



Date : 20 January 2004
Ref : CESR/04-021

**PROVISIONAL MANDATES UNDER THE FUTURE DIRECTIVE ON FINANCIAL INSTRUMENTS MARKETS
(ISD2)**

CALL FOR EVIDENCE

Background:

On 20 January 2004, the European Commission published its first set of “Provisional Mandates to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets”. The request for advice is attached.

The Provisional Mandate sets the deadline for CESR’s technical advice on 31 January 2005.

CESR has established three Expert Groups to deliver its technical advice:

- **Expert Group on Markets:** This expert group will be chaired by Mr Jacob Kaptein (Commissioner at the Dutch securities regulator, the Netherlands Authority for Financial Markets [Autoriteit Financiële Markten]); rapporteur of the Group will be Mr Jari Virta. This expert group will cover the provisional mandates relating to: the admission of financial instruments to trading; pre-trade transparency requirements for multilateral trading facilities (MTFs) and regulated markets; post-trade transparency requirements for MTFs and regulated markets; post trade disclosure by investment firms.
- **Expert Group on intermediaries’ issues:** The expert group will be chaired by Mr Callum McCarthy (Chairman of the UK’s Financial Regulator, The Financial Services Authority [FSA]); rapporteur of the group will be Mr Carlo Comporti. This expert group will cover the provisional mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best execution; prompt, fair and expeditious execution of client orders and client consent prior to executing orders outside the rules and systems of a regulated market or MTFs.
- **Expert Group on cooperation and enforcement issues:** This expert group will be chaired by Mr Michel Prada (President of the French Securities Regulator, the Autorité des Marchés Financiers [AMF]); rapporteur of the group will be Mr Alexander Karpf. This expert group will cover the provisional mandates related to: transaction reporting between competent authorities and exchange of information.

Call for evidence:

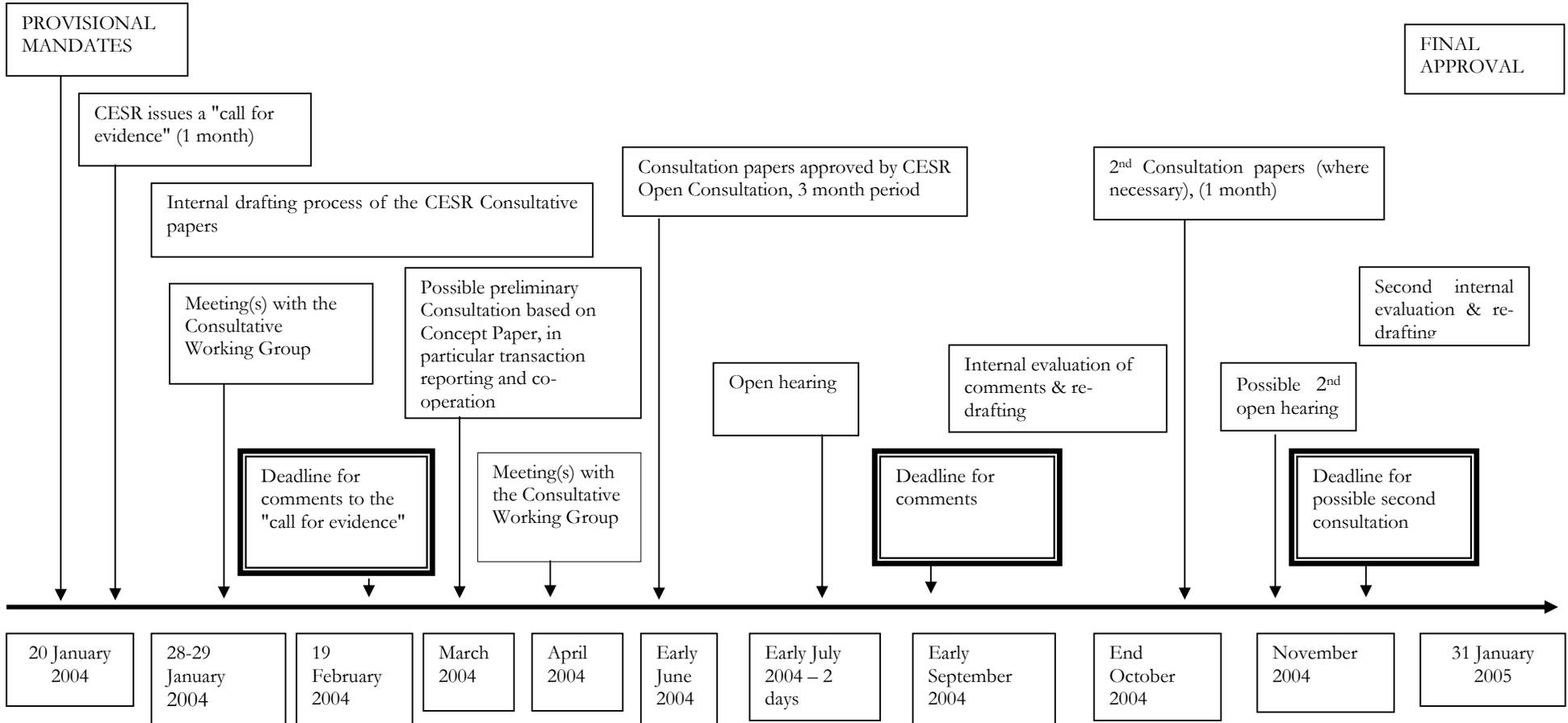
In releasing these requests for technical advice, CESR is inviting all interested parties to submit views as to what CESR should consider in its advice to the European commission. All contributions should be addressed to Mr Fabrice Demarigny, Secretary General, by email to secretariat@europefesco.org, and if necessary, by post to CESR, 11-13 Avenue de Friedland, 75008 Paris, France by 19 February, 2004.

Timetable:

In order to meet the deadlines set by the European Commission, an indicative timetable for the work CESR will be undertaking in response to the provisional mandate is attached. Further details on the consultation (including possible open hearings) will be disclosed once a more precise timetable is established.



