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**CESR TECHNICAL ADVICE ON
IMPLEMENTING MEASURES OF THE PROPOSED FINANCIAL
INSTRUMENTS MARKETS DIRECTIVE (ISD 2)**

**TRANSACTION REPORTING,
COOPERATION AND EXCHANGE OF INFORMATION
BETWEEN COMPETENT AUTHORITIES**

CONSULTATIVE CONCEPT PAPER

MARCH 2004



A. Foreword

On 20 January 2004, the European Commission published its first provisional mandate requesting the Committee of European Securities Regulators (CESR)¹ to provide its advice on possible technical measures to implement the proposed Financial Instruments Markets Directive (commonly referred to as “ISD2”), which will revise the existing Investment Services Directive (ISD). The EU Commission’s provisional mandate (published by CESR on its Website - Ref. CESR/04-021) requests CESR to submit its advice on the appropriate measures to implement the Directive (so-called “Level 2 measures”) by 31 January 2005. In order to be able to meet this deadline, CESR has established three Expert Groups:

- Expert Group on Markets, which covers the provisional mandate related to the admission of financial instruments to trading, pre-trade and post-trade transparency requirements for MTFs and regulated markets, and post-trade disclosure by investment firms.
- Expert Group on Intermediaries, which covers the provisional mandate related to organisational requirements, conflicts of interest, conduct of business rules, best execution and client-order handling rules.
- Expert Group on Cooperation and Enforcement, which covers the provisional mandate related to transaction reporting (Art. 25²), the competent authorities’ obligation to cooperate (Art. 56) and the exchange of information between competent authorities (Art. 58).

Regarding the issues that are dealt with by the Expert Group on Cooperation and Enforcement, unlike the other two Expert Groups, which are able to build upon previous CESR work, CESR has to start its work basically from scratch. Therefore, CESR agreed to start the process by drawing up a so-called “Concept Paper”, in which the general approach and the main orientations in addressing the mandate are set out. As a next step, CESR will seek to identify the issues that should be dealt with at Level 2, thereby responding to the provisional mandate (“Mandate”), and those which would be more appropriately dealt with by CESR at Level 3 of the Lamfalussy Process.

This Consultative Paper follows the Call for Evidence issued by CESR on 20 January 2004, and is meant to collect comments from the industry with respect to the issues covered by the Expert Group on Cooperation and Enforcement at an early stage, before elaborating a consultation paper to be published by CESR in June. The paper aims at presenting CESR’s initial orientations and contains a number of open questions on which CESR would particularly welcome input from all interested parties. In addition, CESR would also welcome comments on what issues should be dealt with at Level 2 or Level 3, respectively, within the limits of the ISD2 and the Mandate. CESR is conscious of the need to ensure that entities concerned have sufficient time to make any necessary system changes as a result of the ISD2. This is

¹ The Committee was established under the terms of the European Commission Decision of 6 June 2001 (2001/1501/EC). The Committee has set out its own operational arrangements in its Charter. The Commission Decision and the CESR’s Charter are available on the CESR Website: www.cesr-eu.org.

² The numbering of the Articles quoted and references to their content are based on the Common Position adopted by the Council on 8 December 2003, Doc. 13421/3/03.



particularly true in respect of the transaction reporting requirements. In this light, interested parties are also invited to identify those areas where possible changes to the transaction reporting requirements would involve additional costs to the entities concerned and to quantify their regulatory impact.

The paper is divided into two parts: the first part covers the area of transaction reporting requirements; and the second one covers the topic of cooperation and exchange of information between competent authorities.

The Expert Group on Cooperation and Enforcement, chaired by Michel Prada, Chairman of the French Autorité des marchés financiers, has already conducted preparatory work by elaborating and evaluating two surveys regarding the way competent authorities currently receive transaction reports and the content of these transaction reports. In addition, a preliminary mapping exercise has been conducted to identify those provisions of the ISD2 that may require an exchange of information between competent authorities. The Consultative Paper has been drafted taking into consideration the preliminary results of this preparatory work. A first draft was presented in the first meeting of the ISD Consultative Working Group³ on 28 January 2004, which provided valuable input for the final Consultative Paper adopted by CESR.

