of views;
- This session was very interactive and interesting: the presence of stakeholders was one of the reasons for that. Facilitators managed to encourage more people to participate in the discussion and were very helpful;
- The meeting with stakeholders;
- Working and exchanging ideas with major stakeholders;
- The consultation process and the extraction of the essence from it;
- I appreciate the top class work by the training team;
- Its interactive character and brainstorming aspects;
- I liked most the willingness of Brogi and Winkler to answer questions and make at most practical.

Question 8 – How useful did you find the following parts of the session?:

	Average rating
December 19	
WG participants meeting with Invited stakeholders who provide first feedback to the written questionnaire *Facilitator: Mr. Riccardo Brogi, Convergence Program and South-East Europe Regional RIA Program Director*	3.7 out of 4 (91.7%)
Preparation of the consultation meeting *Facilitator: Christian Winkler, UK Financial Services Authority;* *Co-facilitator: Riccardo Brogi*	3.3 out of 4 (81.3%)
December 20	
Consultation meeting *Facilitator: Christian Winkler,* *Co-facilitator: Riccardo Brogi*	3.6 out of 4 (90.9%)
Preparation of draft Final Presentation document *Facilitator: Christian Winkler,* *Co-facilitator: Riccardo Brogi*	3.8 out of 4 (95.5%)

Question 9 –What did you learn from preparing the questionnaire

	Average rating
a) learning how the business activity is conducted and how regulation affects it	3.5 out of 4 (86.4%)
b) gathering more evidence about the need for regulatory intervention	3.3 out of 4 (82.5%)
c) gathering evidence for the “do nothing” option	3.0 out of 4 (75.0%)
d) understanding main revenue and cost drivers of the business	3.4 out of 4 (84.1%)

Please comment:

- It is important to extract as much information as possible from stakeholders;
- The information from the investment company was helpful [especially concerning item a) and item d)], to understand the effect of the new regulation on business and how the business responds to regulations, which they consider too burdensome;
- Both assessment of regulatory action and projections about "do nothing" option enable regulators to move ahead and meet failures challenges;
- The most important benefit during the whole workshop was the interaction with the stakeholders. They provided a lot of useful information.

Question 10 –What did you learn from running the consultation

	Average rating
a) You gained a better understanding of the case for regulatory action	2.9 out of 4 (72.5%)
b) you received satisfactory evidence on alternative policy options	3.0 out of 4 (75.0%)
c) the economics of the business have become clearer to you	2.9 out of 4 (72.5%)
d) market participants gave you new insights into how their business operates and how it is affected by regulations	3.4 out of 4 (85.0%)
e) Market participants have shown understanding for the rationale for regulatory intervention	2.9 out of 4 (72.7%)
f) You were able to build consensus about your intended actions with market participants	2.8 out of 4 (69.4%)

Please comment:

- Alternative solutions are important because they provide source for improving regulations;
- The consultation meeting was most useful for the information how the firms operate. We had a fairly good understanding of the problem beforehand, but still some others come. Alternative policy options were recommended but with insufficient evidence.

Question 11 – What did you learn from preparing the recommendation document

	Average rating
a) how much did the questionnaire answers and the consultation feedback shape your understanding of the issues compared to your initial assessment presented in RIIAD?	3.0 out of 4 (75.0%)
b) how did the cost and benefit analysis for the various stakeholders influence your assessment of various policy options?	3.1 out of 4 (77.5%)
c) in what respects did market feedback change significantly your initial position?	3.2 out of 4 (80.6%)
d) in what respect will the policy makers benefit from a recommendation document prepared with market feedback	3.1 out of 4 (77.5%)

Please comment:

- In my opinion, regulators should always prepare RIA before introducing new rules or changing existing rules. This will help them not to disturb the market, and/or to receive market balance. FSC should pay attention to this documents and results from this session and take the necessary actions, if needed, to change the regulation ;
- Policy makers should undertake regulatory action if signals from markets and participants require revision of existing legal framework;
- The recommendation document helps you summarize and gave sometimes rise to additional questions.

Question 12 – Lecturer Assessment:

	Average rating
Riccardo Brogi	
Technically skilled in subject	3.6 out of 4 (90.9%)
Effective workshop design & delivery	3.4 out of 4 (84,1%)
Would you attend or recommend others attend different workshop by this lecturer?	3.3 out of 4 (82.5%)
Comments: - Very good interaction with participants; - Very eager to to help.	
Christian Winkler	
Technically skilled in subject	3.7 out of 4 (93.2%)
Effective workshop design & delivery	3.7 out of 4 (93.2%)
Would you attend or recommend others attend different workshop by this lecturer?	3.6out of 4 (90.9%)
Comments: - Very good interaction with participants; - Very eager to to help.	

Question 13 – Which topics/organizational step, critical for such a practical use of RIA techniques, were missing in this session?

- None, more practical ideas are welcome though;
- None;
- None.

Question 14 – Would you recommend this session to your colleagues?

a. Yes 64%
b. Yes, with minor adjustments 18%
c. Yes, with major adjustments 9%
d. No 9%
100%

e. Please describe below the proposed adjustments
- More practical stuff is welcome.

Question 15 – How soon do you expect to use the knowledge acquired in your work

a. YES, immediately in my regular workflow	27%
b. Partially, if I speak with my superior and colleagues	27%
c. No, but expect to use it in the future	46%
d. No, not even in the foreseeable future	0%
e. Not relevant for my job	0%
	100%

Financial RIA Capacity Building Program in Bulgaria

Session 2 RIA exercise

Excerpts of regulation to practice RIA

WG 1

Requirements to the activities of investment intermediaries
Chapter 8
Section II (Internal Control)

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(4) In the conducting of inspections under para 1 - 3, a protocol shall ce drawn up indicating the concrete contracts and orders, subject of inspection, as well as the established irregularities and the directions given according Art. 76 para 1 item 2.

(5) Within 3 business days after the inspection's carrying out, the protocol shall be submitted to the person in charge of the internal control department, who shall acquaint himself with the findings therein and approve it, or direct the performance of additional actions.

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(2) The report according para 1 shall state the irregularities established and the measures undertaken for their elimination, and the adoption of new measures by the management body shall be proposed. The report shall also contain an assessment of the internal organization and internal control system acting in the investment intermediary, including the rules under Art. 75 para 1 and Art. 80, with a view to their ability to ensure the lawful functioning of the investment intermediary and the timely establishment of performance of activity in violation of the statutory requirements, as well as proposals to the management body for the adoption of amendments to the rules under Art. 75 para 1 and Art. 80, in case that they do not ensure to a sufficient extent the fulfillment of those requirements.
(3) The investment intermediary's management body shall inform within 3 business days of receiving the report under para 1, the Commission about the irregularities established by the internal control department, described therein, and about the undertaken in relation to them measures.

Art. 80. (1) The management body of the investment intermediary shall adopt internal control rules, as well as policies and procedures for the establishment of any risk of default on the investment intermediary's obligations under the MFIA and its implementing instruments and the related risks and adequate measures and procedures for the minimization of these risks, appropriate to the pursued by the investment intermediary business.:

(2) The management body of the investment intermediary on a yearly basis, by 31st of January shall review and assess the rules, policies and procedures under para 1 with the purpose of ensuring the lawful, efficient and reliable functioning of the internal control department, and in case of deficiencies and/or need of the internal control improvement, shall adopt amendments and supplements to the rules. Regardless of the requirement of the preceding sentence, the management body shall adopt amendments and supplements to the rules, policies and procedures according to para 1 whenever the necessity of it is established.

Art. 81. (1) An investment intermediary, by decision of the management body, may not apply in its activities the requirements under Art. 76, para 5 and/or Art. 77 para 3, if they are not needed with a view to the scale and complexity of its activities and the type and scope of the performed investment services and activities and non-compliance with them does not create jeopardy for the lawful, efficient and reliable exercising of the internal control in the investment intermediary.

(2) The investment intermediary shall latest on the next business day after taking the decision under para 1 notify the deputy chairman of that decision, producing evidence for compliance with the conditions under para 1.

(3) On the basis of the notification under para 2 the deputy chairman shall make an assessment of the compliance with the conditions under para 1, and may direct in writing to the investment intermediary to continue to apply in its activities the requirements under Art. 76 para 5 and/or Art. 77 para 3 if those conditions were not complied with. Direction under the preceding sentence may be given after the receiving of the notification under para 2, or upon receiving additional data, on the basis of which the conclusion can be made that the conditions under para 1 were not complied with.

Session 2 RIA exercise

Excerpts of regulation to practice RIA

WG 2

Requirements to the activities of investment intermediaries
Chapter 8
Section III (Risk Management)
and Section IV (Internal Audit)

ORDINANCE No. 38 OF 25 JULY, 2007 ON THE REQUIREMENTS TO THE ACTIVITIES OF INVESTMENT INTERMEDIARIES

In effect as of 1st November, 2007, issued by the Financial Supervision Commission
Promulgated SG, issue 67 from 17 August, 2007

Chapter Eight
INTERNAL ORGANISATION, INTERNAL CONTROL, RISK MANAGEMENT AND INTERNAL AUDIT

Section III
Risk Management

Art. 82. (1) The management body of the investment intermediary shall adopt and apply rules for risk management, adequate to the pursued by the investment intermediary business, which shall:
1. contain policy and procedures which identify the risks relating to the investment intermediary's activities, procedures and systems, as well as to the tolerated by the investment intermediary level of risk, if such can be established;

2. contain effective procedures and measures to manage the risks associated with the investment intermediary's activities, procedures and systems in accordance with the tolerated by the investment intermediary admissible level of risk;

3. include mechanisms for exercising control over the adequacy and efficiency of the policy and procedures under item 1 and over compliance by the investment intermediary and the persons who work under a contract for the investment intermediary, with the procedures and measures under item 2;

4. include mechanisms for control over the adequacy and effectiveness of the measures taken to address such deficiencies and inconsistencies in the policy and procedures under item 1 and the procedures and measures under item 2, including the impossibility for their observance by the persons.

(2) The management body of an investment intermediary shall at least once in a quarter review and assess the rules under para 1, and in case of deficiencies and/or need of improvement of the risk management, shall adopt amendments and settlements to the rules. Regardless of the requirements according the preceding sentence, the management body shall adopt amendments and supplements to the rules under para 1 whenever the need of that is established.

(3) An investment intermediary where applicable and in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business, shall have a risk management department, which operates independently and applies the policy and procedures under para 1.

(4) The risk management department shall prepare and present to the management body, as well as to the supervisory body, if any, of the investment intermediary by the 10th day of every month a report on the department's activities in the preceding month, in which it shall indicate the established deficiencies and inconsistencies in the policy and the procedures under para 1 item 1 and the procedures and measures under para 1 item 2, as well as the measures taken for their elimination.

(5) An investment intermediary may not establish a risk management department according para 3 if the maintenance of such is not appropriate in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business and may prove at any time that the policy and procedures established according para 1 satisfy the requirements of para 1 and are effective.

(6) In the case under para 5, on request of the deputy chairman, the investment intermediary shall submit evidence of the availability of the conditions under para 5. The deputy chairman may order the investment intermediary to establish a risk management department according para 3, if the conditions of para 5 were not complied with.

Section IV
Internal Audit

Art. 83. (1) An investment intermediary, where applicable and in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities undertaken in the course of that business, shall set up and maintain an internal audit department, which functions separately and independently from the other departments and activities and examines and evaluates the adequacy and effectiveness of the adopted by the investment intermediary internal rules and the established systems of internal organization, internal control, information storage and processing, accounting, etc.
(2) To the persons from the internal audit department shall apply accordingly the requirements under Art. 76 para 3 and Art. 77 para 3, and for the person in charge of the department – the requirements under Art. 77 para 2.
(3) The person in charge of the internal audit department shall adopt a plan for conducting the audits under para 1 and shall ensure its observance.

(4) After conducting an audit in consistence with the plan according para 3, the person in charge of the internal audit department may give recommendations for removal of the established deficiencies and inconsistencies. In the cases under the preceding sentence, the department shall check the undertaken in compliance with them actions and the applied measures and shall verify their fulfillment.

(5) The internal audit department shall prepare and present to management body, as well as to the supervisory body, if any, of the investment intermediary by the 10th day of every month, a report on the department's activities for the preceding month, where it shall indicate the established deficiencies and inconsistencies, as well as the measures taken for their removal.

(6) An investment intermediary may not set up an internal audit department, or it may consists of one person only, if the maintenance of such according para 1-3 is not appropriate and

proportionate in view of the nature, scale and complexity of its business and the nature and range of the performed investment services and activities.

(7) In the case under para 6, on request of the deputy chairman, the investment intermediary shall submit evidence of the availability of the conditions under para 6. The deputy chairman may order the investment intermediary to set up an internal audit department, if the existence of such is needed in view of the nature, scale and complexity of the investment intermediary's business and the nature and range of the performed investment services and activities.

(8) The management body of an investment intermediary shall on an annual basis, by 31st January, review and assess the operation of the internal audit department and shall undertake appropriate measures if it is necessary to improve its activities. Regardless of the requirement under the preceding sentence, the management body shall take appropriate measures to improve the internal audit whenever the need of that is established.

Impact Assessment Analysis Document[1]

Session 2

RIA Execution on FSC regulations

Working Group 1

WG Coordinator: Ms. Petya Nikiforova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8 - Section 2

[1] Based on Draft Impact Assessment Guidelines prepared by CESR, CEBS, CEIOPS

Table of contents
3L3 Impact Assessment Steps

3L3 Impact Assessment Steps

1. Identification of the problem

1.1. Was there a significant market failure and/or regulatory failure and what was its nature?

In our view, the problem being addressed by this regulation is that in the absence of regulatory intervention, it will be difficult for investment firm to monitor the compliance of its activities with regulatory requirements in a proper way and it would lead to:
1. 'Information asymmetry' – there is asymmetric information between consumers and the investment firms about the quality of the investment process. Adequate internal control mechanisms might help to protect consumers, because investment firms have less possibilities to make inappropriate use of their informational advantage.
2. "externality" – Internal control mechanisms can maintain/enhance confidence in the investment sector and the financial system as a whole. However, individual firms may not take into account these impacts on the financial sector when deciding about the extent and quality of internal controls.

In addition, we believe that this is also a case of regulatory failure because the existing regulatory regime is no longer appropriate for the realities - the widened catalogue of the investment and ancillary services and activities requires the introduction of more demanding and detailed internal control requirements for investment firms. The effectiveness of the internal organization is crucial for proper functioning of the investment firm. It is guaranteed by more demanding internal control mechanism..

1.2. If no intervention or further intervention would have taken place, would the market have corrected the failure by itself in the short term?

If no intervention or further intervention would have taken place, we think that the the market would have not corrected the failure by itself in the short term for the following reasons(s): Because of the complexity of the investment firms' activity, it would be difficult for them to ensure proper internal control mechanisms without further regulatory requirements for internal control. Without internal control will be impossible to insure lawful performance of different services and activities with regards to different financial instruments by investment firms.

1.3. What is the evidence that establishes that the market/regulatory failure is significant?

Without new more demanding mandatory internal control regime the unified and reliable fulfilment of the regulatory requirements wouldn't be achieved. Because of the new requirements, applicable for all EU investment firms in respect of their entirely activity, there is no tradition on the Bulgarian market to follow them without particular internal control mechanism. Therefore it establishes serious risk of information asymmetry as well as externality to occur significant market failure. At the same time the existing one is not appropriate compared to the whole diversity of the services and activities regulated and requirements imposed by law, so it evidences for significant regulatory failure.

1.4. Which objective – e.g. market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition - is threatened by the failure?

- **Market integrity** – the performance of the investment and ancillary services and activities by the investment firms in accordance to the law is of great importance for the market integrity
- **Market confidence** –effective and efficient internal control helps investment firms to reduce the possibility of unexpected losses or damage to its reputation. This can enhance the confidence to the market.
- **Consumer protection** - By introducing of the reliable internal control in the investment firm will be ensured higher degree of protection of clients' interests as well as the avoidance of conflicts of interests detrimental for the clients. Generally market intermediaries should conduct themselves in a way that protects the interests of their clients and helps to preserve the integrity of the markets. Compliance with all new financial instruments regulatory requirements is a part of the essential foundation of fair and orderly markets as well as investor protection. It is equally important, however, that firms develop a business conduct that values and promotes not only compliance with the "letter of the law," but also a high ethical and investor protection standard.

2. Definition of policy goals

2.1. General goals[2]

a) **protection of consumers** – by introducing internal control mechanisms we approve the quality of services provided and ensure avoidance in high level of conflict of interests, that may occur in the process of providing different services and by ensuring compliance with other legislative requirements;

b) **financial stability** / proper functioning of financial markets – better functioning of all the investment firms in EU, which is ensured by effective and high requiring internal control mechanisms, is of a great importance for proper functioning of EU financial markets and for financial stabilities on those markets.

2.2. Specific goals[3]

a) **Introducing internal procedures for proper functioning of the internal control** – specific requirements for staff involved in this controlling process – to be independent from particular activity/services it controls; to review regularly (for example at least once a week) the particular activity; to report the fulfillment of its tasks to the management body.

b) **Tailor-made internal control mechanism to the specific characteristics of the investment firm** – Due to the huge variety of investment firms and their businesses the internal control mechanism should be in accordance to the volume of firms' business (with respect to the specific activities and services, financial instruments that it deals with; the structure of the financial group it belongs to and so on);

c) **The internal control mechanism shouldn't be too financial consuming** – the financial resources that the firm have to devote to internal control shouldn't be asymmetric to the needs of the particular firm – they mustn't be either less or too much, just enough for ensuring efficient and effective internal control, achieving the goals, mentioned above;

[2] E*xamples include a- financial stability, b- the proper functioning of markets, and c- consumer protection*

[3] Examples (which link respectively to the general objective examples above) include a- capital adequacy provisions that align the economic and regulatory capital of banks and investment firms, b- disclosure regimes, and c- conduct of business rules.

