



Date : 29 June 2004

Ref : CESR/04-323

Formal Request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments (Directive 2004/39/EC)

CALL FOR EVIDENCE

Background:

Following the provisional mandates on the first set of possible implementing measures on the Directive on Markets in Financial Instruments (MiFiD, Directive 2004/39/EC) issued by the DG Internal Market and sent to CESR on the 20th of January 2004, on 29 June 2004, the European Commission published its Final Mandate confirming that Provisional Mandate. The deadline for some of the original mandates has been postponed to end of April 2005.

Furthermore, the Commission sends to CESR additional mandates on a number of provisions of the MiFiD. In particular, the new mandates cover the following provisions:

- Art. 4 on the List of Financial Instruments (Annex I Section C).
- Art. 4.4 on the definition of investment advice.
- Art. 19.1 on general obligation for the investment firms to act fairly, honestly and professionally and in accordance with the best interests of the client.
- Art. 19.4 to 6 on suitability test, appropriateness test and execution only businesses.
- Art. 22.2 on limit orders display.
- Art. 24 on eligible counterparties.
- Art. 27 on pre-trade transparency.
- Art. 27 1 and 2 on the determination of the standard market size and the classes of shares.
- Art. 27.1 and 3 and 22 on multiple quotes.
- Art. 27.3 on the publication of the quotes.
- Art. 27.3 and 5 on withdrawal, updating and protection against multiple hits.
- Art. 27.3 on transactions exempted from the quote firmness.
- Art. 27.3 on retail size orders.

The request for advice is attached.

The Mandate sets the deadline for CESR's technical advice on 30 April 2005.

CESR has established two Expert Groups to deliver its technical advice, Expert Group on Markets and Expert Group on Intermediaries.

- 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 rapporteur of the Group will be Mr Jari Virta.
- 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.



Call for evidence:

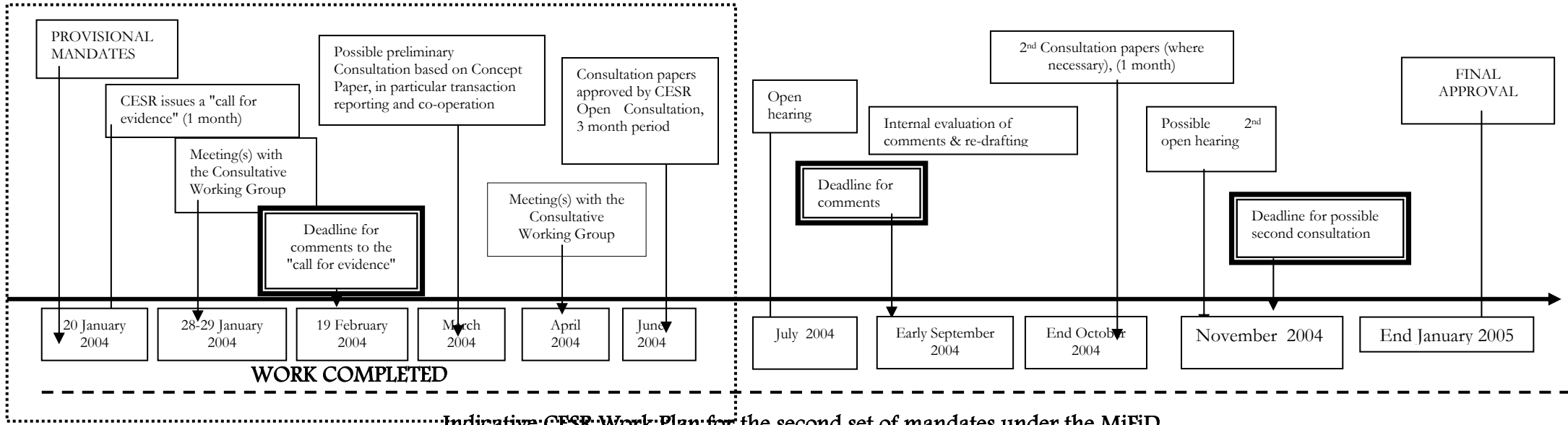
In releasing these requests for technical advice, CESR is inviting all interested parties to submit views as to what CESR should consider in its advice to the European commission. All contributions should be posted by 29 July 2004, on CESR' website in the section "Consultations".