Indicative CESR Work Plan for the first set of provisional mandates under the ISD2





EUROPEAN COMMISSION
Internal Market DG

Brussels,
MARKT/G2 D(2003)

provisional mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets

The present provisional mandate follows the agreement on implementing the Lamfalussy recommendations reached with the European Parliament on 5 February 2002. In this agreement, the Commission committed itself to a number of important points, including increasing transparency. For this reason, this request for technical advice will be made available on DG Internal Market's web site once it has been sent to CESR.

This provisional mandate defines some priority areas where implementing measures are needed at the time of the entry into force of the Directive in order to ensure its effective application in the Member States. This is an initial provisional mandate; it will possibly be completed by additional provisional mandates, depending on the development of the negotiation process of the Level 1 Directive before the Council and the European Parliament.

This provisional mandate for technical advice to CESR does not cover all the articles for which the Directive may establish the need for implementing measures. Nor does it prejudice in any way the ongoing negotiations on any article in the Council and the European Parliament in the context of the co-decision procedure nor the discussions on the final split between Level 1 "principles" and Level 2 "implementing measures". In this context, therefore, this mandate does not cover articles where important differences currently exist between the Council and the European Parliament texts. The formal mandate will be sent to CESR once the directive has been adopted in the codecision procedure by the European Parliament and Council.

The numbering of the Articles in the provisional mandate follows the text of the Council common position adopted on 8.12.03. This numbering might change following negotiations in the Council and the European Parliament

1. BACKGROUND

In its conclusions in March 2000, the Lisbon European Council emphasised that in order to accelerate completion of the internal market for financial services, steps should be taken to set a tight timetable so that the Financial Services Action Plan is implemented by 2005, including among other legislative proposals modification of the current "Investment Services Directive" (ISD).



The proposal for a Directive on Investment Services and Regulated markets¹ - the title of which was adapted during negotiations in Council to proposal for a Directive on Financial Instruments Markets" - follows the four-level approach (essential principles, implementing measures, co-operation and enforcement) proposed by the Committee of Wise Men (chaired by A. Lamfalussy) in February 2001 and endorsed in a Resolution of the Stockholm European Council in March 2001. The European Parliament agreed to this new approach in a Resolution adopted on 5 February 2002. The Commission is assisted by CESR, in its capacity as an independent advisory group, in its preparation of draft implementing measures.

Bearing in mind the deadline set by the FSAP and, in the light of the forthcoming elections of the European Parliament and the new Commission to be appointed in summer 2004, adoption of the level 1 proposal should take place at the latest in April 2004. If the deadline of 2005 is to be met, this will mean not only Directives being adopted before this deadline, but the technical implementing measures as well. This concern is of particular importance for those implementing measures without which the Directive cannot function.

This provisional mandate takes into consideration that CESR needs enough time to prepare and deliver its technical advice. Furthermore, under the Lamfalussy arrangement, the European Parliament will benefit from 3 more months, as a minimum, to review the draft implementing measures. These time constraints clearly show that CESR needs to begin work well in advance of the final adoption of the Directive.

Timely adoption of the implementing measures is even more important given that some Member States may need up to 12 more months – in the cases where the implementing measures are adopted in the form of a Directive - to have them implemented into national legislation. This implies that if the implementation period of the level 1 directive is 24 months after its entry into force (starting at the time of the publication of the directive), the implementing measures will have to be adopted and enter into force no later than 12 months following the entry into force of the level 1 Directive. Implementation of Level 1 and Level 2 measures will need to occur at the same time. This means that respecting the deadlines set in this provisional mandate is imperative.

In order to facilitate and speed up the implementation process, the Commission may, whenever justified, consider proposing the adoption of regulations for the implementation of Level 2 measures for a number of provisions which are covered by the present provisional mandate (e.g. Articles 4, 13, 19, 21, 22, 28, 29, 30, 39, 43, 44 and 58 of the draft Directive). The Stockholm European Council, the European Parliament itself and the Lamfalussy report all urged the use of regulations whenever possible. In other cases, where the Commission has less experience in the field, the form of the implementing measure will be decided at a later stage, depending on the content of the advice that CESR is going to provide the Commission services (e.g. Articles 18 - and eventually 13 (3) - and 22 ???).

¹ Proposal for a Directive of the European Parliament and of the Council on Investment Services and Regulated Markets, amending Council Directive 85/611/EEC and 93/6/EC, and European Parliament and Council Directive 2000/12/EC, of 12.11.02 - COM(2002) final, 2002/0269(COD).

It cannot be excluded, at this stage, that a number of changes will be introduced in the ongoing negotiations on the Directive currently before the European Parliament and the Council. For instance, the European Parliament, during its second reading, might wish to introduce further amendments modifying the substance of certain key articles. In this case, this initial CESR mandate will need to be adapted and supplemented in order to reflect the changes introduced into the text during the negotiations.

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

2.1. The working approach agreed between DG Internal Market and the European Securities Committee

In the meeting of the European Securities Committee of 19 September 2003, the Commission announced its intention to grant provisional mandates to CESR, provided that political agreement would be achieved on 7 October. At that meeting, it was agreed that DG Internal Market would request technical advice on certain priority issues, and that CESR should immediately start the groundwork on these to meet the 2005 deadline set by the Lisbon European Council. The present initial provisional mandate was presented in its present form in the meeting of the European Securities Committee of 18/11/03. On the working approach to be followed by CESR, it was agreed that this request should be based on the following approach:

- CESR should take account of the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001.
- The beginning of work on certain aspects of technical advice by CESR shall not, in any way, prejudice the outcome of the discussions between the European Parliament and Council. The request for technical advice does not touch or prejudice Level 1 issues at any stage, or any point.
- CESR should start work on the basis of the texts of the Directive of the European Parliament and of the Council on markets in financial instruments being discussed in the Council and the European Parliament. The Commission representative attending meetings of CESR or its expert groups will regularly inform CESR of any developments in respect of the text of the Directive.
- CESR should provide comprehensive advice on all subject matters covered by the delegated powers included in the relevant comitology provision of the level 1 Directive as well as in the relevant Commission request included in the mandate. Given the time constraints and the variety and complexity of issues covered by this proposal for a Directive, the Commission, in order to provide guidance to CESR to define the limits of the scope of the mandate, is putting forward in an annex to this provisional mandate a list of indicative elements in respect of each request for advice included in this mandate. On the basis of the experience gained in the context of the preparation of the technical advice for the level 2 measures for the Prospectus and the Market Abuse Directives, the Commission realises that the mandates to CESR must be very clear and precise for the items that have to be covered by CESR's future advice. This indicative guidance is not exhaustive; it could be completed by further questions or replaced by completely different ones by CESR, and it is not binding.