2.3. Operational goals[4]

a) the procedure for exchange of information between compliance staff and other persons, involved in the provision of investment services and activities to be introduced – for proper functioning of the internal control in the firm, there should be adopted and maintained adequate procedures and mechanisms for the exchange of information between compliance officers and the other stuff of the firm, the compliance officers should have the power necessary for fulfillment of their functions; other stuff should be obliged to cooperate closely with them;

b) adequate remuneration for the compliance officers – the compliance officers should be paid properly in order to be independent in fulfillment of their functions and to be objective in their reports; the remuneration of compliance officers shouldn't depend from the remuneration or the commissions for the other stuff;

c) to ensure an **appropriate allocation** of responsibilities

d) to ensure that **staff have the requisite skills** and are suitable for their tasks and that they have access to the information required to perform their tasks;

e) to ensure that the **risks** inherent in the investment firm's business are **identified and assessed**;

f) to ensure that the **investment firm maintains IT systems that are adequate** with regard to its activities and organized in an appropriate manner.

g) to establish quantitative and qualitative objectives for each part of the investment firm' s activity and to monitor their implementation;

3. Development of "do nothing option"

3.1. Please illustrate how the option to "do nothing" would have looked like?

The introduction of further requirements for investment firms according to the EU standards impose to the investment firms a number of obligations that they have to comply with. "Do nothing" option would mean that for investment firms shall continue to apply the existing internal control regime. This would mean that the internal control in the investment firm will continue to cover the same part of firms' activity, so in the new regulatory reality another part of firms' activity would be dropped out of internal control scope.

[4] Examples (which link respectively to the specific objective examples above) include a- specific rules relating to the use of credit evaluation models, b- rules on the publication of prospectuses, and c- rules setting out specific terms of business requirements

4. Development of alternative policy options

4.1. Please illustrate the option that has been implemented in the Regulation

Item of main actions implemented with regard to internal control	MiFID-compliant rules	Super-equivalent rules
1. The investment firm shall have an internal control department, which operates independently and exercises an ongoing control over and assesses the adequacy and efficiency of the measures and procedures adopted by the firm in order to ensure that the activity of the firm is in accordance with the legislative requirements as well as the actions taken for removal of the inconsistencies in the investment firm's operation with those requirements.	**Art. 6 of implementing directive 2006/73/EC (the directive)**	**No**
2. The internal control department should provide advice and assist the persons responsible for the performed by the investment firm services and activities. The internal control shall be established and realized in accordance with the nature, scale and the complexity of the investment firm's activities, as well as with the type and scope of the performed investment services and activities. The regulation imposes further requirements for the officials from internal control department.	**Art. 6 of the directive**	**No**
3. The internal control shall be established and realized in accordance with the nature, scale and the complexity of the investment firm's activities, as well as with the type and scope of the performed investment services and activities. The regulation imposes further requirements for the officials from internal control department.	**Art. 6, para 1 of the directive**	**No**
4. The regulation imposes further requirements for the officials from internal control department. They shall be entitled to full access to the whole needed information and to all documents, related to the exercising of the internal control.	**Art. 6, para 3 of the directive**	**No**
5. The ordinance requires the internal control department to carry on inspections – weekly, monthly, for ensuring that the activity of the firm is in accordance of regulatory requirements. For those inspections the person in charge of the internal control department shall prepare and present to the management and supervisory body report on the inspections carried out by the internal control	**Art. 6, para 3 of the directive**	**No**

Item of main actions implemented with regard to internal control	MiFID-compliant rules	Super-equivalent rules
department. The report according shall state the irregularities established and the measures undertaken for their elimination, and the adoption of new measures by the management body shall be proposed. The report shall also contain an assessment of the internal organization and internal control system acting in the investment firm.		
6. The management body of the investment firm shall adopt internal control rules, as well as policies and procedures for the establishment of any risk of default on the investment firm's obligations under the MFIA and its implementing instruments and the related risks and adequate measures and procedures for the minimization of these risks, appropriate to the pursued by the investment intermediary business.	**Art. 6, para 1 of the directive**	**No**

4.2. In case that option(s) additional to that one implemented in the Regulation were considered, please illustrate the alternative policy option(s)

Due to the implementation of the EU directive, the possibility for additional options is not applicable.

5. Analysis of impacts (Users)[5]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
5.1. **Costs to consumers**	If firms pass on higher costs of applying effective internal control mechanisms there might be higher commissions for clients	Minor
5.2. **Compliance costs**	Not applicable	
5.3**. Benefits**	The interests of the client are better protected, better conditions for avoiding conflicts of interests detrimental for the clients; reduction of losses associated with operational failure and systematic failure; **The internal control for the compliance with regulatory requirements concerning internal organization and conflict of interests, that have been designed to guarantee the stability of the firms, seems to be additional and important mechanism for better protection of the clients' interests.**	**Major**
5.4. **Quantity of the products**	When firms observe higher internal control requirements they shall better monitor their activities to be performed in accordance with the law, the quality of the products and services offered shall raises. By assuring higher quality of the services more clients will be interested of the products offered by the firm.	**Major**
5.5. **Quality of the products offered**	No applicable	
5.6**. Variety of the products offered**	No applicable	
5.7. **Efficiency of competition**	No applicable	

[5] The table above is drawn from the UK Financial Services Authority

6. Analysis of impacts (Regulated firms)[6]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
6.1. **Direct costs**	FSC should envisage additional resources for: - Preparation and adoption of new regulatory internal control policy; - monitoring whether investment firms comply with internal control requirements; Additional reports, prepared by firms should be scrutinized;	**Minor (please quantify these costs)**
6.2. **Compliance costs**	In our point of view to comply with new internal control requirements firms are likely to face the following costs: 1. Costs for analyses necessary for the introduction of internal control in a correct way (staff-time, one-off cost); 2. Costs for adoption of internal control policy (one-off costs): a) costs for organization of management body meeting for the adoption of the policy b) costs for communicating and and for publication (one-off cost); 3. Establishing an independent internal control department – staff costs: - The firm has to hire staff with the appropriate experience and knowledge (one-off cost for the hiring process and ongoing cost for the salaries) 4. Establishing an independent internal control department – training costs: the firm has to provide financial resources for the education of relevant employees (one-off cost); 5. Operational costs for the internal control department: a) salaries for staff (ongoing costs - see 1.) b) necessary IT hardware and software, office equipment and office materials (ongoing and/or one-off costs) c) costs of external communication with supervisory bodies 6. Operational costs for other departments of the investment firm:	**Major**

[6] The table above is drawn from the UK Financial Services Authority

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	- How much time do other departments have to spend to provide the necessary information for the internal control department (e.g. on site inspections, providing data, preparation of protocols?) (on-going cost); 7. Operational cost for management – - costs for annual review of internal control procedures (on-going cost);	
6.3. Benefits	The good reputation of the firm as reliable counter party will be increased; (Please explain the mechanism and why you think this has a major impact)	Major
6.4. **Quantity of the products offered**	Higher quality of the products and better protection of clients' interests that are ensured by internal control mechanisms leads to the enhancement of the products offered. – if the internal control functioning effectively, the risk for incompatibility with the law will be reduced, it is less probable firm to be fined, so the expenses for firms will be reduced and this will reflect the prices	Major
6.5. **Quality of the products offered**	By applying internal control mechanisms the investment firm will increase the quality of the products it offers (CW: Why? Please explain)	Major ?
6.6. **Variety of the products offered**	The introduction of comprehensive and more demanding internal control ensure objectivity and better protection for clients and will raise good repute of the firm. It is important factor for firm to expand its activity and to offer different products, so the variety of the products will be increased; by this the better choice for consumers will be achieved. Because of the demands of the clients the firm will be interested in the offering of various financial products.	**Major ?**
6.7. **Efficiency of competition**	In respect of internal control for all the investment firms the efficiency of the competition will be increased. the competition between firms will raise, so the price and fees will be reduced; **--** because the new regulatory regime gives the firms	**minor**

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	possibility to decide the structure and organization of the internal control in accordance with firm's organization, complexity and volume of business. If the internal control is better fitted to the specifics of the firm, more competitive the firm will be. - the international perspective: this regulation help to create a level-playing field on the EU-level and thus possibly increase of competition	

Annex – Methodological Section

- **Problem identification**:

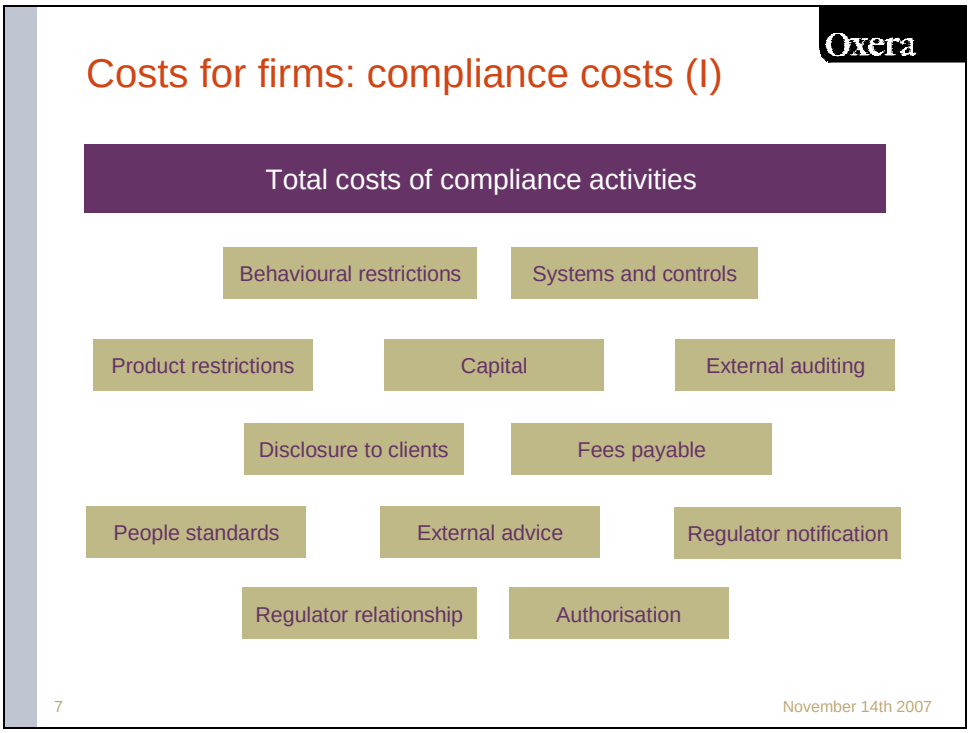
Concepts are explained further in 3L3 Draft *Impact Assessment Guidelines*, at pp. 20-25, Appendix 2 p. 48.

- **Definition of Policy Goals**:

Concepts are explained further in 3L3 Draft *Impact Assessment Guidelines*, at p. 27.

- **Cost and Benefit Analysis**:

The following methodological excerpts by Oxera are also strongly suggested for an effective and systematic approach towards costs and benefits assessment.



Costs for firms: compliance costs (II)

Oxera

Behavioural restrictions | People standards | Systems and controls | Notification | etc

Checking identity of client | Training | Record-keeping | Preparing documents for regulator | Printing and postage | Operating IT systems | Hiring consultants | etc

Incremental costs | Good business practice costs

Incremental costs | Good business practice costs

Total incremental costs of regulation | Total costs of good business practice

Total costs of compliance activities

Types of detrimental market outcomes for consumers

Oxera

Market failures

Risks

Incentive problems

Sub-optimal choice

Reduced choice

Higher costs—from operational risks

Higher costs—from financial risks

Higher costs—from systemic risks

Higher prices—from market power

Higher costs—from transaction inefficiencies

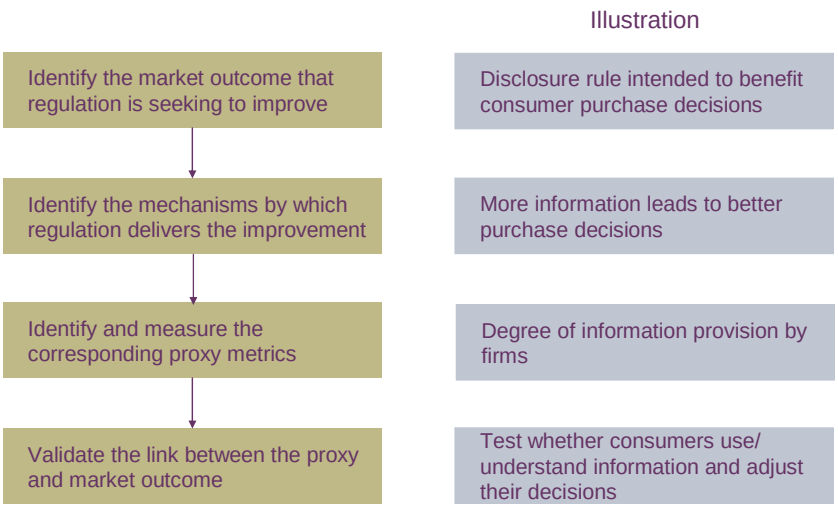
Financial exclusion

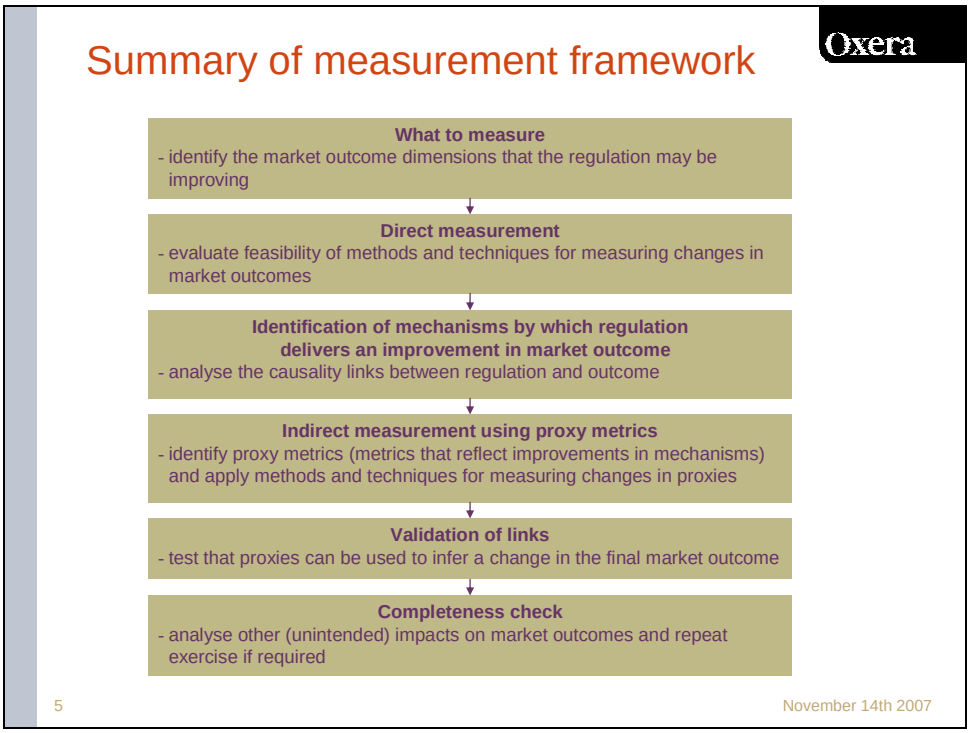
An efficient market may deliver outcomes that are considered 'unfair' from a public policy point of view

Direct measurement of consumer benefits

Type of detrimental market outcome that regulation may improve	Relevant measure of benefit is the **value that consumers derive from …**
Sub-optimal choice	better choice (more optimal fit between what consumers buy and what they need)
Reduced choice	increased choice (wider availability of what consumers need)
Higher costs—operational risks	reduction of losses or other costs associated with operational failure
Higher costs—financial risks	reduction of losses or other costs associated with firm default
Higher costs—systemic risks	reduction of losses or other costs associated with systemic failure
Higher prices—market power	reduction in excessive prices
Higher costs—transaction inefficiencies	reduction in transaction costs, including search costs
Financial exclusion	improved access to financial services

Indirect measurement of benefits (II)





Concepts of cost/benefit assessment are also explained further in 3L3 Draft *Impact Assessment Guidelines*, at pp. 31-34 and in Appendixes 3-4.

Attn:
- Bulgarian National Bank
- Bulgarian Association of Management Companies
- Bulgarian Stock Exchange
- Investment intermediary “Somoni FB”,
- Investment intermediary “Beta corp”
- Investment intermediary “STS Finance”;
- Investment intermediary “Elana trading”

Consultation Questionnaire

Working Group 1

WG Coordinator: Ms. Petya Niciforova (FSC)

Requirements to the activities of investment intermediaries,
Chapter 8
Section II (Internal Control)

Prepared by

WG # 1	***WG Coordinator*** Financial Supervision Commission *Ms. Petya Nikiforova*	Bulgarian National Bank *Mr. Georgi Petkov*	Financial Supervision Commission *Ms. Broyana Dimitrova*	Financial Supervision Commission *Mr. Boyan Dombalov*	Financial Supervision Commission *Ms. Vesela Todorova*	Central Depository AD *Ms. Nadia Daskalova*	Bulgarian Association of Asset Management Companies *Mr. Evgeny Jichev*	Financial Supervision Commission *Mr. Nursen Murad*	Bulgarian National Bank *Mr. Lyubomir Mirchev*	Financial Supervision Commission *Mr. Zhelju Vasilev*

Dear Madame/Sir,

The Bulgarian Financial Supervision Commission together with other entities indicated in the box above are participating in an Impact Assessment (IA) training initiative organized by World Bank administered Convergence Program. The purpose of this initiative is to strengthen our ability to use the disciplines of IA in order to improve the way in which we make policy. IA does this by requiring policy makers to use evidence and economic analysis to justify and explain their proposals. Consultation with stakeholders is a key part of the IA process because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process. The IA training exercise involves us undertaking a retrospective IA on an existing piece of legislation. In this case we are looking at **Ordinance N 38 on the requirements to the activities of investment firms – Chapter 8, Section II (Internal Control) as if it was on draft stage.** We are writing to you in your capacity as one of the key stakeholders affected by this piece of legislation. We have attached to this letter a questionnaire and we would be most grateful if you could arrange for its completion.

The questionnaire is designed to provide us with evidence relating to:
a) the nature of the problem that the regulation was seeking to address and
b) the costs and benefits of the regulation

Once the evidence has been gathered we will complete a final IA report setting out in a clear and transparent fashion what the problem was and why the regulatory response was the best means for addressing the problem. Clearly, since this is a theoretical consultation exercise being undertaken over a shortened period of time, we would not expect you to be able to devote a large amount of resource to this exercise. Nevertheless, we will be following this up with a face-to-face meeting to quality check all stakeholder responses and enhance our understanding of your answers. And, since we do intend to consult with stakeholders in the future, we regard this as a useful exercise for you too, so are looking forward to hearing from you. We very much value your cooperation. If you have any questions regarding this exercise please contact Petya Nikiforova – WG1 group coordinator

We would appreciate having your written response by December 19th 2007 in the morning when we invite you to attend the first round of consultation process as per the agenda that you will receive from FSC .
Then we are also pleased to invite to a more extensive live consultation meeting scheduled in the morning of December 20th.