Timetable:

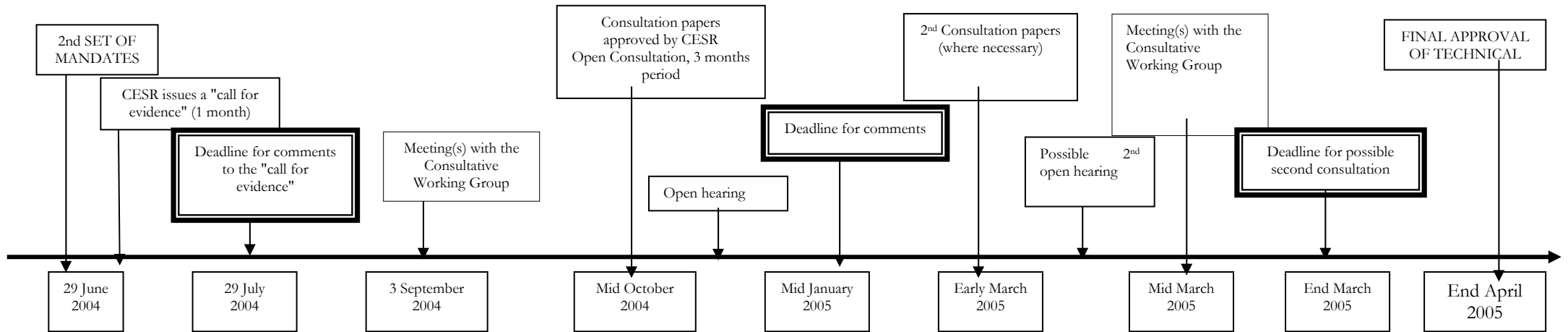
In order to meet the deadlines set by the European Commission, an indicative timetable for the work CESR will be undertaking in response to the mandate is attached. Further details on the consultation (including possible open hearings) will be disclosed once a more precise timetable is established.



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



Indicative CESR Work Plan for the second set of mandates under the MiFiD





Brussels, 25 June 2004

FORMAL MANDATE

Formal Request for Technical Advice on Possible Implementing Measures on the Directive on markets in financial instruments (Directive 2004/39/EC)**A. FINAL MANDATE CONFIRMING THE PROVISIONAL MANDATE FOR TECHNICAL ADVICE PRESENTED TO CESR ON 20/1/2004**

By letter of 20 January 2004, DG Internal Market requested the Committee of European Securities Regulators (CESR) on a provisional basis to provide its technical advice on possible implementing measures on the future Directive on Markets in Financial Instruments. This request was sent to CESR on the 20th of January 2004 and published on the same day.

In this letter, it was made clear that DG Internal Market's request did not cover all the articles for which the Directive establishes the need for implementing measures nor did 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 and the discussions on the final split between Level 1 "principles" and Level 2 "implementing measures". For instance, it did not cover articles where important differences existed between the Council and the European Parliament texts. A formal mandate would be sent to CESR once the Directive had been adopted by the European Parliament and the Council.

The Directive on Markets in Financial Instruments was finally adopted on 21/04/2004. It has been published in the Official Journal of the European Communities the 30/04/2004¹. The Directive entered into force on the date of publication.

In its letter of 20 January 2004, DG Internal Market also invited CESR to take full account of developments in the Council and the European Parliament. After examining the adopted Directive, DG Internal Market considers that the initial requests sent to CESR on 20/01/2004 are in line with the text of the Directive. This is without prejudice at a later stage, if necessary, to future possible mandates to CESR on other issues raised in the Directive concerning the same Articles.

On 1 June 2004, DG Internal Market consulted the European Securities Committee (ESC) on declaring this provisional request of January 2004 as a formal mandate.

As a result, the European Commission herewith declares that the provisional mandate given to CESR on 20/01/2004 is now a formal mandate.

¹ OJ L145 – 30-04-2004 – p.1to 44.

B. New requests to CESR for Technical Advice on Possible Implementing Measures concerning the Directive on Financial Instruments Markets

The present mandate, along the same lines as the provisional mandate presented on 20/01/2004, 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 part of the mandate covers all provisions necessary for the effective entry into force of the Directive on Financial Instruments markets which were not covered in the provisional mandate because there were divergent positions between the Council and the EP and their inclusion in the mandate might have harm the development of negotiations. It therefore completes the first request presented by the Commission.