- Acting independently CESR will determine its own working methods, i.e. by creating expert groups depending on the content of the provisions dealt with. Nevertheless, horizontal questions should be dealt with in a way ensuring coherence between the work carried out by the various expert groups.
- CESR should address to the Commission any questions they might have concerning the clarification on the text of the draft Directive or other parts of Community legislation, which they should consider of relevance to the preparation of its technical advice.
- The Commission itself will not issue a formal mandate to CESR until the final adoption of the Directive on Financial Instruments Markets in Council and Parliament.
- The technical advice given by CESR to the Commission will not take the form of a legal text. However, CESR should follow a structured approach, i.e. provide the Commission with an "articulated" text in a language which is easily understandable and respects current legal terminology used in the field of financial securities law.
- CESR should provide advice which takes account of the different opinions expressed by the market participants (practitioners, consumers and end-users) during the various consultations. CESR will provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation. CESR should also inform, if necessary, the Commission. Particular attention should be paid of the level of detail to be included in level 2 legislation (see point 2.3).

2.2. Consultation of the public

The Stockholm European Council endorsed the Lamfalussy recommendations on consultation and transparency. In particular, it invited the Commission to make use of early, broad and systematic consultation with the institutions and all interested parties in the securities area, especially by strengthening its dialogue with consumers and market practitioners. It also stated that CESR should “*consult extensively, in an open and transparent manner, as set out in the final report of the Committee of Wise Men and should have the confidence of market participants*”.

Article 5 of the Commission Decision establishing the CESR provides that “*before transmitting its opinion to the Commission, the Committee [CESR] shall consult extensively and at the early stage with market participants, consumers and end-users in an open and transparent manner*”.

In this context, DG Internal Market draws CESR’s attention to the European Parliament’s Resolution on the implementation of financial services legislation of 5 February 2002 and the Commission’s formal Declaration in response.

DG Internal Market will ensure that the Stockholm European Council recommendations on consultation have been fully met. In particular, it will satisfy itself that CESR has consulted all interested parties on its technical advice in accordance with the CESR Public Statement on Consultation Practices. This provisional mandate will also be posted on DG MARKT website.



Once the Commission has received the CESR's advice, it will draw up draft legal texts to put forward to the ESC and the European Parliament. It simultaneously publishes those texts on its Internet site. If the Commission amends its draft to reflect discussions in the ESC, those amended drafts will also be made public on the website.

Interested parties will have the opportunity to comment on published draft legal texts. The Commission has set up a dedicated e-mail address (Markt-ESC@cec.eu.int), allowing all interested parties to send their contributions to the Chairman of the ESC. All such comments will in turn be made public on the same Commission website.

Interested parties will have sufficient time to participate in this exercise because the ESC will not be asked for a vote until at least three months have elapsed from the publication of initial draft implementing rules. This will also allow the European Parliament to follow the process and, if it so wishes, to make its views known.

2.3. Access to finance and investor protection

In giving its advice on possible implementing measures, CESR should take full account of two key objectives:

1. The protection of investors and market integrity by establishing harmonised requirements governing the activities of authorised intermediaries;
2. The promotion of fair, competitive, transparent, efficient and integrated financial markets as well as the promotion of competition: this goal should be furthered by implementing the ground-rules governing the negotiation and execution of transactions in financial instruments on organised trading systems and marketplaces, and by investment firms.

CESR should also pay particular attention to striking the right balance between the objective of establishing a set of harmonised conditions for the licensing and operation of investment firms and regulated markets and the need to avoid excessive intervention in respect of the management and organisation of the investment firms. The amount of detail included in the advice should be very carefully calibrated case by case; the advice should ensure clarity and legal certainty but avoid formulations which would lead to overperscriptive, excessively detailed legislation, adding undue burdens and unnecessary costs to the firms and hampering innovation in the field of financial services.

3. CESR IS INVITED TO PROVIDE ADVICE ON THE FOLLOWING PRIORITY ISSUES:

3.1. Organisational requirements (Article 13)

Article 13 establishes the organisational requirements which a person has to comply with in order to be authorised to provide investment services or to perform investment activities. These include compliance



obligations, internal systems, resources and procedures obligations, outsourcing and record keeping obligations and obligations referred to the protection of client's funds.

The obligations under article 13 shall apply, in an appropriate and proportionate manner, taking into account the various risks inherent to the different services or activities, to all types of investment firms. CESR advice should be proportionate.

CESR is expected to provide a comprehensive overview of the necessary, minimal conditions that should be fulfilled by investment firms in order to ensure uniform and consistent application of the obligations provided for in this Article throughout the EU. The advice should avoid excessive detail.

3.1.1. Compliance obligations and treatment of personal transactions (article 13§2)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) the minimum basic elements that the compliance policies and procedures that an investment firm has to set up should contain as well as the principles governing the content of the policies and procedures;
- (2) the criteria for identifying the persons that are to be considered as managers and employees;
- (3) the conditions with which the content of the rules established by the investment firm governing personal transactions by managers, employees and tied agents should comply;
- (4) what is to be considered as a personal transaction for the purposes of the rule.

3.1.2. Obligations related to internal systems, resources and procedures (article 13(4) and (5) second subparagraph)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- Establish the minimum basic criteria that competent authorities should take into account for determining when the investment firm has taken reasonable steps to ensure that:

- (1) their administrative procedures are to be considered as sound;
- (2) their accounting procedures are to be considered as sound; in respect of this request CESR should take account of or refer to any relevant provision of Community Law;
- (3) their internal control mechanisms are to be considered as sound;
- (4) their risk assessment procedures are to be considered as effective. For the definition of the various risks, their categorizations, as well as the means for their assessment, CESR should take account of any relevant provision of Community Law as well as relevant or similar work carried out in the field of financial services in other European and International fora.
- (5) their control and safeguard arrangements for information processing systems are to be considered as effective.