Yours sincerely,

Petya Nikiforova

ANNEX A: Impact Assessment questionnaire

Section 1: What is the problem?

In this section we consider what the rationale for a particular regulatory intervention might have been.

We are looking at FSC **Ordinance N 38 Chapter 8, Section II (Internal Control) on the requirements to the activities of investment firms**

In our view, the problem being addressed by this regulation is that in the absence of regulatory intervention, it will be difficult for investment firm to monitor the compliance of its activities with regulatory requirements in a proper way and it would lead to:
1. 'Information asymmetry' – there is asymmetric information between consumers and the investment firms about the quality of the investment process. Adequate internal control mechanisms might help to protect consumers, because investment firms have less possibilities to make inappropriate use of their informational advantage.
2. "externality" – Internal control mechanisms can maintain/enhance confidence in the investment sector and the financial system as a whole. However, individual firms may not take into account these impacts on the financial sector when deciding about the extent and quality of internal controls.

In addition, we believe that this is also a case of regulatory failure because the existing regulatory regime is no longer appropriate for the realities - the widened catalogue of the investment and ancillary services and activities requires the introduction of more demanding and detailed internal control requirements for investment firms. The effectiveness of the internal organization is crucial for proper functioning of the investment firm. It is guaranteed by more demanding internal control mechanism.

Question 1: do you agree with us that the problem is as described above?
Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible. For example, what evidence do you think would demonstrate or in fact does demonstrate that there was significant regulatory failure? Do you agree that if the internal control wouldn't be designed as it is proposed, regulatory failure as described above would remain?

_____
_____
_____

If no intervention or further intervention would have taken place, we think that the the market would have not corrected the failure by itself in the short term for the following reasons(s): Because of the complexity of the investment firms' activity, it would be difficult for them to ensure proper internal control mechanisms without further regulatory requirements for internal control. Without internal control will be impossible to insure lawful performance of different services and activities with regards to different financial instruments by investment firms.

Question 2: do you agree with us that about the analysis above?.

Section 2: What are the possible policy solutions?

Given that the domestic regulation under review transposes a Directive, we don't analyse other policy options. The main implementation provisions are broken down taking into account when they strictly comply with MiFID and, if any, when they are super-equivalent.

Item of main actions implemented with regard to internal control	MiFID-compliant rules	Super-equivalent rules
1. The investment firm shall have an internal control department, which operates independently and exercises an ongoing control over and assesses the adequacy and efficiency of the measures and procedures adopted by the firm in order to ensure that the activity of the firm is in accordance with the legislative requirements as well as the actions taken for removal of the inconsistencies in the investment firm's operation with those requirements.	**Art. 6 of implementing directive 2006/73/EC (the directive)**	**No**
2. The internal control department should provide advice and assist the persons responsible for the performed by the investment firm services and activities. The internal control shall be established and realized in accordance with the nature, scale and the complexity of the investment firm's activities, as well as with the type and scope of the performed investment services and activities. The regulation imposes further requirements for the officials from internal control department.	**Art. 6 of the directive**	**No**
3. The internal control shall be established and realized in accordance with the nature, scale and the complexity of the investment firm's activities, as well as with the type and scope of	**Art. 6, para 1 of the directive**	**No**

Item of main actions implemented with regard to internal control	MiFID-compliant rules	Super-equivalent rules
the performed investment services and activities. The regulation imposes further requirements for the officials from internal control department.		
4. The regulation imposes further requirements for the officials from internal control department. They shall be entitled to full access to the whole needed information and to all documents, related to the exercising of the internal control.	**Art. 6, para 3 of the directive**	**No**
5. The ordinance requires the internal control department to carry on inspections – weekly, monthly, for ensuring that the activity of the firm is in accordance of regulatory requirements. For those inspections the person in charge of the internal control department shall prepare and present to the management and supervisory body report on the inspections carried out by the internal control department. The report according shall state the irregularities established and the measures undertaken for their elimination, and the adoption of new measures by the management body shall be proposed. The report shall also contain an assessment of the internal organization and internal control system acting in the investment firm.	**Art. 6, para 3 of the directive**	**No**
6. The management body of the investment firm shall adopt internal control rules, as well as policies and procedures for the establishment of any risk of default on the investment firm's obligations under the MFIA and its implementing instruments and the related risks and adequate measures and procedures for the minimization of these risks, appropriate to the pursued by the investment intermediary business.	**Art. 6, para 1 of the directive**	**No**

Section 3: Cost-Benefit Analysis?

I - Analysis of impacts (Users)

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
1. **Costs to consumers (Here we estimate costs for final investors/clients)**	In our point of view if firms pass on higher costs of applying effective internal control mechanisms there might be higher commissions for clients **Question a):** Do you agree with the analysis above? **Question b):** If you agreed with a), please determine how the new regulatory approach would reflect costs to	**Question c):** If you agree with a), please estimate the extend to which the costs to consumers would be reflected (major, minor)
2**. Benefits**	In our point of view the interests of the client are better protected, better conditions for avoiding conflicts of interests detrimental for the clients; reduction of losses associated with operational failure and systematic failure; The internal control for the compliance with regulatory requirements concerning internal organization and conflict of interests, that have been designed to guarantee the stability of the firms, seems to be additional and important mechanism **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please estimate the benefits for consumers (major, minor)

II - Analysis of impacts (Regulated firms)[1]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
3. **Direct costs (those are costs for the regulator in relation to new regulation)**	**Please determine what kind of costs would occur for the FSC;** (In our point of view FSC should envisage additional resources for: - Preparation and adoption of new regulatory internal control policy; - monitoring weather investment firms comply with internal control requirements; Additional reports, prepared by firms should be scrutinized; **)** **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Please, estimate the costs for FSC (major, minor)** **Question b):** If you agree with question a), please estimate the benefits for consumers (major, minor)
4. **Compliance costs** (Those are costs that would occur for investment firms)	**Question a) – Do you agree with the cost categories for investment firms we have identified?** **Please also state other kinds of costs, which you think will arise to investment firms due to the regulations on internal control.** In our point of view to comply with new internal control requirements firms are likely to face the following costs: 1. Costs for analyses necessary for the introduction of internal control in a correct way (staff-time, one-off cost);	**Question b) –** With regard to Question a), please provide an estimate of the costs previously qualified**:** ***(****Please enter cost items, currency and time horizon and other required figures)*

[1] The table above is drawn from the UK Financial Services Authority

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	2. Costs for adoption of internal control policy (one-off costs): a) costs for organization of management body meeting for the adoption of the policy b) costs for communicating and and for publication (one-off cost); 3. Establishing an independent internal control department – staff costs: - The firm has to hire staff with the appropriate experience and knowledge (one-off cost for the hiring process and ongoing cost for the salaries) 4. Establishing an independent internal control department – training costs: the firm has to provide financial resources for the education of relevant employees (one-off cost); 5. Operational costs for the internal control department: a) salaries for staff (ongoing costs - see 1.) b) necessary IT hardware and software, office equipment and office materials (ongoing and/or one-off costs) c) costs of external communication with supervisory bodies 6. Operational costs for other departments of the investment firm: - How much time do other departments have to spend to provide the necessary information for the internal control department (e.g. on site inspections, providing data, preparation of protocols?) (on-going cost); 7. Operational cost for management – - costs for annual review of internal control procedures (on-going cost);	
5. Benefits	In our point of view the good reputation of the firm as reliable counter party will be increased	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	Question a): Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please estimate the benefits (major, minor)
6. **Quantity of the products offered**	In our point of view higher quality of the products and better protection of clients' interests that are ensured by internal control mechanisms leads to the enhancement of the products offered. – if the internal control functioning effectively, the risk for incompatibility with the law will be reduced, it is less probable firm to be fined, so the expenses for firms will be reduced and this will reflect the prices **Question a):** Do you agree that internal control mechanisms will enable you to offer a higher quantity of products? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please estimate to what degree the quantity of the products would be effected (major, minor)
6.5. **Quality of the products offered**	In our point of view by applying internal control mechanisms the investment firm will increase the quality of the products it offers **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please estimate to what degree the quality of the products would be effected (major, minor)
6.6. **Variety of the products offered**	In our point of view the introduction of comprehensive and more demanding internal control ensure objectivity and better protection for clients and will raise good repute of the firm. It is important factor for firm to expand its activity and to offer different products, so the variety of the products will be increased; by this the better choice	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	for consumers will be achieved. Because of the demands of the clients the firm will be interested in the offering of various financial products. **Question a):** Do you think that applying more comprehensive internal control will give you the ability to offer a wider variety of products? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please, estimate the degree to which the variety would be affected (major, minor)
6.7. **Efficiency of competition**	In our point of view in respect of internal control for all the investment firms the efficiency of the competition will be increased. the competition between firms will raise, so the price and fees will be reduced; -- because the new regulatory regime gives the firms possibility to decide the structure and organization of the internal control in accordance with firm's organization, complexity and volume of business. The better the internal control is better fitted to the specifics of the firm, the more competitive the firm will be. **Question a):** Do you think internal control mechanisms have an impact on competition between investment intermediaries? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with question a), please, estimate the degree to which the efficiency of competition would be affected (major, minor)

ANNEX B: Some assessment criteria for costs and benefits

Costs may be assessed using such distinctions as:

• **Fixed costs** are costs which do not vary with output. In the long run, all costs can be considered variable;
• **Variable costs** are costs which vary directly with the output. Variable costs are associated with productive work, and naturally rise and fall with business activity.

• **Set-up (or one-off) costs** are costs which are incurred at the beginning of a project only;
• **On-going costs** are costs which are incurred again and again during a project or an investment. Usually set-up costs are very large in comparison to ongoing costs each time the latter occur.

Benefits may be assessed using one of the following techniques:

• **Comparison to a relevant historical case**: In many cases, an incident or series of incidents over time will be part of the reason to regulate. In order to make an estimate of the expected benefits, the losses in a number of historical cases can be used as an indicator for how much of the loss could have been prevented through the proposed regulation;
• **Evaluation by a proxy**: This approach uses observable variables which are linked to the unobservable variable - e.g. when there exists a known correlation structure - or focuses on simulations of the unobservable variable;
• **Use of a break-even approach**: The third possible approach is what can be called the break-even approach. This approach consists of calculating the amount of benefit needed - for example a reduction in loss needed - to cover the costs incurred, which are quantifiable. With this approach, the loss prevention is separated into the risk of loss and the extent of loss which allows one to capture the impact on the market. The potential loss for each market participant and the risk that a market participant will actually suffer loss are then estimated. It will then be possible to determine by how much the loss, risk of loss or a combination of these elements needs to be reduced in order to cover the costs of regulations and supervision. For this break-even assumption, one can examine whether this would be a realistic expectation. The impact of incidents can often be estimated with the help of event studies. The significance of the impact of incidents can be calculated and an estimate of the extent can be given. In the break-even approach, one can calculate by how much the risk of an incident must be reduced in order to cover the costs.

Source: CESR-CEBS-CEIOPS, Impact Assessment Guidelines, May 2007.

Summary of Questionnaire Results

Working Group 1

WG Coordinator: Ms. Valya Niciforova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8 – Section II (Internal Control)

Section	Question	Consulted stakeholders		
1 - What is the problem		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1	The existing internal control mechanism is functioning well, but there is kind of regulatory/market failure	Yes, there is regulatory/market failure	There is market failure.
	2	Market has partially already corrected the market failure – there is adequate self regulation	The small companies are not self regulated, only large companies are self regulated	But not the internal control would solve the problem /asymmetry of information, externality, Market can address this failure;
2 – Policy solutions				
3 - CBA - Users	1 – a	Yes, this would increase the costs	Yes, this would increase the costs	Yes, this will increase the costs
	1 – b	By increasing the amount of the commission fees;	By increasing the amount of the commission fees;	By increasing the amount of the commission fees and dividends for shareholders;
	1- c	Minor	Minor	Major - each branch will be obliged to have internal control officer;
	2 – a	Yes	Yes	Yes
	2 – b	Major	Major	Major
3- CBA – Regulated firms	3			
	4 – a	Yes – there would be one-off and on-going costs for salaries;	Yes	Yes
	4 - b	Higher for small firms;	Major For operational costs – 5 %; On-going costs will be higher;	1-3 % on going costs for headquarters; 6-12% for branches;
	5 – a	Yes	Yes	Yes
	5 – b	Major	Major	Minor the market place doesn't price the quality of internal control system;
	6 – a	Yes	Yes	No
	6 – b	Major	Minor	
	7 – a	Yes	Yes	Yes
	7 – b	Major	In between Major- Minor	Minor
	8 – a	Yes	Yes	No – initially, but depends on the kind of client

	8 – b	Minor	Minor	Minor
	9 - a	Yes	Yes	Yes
	9 - b	Minor	Minor – will increase the competition between big companies, but will put out of the market small firms;	Minor will increase the competition between big companies, but will put out of the market small firms;

Policy Options – Consultation Document

Working Group 1

WG Coordinator: Ms. Petya Niciforova (FSC)

Requirements to the activities of investment intermediaries,
Chapter 8
Section II (Internal Control)

Section 1: What is the problem?

All stakeholders agree with problem identification. One of them expresses doubt whether the internal control provisions can address this.

One s. proposes to highlight among the problem identification “the consumer protection”

Question: do you think consumers were adequately protected by the previous regulation on internal control?

Question: to what extent you have already in place a mechanism similar to that set by the provisions (i.e. market-drive solutions). Please give evidence.

Section 2: What are the possible policy solutions?

Question: how do you assess consumer protection is addressed with the new set of provisions?

Question: the very critical point that arose from stakeholders feedback is that referring to the compliance of internal control experts pertaining to branches. It seems that this provision is really cumbersome. In case the presence of internal control officers in each branch is eliminated, could you provide evidence of how the Ordinance objectives could be fulfilled? Which feasible alternative solutions do you propose?

Question: There are not policy alternatives since it is a directive transposition but some issues could arise about alternative follow-up implementation steps that could be taken (e.g. self-regulation initiative).Could you please tell more about this and to what extent this relates to this debate? Firms are free to chose how to achieve the objectives. Is this fine?

Section 3: Cost-Benefit Analysis?

I - Analysis of impacts (Users)

costs

Question: what percentage(s) – in terms of business economics - do you thing will be increased due to the translation of incremental costs to consumers?

Benefits

Unanimity about the relevant positive impact to consumers.

II - Analysis of impacts (Regulated firms)

Compliance costs:

Question: the regulation envisages some precise compliance costs (e.g. internal control officer per branch). On the other hand the existence of internal control deparments were already established (due to previous regulation). Could you please define more precisely which additional costs (and their magnitude) will be stemming from this specific regulation?

(Question: How many transactions per year? …)

Benefits:

Question: Could you be more specific on how this could be beneficial?

Question: how does your firm prevent that the internal control may protect the investment intermediary from its misconduct of its employees?

Question: does this mechanism set by the provisions under discussion could prevent misconduct by clients?

Quantity of products offered

Question: for those that affirmed the positive impact, could you please explain more precisely why and through which mechanism?

Quality of products offered

Question: for those that affirmed the positive impact, could you please explain more precisely why and through which mechanism?

Question: have you noticed the decrease in customer complaints since the regulation was enacted?

Variety of products offered:

Question: which kind of products could benefit from this regulation?

Efficiency of competition:
Question: how many firms do you think will close down because of this regulation? How many firms will need to get restructured to face the cumbersome compliance rule requiring one internal control officer per branch?

Question: Do you think that there will be large efficiency gains from restructuring?

Summary of Consultation Feedback

Working Group 1

WG Coordinator: Ms. Petya Niciforova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8 – Section II (Internal Control)

Section 1: What is the problem?

All stakeholders agree with problem identification. One of them expresses doubt whether the internal control provisions can address this.

1 Question: do you think consumers were adequately protected by the previous regulation on internal control? In what way the new regulation is better than the previous version

Section	Question					
1 - What is the problem		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"	Investment intermediary "STS Finance"	Investment intermediary "Elana trading"
	1			New regulation reiterates the internal control function		

2 Question: do you think the new regulation is clear about the duties of firms regarding internal control?

Section	Question					
1 - What is the problem		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"	Investment intermediary "STS Finance"	Investment intermediary "Elana trading"
	2	New regime is an upgrade of the previous one. Step forward. Better definition of duties of compliance officers.		The new one is not burdensome on a daily routine. Problem are compliance officers in each branch. Activities costs much more		

3 Question: to what extent did you have already in place an internal control mechanism similar to that set by the provisions (i.e. market-driven solutions)? Please give evidence.

Section	Question					
1 - What is the problem		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"	Investment intermediary "STS Finance"	Investment intermediary "Elana trading"
	3			Outsourced the legal transposition of the regulation. Apart the legal aspects, everything else was already in place		

Section 2: What are the possible policy solutions?

1.Question: how do you assess consumer protection is addressed with the new set of provisions?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"	Investment intermediary "STS Finance"	Investment intermediary "Elana trading"
	1	The new regime can take benefit from international persperctive (both for the investment firms both for consumers)	It is preferable that regulation (even though a flexible one) takes care of consumer protection			

The very critical point that arose from stakeholders feedback is the necessity of having internal control experts in each branch. It seems that this provision is really cumbersome.

2. Question In case the presence of internal control officers in each branch is eliminated, could you provide evidence of how the Ordinance objectives could be fulfilled? Which feasible alternative solutions do you propose? [art 76 – (4)]

There are not policy alternatives since it is a directive transposition but some issues could arise about alternative follow-up implementation steps that could be taken (e.g. self-regulation initiative).

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"	Investment intermediary "STS Finance"	Investment intermediary "Elana trading"
	2	Outsourcing this activity to external entities. The drawback is about the confidentiality of information		Alternatives: - a branch internal officer controlling the near-by branches or having a "mobile squad" responsible for several branches; - software platform sending scanned documents; -scanning documents in pdf file and send them to the hq; - division of labour between hq (periodical work) and the branch (day-to-day activity) (or having sb to co-authorize);		

Section 3: Cost-Benefit Analysis?