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 "Investment Services Directive" (ISD).

The proposal for a Directive on Investment Services and Regulated markets² - the title of which was adapted during negotiations in Council to proposal for a Directive on Markets in Financial Instruments" - 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.

Adoption of the level 1 proposal has taken place in April 2004. It has been published in the OJ on the 30 April 2004. If the deadline of 2006 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 mandate takes into consideration that CESR has indicated that they need enough time to prepare and deliver their 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.

Timely adoption of the implementing measures is even more important given that some Member States may need at least 6 more months – in the cases where the implementing measures are

² 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).

adopted in the form of a Directive - to have them implemented into national legislation. 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 18 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 mandate is imperative. Nevertheless, in exceptional cases and subject to adequate justification, CESR should have the right to ask the Commission to defer the deadline set in the mandate for delicate and problematic issues.

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 mandate, especially in respect of articles 4 and 27. The Stockholm European Council, the European Parliament itself and the Lamfalussy report all urged the use of regulations whenever possible.

2. THE PRINCIPLES THAT CESR SHOULD TAKE ACCOUNT OF

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

The present mandate was presented in its present form in the meeting of the European Securities Committee of 1/06/04. 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.
- CESR should respond efficiently to the content of the mandates by providing 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. 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 has realised that mandates to CESR must be very clear and precise for the items that have to be covered by the advice required are concerned.
- 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 technical advice given by CESR to the Commission will not take the form of a legal text. However, CESR should provide the Commission with an "articulated" text which means a clear and structured text, accompanied by sufficient and detailed explanations for the advice given, and which is presented in an easily understandable language respecting legal terminology used in the field of securities markets.

- CESR should provide an advice which takes account of the different opinions expressed by the market participants during the various consultations. In case it deviates from the opinion generally expressed it should inform the Commission and justify their position. Particular attention should be paid of the level of detail required by market participants 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 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 three 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 carefully evaluated case by case; the advice should ensure clarity and legal certainty but avoid formulations which would lead to overprescriptive, excessively detailed legislation, adding undue burdens 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. List of Financial Instruments (Article 4 – Annex I Section C)

The Directive establishes in Annex I a list of the instruments, including two open categories (Commodity derivatives that can be physically settled and non-financial non-commodity derivatives) that are considered as financial instruments for the purpose of the Directive.

The Directive establishes some guidelines as to when those instruments could be considered as similar to the other financial instruments “per se” under the scope of the directive. These guidelines, such as being traded on a regulated market or MTF, being cleared through a recognised clearing house or being subject to regular margin calls, are not to be considered as exhaustive. The fact that an instrument does not comply with any of the guidelines should not prevent that instrument from being considered as a financial instrument if it has the characteristics of other derivative financial instruments.

CESR advice should be detailed and precise in order to allow for a harmonised and uniform definition of the financial instruments that fall under the scope of the Directive.

In responding to this mandate, CESR should have regard to recital (4) of the directive which indicates that the directive should apply to derivatives which are constituted and traded in such a manner as to give rise to regulatory issues comparable to traditional financial instruments.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on following issues:

(1) A definition of commodity.

(2) The conditions under which an option, future, swap forward rate agreement or other derivative contract related to commodities (which can be physically settled and is not otherwise covered by Section C.6) should be determined not to be for a commercial purpose.

(3) The conditions (other than cleared and settled through recognised clearing houses or subject to regular margin calls) for considering when a derivative contract of the type included in Annex I Section C 7 has the characteristics of other derivative financial instruments.;

(4) The definition of climatic variables, freight rates, emission allowances, inflation rates, official economic statistics.

(5) Whether there are, at this time, other categories of assets, rights, obligations, indices and measures not otherwise mentioned in Section C, where contracts relating thereto should be determined to fall within Section C.10. CESR should explicitly detail those categories..

(5) The conditions (other than cleared and settled through recognised clearing houses, subject to regular margin calls or traded on a Regulated Market or an MTF) under which an option, future, swap forward rate agreement or other derivative contract relating to the underlying referred to in 4 and, if any, in 5 above should be determined to have the characteristics of other derivative financial instruments where the contract must be settled in cash or may be settled in cash at the option of one of the parties - otherwise than by reason of a default or other termination event -)

3. 2. Definition of "Investment advice" (Art. 4 (4))

According to article 4, *Investment advice* means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments. This definition is essential to the functioning of other Articles which are covered by this mandate (for instance Articles 19 (4)-(6)).