3.1.3. Obligation to avoid undue additional operational risk in case of outsourcing (Article 13§5 first subparagraph)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) Determine what is meant by operational functions; establish the criteria for determining which functions are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis.
- (2) Establish the conditions to which the firm is subject and the arrangements to put in place, when outsourcing its operational functions.
- (3) Specify what is to be considered as outsourcing for the purposes of this rule

3. 1. 4. Record keeping obligation (article 13§6)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) Establish the conditions with which the arrangements that an investment firm has to put in place in respect of its records have to comply in order to be considered as sufficient to enable the authorities to verify the investment firm's compliance with the applicable rules
- (2) Specify which records are covered by this obligation
- (3) Specify the period of time for keeping the records

In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to data protection.

3. 1. 5. Protection of client's financial instruments and funds when a firm holds financial instruments and funds belonging to clients (Article 13 (7) and (8))

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) Determine the conditions with which the arrangements that an investment firm has to put in place in respect of its client's financial instruments have to comply in order to be considered as sufficient to safeguard their ownership rights and to prevent their use on own account by the firm except with the client's express consent.
- (2) Determine the conditions with which the arrangements that an investment firm has to put in place in respect of its client's funds have to comply in order to be considered as sufficient to safeguard their ownership rights and, except in the case of credit institutions, to prevent their use on own account by the firm.
- (3) Establish the conditions with which the procedures for obtaining the client's express consent to allow the investment firm to use the client's financial instruments on own account have to comply.

3. 2. Conflicts of interest (Art. 18 and 13(3))

Investment firms shall take all reasonable steps to identify conflicts of interest and shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interests of its clients.

As for article 13 these obligations should be proportionate and take into account the risks inherent to the different services or activities with respect to the interests of the clients.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) the appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the clients or potential clients of the investment firm
- (2) the steps that investment firms might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest when providing various investment and ancillary services and combinations thereof.

This request should be combined with other requests formulated with respect of other parts of article 13 and in particular the internal control procedures. The technical advice should take into account the implementing measures of the Market Abuse Directive regarding the fair presentation of investment recommendations and the disclosure of conflicts of interest and other works carried out in other forums, such as IOSCO or the Forum Group on Financial Analysts.

3. 3. Conduct of Business Obligations when providing investment services to clients (Article 19, §§ 2, 3, 7 and 8)

Article 19 lays down the general Conduct of Business Obligations which investment firms have to comply with when providing investment services to clients. Like Article 13, this is a general article covering a variety of different situations. In order to guarantee investor protection in a proportionate and appropriate manner, application of this Article has to be nuanced on the basis of various parameters to be taken into consideration when laying down conduct of business obligations.

CESR should define, where relevant, the exact content of each of the obligations laid down in article 19 on the basis of the following criteria:

- The nature of the service(s) offered or provided to the client or potential client, taking into account the type, object, size and frequency of the transactions.
- The nature of the financial instruments being offered or considered.
- The retail or professional nature of the client or potential clients.

CESR should consider the possibility of establishing a general typology by their nature of investment services and financial instruments, or certain criteria for categorising by their nature those services and instruments. The same criteria should be applicable in the context of all the obligations laid down in this article.

In particular article 19 establishes the following conduct of business obligations:

3. 3. 1. Publicity and marketing communications (article 19§2)

The directive establishes that all information addressed to clients have to be fair, clear and not misleading. In particular, marketing communications shall be clearly identifiable as such.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) Specify the criteria for assessing the fairness, clearness and not misleading character of marketing communications and of any other promotional/publicity communication addressed to clients or potential clients"
- (2) Specify what is to be considered as a marketing communication in the context of this provision.

In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to publicity and marketing communications.

3. 3. 2. Appropriate information to be provided to the clients or potential clients (article 19 (3))

This includes following obligations:

- the obligation to give appropriate information to the client or potential client about the investment firm and its services
- the obligation to give appropriate information to the client on the execution venues
- the obligation to give appropriate information to the client or potential client about costs and associated charges

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

- (1) Specify the content of the appropriate minimum information that the investment firm should supply to its clients and potential clients in respect of its services and of the firm itself. The content of the minimum information should depend on each type of service.
- (2) Specify the content of the appropriate minimum information, including the different warnings, that the investment firm should supply its clients in respect of financial instruments and/or investment strategies
- (3) Specify the content of the appropriate minimum information that the investment firm should supply to its clients concerning the different execution venues. This request should be combined with the requests formulated in the context of Article 19.
- (4) Specify the content of the appropriate minimum information that the investment firm should supply to its clients in respect of the costs and associated charges that the client's or potential will have to pay for the provision of the different investment services.
- (5) Specify which information should be provided at the outset of the relationship and which should be updated on a continuous basis; determine the form in which the information is to be made available as well as the arrangements for making it available.

3. 3. 3. Client Records (article 19(7))

This paragraph obliges investment firms to maintain records concerning their clients containing a series of documents, for instance those agreed between the firm and the client that set out the rights and obligations of the parties, and the other terms on which the firm will provide services to the client.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the minimum content of the client records, in particular the customer agreement and the time at which such records must be established by the investment firm. This request should be combined with the request formulate with respect to Article 13 (.7)

3. 3. 4. Reports from the firm to its clients (article 19(8))

This provision obliges investment firms to provide to their clients adequate reports on the services provided. The reports should include the costs associated with the transactions to which they refer.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the criteria for determining when and in which manner the investment firm should report to its clients

3. 4. Best execution obligation (Art. 21)

Article 21 obliges investment firms to obtain, when executing orders, the best possible result for their clients, following always the specific clients' instructions. To this end, they will establish an order execution policy; they will inform about it to the clients and obtain their prior consent. Investment firms are also obliged to monitor the effectiveness of their order execution policy and correct any deficiencies.

CESR should bear in mind that there is a need for a comprehensible set of criteria to be put in place to allow firms to determine whether they are complying with their obligations as well as to allow clients to understand execution policies.

3.4.1 Criteria for determining the relative importance of the different factors to be taken into account for best execution (21.1)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the criteria that the investment firm should take into account when executing clients' orders for determining the relative importance of the factors such as price, costs, speed, likelihood of execution and settlement, size and nature of the order and any other relevant consideration. Those criteria should take into account the retail or professional nature of the client.

3.4.2. Trading venues to be included in the order execution policy (21.2).

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the criteria for determining the venues that enable investment firms to obtain on a consistent basis the best possible result for executing the client orders.