I - Analysis of impacts (Users)

Costs

1.Question: what percentage(s) of the additional (incremental) cost of the new regulation can you pass on to the customers?

Section	Question			
		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1			Difficult to say. Maybe in the long run, business model will change and intermediaries will charge for advisory services. However, it is not clear if this will be related to this new set of regulation.

Benefits

Unanimity about the relevant positive impact to consumers.

II - Analysis of impacts (Regulated firms)

Compliance costs:

Question: In many firms internal control departments were already established (due to previous regulation). Could you please define more precisely which additional costs (and their magnitude) are due to the **new** regulation on internal control (e.g. internal control officer per branch, hiring other staff, training costs, IT costs, etc.)?

Section	Question			
		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1	Minor impact		Additional burden is not significant, apart from the provision on internal control officer per branch

Benefits:

1.Question: Could you be more specific on how this could be beneficial?
2.**Question**: Do the new internal control mechanisms protect investment intermediaries better from misconduct of its employees?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	2	Internal control mechanisms significantly reduce the risk for misconducts		In principle the internal control function should reduce the risk of misconduct. In practice there are some criticalities, mainly the internal control officer has not the knowledge that the (controlled) financial analyst/ salesperson has

3Question: Do the new internal control mechanisms help you to detect misconduct by clients?

4Question: Have you noticed the decrease in customer complaints since the regulation was enacted?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	4	FSC (as addressee of customer complaints): not possible yet, time since implementation is too short		

Quantity of products offered

Question: For those that affirmed the positive impact, could you please explain more precisely why the quantity of products will be higher? Through which mechanism does this occur?

Quality of products offered

Question: For those that affirmed the positive impact, could you please explain more precisely why the quality of products will be higher? Through which mechanism does this occur?

Question: have you noticed a decrease in customer complaints since the regulation was enacted?

Variety of products offered:

Question: For those that affirmed the positive impact, could you please explain more precisely why the variety of products will be higher? Through which mechanism does this occur? Which kind of products will be affected?

General comment on the questions relating to quantity, quality and variety of products:

There is a general sense that the regulations are beneficial (increased trust, confidence, possibly more demand for higher-risk investment products, etc.). However, it is difficult to assess which part of this is due to the regulations on internal control, internal audit and risk management or if this is due to the implementation of MiFID as a whole.

Comment from Beta Corp: In their opinion for investment intermediaries 95% of the change is market driven issue, only 5% are driven by MiFID/Ordinance 38.

Efficiency of competition:

Question: how many firms do you think will close down because of this regulation? How many firms will need to get restructured to face the cumbersome compliance rule requiring one internal control officer per branch?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1		1-2%: out of the market; 20%-restructuring.	It depends on the enforcement of the regulation by FSC. It's difficult to say.

Question: Do you think that there will be large efficiency gains from restructuring?

Suggestions for policy recommendations

1. The FSC monitors the status of implementation of the rules (looking specifically at the potential identified problems: compliance officers for each branch). Dialogue with firms is necessary for that.
2. The FSC monitors the number of complaints which relate to this regulation.
3. The FSC monitors the market structure of the investment intermediaries market (i.e. how many firms go out of the market, how many firms enter the market)
4. If the FSC thinks after a certain (1 year?) that the implementation is not going smoothly, the FSC could suggest to:
   - Allow firms to use e.g. “mobile squads” of compliance officers or to have one compliance officer who is responsible for several branches;.
   - This could be done either via FSC guidance or via revision of the Art. 76(4) of Ordinance 38;
   - It is important that the market participants should be consulted.

Financial RIA Capacity Building Program in Bulgaria

Policy Recommendations

Working Group 1

WG Coordinator: Ms. Petya Niciforova (FSC)

Requirements to the activities of investment intermediaries, Chapter 8 Section II (Internal Control)

EXECUTIVE SUMMARY

The World Bank administered Convergence Program has organized in 2007/2008 in Bulgaria a knowledge transfer and capacity building program, designed to help participants from various regulation and supervision authorities to get acquainted with the basics of Regulatory Impact Assessment (RIA).

After an introductory session, where presentations were made by experienced speakers from EU authorities and their consultants, participants joined in Working Groups (WG) and they took part in a training exercise, designed to develop basic skills in undertaking a RIA.

Working Group 1, consisting of representatives from (pls insert) has chosen to set up an ex-post RIA on an existing piece of legislation, **Ordinance No. 38 on the requirements to the activities of investment intermediaries, Chapter 8, Section II (Internal Control)**. The group identified categories of key stakeholders that are affected by this regulation, then they were contacted and a consultation was organized (written questionnaire and face-to face interviews.)

Under the guidance of experts from the World Bank Convergence Programme and facilitators, the WG performed the main steps recommended by the Impact Assessment Guidelines for EU Level 3 Committees jointly issued by CESR, CEBS and CEIOPS in May 2007, drafting the suitable documents related to each step.

These documents included:

- a consultation document;
- a summary of consultation feedback; and finally
- a policy recommendations document.

The present document is a summary of all the activities described, and it ends with policy recommendations based on the Impact Assessment.

PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

This document is the outcome of an Impact Assessment (IA) knowledge transfer and capacity building program organized by the World Bank administered Convergence Program. The participants of the Working Group are representatives of Bulgarian authorities involved in regulation of financial markets issues (pls insert).

The IA training exercise was undertaking a retrospective IA – ex-post RIA - on an existing piece of legislation, **Ordinance No. 38 on the requirements to the activities of investment intermediaries, Chapter 8, Section II (Internal Control)**. After discussions some categories of key stakeholders were identified as being affected by this piece of legislation.

Consultation with stakeholders is a key part of the IA process, because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process. The Working Group has conducted a stakeholder consultation. They have designed an explanatory cover letter and a questionnaire, which were sent to a set of selected stakeholders.

The questionnaire was designed to provide evidence relating to:

a) the nature of the problem that the regulation was seeking to address, and

b) the costs and benefits of the regulation and of two alternative policy options that in theory could have been chosen instead of it, thus recognizing the fact that in a "live" IA exercise different policy responses could be considered to address the same policy problem.

Stakeholders were also asked to help after the questionnaire-answering phase was completed by attending a face-to-face meeting to quality check all stakeholder responses and enhance the WG's understanding of their answers.

After reception of answers from stakeholders, a summary of questionnaire results was drafted, then these were processed into a consultation document. The consultation document, including more in-depth issues that were raised during the meeting with stakeholders, became the basis for drafting a summary of consultation feedback, which was used in its turn as the underlying evidence for this report, summarizing all findings gathered during the process.

PROBLEM IDENTIFICATION

Investment firms should conduct their business in a way that protects the interest of consumers and fosters the integrity and efficient operation of the markets. Compliance with the regulatory framework is clearly central to meeting this goal.

In our view, the problem being addressed by this regulation is that in the absence of regulatory intervention, it will be difficult for investment firm to monitor the compliance of its

activities with regulatory requirements in a proper way. This would be detrimental to consumers, as there is asymmetric information between consumers and investment firms. It could also have negative impacts on market confidence, as the misbehaviour of individual firms could also damage the reputation of the market as a whole (negative externality).

In addition, we believe that this is also a case of regulatory failure because the existing regulatory regime is no longer appropriate for the realities - the widened catalogue of the investment and ancillary services and activities requires the introduction of more demanding and detailed internal control requirements for investment firms. The effectiveness of the internal organization is crucial for the proper functioning of an investment firm. Internal control mechanism are an important part of that.

Stakeholders were asked to provide answers to the following questions:

Question 1: Do you agree with us that the problem is as described above and with the analyzes provided? Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible. For example, what evidence do you think would demonstrate or in fact does demonstrate that there was significant regulatory failure? Do you agree that if the internal control wouldn't be designed as it is proposed, regulatory failure as described above would remain?

Question 1.1: Do you think consumers were adequately protected by the previous regulation on internal control? In what way the new regulation is better than the previous version

Question 1.2: do you think the new regulation is clear about the duties of firms regarding internal control?

Question 2: If no intervention or further intervention would take place, would the market have corrected the failure by itself in the short terms?

Question 3: to what extent did you have already in place an internal control mechanism similar to that set by the provisions (i.e. market-driven solutions)? Please give evidence.

Feedback from consulted stakeholders: Consulted stakeholders believe that there is market failure, but part of them consider that the market would be able to correct this itself in the future. Due to the previous regulatory regime all the firms already had internal control departments. With respect to small firms all the stakeholders agreed that those firms will not be able to regulate themselves. One shareholder believes that the new regime is a step forward compared with the previous one as the duties of compliance officers are defined more clearly. However, the new regulation requires a dedicated compliance officer in each branch of the intermediary, which is very costly.

Our response: In our point of view we should adopt this new regulation because it concerns the interest of the clients and we have evidence from regulating investment firms that that some of the firms are not willing to maintain proper internal control without particular regulatory requirements to do so. In 2007, 90 penalties to investment firms have been imposed concerning breaches of the requirements of Ordinance N 1 on the requirements to the

activities of investment intermediaries and 10 complaints have been made by clients or potential clients against investment intermediaries.
Furthermore the rules should be equivalent for all the participants in the market, so there should be a comprehensive internal control regime for all the investment firms. The new rules address the specific situation of small firms.
We will address the comment on the costs of having compliance officers in each branch in the cost and benefit section of this document.

OBJECTIVES / GOALS

General objectives

- **protection of consumers** – Amending internal control mechanisms should help to improve consumer protection in two ways: it should help to avoid conflicts of interests, that may occur in the process of providing different services and should help to ensure compliance with other legislative requirements. As a result the quality of services provided should be improved.

- **Proper functioning of financial markets / financial stability** – high and effective internal control standards are important for proper functioning of EU financial markets and for financial stability

Specific / Operational objectives

- **Introducing internal procedures for proper functioning of the internal control** – We identified the following requirements for staff involved in this controlling process to achieve this objective: to be independent from the activity/services it controls; to review regularly (for example at least once a week) the particular activity; regular reporting of its activities to senior management.

- **Tailor-made internal control mechanism to the specific characteristics of the investment firm** – Due to the huge variety of investment firms and their businesses the internal control mechanism should be in accordance to the volume of firms' business (e.g. with respect to the specific activities and services, the financial instruments that it deals with, and the structure of the financial group it belongs to)

POLICY OPTIONS

The Ordinance N 38 introduces into Bulgarian legislation requirements of Directive 2006/ 73 EK, implementing MiFID, so we are obliged to adopt such a regulation and in this case "do nothing option" is not applicable.

In our questionnaire we asked stakeholders about their views on the implementation of internal control procedures in Ordinance 38. Stakeholders seemed to have a problem with the requirement to have a dedicated compliance officer in each branch. We followed this up in our stakeholder consultation meeting.

Question 1: How do you assess consumer protection is addressed with the new set of provisions?

Question 2: In case the presence of internal control officers in each branch is eliminated, could you provide evidence of how the Ordinance objectives could be fulfilled? Which feasible alternative solutions do you propose?

Feedback from consulted stakeholders: Stakeholders appreciated that the new regulatory regime is beneficial both for firms and for their clients, who are better protected. On the other hand they consider that the requirement for permanent presence in each branch or office of internal control officer is too burdensome and suggested alternative mechanisms aimed at ensure the fulfillment of all the requirements of the Ordinance concerning the activity of the investment firm and the responsibility of internal control function. Alternative mechanisms could include a internal compliance officer responsible for several branches or having a "mobile squad" responsible for several branches. One stakeholder also suggested a division of labor between the headquarters (periodical work) and the branches (day-to-day activity).

Our response: We accept the suggestions for alternative solutions with respect to internal control function and the requirement mentioned above concerning the presence of internal control officer in each branch and office.

ANALYSIS OF QUALITATIVE AND QUANTITATIVE IMPACT

Costs

Costs to the regulator – direct costs

The direct costs will consist of:

- Preparation and adoption of new regulatory internal control policy;
- monitoring whether investment firms comply with internal control requirements;
- Additional reporting provided by firms has to be analyzed

We expect these costs to be of minor significance.

Costs to regulated firms – compliance costs

We identified the following categories of compliance costs related to internal control procedures:

One-off costs:

- Costs for analyses on how to implement the rules on internal control, e.g. development of policy and procedures, communication of the rules, management time (staff-time/salaries)
- Costs for hiring staff with appropriate experience and knowledge (one-off cost for the hiring process)
- Training costs for the employees on the new rules

- Costs new IT systems and other office equipment (if applicable)

Ongoing costs:

- Salary for employees
- Other ongoing costs for the operation of the department (e.g. software license, office material, etc.)
- Time other departments have to spend to deal with internal control issues
- Management time – Time for dealing with internal control issues on an ongoing basis as well as costs for reviewing and assessing the rules for internal compliance

Stakeholders were asked the following questions concerning costs due to internal control mechanisms by WG1:

Question 1: Do you agree with the costs categories for investment firms?

Question 2: Can you give cost estimates? In many firms internal control departments were already established (due to previous regulation). Could you please define precisely which additional costs (and their magnitude) are due to the **new** regulation on internal control (e.g. internal control officer per branch, hiring other staff, training costs, IT costs, etc.)?

Feedback from consulted stakeholders: Participants considered that there will be mainly one-off cost initially and on-going costs for internal control officers' salaries. Those costs will be higher for small firms and higher for branches than for headquarters. Generally, the additional burdens for firms with respect to new regime have been considered as not significant. However, there is one specific issue: The requirement to have a dedicated compliance officer in each branch of the investment firms. This is considered as very costly and overly burdensome.

Stakeholders agreed that his new regime will significantly reduce the risks of misconducts. It was noticed that is still early to be made observance over clients' claims.

Our response: Apart from the costs due to the requirement of dedicated compliance officers in each branch, we think that he costs that firms will face are not significant. Compared to benefits they are worth to be made.
We will look in more detail at the requirement of dedicated compliance officers for each branch. Apart from that, we don't consider there is need for change for the rules on internal compliance.

Costs to consumers

Consumers potentially face the risk that firms pass on higher costs for internal control mechanisms to them. Stakeholders said, that apart from the requirement on compliance officers for each branch, additional costs are not significant. This also limits the risk of higher prices/commissions for consumers.

Benefits

WG1 asked stakeholders about the potential impact of the new rules on internal control on the variety, quality and quantity of products offered. Concerning the quality of the service, we also analyzed whether the number of customer complaints has decreased since the regulation was enacted.

Feedback from consulted stakeholders relating to quantity, quality and variety of products:

There is a general sense that the regulations are beneficial (increased trust, confidence, possibly more demand for higher-risk investment products, etc.). However, it is difficult to assess which part of this is due to the regulations on internal control, internal audit and risk management or if this is due to the implementation of MiFID as a whole.

One stakeholder specifically commented that in their opinion for investment intermediaries 95% of the change is market driven issue, only 5% are driven by MiFID/Ordinance 38.

Our response:

Feedback from stakeholders confirmed the regulation suggested as beneficial. We cannot draw any conclusions on the customer complaints at the moment, as the time since the implementation of Ordinance 38 is too short.

At this stage we consider here is no need to change our policy with this respect. In the future we will continue to observe the impact of the regulation and if necessary will make some amendments.

Efficiency of competition:

We asked the stakeholders the following question concerning efficiency of competition

Question 1: How many firms do you think will close down because of this regulation? How many firms will need to get restructured to face the cumbersome compliance rule requiring one internal control officer per branch?

Feedback from consulted stakeholders: It was suggested that in the future the new regulatory regime will cause restructuring of the market. A small number of firms is likely to be forced out of the market. A significant number of firms (possibly 20 %) of the firms will have to restructure their business due to the requirement of having an internal control officer in each branch.

Our response: On this stage we consider here is no need to change our policy with respect to competion issues. In the future we will continue to observe the impact of the regulation and if necessary will make some amendments.

COMPARISON OF THE OPTIONS

This is an ex-post Regulatory Impact Assessment and deals with the implementation of an EU directive. Therefore we didn't compare different regulatory options.

POLICY RECOMMENDATIONS

The working group identified one particular issue in the implementation of internal control mechanisms: the requirement of having a dedicated internal control officer in each branch of an investment intermediary. Stakeholders described this requirement as very costly and overly burdensome.

Based on this observation, our **general policy recommendations** with respect to internal control mechanisms are as follows:

1. The FSC monitors the status of implementation of the rules (looking specifically at the identified problem: compliance officers for each branch). The monitoring could include documentary and on-site inspections, monitoring of market behaviour of investment intermediaries. Dialogue with firms is necessary and it will be maintained by public consultation initiatives, round tables, seminars and other.
2. The FSC monitors the number of complaints which relate to this regulation.
3. The FSC monitors the market structure of the investment intermediaries market (i.e. how many firms go out of the market, how many firms enter the market)
4. If the FSC thinks after a certain period (e.g. 1 year) that the implementation is not going smoothly, the FSC could suggest to:
   - Alleviate the burden related to the requirement of compliance officers in each branch. This could be achieved by either allowing firms to use e.g. “mobile squads” of compliance officers or to have one compliance officer who is responsible for several branches.
   - This could be done either via FSC guidance or via revision of Art. 76(4) of Ordinance 38.
   - It is important to consult with market participants in this process.

Impact Assessment Analysis Document[1]

Session 2

RIA Execution on FSC regulations

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries,
Chapter 8 – Sections 3-4

[1] Based on Draft Impact Assessment Guidelines prepared by CESR, CEBS, CEIOPS

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3L3 Impact Assessment Steps

3L3 Impact Assessment Steps

1. Identification of the problem

1.1. Was there a significant market failure and/or regulatory failure and what was its nature?

Please state which potential market failures / regulatory failures MiFID and specifically the rules for internal audit and risk management address (see page 20/21 and 48-52 of the CESR Impact Assessment guide)

(The question about the significant market failure is connected with the problematical discussion, concerning the different aspects of the risk management and its reflections on the future development of the intermediaries. The principal scope of the Art.82 of the Bulgarian Ordinance № 38 is to oblige the participants in the investment intermediary business to define the frontiers of their actions, regarding the fulfilment of the accepted orders, taking into account the distinguishing between the big and small intermediaries and the grade of their capacity to support an eventual negative, resulted from successless market actions. We are of the opinion, that a new market must be protected not only in the state level, but also through the own initiative of the persons, interested in its increasing and in such way to give them possibility to create impediments for undertaking of imprudent risks in the portfolios management.) --> this does not answer the question

Regulatory failure

Common market – the absence of common rules has caused obstacles for the development of the common financial market. The introduction of the MiFid has solved this problem.