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The deadline for submitting written responses to the Consultative Paper is 12 April 2004. Responses should be posted directly on CESR's Website: www.cesr-eu.org – “Consultations”.

³ A consultative group of market participants has also been appointed to provide technical advice to the Expert Groups. The market participants are experts drawn from across the European markets. They are not intended to represent national or a specific firm's interest and do not replace the important process of full consultation with all market participants.



B. Transaction Reporting

1. The ISD2 and the Mandate

Pursuant to Art. 25 par. 3 sub-par. 1, investment firms have to report transactions in financial instruments admitted to trading on a regulated market to the competent authority of the home Member State. Art. 25 par. 3 sub-par. 2 provides that competent authorities shall establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for financial instruments also receives that information. Pursuant to Art. 32 par. 7, in case of branches, transactions reports have to be made to the competent authority of the host Member State. Finally, Recital 44 states that Member States should be able to apply transaction reporting obligations of the ISD2 to financial instruments that are not admitted to trading on a regulated market.

The EU Commission requests CESR to provide technical advice on implementing measures concerning transaction reporting as set out in Art. 25. (The wording of the Mandate regarding Art. 25 can be found in the Annex.)

2. Initial orientations and open questions

2.1. Objectives

Promotion of market integrity across Europe is an objective shared both by regulators and market participants as they have a common interest in the proper functioning of the market and a common responsibility in solving problems and maintaining investors' confidence. In addition, CESR is guided in its approach by the need to encourage greater convergence of supervisory rules and practices across Europe for issues of common concern, so that the advantages of an efficient single market can be realised.

In a situation of increasing cross-border activities in financial markets and of competition between different trading venues, possibly resulting in market fragmentation, the requirement for investment firms to report transactions to competent authorities (and the exchange of that information between competent authorities) is to be considered as a mechanism of utmost importance for the regulators in order for them to be able to fulfil their supervisory duties, in particular those related to market integrity and investor protection.

Transaction reporting is an essential tool in the detection, investigation and enforcement of market abuse, which becomes even more important with the adoption of the Market Abuse Directive.

In addition transaction reports may also be used for the detection of potential breaches by investment firms of conduct of business rules (such as front-running behaviour), or to assess whether trading venues are functioning in an orderly manner.

Through transaction reports other, ancillary objectives may also be pursued, such as the detection of money laundering or the identification of market trends.

Moreover, the harmonisation of transaction reporting requirements could create additional benefits for the proper monitoring and promotion of the fairness and efficiency of markets,



such as compatibility of relevant databases and greater efficiency in exchange of information.

2.2. Methods and arrangements for reporting financial transactions

Pursuant to Art. 25 par. 5, Member States shall provide for the reports of financial transactions to be made to the competent authority by:

- the investment firm itself; or
- a trade-matching and reporting system approved by the competent authority; or
- the regulated market through whose systems the transaction was completed; or
- an MTF through whose systems the transaction was completed.

CESR is asked to provide technical advice as regards the methods and arrangements for reporting financial transactions. In this respect, CESR could draw up an inventory of minimum conditions (e.g. data security, system reliability) with which the abovementioned systems would have to comply in order to be considered valid to report transactions to the competent authorities. Such an inventory could include specific 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 for the waiver of the obligation to report directly by investment firms as provided for in Art. 25 par. 5.

Applying cost-benefit considerations, CESR is considering the existing arrangements for transaction reporting as a working basis and will seek to refrain from imposing unwarranted new requirements, which would involve radical changes to the existing arrangements and would bring about excessive additional costs for the entities concerned; at the same time, CESR is required to respond to the Mandates appropriately, so that the arrangements are effective.

In examining these issues, CESR will take into account the potential overlaps between the information required by Article 25 and the information required under the post-trade transparency requirements of the Directive. Whilst such information is used for different purposes, CESR is keen to explore ways in which commonalities between the two can be exploited so as to avoid unnecessary duplication and costs for both regulators and the industry.