3.4.3 Information to the clients on the execution policy of the firm (21.2)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30 December on the information to be provided to the client or potential client.

3.4.4. Obligation to monitor and update the order execution policy (21.3)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate.

3. 5. Client order handling rules (Art. 22)

Investment firms authorised to execute orders on behalf of clients are obliged to implement adequate procedures and arrangements to handle clients' orders which result in the prompt, fair and expeditious execution of them, taking into account the time of the reception of the order.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

(1) the conditions with which the order handling procedures and arrangements that investment firms have to set up shall comply in order to obtain prompt, fair and expeditious execution of client orders.

(2) the situations in which or types of transaction for which investment firms may reasonably deviate from prompt execution so as obtain more favourable terms for clients.

To respond to these requests CESR should take into account the retail or professional nature of the client.

3. 6. Reporting of transactions (Art. 25 (3), (4), (5) and (5.a))

Article 25 (3) establishes the obligation for the investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority. Article 25(5) provides the different ways that investment firms have to comply with the reporting obligations and for a waiver for this obligation.

Article 25 (3) second subparagraph obliges competent authorities to establish, in accordance with article 58, the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for those financial instruments also receives the information on transactions.

Article 25 (4) establishes which should be the minimum content of the reports that should be sent to the competent authorities.

In delivering its advice CESR should ensure that the arrangements are proportionate, that they facilitate exchanges of information between regulators and the comparability of reports and that they provide regulators with the adequate data to fulfil their responsibilities.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

(1) the methods and arrangements for reporting financial transactions.

(2) the criteria for assessing liquidity in order to define a relevant market in terms of liquidity for financial instruments.

(3) the minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities

3. 7. Transparency obligations (Articles 28, 29, 30, 43 and 44)

The Directive establishes a comprehensive transparency regime that covers all types of trading venues and methodologies. These transparency obligations are necessary in order to avoid the possible negative effects that fragmentation of trading could cause to the efficient functioning of the market.

CESR should take into account of the necessity to facilitate the consolidation of trading information so that all market participants could have an easy access to comprehensible and comparable information and, consequently, be able to make efficient investment decisions and allow for a smooth functioning of the best execution obligation. CESR should also, when determining the content of the information to be disclosed, take account of the need to ensure an efficient price formation process and to protect investors.

The Directive applies comparable transparency regimes to similar trading systems. This is the case of Regulated Markets and MTF's where differentiation should be based, in principle on the type of trading methodologies or market models and not on the Institutional choice for the organisation of the market. Nevertheless, CESR is invited to analyse, in respect of all the mandates related to regulated markets



whether there are substantial reasons in terms of market efficiency and investor protection that could require some degree of differentiation between MTFs and Regulated Markets.

3. 7. 1. Pre-trade Transparency requirements for Regulated Markets (Article 43) and MTFs (Article 29)

Following issues are covered by this Article:

- the obligation to make public prices and volumes advertised through the market systems (Article 43.1)
- The waiver of the pre-trade transparency obligation in respect of the type and size of orders – block orders (Article 43.2)
- the waiver of the pre-trade transparency obligation in respect of the market model (Article 43.2)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

- Specify the range of bid and offers or designated market-maker quotes, and the depth of trading interest at those prices that are to be made public
- Establish the criteria for determining the type and size of orders for which pre-trade transparency obligations may be waived and define orders that are "large in scale compared with normal market size".

In respect of size, and in particular when defining the orders that are "large in scale compared with normal market size" (block orders), CESR advice should take account of the fact that the objective of the waiver is to exempt from the pre-trade transparency obligation those transactions which size could have a market impact that could affect the investors and/or that could affect the provision of liquidity by market makers and/or could affect the quality of the price formation process on the market. In this respect, CESR should also take particular account of the differences between order and quote driven markets. The definition of block orders should be analysed with a view to establish harmonised criteria for each type of shares in the EU, to promote legal certainty and to develop as simple a model as possible. At this respect, CESR, in delivering its advice, might wish to analyse the possibility to establish a single measure in terms of number of shares and/or of quantity that could be applicable to most of the trading in shares in the EU.

- Establish the criteria for determining the market models for which pre-trade transparency obligations may be waived

3. 7. 2. Post-trade Transparency requirements for Regulated Markets (Article 44) and MTFs (Article 30)

Following issues are considered in this Article:

- the obligation to make public details of the transactions executed on regulated markets
- the possibility to defer publication of some types of transactions

CESR should consider that part of these measures do also apply (though article 26) to off-exchange trading. CESR should analyse the conditions under which those obligations should apply to off-exchange trading as well as the relevance of the obligations for off-exchange trading.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

- (1) Specify the scope and content of the information to be made public

(2) Establish the conditions under which deferred publication of trades may be allowed as well as the criteria to be applied when deciding the transactions for which, due to their size or the type of share involved, deferred publication is allowed".

In respect of large orders, CESR should, where relevant, combine this request with the requests formulate in the context of Article 43

3. 7. 3. Post-trade Transparency requirements for Investment Firms (Article 28)

This provision establishes an obligation on investment firms that deal or execute client orders outside Regulated Markets or MTFs to make public the terms of the corresponding transactions.

The mandate in respect of article 28 will only deal with those issues that have not been tackled through the mandates of article 44.

In delivering its advice CESR should take account of the need for investment firms to have a genuine choice of reporting arrangements.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

(1) Specify the means by which investment firms may comply with their post-trade transparency obligations including the following possibilities: (i) through the facilities of any regulated market which has admitted the instrument in question to trading or through the facilities of an MTF in which the share in question is traded;(ii) through the offices of a third party; (iii) through proprietary arrangements

(2) Specify the scope (which types of transactions) and the conditions of application of the post-trade transparency obligation to transactions involving the use of shares for collateral, lending or other purposes where the exchange of shares is determined by factors other than the current market valuation of the share

3. 8. Admission of financial instruments to trading (Art. 39)

Following issues are considered in this

- The minimum contents of the rules on admission to trading that each Regulated market has to establish (Article 39 (1), (2) and (6a))

- The obligation for the Regulated market to establish the necessary arrangements to verify that the issuers of securities comply with their obligations under community law (Article 39 (3), first subparagraph and (6) (b)).