The Bulgarian Markets in Financial Instruments Act provides protection of the investors in financial instruments, which premises previous ensuring of the level of their knowledge about the nature of the financial instruments market;

The creation of prerequisites for the development of a fair, transparent and efficient financial instruments market;

The notion of the market failure includes asymmetric information to be on hand, as far as it regards investors' knowledge about the financial instruments market, which exercises an influence over the process of making individual decisions.

The intermediaries in the different Member states deliver different information as a content and scope.

Question 1: Do you agree with our statement about the regulatory and market failure solved by MiFID?

1.2. If no intervention or further intervention would have taken place, would the market have corrected the failure by itself in the short term?

The Bulgarian capital market is a new one, and this is the reason, that it could not be considered as experienced in the matter of solving the disruptive processes, as far as they concern the stability of the not professional clients and the dimensions of their eventual damages.

Especially with respect to the big (with full license) intermediaries, the irregular management of their internal processes and especially the false defining of the operational and market risks could conduce to damages for their financial status and to influence the market stability and confidence of the investors.

~~The absence of special rules in regard to the regulatory intervention would cause as consequence the further operation of the small (with limited license) intermediaries, because their existence couldn't be considered as a material systematic risk for the financial market in a case of failure and they wouldn't cause big disruption in the credence of the investors.~~

This is a dangerous statement. You effectively say that having small firms in the market is not efficient (which normally is not true).

The both problems mentioned above could not be solved by the intermediaries in a short time, without a regulatory intervention and only as a result of the competition and informational exchange between the associations of the intermediaries' firms.

Question 2 **:** Do you think that the regulatory and market failure caused before introducing of the MiFID regulation could not have been corrected by themselves without any intervention ?

1.3. What is the evidence that establishes that the market/regulatory failure is significant?

Please argue (on a general level) whether the market failures/regulatory failures identified in 1.1 are significant.

The rules, concerning the process of creating of prerequisites for a fair, transparent and efficient market of financial instruments are orientated to the harmonization of the operating requirements for all of the investment firms, which includes conduction of business rules and has as scope to provide a high-level protection for the investors.

(The aim of the norm in Ordinance № 38 is to prevent the appearance of market disruptions. The Bulgarian legislator has followed the content of the Directive, trying to implement their provisions in the Bulgarian law, having taken into account a bit of the own experience. We are persuaded that these rules are necessary and useful for the further development of the business of the investment intermediaries and the non banking financial market.)

--> This is not related to question 1.3, but actually is a good introduction for question 2.1,

1.4. Which objective – e.g. market integrity, market confidence, consumer protection, facilitating innovation, enhancing competition - is threatened by the failure?

The rules about the management of the operational, financial and market risks mentioned above, are of big importance for the consumer protection and for the increasing of the investors' confidence.

(In fact, the common rules are to be regarded as necessary for the enhancing competition too.) (you should only state that if you come to the conclusion below in 5.7 and 6.7 that the rules on internal audit and risk management have a positive effect on competition)

The introduction of the common rules, concerning the risk management and the internal audit results in the upholding of the integrity of the whole European Financial Market.

In regard of our market, these rules contribute for the facilitating innovation of the Bulgarian market.

2. Definition of policy goals

2.1. General goals[2]

The aim of the norm in Ordinance № 38 is to prevent the appearance of market disruptions. The Bulgarian legislator has followed the content of the Directive, trying to implement their provisions in the Bulgarian law, having taken into account a bit of the own experience. We are persuaded that these rules are necessary and useful for the further development of the business of the investment intermediaries and the non banking financial market.

The stability, the transparency and the credibility of the financial markets, as well the protection of the investors' interests and the insured persons are the principal objectives of the FSC strategy.

Please state which of these goals (and how) the rules on internal audit and risk management might help to achieve.

The risk management and the internal audit are the necessary conditions for the financial stability and the credibility of the financial markets.

Its scope is also to contribute for the economic growth and for reaching a high rate of employment on national level .

can internal audit and risk management rules really help to achieve that?

The enlargement of the existing business conduces to the employing of new workers and office – employees and to the emergence of new business activities in different areas. It corresponds to the principle "stabile credence – bigger consumption – economical increasing".

[2] E*xamples include a- financial stability, b- the proper functioning of markets, and c- consumer protection*

2.2. Specific goals[3]

The specific goals are such type of aims, connected to or deriving from the principles, on which the market policy is built. They should be achieved in a cost-efficient manner, thus conserving the equilibrium between costs and benefits. ~~(to try to avoid the hyper indebtedness of the intermediaries~~).
The following four groups of goals are the most important:

- amelioration of the internal organization;
- defining of the personal responsibilities of the investors' employees;
- avoiding of conflicts of interests;
- giving a better definition of the risks and their reflection.

2.3. Operational goals[4]

- Establishing and introducing of common rules regarding the risk management and containing policy and procedures, which identify the risks relating to the investment intermediary's activities and including mechanisms for exercising control over the adequacy and efficiency of the policy procedures;

- Increasing of the investment intermediaries' risk management, creating internal audit department and creating a risk-management department – an internal unit or an external company to estimate customer and financial instruments related risks.

[3] Examples (which link respectively to the general objective examples above) include a- capital adequacy provisions that align the economic and regulatory capital of banks and investment firms, b- disclosure regimes, and c- conduct of business rules.
[4] Examples (which link respectively to the specific objective examples above) include a- specific rules relating to the use of credit evaluation models, b- rules on the publication of prospectuses, and c- rules setting out specific terms of business requirements

3. Development of “do nothing option”

3.1. Please illustrate how the option to “do nothing” would have looked like?

(In the hypothesis of the “do nothing” option, the absence of special rules in regard to the regulatory intervention would cause as consequence the further operation of the small intermediaries, because their existence couldn’t be considered as a material systematic risk for the financial market in the case of failure and they wouldn’t cause big disruption of the credence of the investors.)

--> This is a dangerous statement. You effectively say that having small firms in the market is not efficient and not a good thing (which generally is not true).

please describe here what the regulations on internal audit and risk management would have been without implementing MiFID.

The rule about the risk management has been implemented as a requirement of the Directive about the capital adequacy from 1.01.2007.

The internal audit contributes to the overview of the internal rules and procedures and gives ideas for the improvement of the market’s functioning. Before the implementation of the MiFID in the Bulgarian legislation, this activity has been realized by the company’s managing bodies and not on regulated basis.

In the case of "doing nothing", as far as it concerns the big intermediaries, the irregular management of their internal processes and especially the false defining of the operational and market risks could conduce to big damages for their financial status and for the market stability and confidence of the investors.

Question 3: Would the self regulation of the investment intermediaries be effective? And would it have solved the failure in short terms?

.

4. Development of alternative policy options

4.1. Please illustrate the option that has been implemented in the Regulation

Establishing and introducing of common rules regarding the risk management and containing policy and procedures, which identify the risks relating to the investment intermediary's activities and including mechanisms for exercising control over the adequacy and efficiency of the policy procedures.

Increasing the investment intermediaries' risk management, creating internal audit department and creating a risk-management division – an internal unit or an external company to estimate customer and financial instruments related risks.

4.2. In case that option(s) additional to that one implemented in the Regulation were considered, please illustrate the alternative policy option(s)

~~In certain cases the small intermediaries could not create departments for internal audit and risk management.~~

Not relevant here, as an EU directive is implemented.

It concerns the possibility to introduce either the internal audit, or the risk management.

5. Analysis of impacts (Users)[5]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
5.1. **Costs to consumers**	If firms pass on higher costs of applying internal audit and risk management mechanisms, there would appear a risk of increasing of charges for the clients.	minor
5.2. **Compliance costs**	There are not any.	
5.3**. Benefits**	More investors and retail clients will purchase investment services as their trust in the investment intermediaries will rise. --> can you give an indication whether this will have significant or only minor impacts?	major high quality of the service
5.4. **Quantity of the products**	**See 5.3** It won't reflect on the variety of the products, but it will concern the number of the offered services.	minor
5.5. **Quality of the products offered**	~~Portfolio management by investment intermediaries will become a more secure and widespread investment opportunity. (please explain why)~~ --> this sits better under regulated firms Improving the quality of the products.	major
5.6**. Variety of the products offered**	The variety of the products offered would aggrandize on the applying of the MiFID basis. The market same and the free offering of diverse services, without the requirement to be occupied simultaneously of the both activities of the risk management and the internal audit would contribute to it.	minor

[5] The table above is drawn from the UK Financial Services Authority

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
5.7. **Efficiency of competition**	The common rules for all investment intermediaries will lead to the enhancing competition please explain why you think this is so The introduction of common rules and a single passport will allow investment intermediaries to provide their services on the single EU market. New intermediaries will appear on the home market in every EU country which lead to increasing the competition between Home member firms and other passporting EU firms.	major

Question 4: Do you think that the new implemented provisions can bring additional expenses to the consumers?

Question 5: Do you think that there are some benefits for clients? Do the introduction of these rules will have impacts on the consumers' behaviour?

Question 6: Do you think that the new provisions will impact on quantity/number of sold services ?

6. Analysis of impacts (Regulated firms)[6]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
6.1. **Compliance costs**	- setting up a new risk management department (salary for employees, cost for the maintain working place, training for employees, fixed overheads, cost for buying and introducing a new electronic	Major for the big one with complex business

[6] The table above is drawn from the UK Financial Services Authority

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	system) - setting up a new internal audit department (salary for employees, cost for the maintain working place, training for employees, fixed overheads) - appointing new staff in the above; - development of the policy and procedures under art. 82 (salary for employees, fixed overheads) - developing of the mechanisms for exercising control (salary for employees, fixed overheads) - creating internal rules for proceeding the risk management department (salary for employees, fixed overheads) - exercising the control in according with these mechanisms, preparing the monthly reports for department's activities (salary for employees, fixed overheads - reviewing and assessing the rules for risk management by management body on a quarter basis (salary for management body and fixed overheads) - developing of the internal rules for proceeding the internal audit department (salary for employees, fixed overheads per person) - exercising the audit (a plan for auditing, preparing recommendations, preparing the monthly reports for department's activities (salary for employees, fixed overheads per person, training, preparing information system) - reviewing and assessing the proceeding of the internal audit department by management body on annual basis (salary for management body and fixed overheads) Above mentioned costs depend on the nature, scale and complexity of the business	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	of the investment intermediaries. Same costs they may decrease by using the developed common policy and procedures by association of the investment intermediaries for example.	
6.2. **Direct costs**	If the association of the investment intermediaries decides to develop common rules for managing risks and internal audit – examining/considering these rules by the regulator, discussing with the association (salary for employees within the regulator, fixed overheads per person) - developing a manual for ongoing and periodical supervision by the regulator (salary for employees, fixed overheads per person) - costs for compliance inspection (salary for employees, fixed overheads per person, costs for business trip if the investment intermediary has seat out of the capital) - costs for enforcement, investigation, sanction, administrative procedures (salary for employees, fixed overheads per person)	
6.3. Benefits	Better internal organization of the business can lead to a decrease of operational and market risks (what do you mean with market risks? Please explain) associating with activities of the investment intermediaries; --> can you give an indication whether this will have significant or only minor impacts?	major
6.4. **Quantity of the products offered**		

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
6.5. **Quality of the products offered**	Portfolio management by investment intermediaries will become a more secure and widespread investment opportunity. (please explain why) The applying of the rules about the risk management as far as it concerns the own portfolio reflects on the financial stability of the intermediary. Through the optimizing of the operational risk will be realized the amelioration of the quality of the products offered.	
6.6. **Variety of the products offered**		
6.7. **Efficiency of competition**	The incremental costs associated with applying these new rules will affect a restriction to the business of the small intermediaries because of the high costs and will improve the environment for the pursuing of the activities of the other participants. (what does this mean? Does that mean that there are less firms in the market? This would be detrimental to competition! As a result of the market competition the incomes and also the price of the service will be minimized as a consequence of it. The conservation of the price and the increasing of the costs at the same time would result in the failure of the small market participants in a short period and in the diminishing of the number of the market participants as whole.	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)

Question 7 : Do you think that there are other benefits for investment intermediaries then the below mentioned which have not been considered? Please suggest!

Question 8: Do you think that provisions about risk management and internal audit will increase costs incurred by investment intermediaries? Please provide an approximate values of the below itemized cost categories!

Question 9: Are there any indirect costs to intermediaries in your opinion?

Impact Assessment Questionnaire is a consultation paper between us and the the investment intermediaries which are not credit institutions.

Annex – Methodological Section

- **Problem identification**:

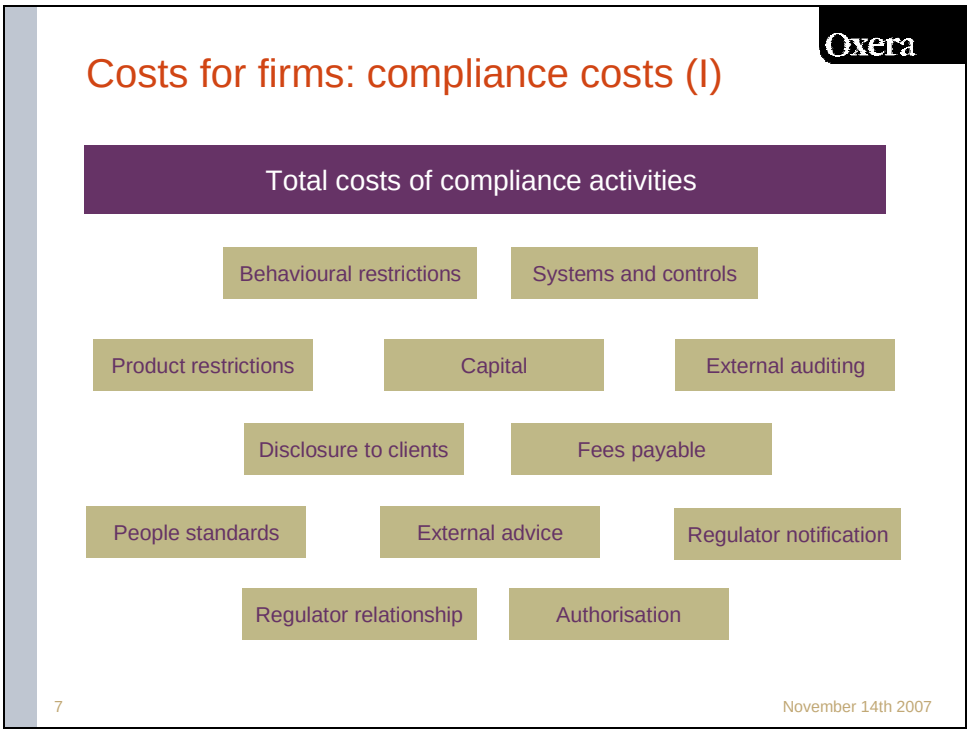
Concepts are explained further in 3L3 Draft *Impact Assessment Guidelines*, at pp. 20-25, Appendix 2 p. 48.

- **Definition of Policy Goals**:

Concepts are explained further in 3L3 Draft *Impact Assessment Guidelines*, at p. 27.

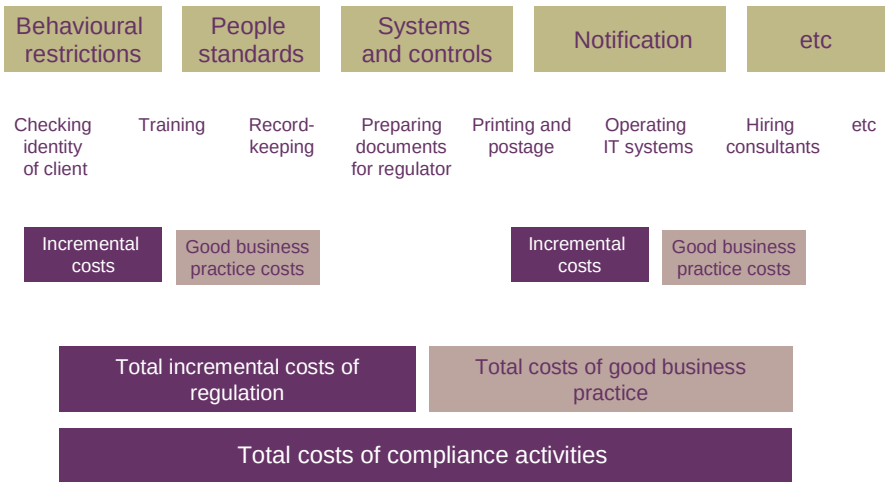
- **Cost and Benefit Analysis**:

The following methodological excerpts by Oxera are also strongly suggested for an effective and systematic approach towards costs and benefits assessment.