Questions:

Q 1: *Do you agree with the approach suggested above to determine the methods and arrangements for reporting financial transactions in one set of criteria applicable to, both, the conditions for a trade matching and reporting system to be considered valid to report transactions to competent authorities, and the criteria allowing for a waiver? If you do not agree, what other approach would be more appropriate in your view?*

Q 2: *What requirements should such an inventory contain?*

Q 3: *What other issues, if any, should CESR take into account when responding to the Mandate concerning the “methods and arrangements for reporting financial transactions”?*



2.3. The criteria for assessing liquidity in order to define a relevant market in terms of liquidity for financial instruments

2.3.1. General

Pursuant to Art. 25 par. 3, details of transactions in any financial instrument admitted to trading on a regulated market have to be reported to the competent authority by investment firms as quickly as possible, and no later than the close of the following working day, whether or not such transactions were carried out on a regulated market. Moreover, competent authorities have to establish 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 this information".

This provision would permit the competent authority of the "most liquid market" in a particular financial instrument also to receive information on transactions in that instrument executed on trading venues situated in another Member State, providing it with a more complete picture of trading of that instrument within the EU.

It is not the intention of CESR that such arrangements established between competent authorities to exchange information would impose any additional obligations or burden on investment firms with respect to their reporting obligations.

In CESR's view, the following considerations might have to be taken into account:

- Assessing liquidity of a market and comparing liquidity of different markets for the purpose stated in the Mandate necessarily leads to difficulties as liquidity is neither static, nor can liquidity in different markets with varying market structures and models easily be calculated and compared.
- Neither the wording of Art. 25 nor the wording of the respective Mandate provide clear indications on the precise timeframe in which such information has to be delivered to the "competent authority of the most relevant market in terms of liquidity" which is not the competent authority of the home Member State.

It appears necessary to find a commonly accepted definition of "liquidity" and to establish criteria that can be used to assess and compare liquidity under different market circumstances and conditions, also taking account of work conducted by the other ISD Expert Groups as regards liquidity.

2.3.2. Definition of liquidity

The common understanding of liquidity might be best described as "the ability of investors to find a counterpart and to execute their orders at the best conditions (in terms of price, speed, etc.)." Liquidity refers to the ability of investors to trade quickly at prices that are reasonable in light of underlying demand/supply conditions.

Criteria that might be taken into account for determining liquidity are, in particular, the market to be considered, the mechanisms for analysing and checking liquidity, and the revision procedures.



The following general criteria might be considered for measuring liquidity in the context of the Mandate relating to Art. 25 par. 3:

- The concept should be flexible enough so as to allow for a comparison of activities in very different markets/market models.
- The concept should be easy to implement.
- The concept should grant a balance between actuality and reliability.
- The concept should take into account cost-benefit issues.

Specific criteria for measuring liquidity could, in particular, be volume or turnover.

Questions:

Q 4: *What would general criteria for measuring liquidity be?*

Q 5: *What specific criteria could be useful in measuring liquidity? Should they be prioritised?*

Q 6: *What could be an appropriate mechanism for assessing liquidity in a simple way for the purposes of this provision?*

Q 7: *What other considerations should guide CESR in its work regarding the assessment of liquidity in order to define a relevant market in terms of liquidity?*

2.4. The minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities

As stipulated in Art. 25 par. 4, the transaction reports from investment firms/obliged reporting parties shall, in particular, include details of the names and numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the investment firms concerned.

This is elaborated further in the Mandate concerning the indicative elements in respect of the harmonised content of the reports which may be taken into account by CESR in providing its technical advice, which refers to:

- 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).

Moreover, the Mandate refers to any other aspect that is 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.



Therefore, it is considered important by CESR that when delivering its advice it should ensure that arrangements facilitate the efficient exchange of information between regulators and the comparability of reports, that they provide regulators with adequate data to fulfil their responsibilities, and that they are proportionate.

In order to respond to the Mandate as to the minimum content and the common standard or format of transaction reports, CESR proposes to follow a two-step approach:

- In a first step, it would identify those types of information in transaction reports that competent authorities would request from investment firms/obliged reporting parties as a minimum (also distinguishing between financial instruments, as far as necessary).
- In a second step, it would extract from that list those types of information (transaction reporting fields) that are considered essential for establishing exchangeable transaction reports, and define a common standard/format for these transaction reporting fields, as well.