- The obligation imposed Regulated Markets to ensure that information previously disclosed is accessible to its members or participants (Article 39 (3), second subparagraph and (6)(c)).

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

(1) specify the characteristics of different classes of instruments to be taken into account by the regulated market when assessing whether an instrument is issued in a manner that allows it to be traded on a fair, orderly and efficient manner; in the case of transferable securities, define the conditions under which financial instruments are freely negotiable.

(2) clarify the arrangements that the regulated market is to implement so as to be considered to have fulfilled its obligation to verify that the issuer of a transferable security complies with its obligations under Community law in respect of initial, ongoing or *ad hoc* disclosure obligations.

(3) clarify the arrangements that a regulated market that admits transferable securities to trading has to establish in order to facilitate its members or participants in obtaining access to information which has been made public in the conditions established under Community law.

3. 9. Obligation to cooperate (Art. 56)

This provision establishes the obligation for competent authorities to establish proportionate cooperation arrangements when a regulated market has established arrangements in a host member state and provided that, taking into account the situation of the securities markets in the host member state, these arrangements have become of substantial importance for the functioning of the securities markets and the protection of investors in the host member state.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on:

The criteria under which the operations of a regulated market in a host member state could be considered as of substantial importance for the functioning of the securities markets and the protection of investors in the host member state

3. 10. Exchange of information (Art. 58)

The provision establishes the obligation of competent authorities designated as contact points to immediately supply one another with the information required for the purposes of carrying out the duties of the competent authorities set out in the provisions adopted pursuant to the Directive.

In delivering its advice CESR should take into account the effectiveness of existing arrangements.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the procedures for the exchange of information between competent authorities designated as contact points. CESR should take into account the Memorandums of Understanding adopted in international fora, including IOSCO, and/or European fora or on a bilateral basis and on the experience gained after its entry into force.

TECHNICAL ANNEX

Indicative elements in respect of the provisional mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets

3.1. Organisational requirements (Article 13)

3.1.1. Compliance obligations and treatment of personal transactions (article 13§2)

- The establishment of a code of conduct by the investment firm as well as its minimum content.
- The establishment of a compliance function as well as the necessary arrangements for ensuring its independence; the tasks to be assigned to the compliance function and in particular the procedures to prevent and detect violations of the applicable rules and of the code of conduct.
- Which transactions and under which conditions personal transactions from employees could be admitted. In this respect, account could be taken of the different functions performed by the personnel of the investment firm in order to define the rules and conditions for each different category of employees, managers or tied agents.

3.1.2. Obligations related to internal systems, resources and procedures (article 13(4) and (5) second subparagraph)

- How the procedures are to be formalised, the means for doing so (written, etc.) and the areas where formal administrative procedures are necessary.
- The duties/functions (if any) that, in principle, should be segregated in order to ensure a sound functioning of the firm. The means, procedures and arrangements put in place in the context of administrative, accounting and internal control procedures in order and to take account of the principle of segregation of duties/functions. To what extent administrative, accounting and internal control procedures should take account of the principle of segregation of duties/functions.- The necessity to establish a segregated accounting function as well as the arrangements for ensuring its independence.
- The minimum contents of the accounting procedures of the firm. In particular and if necessary, aspects that may be considered relevant for ensuring the good functioning of the accounting function and of the accounts of the investment firm (take into account the interaction of this point with the general accounting regulation, this is without defining the content of the accounting rules which are subject to a different regulation).- Apart from the segregation of duties, determine further internal control mechanisms that an investment firm should put in place.

- The opportunity of the establishment of an internal audit function as well as the necessary arrangements for ensuring its independence. The tasks to be assigned to the audit function and in particular the procedures to ensure the correct functioning of the internal control mechanisms of the firm.
- The different risks than an investment firm faces in the exercise of its activities as well as the arrangements to put in place for dealing with them (in particular in respect of operational risk) and in particular, the opportunity for the investment firm to define a risk policy as well as to create a risk assessment function. Define the tasks that are to be assigned to the risk assessment function.
- The principles that should govern the proprietary trading of an investment firm in order to minimise the risks that this activity could cause to the firm and its clients.
- The requirements with which efficient information processing systems should comply and the arrangements and procedures that an investment firm should establish in order to guarantee the security of its information processing systems, in particular in respect of access to the systems, the data contained in them and its handling as well as in order to cope with possible failures of the systems and disaster recovery plans.

3. 1. 3. Obligation to avoid undue additional operational risk in case of outsourcing (Article 13§5 first subparagraph)

- The criteria for categorising the operational functions of the firm between those that are a) critical for the provision of continuous and satisfactory service to clients; b) others.
- The different allocation of roles between the outsourcing firm and the third person carrying out the outsourced .
- The minimum criteria with which the third person carrying out the outsourced function must comply as well as the controls and rules that the outsourcing firm should impose on the person carrying out the outsourced function in order to be able to outsource to the latter part of its operational functions; examine in particular the arrangements to put in place in order to avoid outsourcing from "impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations".

3. 1. 4. Record keeping obligation (article 13§7)

- The minimum information that the records of the investment firm should contain (in respect of each service and/or transaction). This information should take account of the need to verify compliance by the investment firm in respect of each transaction with the obligations established under this directive.

- The procedures and arrangements for the keeping of the records, in particular those related to the security and confidentiality of the records, of the organisation of the records and those related specifically to the recording of phone conversations.

3. 1. 5. Protection of client's financial instruments and funds when a firm holds financial instruments and funds belonging to clients (Article 13 (8) and (9))

- The criteria for defining what should be understood as client funds for the purposes of the Directive (for instance in the coverage of margins or settlement guarantees).

- The different arrangements and internal controls that an investment firm should use in order to protect its client's assets. In particular the specific rules with which an investment firms should comply when selecting a third party as custodian of the financial instruments of its clients and the possible rules to be established relating to the use of omnibus accounts, margin segregation in respect of derivatives and stock lending.

- The minimum content of the information that an investment firm should give to their clients in respect of how the arrangements that the firm has established in order to protect its client's assets and moneys, in particular when using the services of third parties. This request should be dealt with together with the requests formulated in the context of Article 19.

- The procedures and the information to be given to the client for obtaining its consent to use its financial instruments.