DG Internal Market requests CESR to provide technical advice on possible implementing measures on the definition of "investment advice" by 30/04/2005 and in particular on the criteria for differentiating a personal recommendation from:

- General recommendations,
- Marketing communications,
- Information given to the clients or from
- Simple offer
- The activities carried out by tied agents.

3.3. Conduct of business rules (Article 19)

CESR when delivering its advice in respect of Article 19 should take account 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 clients or potential clients.

3.3.1. General Obligation to act fairly, honestly and professionally and in accordance with the best interests of the client (article 19.1)

Article 19.1 establishes a general obligation for the investment firms to act fairly, honestly and professionally when providing investment or ancillary services to their clients. This obligation applies to all types of services.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on obligation for the investment firms to act fairly, honestly and professionally when providing investment or ancillary services other than the service of execution of orders on behalf of clients.

3.3.2. Suitability test/ Appropriateness test/ Execution only businesses (article 19§4 to 6)

3. 3. 2.1. Suitability test (article 19§4)

This paragraph provides for an obligation for the investment firm to carry out a "suitability test" of the client when providing investment advice or portfolio management.

In providing its advice on article 19(4), (5) and (6), CESR should take into account 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.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on following issues:

(1) Define the criteria for assessing the minimum level of information that should be obtained from the client regarding his knowledge and experience in the investment field, his financial situation and his investment objectives.

(2) Determine the criteria for assessing, on the basis of the information received, the suitability of the investment service or financial instrument for the client or potential client.

3. 3.2.2. Information about the client knowledge and experience in the investment field (article 19§5)

This paragraph obliges investment firms, when providing services other than advice and portfolio management to ask some information from their clients in order to assess their appropriateness with respect to the service provided.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on following issues:

(1) Define the criteria for assessing the minimum level of information that should be obtained from the client regarding his knowledge and experience in the investment field.

(2) Determine the criteria for assessing, on the basis of the information received, the appropriateness for the client or potential client of the investment service or product envisaged as well as the content of the related warnings

3. 3.3.3. Execution only (article 19§6)

This paragraph allows investment firms to provide services that only consist in execution and/or the reception or transmission of orders without the need to ask for information or to carry out the suitability test, subject to certain conditions defined.

CESR, when establishing the criteria for determining when a service is provided at the initiative of the client should take careful consideration of the content of Recital 30.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on:

- The criteria for determining what is to be considered a non-complex instrument for the purposes of this rule;
- The criteria for determining when a service is provided at the initiative of the client and on
- The content of the related warnings.

3.4 Best execution/Pre-trade transparency for Regulated Markets and MTFs/Post-trade transparency for Regulated Markets, MTFs and Investment Firms.

It is necessary to ensure the overall coherence between the different rules that are designed to ensure a high degree of competition and efficiency in European markets and in particular between the transparency and best execution provisions of the Directive. To this end, the Commission has decided to extend the delay given to CESR in respect of its advice on articles 21 (best execution), 28 (post-trade transparency disclosure by investment firms), 29 (pre-trade transparency requirements for MTFs), 30 (post-trade transparency requirements for MTFs), 44 (pre-trade transparency requirements for Regulated Markets) and 45 (post-trade transparency requirements for Regulated Markets) to the 30/04/2005.

3. 5. Limit orders display (Article 22.2)

Article 22 provides that investment firms should, in case limit orders that they receive from their clients are not immediately executed either internally or externally, disclose the limit orders in a manner that is easily accessible to other market participants. This rule tries to increase price competition at the marketplace whilst avoiding that important price formation information is kept secret from the market. This obligation does not apply when clients expressly instruct otherwise.

Article 22 does also allow Member States to choose between obliging investment firms to send that orders to RMs or MTFs or giving the investment firm itself the possibility to choose the means for disclosing limit orders provided that general access is granted to those orders. The first possibility (i.e. obliging investment firms to route their limit orders to RMs or MTFs) should not however be understood as a best execution safe-harbour for limit orders as all the obligations in respect of best execution continue to apply to those type of orders.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on the different arrangements through which an investment firm can be deemed to have met its obligation to disclose not immediately executable client limit orders to the market in a manner which is easily accessible to other market participants.