Questions:

Q 8: *Do you agree with the approach proposed by CESR for determining the minimum content and common standard/format for transaction reports? Are there other approaches that could usefully be considered?*

Q 9: *Apart from the types of information set out in Art. 25 par. 4 and the Mandate, what other information might be usefully included in transaction reports?*

A harmonised content has to be determined taking into account the waiver as provided for in Art. 25 par. 5. In order to avoid unequal treatment of reporting parties, it ought to be ensured that the requirements as regards the content of transaction reports are identical, no matter whether reported by the investment firm or by a third party (regulated market/MTF), or whether transactions take place on a trading venue or OTC.

Question:

Q 10: *Do you agree that the content of transaction reports has to be equal irrespective of the entity reporting the transaction? What considerations could justify a different treatment of reporting parties?*



C. Cooperation

1. The Mandate

The EU Commission requests CESR to provide technical advice, in view of the adoption of Level 2 measures, with respect to Article 56 (obligation to cooperate) and Article 58 (exchange of information). (As to the wording of the Mandate, refer to the Annex.)

2. Initial orientations and open questions

2.1. Obligation to cooperate – Art. 56 par. 5

According to Art. 56 par. 2, “when, taking into account the situation of the securities markets in the host Member State, the operations of a regulated market that has established arrangements in a host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, the home and host competent authorities of the regulated market shall establish proportionate cooperation arrangements”.

As per Art. 56 par. 5, “in order to ensure the uniform application of paragraph 2, the Commission may adopt (...) implementing measures to establish 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 the investors in that host Member State”.

Implementing measures are envisaged only with respect to the “criteria under which the operations of a regulated market in a host Member State can be considered as of substantial importance”, and would not cover the “proportionate cooperation arrangements” to be put in place by the authorities involved.

The Expert Group is planning to start a fact-finding exercise on regulated markets currently operating on a cross-border basis in the European Union, on the basis of which possible criteria for assessing the importance of operations of a regulated market could be defined.

Questions:

Q 11: *Do you agree that this preliminary assessment on the scope of the implementing measures is appropriate, and with the approach suggested above to determine the criteria under which the operations of a regulated market in a host Member State can be considered as of substantial importance, or would you consider another approach more appropriate?*

Q 12: *What relevant criteria should be taken into account in order to assess the substantial importance of the operations of a regulated market in a host Member State?*

2.2. Exchange of information – Art. 58



Even though the issue of cooperation and exchange of information between competent authorities is primarily of interest to these authorities, CESR would like to seek comments in this area, too.

The “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” that may be taken into account by CESR, as provided in the Technical Annex, are as follows:

“- 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.”

Questions:

Q 13: *What other indicative elements should CESR take into account when drafting its technical advice in this field?*

Q 14: *To what extent should CESR take into account the nature of the information to be exchanged in order to set up different categories of information and corresponding procedures of exchange of information (i.e. routine, case specific)?*

CESR holds the view that the issue of cooperation among regulators requires striking a balance between greater clarity and legal certainty, on the one hand, and retaining flexibility to cater for different scenarios, on the other hand. It may be worth noting that the Mandate encourages CESR to "take into account the MoU [Memoranda of Understanding] adopted in international fora, including IOSCO, and/or European fora or on a bilateral basis and on the experience gained" in the field of exchange of information. Therefore, special attention would have to be paid to the CESR Multilateral MoU and the work of CESR-Pol, and to the fact that it is not the intention of CESR to impose unjustified burden or costs on the industry.

There are certain common characteristics between the exchange of information for the purposes provided for in the Directive and the exchange of information under other Directives, such as the Market Abuse Directive 2003/6/EC or the Prospectus Directive 2003/71/EC. The work of CESR on the procedures for the exchange of information under this Mandate could be an opportunity for aligning, where appropriate, existing procedures in order to ensure a consistent approach for the exchange of information between competent authorities.

Question:

Q 15: *To what extent do you agree with the approach outlined above? In particular, are there any issues which you believe would be more appropriately dealt with at Level*



3? What other considerations should guide CESR?



ANNEX

Extract from the Provisional Mandate of the European Commission to CESR published on 20 January, 2004

“3.6. Reporting of transactions (Art. 25 (3), (4), (5) and ([6]))

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[.]”*

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 (Technical Annex):

“- 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. 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[.]”

[Note: The European Commission does not suggest any specific indicative elements to be taken into account by CESR in providing its advice on this topic.]

“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 Memorand[a] 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.”



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 (Technical Annex):

“- 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.”