3. 2. Conflicts of interest (Art. 18 and 13(3))

- The appropriate criteria for identifying conflicts of interests whose existence may damage the interest of the clients or potential clients: a) between the firm and its clients, in particular when the firm combines different investment services or activities b) between the managers, employees or tied agents and the clients c) between any person directly or indirectly linked by control to the investment firm and the clients d) between clients.

In establishing these categories, particular attention should be paid to the types of conflicts of interest that can result from certain practices such as: a) payment for order flow b) the transmission of clients' orders received to other investment firms for their execution and c) the distribution of units in collective investment undertakings d) soft Commissions. Address conflicts that arise from any inducement that is received or self-interest that arises in connection with the performance of an investment service which may compromise the quality or fairness of a related investment service that is performed on behalf of or provided to a client.

- The arrangements that the investment firm has to put in place in order to a) identify the different conflict of interests in which it could be involved b) manage the conflicts of interest so as to prevent them from affecting the interests of its clients c) disclose the conflicts of interests (where, how and when) so as to ensure the awareness of the client
- Under which conditions organisational arrangements taken by an investment firm could be considered as effective or non-sufficient to ensure that risks of damage to client interests will be prevented.
- Particular attention should be paid to the frequency of conflicts of interest (whether they occur regularly or in limited individual cases) in different types of investment firms as well as that there is an appropriate mix of prevention, management and disclosure

3. 3. Conduct of Business Obligations when providing investment services to clients (Article 19)

3. 3. 1. Publicity and marketing communications (article 19§2)

- Types of marketing communications and its distinction from a personal recommendation.
- Criteria for assessing the minimum content of marketing communications or aspects that should necessarily be disclosed in respect of marketing communications so as to avoid that they are misleading or unfair (i.e. name of the person that has done the advertisement- identification of sources).
- Analyse rules regarding specific issues included in marketing communications (Rules regarding promises or specific results, special offers, treatment of comparisons).
- Criteria for considering when an information should be considered as misleading (context of the information, the audience to which it is directed, its overall clarity, etc.).

3. 3. 2. Appropriate information to be provided to the clients or potential clients (article 19 (3))

- Categorisation of financial instruments: Establish the different elements for categorising financial instruments for the purposes of this implementing measure (i.e. by risk, by legal characteristics, complexity, investors that have access to the instrument, etc.).
- Categorisation of investment strategies.- Identification of the risks inherent to specific financial instruments and strategies and determine the minimum content of the adequate warning in respect of those instruments and strategies.
- Means for making those warnings acknowledgeable to the clients or potential clients.
- CESR, in order to determine the appropriateness of the information might take account of the complexity of the investment services and financial instruments proposed.



- CESR should analyse how the obligation to inform about the execution venues might apply to potential clients.

3. 3. 3. Client Records (article 19(7))

- The content of the records that each investment firm has to have in respect of each client: documents, agreements, etc.
- The minimum content of the documents agreed between the firm and its client: In particular those that set out the rights and obligations.
- The arrangements to keep the records (take account of organisational measures in article 13).
- Period to keep the record. Examine the possibility to differentiate on the basis of the different type of documents that have to be part of the records.

3. 3. 4. Reports from the firm to its clients (article 19 (8))

- Events that give rise to a reporting obligation and its periodicity.
- Minimum content of the reports.
- Valid arrangements for delivering the reports to the clients.

3. 4. Best execution obligation (Art. 21)

3.4.1 Criteria for determining the relative importance of the different factors to be taken into account for best execution (21.1)

The content of the different elements that are to be taken into account in order to evaluate the execution of the client's orders: a) Price, for each financial instrument; b) Costs: the different costs that need to be considered c) Likelihood of execution: how to assess it; d) Nature of the orders e) Other relevant considerations, in particular taking into account the characteristics of the market for that financial instrument.

3.4.2. Trading venues to be included in the order execution policy (21.2).

- The different execution methods and the price availability: regulated markets, MTFs, systematic internalisation systems, crossing systems, broker that arranges transactions, etc.
- The criteria for determining when an execution venue is offering the best results on a consistent basis. Specify what could be considered "consistent basis".
- The conditions of the order and the conditions prevailing in the marketplace.



3.4.3 Information to the clients on the execution policy of the firm (21.2)

- the minimum information that investment firms have to provide to their client on their order execution policy, in respect of each class of instruments, such as the different venues where the investment firms execute their clients orders indicating whether they access directly or indirectly through another firm and the factors affecting the choice of execution venue;
- the way and timing this information has to be provided;
- the information that has to be given to the clients when the firm changes its execution policy;
- CESR may wish to take into account the retail or professional nature of the client

3.4.4. Obligation to monitor and update the order execution policy (21.3)

- Periodical revision and monitoring of the execution policy. The arrangements that the investment firm has to put in place in order to revise and monitor the order execution policy of the firm.
- Availability of comparative information for making the revision effective.

3. 5. *Client order handling rules (Art. 22)*

- The general handling conditions that investment firms should apply to its client's orders and the minimum content of the handling policy of the firm. In particular the following aspects should be examined: a) Minimum content that should be contained in the order; b) Registration (documents) and record-keeping of the orders; c) Allocation and distribution rules; d) Aggregation of orders; e) Policy in respect of cancellations; f) Management of the order log; g) crossing of client's orders h) Conditions under which and reasons why the prompt execution principle could be overruled.
- Analysis of the different types of orders.
- Criteria, in respect of each different type of order, for determining what could be considered a prompt, fair and expeditious execution. In analysing this aspect account should be taken of following issues: a) the conflict of interest (dealing on own account, underwriting, placement, etc.), (Art 18) b) best execution (Art 21)

3. 6. Reporting of transactions (Art. 25 (3), (4), (5) and (6))

- The criteria for determining when the arrangements put in place by a regulated market, an MTF or a trade matching and reporting system are sufficient to allow the waiver of the obligation to report directly by investment firms.
- The conditions with which all the reporting methods and arrangements have to comply in order to be considered valid. A common standard or format should be defined for the reports to facilitate its exchange between competent authorities.
- The criteria in order to determine liquidity: a) the market to be considered; b) the mechanisms for analysing and checking liquidity; c) the revision procedures; etc. -
- In respect of the harmonised content of the reports: a) the content of the information related to quantity in respect of each type of financial instrument: volume of instruments, monetary amount, etc. b) the content of the information in respect of prices in respect of each financial instrument; c) the methods for reporting the time and date of the transaction; d) the means for identifying the investment firms concerned; e) The means for identifying the instruments bought or sold (security codes).
- Any other aspects that are necessary in order for the reporting to be useful in respect of supervisory issues – such as the identification of the markets where the transaction has been executed, whether the transaction is executed as agent or as principal, etc.