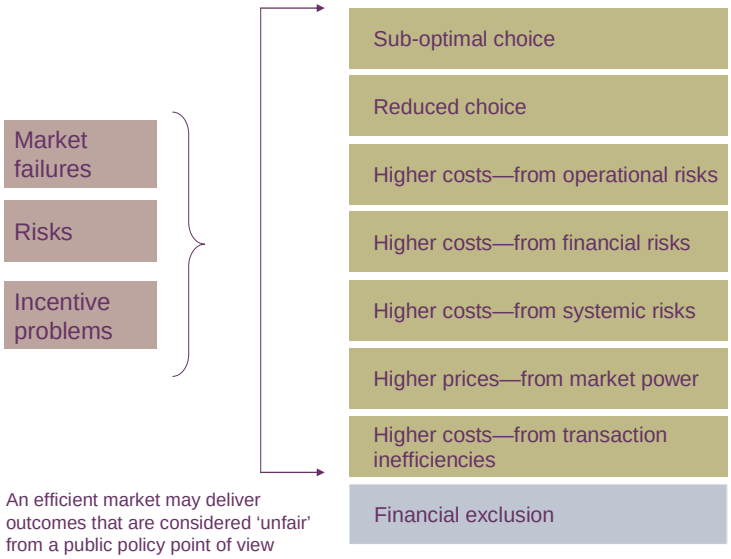
Costs for firms: compliance costs (II)

Oxera



Types of detrimental market outcomes for consumers

Oxera

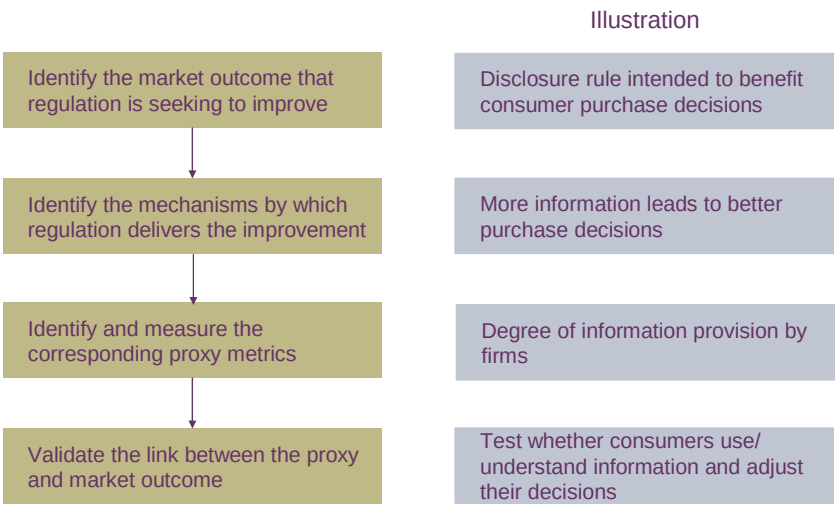


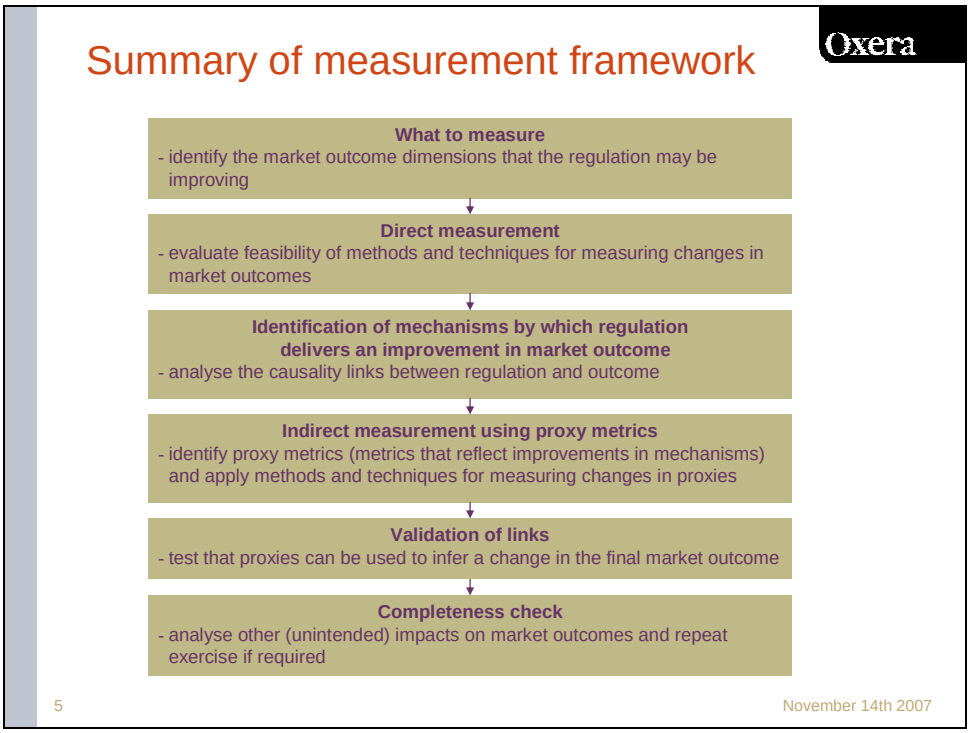
An efficient market may deliver outcomes that are considered 'unfair' from a public policy point of view

Direct measurement of consumer benefits

Type of detrimental market outcome that regulation may improve	Relevant measure of benefit is the **value that consumers derive from …**
Sub-optimal choice	better choice (more optimal fit between what consumers buy and what they need)
Reduced choice	increased choice (wider availability of what consumers need)
Higher costs—operational risks	reduction of losses or other costs associated with operational failure
Higher costs—financial risks	reduction of losses or other costs associated with firm default
Higher costs—systemic risks	reduction of losses or other costs associated with systemic failure
Higher prices—market power	reduction in excessive prices
Higher costs—transaction inefficiencies	reduction in transaction costs, including search costs
Financial exclusion	improved access to financial services

Indirect measurement of benefits (II)





Concepts of cost/benefit assessment are also explained further in 3L3 Draft *Impact Assessment Guidelines*, at pp. 31-34 and in Appendixes 3-4.

Attn:
- Bulgarian National Bank
- Bulgarian Association of Management Companies
- Bulgarian Stock Exchange
- Investment intermediary “Somoni FB”
- Investment intermediary “Beta Corp”
- Investment intermediary “STS Finance”;
- Investment intermediary “Elana Trading”

Consultation Questionnaire

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8
Section III (Risk Mangement), Section IV (Internal Audit)

Prepared by

WG # 2	***WG Coordinator*** Financial Supervision Commission *Ms. Valentina Stefanova*	Financial Supervision Commission *Ms. Lidiya Valchovska*	Bulgarian Stock Exchange-Sofia *Mr. Ivo Stankov*	Financial Supervision Commission *Ms. Tzveta Grigorova*	Association of Banks in Bulgaria *Ms. Irina Kazandjieva*	Financial Supervision Commission *Mr. Julian Razpopov*	Financial Supervision Commission *Ms. Suzana Kapsazova*	Financial Supervision Commission *Mr. Vladimir Karamfilov*	Financial Supervision Commission *Mr. Damyan Staykov*	Ministry of finance *Ms. Denitza Markova*

Dear Sir,
The Bulgarian Financial Supervision Commission together with other entities indicated in the box above are participating in an Impact Assessment (IA) training initiative organized by World Bank administered Convergence Program. The purpose of this initiative is to strengthen our ability to use the disciplines of IA in order to improve the way in which we make policy. IA does this by requiring policy makers to use evidence and economic analysis to justify and explain their proposals. Consultation with stakeholders is a key part of the IA process because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process. The IA training exercise involves us undertaking a retrospective IA on an existing piece of legislation. In this case we are looking at **Ordinance N 38 on the requirements to the activities of investment firms – Chapter 8, Section III (Risk Management) and Section IV (Internal Audit) as if it was on draft stage.** We are writing to you in your capacity as one of the key stakeholders affected by this piece of legislation. We have attached to this letter a questionnaire and we would be most grateful if you could arrange for its completion.

The questionnaire is designed to provide us with evidence relating to:
a) the nature of the problem that the regulation was seeking to address and
b) the costs and benefits of the regulation

Once the evidence has been gathered we will complete a final IA report setting out in a clear and transparent fashion what the problem was and why the regulatory response was the best means for addressing the problem. Clearly, since this is a theoretical consultation exercise being undertaken over a shortened period of time, we would not expect you to be able to devote a large amount of resource to this exercise. Nevertheless, we will be following this up with a face-to-face meeting to quality check all stakeholder responses and enhance our understanding of your answers. And, since we do intend to consult with stakeholders in the future, we regard this as a useful exercise for you too, so are looking forward to hearing from you. We very much value your cooperation. If you have any questions regarding this exercise please contact …..

We would appreciate having your written response by December 19th 2007 in the morning when we invite you to attend the first round of consultation process as per the agenda that you will receive/have already received from FSC .
Then we are also pleased to invite to a more extensive live consultation meeting scheduled in the morning of December 20th.

Yours sincerely,

NAME ….

ANNEX A: Impact Assessment questionnaire

Section 1: What is the problem?

In this section we consider what the rationale for a particular regulatory intervention might have been.

We are looking at FSC **Ordinance N 38 Chapter 8, Section III (Risk Management) and Section IV (Internal Audit) on the requirements to the activities of investment firms**

There is asymmetric information between consumers and the investment firms about the quality of the investment process. Especially with respect to the big (with full license) intermediaries, the irregular management of their internal processes and especially the false defining of the operational and market risks could damage their financial status and have a negative impact on market stability and investor confidence.

In our view there is also a regulatory failure related to a level-playing field for investment intermediaries in the EU Common Market. The absence of common rules for investment intermediaries has caused obstacles for the development of the common financial market. The introduction of the MiFid is a prerequisite for the development of a fair, transparent and efficient financial instruments market;

Question 1: do you agree with us that the problem is as described above?
Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible. For example, what evidence do you think would demonstrate or in fact does demonstrate that there was significant regulatory failure? Do you agree that if the internal control wouldn't be designed as it is proposed, regulatory failure as described above would remain?

_____
_____
_____

If no intervention or further intervention would have taken place, we think that the the market would have not corrected the failure by itself in the short term for the following reasons(s):
In our opinion the Bulgarian capital market is a new one, and this is the reason, that it could not be considered as experienced in the matter of solving disruptive processes, as far as they concern investor protection and market confidence.

Question 2: **do you agree with us that about the analysis above?.**

_____
_____
_____

Section 2: What are the possible policy solutions?

Given that the domestic regulation under review transposes a Directive, we don't analyse other policy options. The main implementation provisions are broken down taking into account when they strictly comply with MiFID and, if any, when they are super-equivalent.

Item of main actions implemented with regard to internal control	MiFID-compliant rules	Super-equivalent rules

Section 3: Cost-Benefit Analysis

I - Analysis of impacts (Users)

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
1. **Costs to consumers**	In our point of view, if firms pass on higher costs of applying internal audit and risk management mechanisms, there would be a risk of increasing of charges for the clients. **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b):** If you agree with a), please estimate the extend to which the costs to consumers would be reflected (major, minor)
2**. Benefits**	We think that more investors and retail clients will purchase investment services as their trust in the investment intermediaries will rise. **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible* -	**Question b):** If you agree with question a), please estimate the benefits for consumers (major, minor)

II - Analysis of impacts (Regulated firms)[1]

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
3. **Direct costs**	Cost items: – examining/considering these rules by the regulator, discussing with the association (salary for employees within the regulator, fixed overheads per person) - developing a manual for ongoing and periodical supervision by the regulator (salary for employees, fixed overheads per person) - costs for compliance inspection (salary for employees, fixed overheads per person, costs for business trip if the investment intermediary has seat out of the capital) - costs for enforcement, investigation, sanction, administrative procedures (salary for employees, fixed overheads per person)	
4. **Compliance costs**	**Question a)** – Do you agree with the cost categories for investment firms we have identified here below? Please also state other kinds of costs, which you think will arise to investment firms due to the regulations on internal control. Rules on risk management: 1. Costs for analyses on how to implement the rules on risk management, e.g. development of policy and procedures under Art. 82 and creating the internal rules (one-off costs, staff-time/salaries, salaries should always include fixed overhead costs) 2. Costs for setting up a new risk management department (if applicable):	**Question b) –** With regard to Question a), please provide an estimate of the costs previously qualified**:** ***(****Please enter cost items, currency and time horizon and other required figures)* 1) first full year 2) over 5- year horizon

[1] The table above is drawn from the UK Financial Services Authority

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	a) hiring staff with appropriate experience and knowledge (one-off cost for the hiring process) b) the firm has to provide training for the employees on the new rules (one-off costs), c) cost for buying and introducing a new electronic system and other office equipment (one-off costs) 3. Ongoing costs of the risk management department: a) salary for employees (ongoing costs) b) other ongoing costs for the operation of the departement (e.g. software licences, office material, …), 4. Operational cost for management: -Costs for reviewing and assessing the rules for risk management by management body on a quarterly basis (salary for management body, ongoing costs) Rules on internal audit: 5. Costs for analyses on how to implement the rules on internal audit (developing the mechanisms, creating the internal rules 6. Costs for setting up a new internal audit department (if applicable): a) hiring staff with appropriate experience and knowledge (one-off cost for the hiring process) b) the firm has to provide training for the employees on the new rules (one-off costs), c) cost for buying and introducing a new electronic system and other office equipment (one-off costs) 7. Ongoing costs of the internal audit department: a) salary for employees (ongoing costs) b) other ongoing costs for the operation of the department (e.g. software licences, office material, …) 8. Operational cost for management: -Costs for reviewing and assessing the rules for internal audit by management body on an annual	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	basis (salary for management body, ongoing costs) General: - The costs described above depend on the nature, scale and complexity of the business of the investment intermediaries. We will ask in section 7. about the potential impact on small investment intermediaries. - The costs may decrease by using the developed common policy and procedures provided by the association of the investment intermediaries. Do you agree with that? If you have used this common policy, can you please give an estimate how much costs this has saved you?	
5. Benefits	In our point of view, there will be major benefits as better internal organization of the business can lead to a decrease of operational and market risks (what do you mean with market risks? Please explain) associating with activities of the investment intermediaries. Applying these rules can lead to better reputation for an investment firm and to greater confidence in the market as a whole. **Question a):** Do you agree with the analysis above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	**Question b) –** With regard to Question a), please provide an estimate of the costs previously qualified**:** ***(****Please enter cost items, currency and time horizon and other required figures)* 1. first full year 2. over 5- year horizon
6. **Quality of the products offered**	We are of the opinion that portfolio management by investment intermediaries will become a more secure and widespread investment opportunity. This is because the applying of the rules about the risk management as far as it concerns the own portfolio reflects on the financial stability of the	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)
	intermediary. Through the optimizing of the operational risk will be realized the amelioration of the quality of the products offered. **Question a):** Do you agree that risk management and internal audit mechanisms will enable you to offer a higher quality of products as stated above? *Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	
7. **Efficiency of competition**	It is possible that the incremental costs associated with applying these new rules are more difficult to bear for small intermediaries. Ultimately this could force small intermediaries to close down their business. In the longer run this could lead to a lower number of market participants, which could be detrimental to competition. **Questions:** **a)** Do you think small firms are more affected by the implementation and ongoing costs of the rules on risk management and internal audit than large firms? b) How do you think competition will be affected by the rules on risk management and internal audit? *Please explain your answers, including evidence (or suggesting the type of evidence that would be relevant) where at all possible*	

Benefits & Costs	Qualitative description	Quantitative description (e.g. major, minor)

ANNEX B: Some assessment criteria for costs and benefits

Costs may be assessed using such distinctions as:

• **Fixed costs** are costs which do not vary with output. In the long run, all costs can be considered variable;
• **Variable costs** are costs which vary directly with the output. Variable costs are associated with productive work, and naturally rise and fall with business activity.

• **Set-up (or one-off) costs** are costs which are incurred at the beginning of a project only;
• **On-going costs** are costs which are incurred again and again during a project or an investment. Usually set-up costs are very large in comparison to ongoing costs each time the latter occur.

Benefits may be assessed using one of the following techniques:

• **Comparison to a relevant historical case**: In many cases, an incident or series of incidents over time will be part of the reason to regulate. In order to make an estimate of the expected benefits, the losses in a number of historical cases can be used as an indicator for how much of the loss could have been prevented through the proposed regulation;
• **Evaluation by a proxy**: This approach uses observable variables which are linked to the unobservable variable - e.g. when there exists a known correlation structure - or focuses on simulations of the unobservable variable;
• **Use of a break-even approach**: The third possible approach is what can be called the break-even approach. This approach consists of calculating the amount of benefit needed - for example a reduction in loss needed - to cover the costs incurred, which are quantifiable. With this approach, the loss prevention is separated into the risk of loss and the extent of loss which allows one to capture the impact on the market. The potential loss for each market participant and the risk that a market participant will actually suffer loss are then estimated. It will then be possible to determine by how much the loss, risk of loss or a combination of these elements needs to be reduced in order to cover the costs of regulations and supervision. For this break-even assumption, one can examine whether this would be a realistic expectation. The impact of incidents can often be estimated with the help of event studies. The significance of the impact of incidents can be calculated and an estimate of the extent can be given. In the break-even approach, one can calculate by how much the risk of an incident must be reduced in order to cover the costs.

Source: CESR-CEBS-CEIOPS, Impact Assessment Guidelines, May 2007.

Summary of Questionnaire Results

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries,
Chapter 8
Section III (Risk Mangement), Section IV (Internal Audit)

Section	Question	Consulted stakeholders		
1 - What is the problem		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1	It's necessary to reduce the asymmetry. On the other hand, there will be a duplication in the functions of the internal audit and the internal control. It's important that the self – regulation is given as a possibility.	The regulation is flexible. The risk management is more focused on the companies' side. It must be focused on the both of them.	Each of them is a different institution. There is no point to separate the internal audit and the internal control. The asymmetry is in an acceptable band.
	2	Yes.	Yes.	We don't need a regulatory intervention. At least a part of the market has already addressed the risk management issue (setting up risk profile solutions).
2 – Policy solutions				
3 - CBA - Users	1 – a	Yes.	Yes.	Yes.
	1 – b	Minor.	Minor.	Minor for big and major for small firms.
	1- c			
	2 – a	Yes.	Yes.	Yes.
	2 – b	Minor. (net benefit).	Minor (small net benefit).	Minor (negligible net benefit)
3- CBA – Regulated firms	3			
	4 – a	Yes.	Yes.	Yes.
	4 - b	Major costs.	Major costs.	2500 – 5000 Euro for the internal risk regulation as legal advise and between 7000 – 13000 Euro good training. For the software solution between 3.5-

				7.5 000. In total the burden will be insignificant – about 3-7% continuous operational costs 100% increasing investment.
	5 – a		Yes.	Insignificant for the first year and more significant for the next years.
	5 – b		Minor.	
	6 – a		Positive effect for the internal audit and risk management.	Positive in regard to the risk management.
	6 – b		Minor in the short and major in the long.	Initially minor and afterwards major.
	7 – a		The competition between the big companies will increase and will throw out of the business the small companies.	Yes. Negative impact and HHI increase.
	7 – b			
	8 – a			
	8 – b			

Policy Options – Consultation Document

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries,
Chapter 8
Section III (Risk Mangement), Section IV (Internal Audit)

Section 1: What is the problem?

Question: which risk management mechanism was already in place before the new regulation was introduced? Can you please specify?

Question: which functions of internal control/internal audit overlap? How do you suggest to deal with that?

Question: on which basis/parameters do you think that the informational asymmetry was at an acceptable level before the new regulation was enacted? Which level would be unacceptable?

Section 2: What are the possible policy solutions?

Question: Do you think that consumer protection is adequately addressed with the new set of provisions?