3. 6. Eligible counterparties (Art. 24)

This provision allows investment firms to provide to a defined category of persons specific type of services without the need to comply with certain obligations laid down in the Directive.

CESR should consider that arrangements need to be simple and effective in order to facilitate the exercise of choice offered by this Article and that the requirements for being considered as an eligible counterparty take account of market efficiency and investor protection.

3. 6. 1. Eligible counterparties "per se" requesting a more protective treatment

Article 24 (2) lists the entities considered as eligible counterparties "per se". However, these entities are entitled to request a more protective treatment.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on the procedures that eligible counterparties "per se" have to follow in order to request a more protective treatment from the part of the investment firm, either on a general form or on a trade by trade basis.

3.6. 2. Other eligible counterparties

According to article 24 (3), those Member States that decide so, may recognise as eligible counterparties undertakings other than those mentioned in paragraph 2 that meet certain requirements. These requirements have to be proportionate, this is they have to allow for the existence of counterparties in the relevant markets and adapt to the real need in terms of investor protection. They shall also include quantitative thresholds.

In case investment firms enter into transactions with these entities, they must obtain their express confirmation that they want to be treated as eligible counterparties. Prospective counterparties must also give their express consent to be treated as eligible counterparties.

The procedures for obtaining that confirmation will also apply to third country undertakings such as those mentioned in article 24(3) by virtue of the second paragraph of article 24(4)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on:

- The criteria, including quantitative thresholds, that would allow considering an undertaking as an eligible counterparty and
- The procedures for obtaining their express confirmation to be treated as eligible counterparties.

3. 7. Transparency

The Directive considers transparency as a fundamental mean to ensure market efficiency and investor protection in a fragmented and competitive marketplace. To this end the ISD2 highlights the importance of the disclosure of price information as well as its availability to all market participants in a manner that could allow them to take their investment decisions in an informed manner and to the intermediaries to provide for effective best execution. In this respect, the Directive considers that the information should be provided and handled in a manner that could allow markets to consolidate it. One of the aspects that CESR should carefully evaluate when dealing with market information and the means for disseminating it is the existence of possible barriers for the consolidation of information. CESR should include in its advice all the necessary elements for eliminating the barriers for the consolidation of market information as well as all other means for ensuring that this information is handled in a manner that provides for its effective consolidation.

Pre-trade transparency – Systematic Internaliser (Articles 4 and 27)

3.7.1 Systematic Internaliser

The Directive includes a definition of systematic internaliser applicable to those investment firms that deal on own account on an organised, frequent and systematic basis by executing client orders outside a Regulated Market or MTF. This definition covers trading in all sizes and in respect all financial instruments.

The main purpose of the definition is to determine which firms will be subject by the pre-trade transparency obligation of article 27. CESR should consider that an investment firm should not be deemed to trade on own account on a given security on a systematic and on a non-systematic basis at the same time as this could include an element of legal uncertainty and jeopardize the effectiveness of the pre-trade transparency rule (taking into account recital 53).

Moreover, the Directive follows an objective approach that focuses on the activity performed refraining from linking the provision of the service on a systematic manner to the use of any specific technical or automated mean.

It does also apply to all dealing on own account activities of the investment firm whether with eligible counterparties (which for the purpose of the directive are to be considered as clients) or not.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on the criteria for determining when an investment firm deals on own account on an organised, frequent and systematic basis by executing client orders.

3.7.2 Pre-trade Transparency (article 27)

3.7.2.1 Scope of the Rule (27.1)

The pre-trade transparency rule applies to investment firms that practice systematic internalisation in shares admitted to trading on a regulated market for which there is a liquid market. The Directive states that, although for non-liquid shares there should be some pre-disclosure of the transaction terms, quote disclosure as established in article 27 should not apply to illiquid shares for which the risk incurred by liquidity providers is deemed to be more important than the necessity to inform the overall market. The Directive states that for non-liquid shares systematic internalisers should disclose quotes to their clients on request.

CESR, when examining this issue, should take into account that the Directive establishes transparency (either pre or post) as a principle and that derogations are only allowed, at level 1, when it has been considered that it is justified in terms of liquidity or competition purposes and specified in the Directive.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on what is to be considered a liquid market in an individual share for the purpose of article 27.