3. 7. Transparency obligations (Articles 28, 29, 30, 43 and 44)

3. 7. 1. Pre-trade Transparency requirements for Regulated Markets (Article 43) and MTFs (Article 29)

- When and how the information is considered to be made public:
 - o differentiate between the information accessible to the members of the market and that accessible to the investors.
 - o The conditions under which the information may considered as accessible to the investors and the arrangements that a Regulated Market has to put in place, directly or indirectly, in order to fulfil its obligation to make public the information.
 - o In case that the information is disclosed indirectly: the minimum arrangements that the systems used by the regulated market or the market operator have to put in place in order that the



regulated market or the MTF can ensure compliance with the obligation contained in articles 43 and 29.

- The content of the terms "bid" and "offer" for quote and for order driven systems.
- What is to be considered as "depth of trading interests" for quote and for order driven systems.
- The range of the information that should be made available (i.e. all the order book, only part of it, all the quotes from market makers, only the best ones, etc.). Examine whether some criteria in respect of the form in which the information is presented are necessary (i.e. aggregated for the same price, etc.). In respect of the range of the information examine whether the same range should be available both to members of the market and to investors or if there might be some reasons for limiting the amount of information available to the latter.
- The general criteria for determining when a type of order also quotes and other indications of interest) may be exempted from the obligation to be made public. In this respect it might be useful to establish an open list with the different types of orders that are expressly eligible for the waiver.
- For those types of orders, the conditions under which the pre-trade transparency obligation may be waived.
- In respect of Block orders: a) criteria for grouping shares into types, in particular their liquidity; b) what is to be considered a normal market size; c) What is to be considered as large in scale compared to the normal market size.- The general criteria for determining when a market model may be exempted from the obligation to make public pre-trade information. In this respect it might be useful to establish criteria to define the different types of market models that are expressly eligible for the waiver.

In analysing those different elements CESR should take account of the differences as expressed in the mandate between different types of market models and in particular between order and quote driven systems. CESR should be particularly careful, in order not to stifle competition, in considering the special characteristics of quote driven systems and, in particular the risks incurred by market markers.

In analysing the feasibility of a single and simple model for block orders CESR might wish to take account of the experiences of other non-european jurisdictions.

- For those types of market models, the conditions under which (for instance minimum information about the model that should be given to the members, conditions for its functioning, etc.) the pre-trade transparency obligation may be waived.

3. 7. 2. Post-trade Transparency requirements for Regulated Markets (Article 44) and MTFs (Article 30)

- When and how the information is considered to be made public. In particular differentiate between the information accessible to the members of the market and that accessible to the investors. Conditions under which the information may be considered as accessible to the investors and the arrangements that a Regulated Market has to put in place, directly or indirectly, in order to fulfil its obligation to make public the information. In this respect establish also the criteria for determining what can be considered as "reasonable commercial basis". In case that the information is disclosed indirectly the minimum arrangements that the systems used by the regulated market or the market operator have to put in place in respect of the disclosure of post-trade information, in order that the regulated market or the MTF can ensure compliance with the content of articles 44 and 30.

- The exact content of the information that has to be made public as well as the different forms in which it can be presented: i.e. in an aggregated manner, trade by trade, etc. Differentiate between the information that has to be made public during the trading session and that that has to be disclosed at the end of the trading session. In respect of the latest take into account the current level of information as mandated by Directive 93/22.

- On the basis of the information disclosed and the recipients of the information the different criteria for assessing whether the information has been disclosed "as close to real time as possible" and how it could be made possible across the EU.

- The criteria for deciding the transactions for which deferred publication is allowed. In this respect it might be useful to establish an open list with the different types of transactions that are expressly eligible for deferred publication.

- Taking into account the conditions established in respect of the mandate of article 41 the criteria for determining the size for which transactions could be eligible for deferred publication.

- For the specific types of transactions, the conditions and the limits for the deferred publication of transactions.

- How the arrangements for deferred publication are to be disclosed to the market as well as the content of the arrangements that has to be disclosed to the market.

3. 7. 3. Post-trade Transparency requirements for Investment Firms (Article 28)

- The arrangements that the investment firm has to put in place as well as the conditions with which those arrangements have to comply in order that the investment firm can ensure compliance with its obligation under article 28.

In case that the investment firm decides to disclose post-trade information through the offices of third parties, the minimum arrangements that the third party systems used by the investment firm have to put in

place in respect of the disclosure of post-trade information, in order that the investment firm can ensure compliance with the content of article 28.

- the types of transactions for which the exchange of shares could be considered as determined by factors other than price (take account of the cases specifically covered by article 28, collateral and lending) and to other transactions that contain little or no useful price information

- How, if necessary, the obligation applies to those types of transactions. In particular examine the case of (lending of shares for covering short positions) short selling.

3. 8. Admission of financial instruments to trading (Art. 39)

- In order to define the conditions under which a financial instrument can be traded on a fair, orderly and efficient manner, and taking into account the current developments in Community Legislation, the following elements should be analysed a) the different aspects related to the issuer of the securities; b) the different aspects related to the instrument itself; specific rules with respect to derivatives; c) the different aspects related to the market for that particular instrument.; take account of the different types of market structures and of investors that have access to the market;

- Whether the regulated market should establish formal separations or segments in respect of the different characteristics of the same type of instruments; define those characteristics.

- With respect to the obligation imposed upon regulated markets to make information accessible to their members or participants analyse the case of "parallel trading".

3. 10. Exchange of information (Art. 58)

- Define the way requests for information should be made and executed, taking into account the need to foresee a plan for urgent cases.

- Establish the criteria to identify those particular cases where the information should be immediately supplied to other competent authorities without mediating any request. Particular attention should be paid to the transmission of information on the transactions in financial instruments to the competent authority of the most relevant market in terms of liquidity.

- Identify the provisions of the Directive which implementation will require the exchange of information between competent authorities.