There are not policy alternatives since it is a directive transposition but some issues could arise about alternative follow-up implementation steps that could be taken (e.g. self-regulation initiative).

Question: Did you find the guidance prepared by the Bulgarian Association of Asset Management Companies helpful? Do you generally think guidance provided by the industry is good way to regulate a market?

Section 3: Cost-Benefit Analysis?

I - Analysis of impacts (Users)

Costs

Question: what percentage(s) of the additional (incremental) cost of the new regulation can you pass on to the customers?

Question: Does your firm plan to inform the customers of the **new** risk management mechanism?

Question: Does your firm plan to inform the customers about the incremental benefits arising from complying with the regulation?

II - Analysis of impacts (Regulated firms)

Compliance cost:

Question: Could you please define more precisely which additional costs (and their magnitude) are due to the **new** regulation on risk management and internal audit (e.g. hiring new staff, training costs, IT costs, etc.)?

Question (to firms): do you use the implementation guidance prepared by the Bulgarian Association of Asset Management Companies (BAAMC)?

Question (to firms): Has the Guide helped to reduce implementation costs?

Question (to BAAMC): have you a sense of savings the code has produced to the whole industry?

Question (to BAAMC): How much did it cost to the association to produce the guide?

Benefits:

Question: could you please specify more in detail through which mechanism your firm will benefit from this regulation?

Question: Through which figure could you measure the benefit? (e.g. more product sales, higher profit margins, less complaints)

Question:
Do you think that complying with risk management provisions could bring a competitive advantage to the firm?
(please provide evidence on increase in clients, higher demand for asset management services..)

Which percentage of this advantage is due to higher trust/better reputation?

Quality of the products offered:

Question: For those that affirmed the positive impact, could you please explain more precisely why the quality of products will be higher? Through which mechanism does this occur?

Efficiency of competition:

Question: how many (small) firms do you think will close down because of this regulation? How many other firms will need to get restructured to face the new regulation?

Question: How much do you think that international competition will increase because of MiFID overall?

Summary of Consultation Feedback

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8 – Section III (Risk Mangement), Section IV (Internal Audit)

Section 1: What is the problem?

1.Question: which risk management mechanism was already in place before the new regulation was introduced? Can you please specify?

Question			
	Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
1			Risk management is not only the compliance part but also the clients in the portfolio mgmnt in terms of risk. This rules address certain issues about large exposures, specific risk concentration. We had already in place a questionnaire to clients. Things brought by the new regulation: format of the contract, inclusion in the contract of the type of product

2.Question: which functions of internal control/internal audit overlap? How do you suggest to deal with that?

Question			
	Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
2		In general it is not necessary to have two different departments	Having two separate departments for internal control is a huge burden (also compared to banks which have both functions included in one division → suggestion of "2 in 1" solution, having one department responsible for internal control and internal audit

Section 2: What are the possible policy solutions?

Question: Do you think that consumer protection is adequately addressed with the new set of provisions?

There are not policy alternatives since it is a directive transposition but some issues could arise about alternative follow-up implementation steps that could be taken (e.g. self-regulation initiative).

2.Question: Did you find the guidance prepared by the Bulgarian Association of Asset Management Companies helpful? Do you generally think guidance provided by the industry is good way to regulate a market?
→ see section on compliance costs

Section 3: Cost-Benefit Analysis?

I - Analysis of impacts (Users)

Costs

1Question: what percentage(s) of the additional (incremental) cost of the new regulation can you pass on to the customers?

Section	Question			
		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1			Not too much at this stage

2Question: Does your firm plan to inform the customers of the **new** risk management mechanism?

3Question: Does your firm plan to inform the customers about the incremental benefits arising from complying with the regulation?

Section	Question			
		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	2			It is a difficult task. At this stage this kind of communication is difficult.
	3			It's hard to sell this at the moment

II - Analysis of impacts (Regulated firms)

Compliance cost:

1Question: Could you please define more precisely which additional costs (and their magnitude) are due to the **new** regulation on risk management and internal audit (e.g. hiring new staff, training costs, IT costs, etc.)?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1			Costs for legal advice: 2500-5000 Euro are for Ordinance 38 as a whole. Training costs: 7000 – 13000 Euros: Mainly for risk management; not that much for internal audit Software costs: - 3.500 – 7.000 Euros - 4 people * 1 week each Approximately 90% of these costs were due to the new regulations. Implementation of new rules (Ordinance 38 / Mifid as whole: - risk and compliance officer spends 6 months on new regulation - The regulations on internal control, internal audit and risk management possibly account for 15-20% of these costs.

2Question (to firms): do you use the implementation guidance prepared by the Bulgarian Association of Asset Management Companies (BAAMC)?

3Question (to firms): Has the Guide helped to reduce implementation costs?

4Question (to BAAMC): have you a sense of savings the code has produced to the whole industry?

5Question (to BAAMC): How much did it cost to the association to produce the guide?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	2			No, Beta Corp. have not used it
	3			Not applicable here, as code was not used
	4	Most of the members have adopted the code. Savings in as "in house" legal assistance, Overall savings difficult to quantify		
	5	10 people*3meetings*1 Full-Time-Equivalent (FTE)+preparatory interim work		

Benefits:

General comment on the questions relating to benefits:
There is a general sense that the regulations are beneficial (increased trust, confidence, possibly more demand for higher-risk investment products, etc.). However, it is difficult to assess which part of this is due to the regulations on internal control, internal audit and risk management or if this is due to the implementation of MiFID as a whole.

Question could you please specify more in detail through which mechanism your firm will benefit from this regulation?

Question: Through which figure could you measure the benefit? (e.g. more product sales, higher profit margins, less complaints)

Question:
Do you think that complying with risk management provisions could bring a competitive advantage to the firm?
(please provide evidence on increase in clients, higher demand for asset management services..)

Which percentage of this advantage is due to higher trust/better reputation?

Quality of the products offered:

Question: For those that affirmed the positive impact, could you please explain more precisely why the quality of products will be higher? Through which mechanism does this occur?

Efficiency of competition:

1.Question: how many (small) firms do you think will close down because of this regulation? How many other firms will need to get restructured to face the new regulation?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	1		1-2%: out of the market; 20%-restructuring.	It depends on the enforcement of the regulation by FSC. It's difficult to say.

2. Question: How much do you think that international competition will increase because of MiFID overall?

		Bulgaria Association of Asset Management Companies	Central Depositary	Investment intermediary "Beta corp"
	2	We expect an increase in competition. Foreign firms already have applied for membership in the BAAMC. BAAMC is considering this.		We expect foreign competition. It takes time to have large western competitors entering the market because it is still small to date. We think 2-3 foreign competitors will enter.

Suggestions for policy recommendations

1. The FSC monitors the status of implementation of the rules (looking specifically at the potential identified problems: overlap of internal audit and internal control). Dialogue with the firms is necessary for that.
2. The FSC monitors the number of complaints which relate to this regulation.
3. The FSC monitors the market structure of the investment intermediaries market (i.e. how many firms go out of the market, how many firms enter the market)
4. If the FSC thinks after a certain (1 year?) that the implementation is not smoothly, the FSC could suggest to:
   - Allow firms to combine their independent internal audit and internal control departments into 1 independent department.
   - It is important that the market participants should be consulted

Financial RIA Capacity Building Program in Bulgaria

Policy Recommendations

Working Group 2

WG Coordinator: Ms. Valentina Stefanova (FSC)

Requirements to the activities of investment intermediaries
Chapter 8
Section III (Risk Mangement), Section IV (Internal Audit)

EXECUTIVE SUMMARY

The World Bank administered Convergence Program has organized in 2007/2008 in Bulgaria a knowledge transfer and capacity building program, designed to help participants from various regulation and supervision authorities to get acquainted with the basics of Regulatory Impact Assessment (RIA).

After an introductory session, where presentations were made by experienced speakers from EU authorities and their consultants, participants joined in Working Groups (WG) and they took part in a training exercise, designed to develop basic skills in undertaking a RIA.

Working Group 2, consisting of representatives from (pls insert) has chosen to set up an ex-post RIA on an existing piece of legislation, **Ordinance No. 38 on the requirements to the activities of investment intermediaries, Chapter 8, Section III and IV (Risk Management and Internal Audit)**. The group identified categories of key stakeholders that are affected by this regulation, contacted them and organized a consultation (written questionnaire and face-to face interviews).

Under the guidance of experts from the World Bank Convergence Programme and facilitators, the WG performed the main steps recommended by the Impact Assessment Guidelines for EU Level 3 Committees jointly issued by CESR, CEBS and CEIOPS in May 2007, drafting the suitable documents related to each step.

These documents included:

- a consultation document;
- a summary of consultation feedback; and finally
- a policy recommendations document.

The present document is a summary of all the activities described, and it ends with policy recommendations based on the Impact Assessment.

PROCEDURAL ISSUES AND CONSULTATION OF INTERESTED PARTIES

This document is the outcome of an Impact Assessment (IA) knowledge transfer and capacity building program organized by the World Bank administered Convergence Program. The participants of the Working Group are representatives of Bulgarian authorities involved in regulation of financial markets issues (pls insert).

The IA training exercise was undertaking a retrospective IA – ex-post RIA - on an existing piece of legislation, **Ordinance No. 38 on the requirements to the activities of investment intermediaries, Chapter 8, Section III and IV (Risk Management and Internal Audit)**. After discussions some categories of key stakeholders were identified as being affected by this piece of legislation.

Consultation with stakeholders is a key part of the IA process, because it promotes public accountability and provides stakeholders with the opportunity to contribute to the evidence base that should underpin the policy making process. The Working Group has conducted a stakeholder consultation. They have designed an explanatory cover letter and a questionnaire, which were sent to a set of selected stakeholders.

The questionnaire was designed to provide evidence relating to:

a) the nature of the problem that the regulation was seeking to address, and

b) the costs and benefits of the regulation and of two alternative policy options that in theory could have been chosen instead of it, thus recognizing the fact that in a "live" IA exercise different policy responses could be considered to address the same policy problem.

Stakeholders were also asked to help after the questionnaire-answering phase was completed by attending a face-to-face meeting to quality check all stakeholder responses and enhance the WG's understanding of their answers.

After reception of answers from stakeholders, a summary of questionnaire results was drafted, then these were processed into a consultation document. The consultation document, including more in-depth issues that were raised during the meeting with stakeholders, became the basis for drafting a summary of consultation feedback, which was used in its turn as the underlying evidence for this report, summarizing all findings gathered during the process.

PROBLEM IDENTIFICATION

The irregular management of internal processes and especially the false defining of the operational and market risks could damage the financial status of investment intermediaries and have a negative impact on market stability and investor confidence. This is especially true for large intermediaries (i.e. intermediaries with a full license). Further there is also an

element of asymmetric information between consumers and the investment firms about the quality of the service.

In our view there is also a regulatory failure related to a level-playing field for investment intermediaries in the EU Common Market. The absence of common rules for investment intermediaries has caused obstacles for the development of the common financial market. The introduction of the MiFID is a prerequisite for the development of a fair, transparent and efficient financial instruments market in the EU.

If no intervention or further intervention would have taken place, we think that the the market would not have corrected the failure by itself in the short term for the following reasons(s): The Bulgarian capital market is relatively new. Therefore, we believe, that it is not experienced enough in solving disruptive processes, as far as they concern investors' protection and market confidence.

We asked stakeholders about their opinions with respect to these issues.

Question 1: Do you agree with us that the problem is as described above**?**
Please explain your answer, including evidence (or suggesting the type of evidence that would be relevant) where at all possible. For example, what evidence do you think would demonstrate or in fact does demonstrate that there was significant regulatory failure? Do you agree that if risk management and internal audit wouldn't be designed as it is proposed, regulatory failure as described above would remain?
Question 1.1: Which risk management mechanisms were already in place before the new regulation?
Question 1.2.: Which functions of internal control / internal audit overlap?

Question 2: If no intervention or further intervention would take place, would the market have corrected the failure by itself in the short terms?

Feedback from consulted stakeholders:
Some of the stakeholders shared the same position some of them thought that the market failures were in an acceptable band and there was no necessity of new regulatory intervention as some market participants had already addressed the risk management issue.

Stakeholders mentioned that there is a potential overlay between internal control and internal audit functions. In their view – especially for smaller firms – it would not be sufficient to have 1 central department for both functions.

Our response:

In our view, market failure is significant, because not addressing the internal risk management and the internal audit issues properly might result in a negative influence over the market confidence.

The introduction of the common rules, concerning the risk management and the internal audit results in the upholding of the integrity of the whole European Financial Market and the increasing of the consumers' protection.

In regard of our market, these rules contribute for the facilitating innovation of the Bulgarian market.

We will deal with the stakeholders comments on the overlap of internal audit and internal control functions in the costs section and in our policy recommendations.

GOALS

General Goals

The aim of Ordinance № 38 is to prevent market disruptions. The Bulgarian legislator has followed the content of the Directive, trying to implement its provisions in the Bulgarian law, having taken into account some of its own experience. We are persuaded that these rules are necessary and useful for the further development of the business of the investment intermediaries and the non banking financial market.

The stability, the transparency and the credibility of the financial markets, as well the protection of the investors' interests and the insured persons are the principal objectives of the FSC strategy. Adequate risk management and internal audit processes are the necessary conditions for the financial stability and the credibility of the financial markets.

Specific goals

The specific goals are such type of aims, connected to or deriving from the principles, on which regulation is built. They should be achieved in a cost-efficient manner, thus conserving the equilibrium between costs and benefits.

The following four groups of goals are the most important:

- improvement of the internal organization;
- defining the personal responsibilities of the investors' employees;
- avoiding of conflicts of interests;
- giving a better definition of the risks and their reflection.

Operational goals

In order to achieve the above mentioned general goals, the following specific steps should be taken:

- Establishing and introducing of common rules regarding the risk management and containing policy and procedures, which identify the risks relating to the investment intermediary's activities and including mechanisms for exercising control over the adequacy and the efficiency of the policy procedures;

- Increasing of the investment intermediaries' risk management, creating internal audit department and creating a risk-management department – an internal unit or an external company to estimate customer and financial instruments related risks.
- Monitoring:
  - applying of rules concerning the risk management and the internal audit – how do they impact the internal organization, the decrease of the conflict of interests, the decrease of the risk associated with the investing company's own funds and services provided to clients;
  - a quantitative impact on the business of the investment intermediaries – business costs as a whole (increasing of employees' salary, recruiting more employees or outsourcing same activities, changing the price of services and their quality).

POLICY OPTIONS

Given that the domestic regulation under review transposes a Directive, we don't analyse other policy options.

The rule about the risk management has been implemented as a requirement of the Directive about the capital adequacy from 1.01.2007.

The internal audit contributes to the overview of the internal rules and procedures and gives ideas for the amelioration of the market's functioning. Before the implementation of the MiFID in the Bulgarian legislation, this activity has been realized by the company's managing organs and not on regulated basis.

However, "doing nothing" with respect to risk management and internal audit procedures would have several negative implications. As far as big investment intermediaries are concerned, the irregular management of their internal processes and especially inadequate dealing with operational and market risks could lead to big damages of their financial position as well as to damages for market stability and investor confidence.

ANALYSIS OF QUALITATIVE AND QUANTITATIVE IMPACT

Costs

Costs to the regulator (direct costs)

The direct costs will consist of: .

- Developing a manual for the ongoing supervision of the investment intermediaries (salaries): one-off costs of approximately 2800-3000 Euro.
- Costs for compliance inspections (salaries, costs for business trips if the investment intermediary has seat out of the capital): ongoing costs of approximately 25 000- 35 000 Euro per year. These costs are estimated to be higher at the beginning of applying the provisions, and lower in a long-term perspective.
- Costs for enforcement, investigations, sanctions, and administrative procedures (salaries): ongoing costs of approximately 5 000 – 10 000 Euro per year. These costs are estimated to be higher at the beginning of applying the provisions, and lower in a long-term perspective.
- If the association of the investment intermediaries decides to develop common rules for managing risks and internal audit, costs for examining/considering these rules by the regulator and discussions with the association will arise (salaries): one-off costs of approximately 2800-3000 Euro

Compliance costs to regulated firms

We think that the compliance costs to regulated firms will be dependent on companies' nature, scale and complexity of the business of the investment intermediaries. The costs may decrease by using the developed common policy and procedures provided by the association of the investment intermediaries.

We identified the following categories of compliance costs related to risk management and internal audit procedures:
One-off costs:

- Costs for analyses on how to implement the rules on risk management and internal audit, e.g. development of policy and procedures and creating the internal rules (staff-time/salaries)
- Costs for hiring staff with appropriate experience and knowledge (one-off cost for the hiring process)
- Training costs for the employees on the new rules
- Costs new IT systems and other office equipment (if applicable)

Ongoing costs:

- Salary for employees
- Other ongoing costs for the operation of the department (e.g. software license, office material, etc.)
- Management time – Time for dealing with internal audit and risk management issues on an ongoing basis as well as costs for reviewing and assessing the rules for risk management and internal audit

WG 2 tried to gather cost estimates from external stakeholders and has received several qualitative comments and a quantitative cost estimate from one medium-sized stakeholder

Feedback from consulted stakeholders:
The stakeholders agreed that the compliance costs would be major. One stakeholder estimated the costs for legal advice to be between 2500 and 5000 Euro, software costs to be 3500-7000 Euro. The implementation of the new software was done by xx people working one week each. These figures are for the implementation of Ordinance 38 as whole. Implementation costs of the new rules on risk management and internal audit would account for 15-20% of these costs.
Further the stakeholder identified training costs for risk management staff to 7000-13000 Euro. Implementation of the procedures would take six months of work of the risk manager and the compliance officer.

One investment intermediary mentioned that some of the functions of internal control and internal audit are overlapping. According to the stakeholders it is not necessary to have two different departments. Further it represents a considerable burden for them. They gave the example that in banks both functions are carried out by one division. Their proposed solution is to have one department responsible both or internal control and internal audit.

Our response:
With respect to compliance costs the opinion of the stakeholders confirms our estimate that the compliance costs would be major.
In respect of the proposition "2 functions in 1 division" we think that there is no obstacle for the intermediaries to carry out two functions by one person or one division.

Costs to consumers

We think that the costs to consumers would be minor. Nevertheless if some firms pass on higher costs of applying internal audit and risk management mechanisms, there would appear a risk of increasing of charges for the clients.

Feedback from consulted stakeholders:
The stakeholders implied the passing costs to the retail clients would be minor for big companies and major for small ones.

Our response:
WG 2 agrees with stakeholders' statement, but in our point of view due to the increase of the international competition it is highly unlikely that this risk might happen.

Benefits

Benefits to consumers

The risk management and the internal audit divisions will improve the clients' trust in the investment intermediaries. It will also increase the quality of the products and services offered, as firms are dealing with their operational risks in a more concise way. In the long run, this could also contribute to a higher demand for investment services by investors and retail clients, although we expect this effect to be minor.

The WG thinks that there would be a minor improvement in the variety of the products offered. This would be a result of local investors gaining access to all the European markets through investment intermediaries from other countries.

Feedback from consulted stakeholders:
The stakeholders implied that the net effect on retail clients would be beneficial but minor/negligible.

Our response:
Despite the expressed opinion of the stakeholders, we think that the benefit to the consumers will be important, because the regulations in question address one of the most important market failures – investors' protection.

Benefits to regulated firms

In our point of view, there will be benefits as better internal organization of the business can lead to decreasing operational risks. Applying these rules can further lead to better reputation for an investment firm and to greater confidence in the market as a whole.

Feedback from consulted stakeholders:
The stakeholders implied that the benefits would be insignificant for the first year and increase in significance in the long run.

Our response:
The stakeholders confirm our opinion, that in a mid- and long term period the benefits will become more significant.

Efficiency of competition

The introduction of new requirement on internal audit and risk management could reduce the number of small and possibly ineffective intermediaries.

More generally MiFID as a whole will have a major effect on the efficiency of the competition, as the introduction of common rules and a single passport will allow investment intermediaries to provide their services on the single EU market. New intermediaries will enter the home market in every EU country. This will lead to increasing competition between the investment firms in the home states and other EU firms.

Feedback from consulted stakeholders:
The stakeholders stated that the competition between the big companies would increase and would force the small ones out of the business. They think that the small companies would be more affected by the implementation and ongoing costs of the rules in question.

Our response:
The stakeholders partly confirm our opinion, but WG2 thinks that the quality of the competition will increase.

COMPARISON OF THE OPTIONS

This is an ex-post Regulatory Impact Assessment and deals with the implementation of an EU directive. Therefore we didn't compare different regulatory options.

POLICY RECOMMENDATIONS

The working group identified one particular issue in the implementation of internal audit mechanisms: the overlap of internal audit and internal control functions and the requirement of having two separate departments for these functions. Stakeholders described this requirement as very costly and overly burdensome.

WG2 acknowledges this issue and suggests is to change the provision concerning the internal control and the internal audit departments. We suggest to change Ordinance 38 in a way, that allows investment intermediaries – where this is appropriate – to combine the internal control and the internal audit activities in one department.

Financial RIA Capacity Building Program in Bulgaria

Final Presentations

4 February, 2008 at 14:00

Financial Supervision Commission

AGENDA

14:00 – 14:05	**Welcome address – *FSC Chairman***
14:05 – 14:10	**Session introduction – *Convergence Program***
14:10 – 14:35	**Chapter 8 of the Requirements to the activities of investment intermediaries – Section II (Internal Control) – *PWG coordinator*** Introduced by: *Mr. Christian Winkler, Senior Regulator, UK Financial Services Authority*
14:35 – 15:05	**Chapter 8 of the Requirements to the activities of investment intermediaries – Section III (Risk Management) and Section IV (Internal Audit) – *PWG coordinator*** Introduced by: *Mr. Riccardo Brogi, Convergence Program*
15:05 – 15:30	Questions and Answers

Financial RIA Capacity Building Program in Bulgaria

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Regulatory Impact Assessment

- Main Findings and Policy Recommendations -

Ordinance N. 38, 2007
Requirements to the activities of investment intermediaries
-Chapter 8 –
Section II (Internal Control)

Financial Supervision Commission

Sofia

February 4, 2008

Working Group Composition

WG#1				
WG Coordinator	Bulgarian National Bank	Financial Supervision Commission	Financial Supervision Commission	Financial Supervision Commission
Financial Supervision Commission				
Ms. Petya Nikiforova	*Mr. Georgi Petkov*	*Ms. Broyana Dimitrova*	*Mr. Boyan Dombalov*	*Ms. Vesela Todorova*
Central Depository AD	Bulgarian Association of Asset Management Companies	Financial Supervision Commission	Bulgarian National Bank	Financial Supervision Commission
Ms. Nadia Daskalova	*Mr. Evgeny Jichev*	*Mr. Nursen Murad*	*Mr. Lyubomir Mirchev*	*Mr. Zhelju Vasilev*

Facilitator — *Mr. Christian Winkler, Senior Regulator, UK Financial Services Authority*

Co-facilitator — *Mr. Riccardo Brogi, Senior Regulatory Economist, Convergence Program*

Table of content (1)

Table of content (2)

1. Regulatory context

• Ordinance N. 38 implements MiFID Directive 2006/73/EC with detailed provisions about **Internal Control** on the following areas:

- procedures;
- profiles with specific tasks and responsibilities;
- planning and ex-post reporting activities.

2. Problem identification (1)

In the absence of intervention, it will be difficult for investment firms to monitor the compliance of its activities with regulatory requirements in a proper way. Investors would have been damaged accordingly.

The introduction of this regulation addresses the following:

- **Market failure**
  - asymmetric information between consumers and investment firms;
  - negative externality (market reputation).

2. Problem identification (2)

- **Regulatory failure**

Existing regulation is no longer appropriate for the current context (i.e. widened catalogue of the investment and ancillary services and activities requires the introduction of more demanding and detailed internal control requirements for investment firms)

3. Statutory goals at risk

The Working Group identified the following risks:

- **Protection of consumers**

Without adequate internal control mechanisms

- conflicts of interest between investment firms and customers (may occur in the process of providing different investment and ancillary services) can arise

- quality of services can be negatively affected.

- **Financial stability**

High and effective internal control standards are key for proper functioning of EU financial markets and financial stability.

4. Proposed regulatory action (1)

Ordinance N. 38 transposes Directive 2006/73/EC;

In doing so, a specific requirement for investment firms to have a dedicated and qualified compliance officer in each branch was introduced.

4. Proposed regulatory action (2)

If no intervention would have taken place, the market would have not corrected the failure by itself in the short term for the following reasons:

✓ Because of the complexity of the investment firms' activity, it would be difficult for them to ensure proper internal control mechanisms without further regulatory requirements for internal control;

✓ Without internal control will be impossible to insure lawful performance of different services and activities with regards to different financial instruments by investment firms.

5. Stakeholders consulted

- One Investment Firm;
- Bulgarian Association of Asset Management Companies;
- Central Depositary AD.

6. Feedback goals

- To what extent does the new regulation fit investment firm operational patterns?

- Is the regulation aligned with market practice? Is there some super equivalence vs the EU Directive?

7. Questions asked

First round consultation (to touch ground)

"Market and regulatory failures"

- Do you agree with us that the problem is as described before?

- Do you agree with our analysis if no intervention or further intervention would have taken place?

7. Questions asked

First round consultation (to touch ground)

"CBA on consumers"

- Do you agree with the analysis that we envisage about cost impacts? Please determine how the new regulatory approach would reflect costs to consumers and try to provide an estimate;

- Do you agree with our analysis about benefit impacts? Please determine how the new regulatory approach would reflect benefits to consumers and try to provide a qualitative estimate

7. Questions asked

First round consultation (to touch ground)

"CBA on regulator and regulated firms (1)"

- Estimate of the incremental direct costs that could arise from the regulation under review;

- We have identified 7 different types of incremental compliance costs that could be incurred by regulated firms. Do you agree with our analysis? Please provide an estimate.

7. Questions asked

First round consultation (to touch ground)

"CBA on regulator and regulated firms (2)"

- Do you agree with our analysis about the benefit impact for regulated firms? Please provide a qualitative estimate;

- Do you agree with our description of the regulatory impact of internal control in the following regards (quantity, quality and variety of products offered, efficiency of competition)?

7. Questions asked

Second round consultation (to deepen analysis)

"Market and regulatory failures"

- Do you think consumers were adequately protected by the previous regulation on internal control?

- To what extent do you have already in place a mechanism similar to that set by the provisions (i.e. market-driven solutions)? Please give evidence.

7. Questions asked

Second round consultation (to deepen analysis)

"What are the possible policy solutions?"

- In case the presence of internal control officers in each branch is eliminated, could you provide evidence of how the objectives of the Ordinance could be fulfilled? Which feasible alternative solutions do you propose?

8. Overall feedback and Responses: Problem identification

Stakeholders

Stakeholders believe that there is market failure, but part of them consider that the market would be able to correct this itself in the future. Due to the previous regulatory regime all the firms already had internal control departments.

However, the new regulation requires a dedicated compliance officer (who deals and has to be in compliance with the new and stricter requirements) to be present in each branch or office of the firm where clients are admitted. This is considered as too costly for investment firms.

WG

There is evidence from regulating investment firms that some of the firms are not willing to maintain proper internal control without particular regulatory requirements to do so.

In 2007, approximately 90 penalties to investment firms have been imposed concerning breaches of the requirements of Ordinance N. 1 on the requirements to the activities of investment intermediaries and 10 complaints have been made by clients or potential clients against investment intermediaries.

8. Overall feedback and Responses: Policy Options

Stakeholders

In the stakeholders' view the new regulation is beneficial both for firms and for their clients, who are better protected.

The requirement for the permanent presence of an internal control officer in each branch or office has been considered as too burdensome. Alternative suggestions are:

- an internal compliance officer responsible for several branches;
- a "mobile squad" responsible for several branches or a division of labor between the headquarters (periodical work) and the branches (day-to-day activity).

WG

WG1 considers the suggestions for alternative solutions with respect to internal control function and the requirement mentioned above concerning the presence of qualified internal control officer in each branch and office.

8. Feedback and Responses: Cost-Benefit Analysis

Stakeholders

Participants considered that there will be one-off cost initially and on-going costs for internal control officers' salaries. These costs are part of the whole package of implementing Ordinance 38.

Those costs will be higher for small firms and for branches than for headquarters.

The requirement to have a qualified compliance officer in each branch of the investment firms is considered as very costly and overly burdensome.

All agree that this new regime will significantly reduce the risks of misconducts.

WG

WG will look in more detail at the requirement mentioned above. Apart from that, we don't consider there is a need for changing the rules on internal compliance.

9. Policy Recommendations (1)

- The FSC monitors the status of implementation of the rules

The monitoring could include documentation and on-site inspections, monitoring of market behavior of investment intermediaries. In particular, the following monitoring actions are recommended:

i) The FSC monitors the number of complaints which relate to this regulation;

ii) The FSC monitors the capital market structure concerning investment intermediaries (i.e. how many firms go out of the market, how many firms enter the market).

- Dialogue with firms is necessary and it will be maintained

(e.g. public consultation initiatives, round tables, seminars)

9. Policy Recommendations (2)

- A “sunset mechanism” could be introduced

If following the aforesaid actions FSC thinks after a certain period (e.g. 1 year) that the implementation is not going smoothly, the FSC could suggest to alleviate the burden related to the requirement of qualified compliance officers in each branch. This could be achieved by applying the proposals raised during the consultation process with stakeholders.

Financial RIA Capacity Building Program in Bulgaria

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Regulatory Impact Assessment

- Main Findings and Policy Recommendations -

Ordinance N. 38, 2007
Requirements to the activities
of investment intermediaries

-Chapter 8 –

Section III (Risk Management)
Section IV (Internal Audit)

Financial Supervision Commission
Sofia

February 4, 2008

Working Group Composition

WG#2				
WG Coordinator Financial Supervision Commision	Financial Supervision Commision *Ms. Lidiya Valchovska*	Bulgarian Stock Exchange-Sofia *Mr. Ivo Stankov*	Financial Supervision Commision *Mr. Julian Razpopov*	Association of Banks in Bulgaria *Ms. Irina Kazandjieva*
Ms. Valentina Stefanova	Financial Supervision Commision *Ms. Suzana Kapsazova*	Financial Supervision Commision *Mr. Vladimir Karamfilov*	Financial Supervision Commision *Ms. Denitza Markova*	Ministry of finance *Mr. Damyan Staykov*

Facilitator — *Mr. Christian Winkler, Senior Regulator, UK Financial Services Authority*

Co-facilitator — *Mr. Riccardo Brogi, Senior Regulatory Economist, Convergence Program*

Table of content (1)

Table of content (2)

1. Regulatory context

Ordinance N. 38 transposes MiFID Directive 2006/73/EC with detailed provisions about **Risk Management** and **Internal Audit** on the following areas:

- procedures;
- profiles with specific tasks and responsibilities;
- planning and ex-post reporting activities.

2. Problem identification

In the absence of intervention, there would be the risk of irregular management of internal processes and false definitions of operational/market risks.

The introduction of this regulation addresses the following:

- **Market failure**
  - asymmetric information;
  - negative externality (market reputation).
- **Regulatory failure**

Absence of such rules would have caused obstacles for the development of a common financial market

3. Statutory goals at risk

The Working Group identified the risk of market disruption that could have negatively affected:

- **Financial stability;**

- **Financial market transparency and reputation;**

- **Investors' protection.**

4. Proposed regulatory action

Ordinance N. 38 transposes MiFID Directive 2006/EC/73, therefore other policy options cannot be analyzed.

"Doing nothing" could have had several negative implications:

irregular management of internal processes by big investment intermediaries and especially inadequate dealing with operational and market risks could lead to big damages of their financial position as well as negative impacts on market stability and investor confidence).

5. Stakeholders consulted

- One Financial Firm;
- Bulgaria Association of Asset Management Companies;
- Central Depositary AD.

6. Feedback goals

- To learn about the trade-off between incremental compliance costs incurred by recipients and achievement of the policy goals;

7. Questions asked

First round consultation (to touch ground)

"Market and regulatory failures"

- Do you agree with us that the problem is as described?

- Do you agree with our analysis if no intervention would have taken place?

7. Questions asked

First round consultation (to touch ground)

"CBA on consumers (1)"

- Do you agree with us that if firms pass on higher costs of applying internal audit and risk management mechanisms, there would be a risk of increased charges for the clients?

- Please estimate the extent to which the costs to consumers would be reflected;

7. Questions asked

First round consultation (to touch ground)

"CBA on consumers (2)"

- As for the benefit side, we think that more investors and retail clients will purchase investment services as their trust in the investment intermediaries will rise. Do you agree? Provide a qualitative estimate.

7. Questions asked

First round consultation (to touch ground)

"CBA on regulator and regulated firms (1)"

- Estimate of the incremental direct costs that could be incurred by the regulator and arising from the regulation under review;

- WG has identified 8 categories of compliance costs arising from the new provisions on risk management and internal audit. Please provide your estimate on one-off vs ongoing basis.

7. Questions asked

First round consultation (to touch ground)

"CBA on regulator and regulated firms (2)"

Benefit: according to WG2, there will be major benefits as better internal organization of the business can lead to a decrease of operational and market risks associated with activities of the investment intermediaries. Applying these rules can lead to better reputation for an investment firm and to greater confidence in the market as a whole.

- Do you agree with our analysis? Please provide a qualitative estimate.

7. Questions asked

Second round consultation (to deepen analysis)

"Market and regulatory failures"

- Which risk management mechanism was already in place before the new regulation was introduced? Can you please specify?

- Which functions of internal control/internal audit overlap? How do you suggest to deal with that?

7. Questions asked

Second round consultation (to deepen analysis)

"What are the possible policy solutions?"

- Do you think that consumer protection is adequately addressed with the new set of provisions?
- Did you find the guidance prepared by the Bulgarian Association of Asset Management Companies helpful? Do you generally think guidance provided by the industry is good way to regulate a market?

8. Overall feedback and Responses: Problem identification

Stakeholders

Some of the stakeholders shared our position, some of them thought that the market failures were in an acceptable band and there was no necessity of new regulatory intervention as some market participants had already addressed the risk management issue.
There is a potential overlap between internal control and internal audit functions. Especially for smaller firms, it would be sufficient to have 1 central department for both functions.

WG

Market failure is significant, because not addressing the internal risk management and the internal audit issues properly might result in a negative influence over the market confidence.

The introduction of the common rules, contribute to facilitating innovation in the Bulgarian financial services market.

8. Overall feedback and Responses: Cost-Benefit Analysis

Stakeholders

- They all agree that the compliance costs would be major;
- For the implementation of the whole Ordinance 38, one stakeholder estimated that costs for legal advice to be between 2,500 and 5,000 Euro, software costs to be 3,500-7,000 Euro other than dedicated staff for the implementation of the new software;
- The new rules on risk management and internal audit would account for 15-20% of these costs;
- Further the stakeholder identified training costs for risk management staff to 7,000-13,000 Euro. Implementation of the procedures would take six months of work of the risk manager and the compliance officer.
- One investment intermediary mentioned that some of the functions of internal control and internal audit are overlapping. There is no need to have two different departments. Further it represents a considerable burden for them.
- A proposed solution is to have one department responsible both or internal control and internal audit.

8. Overall feedback and Responses: Cost-Benefit Analysis

WG

- With respect to compliance costs the opinion of the stakeholders confirms WG2's estimate that the compliance costs would be major;

- In respect of the proposition "2 functions in 1 division" we think that there is no obstacle for the intermediaries to carry out two functions by one person or one division.

8. Overall feedback and Responses: Cost-Benefit Analysis

Stakeholders

Costs to consumers: They implied the passing costs to the retail clients would be a minor risk as far as big companies are concerned, but a major risk for small investment intermediaries.

WG

WG agrees with stakeholders' statement, but in our point of view due to the increase of the international competition it is highly unlikely that this risk might happen.

Stakeholders

Benefits to consumers: The stakeholders implied that the net effect on retail clients would be beneficial but minor/negligible.

WG

WG think that the benefit to the consumers will be important, because the regulations in question address one of the most important market failures – investors' protection.

9. Policy Recommendations

The working group identified one particular issue in the implementation of internal audit mechanisms: the overlap of internal audit and internal control functions and the requirement of having two separate departments for these functions. Stakeholders described this requirement as very costly and overly burdensome.

- WG2 acknowledges this issue and suggests that Ordinance 38 might be modified in a way that allows investment intermediaries – where this is appropriate – to combine the internal control and the internal audit activities in one department. This should not have negative impacts on achieving the policy goals related to internal audit.