3.7.2.2 The determination of the Standard Market Size/Classes of shares (27.1 and 2)

The Directive establishes that a systematic internaliser will only have to disclose quotes for a size (or sizes) up to a standard market size (SMS). Above that size it is considered that the internaliser can execute the orders it receives from its clients without the need to make previously available a quotation.

The standard market size will be fixed for each class of share. All liquid shares will be grouped into classes on the basis of the average value of all the orders (either RM, MTF, systematic internalisers and non-systematic internalisers) executed in the European Union; with the only exception of block size orders (orders large in scale compared to normal market size). For each class, a SMS should be fixed. This size, that should be representative of the average sizes of the shares included in the class, will be the SMS applicable in respect of the quotations on each share included into the class.

The Directive does not establish the time period that should be taken into account for calculating the average size. However, this time period should be linked to the revision period that CESR should have to establish on the basis of paragraph 2, unless there are important reasons for deciding a different one. Besides, CESR in determining the time period for the revision of the calculations (the Directive provides that it should be done at least annually) should take into account the necessity that systematic internalisers and markets could function in a stable manner and that to impose the obligation to change frequently the SMS could result in an unnecessary burden on systematic internalisers. To this end the Commission considers that CESR should, in principle, adopt an annual revision is justifiable in technical, financial and practical terms.

The aim of establishing a standard market size by class of shares is mainly practical; as it has been considered that a different SMS by single share will create problems in respect of the implementation and compliance of article 27 by systematic internalisers. This should not, however, lead to the establishment of an artificially low number of classes of shares that could result in a SMS, especially for those with higher average size, which will not finally be representative of the shares that are included into the class (see also recital 54).

CESR, when defining the classes of shares should take into account that whilst the aim of this grouping is to facilitate the application of the quotation rule, the determination of each class should be based on the current grouping of average values by shares in the EU and that it should not artificially deviate from this grouping.

The Directive also establishes that there will only be one competent authority (the one provided for in Article 25) by share in order to determine the average size of the orders and consequently to define to which class of share it belongs. It also provides for the transparency of this classification.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 by

- Specifying the criteria for determining when a the price or prices reflect prevailing market conditions;
- Defining the classes in which liquid shares should be grouped as well as the criteria for its revision if necessary.
- Defining what is to be considered an order large in scale compared to normal market size.
- Defining the SMS for each class of shares as well as the criteria for its revision if necessary.
- Determining the arrangements through which competent authorities will calculate the arithmetic average value of the orders executed in the market for each share for determining the class to which each share belongs and in particular the period for revision and the time period for determining which orders are to be included in the calculation.
- Determining the arrangements through which competent authorities shall make public to all market participants the class of shares to which each share belongs.

3.7.2.3 Multiple quotes (27.1 and 3 and 22)

The Directive establishes that Systematic internalisers are allowed to publish multiple quotes (article 27.1) in which case they shall allocate the orders they receive from their clients between the different quotes taking into account the access conditions attached to each quote (Recital 49) and in compliance with the conditions established in article 22.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on specifying the general criteria for the handling of client orders in case that the systematic internalisers publish multiple quotes;

3.7.2.4 The publication of the quotes (27.3)

The Directive establishes that systematic internalisers have to publish quotes on a regular and continuous basis. It also obliges systematic internalisers to make the quotes public in a way that it is easily accessible to market participants so that the market can be aware of the prices offered by them.

Access to information is considered as a key principle by the Directive not only in respect of systematic internalisers but also regarding Regulated Markets and other trading venues. The Directive considers transparency as a fundamental mean for dealing with the possible negative effects of fragmentation. To this end it is important to bear in mind that the regulatory intervention should be focused in facilitating general access to information and the use of the most effective means for disseminating price information in a consolidated manner (to this end see the introductory comments to this section).

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 by

Specifying the criteria for determining when a quote is published on a regular and continuous basis and is easily accessible as well as, the means by which investment firms may comply with their obligation to make public their quotes, which shall include the following possibilities:

- a) Through the facilities of any regulated market which has admitted the instrument in question to trading;
- b) Through the offices of a third party;
- c) Through proprietary arrangements.

3.7.2.5 Withdrawal, updating and protection against multiple hits (27.3 and 5)

The Directive establishes the basic principle that quotes are “firm”. However, it also takes into account the fact that systematic internalisers should have some protections in respect of their liquidity provision function. These protections refer mainly to the possibility they have to update or even withdraw the prices they publish and to limit their exposure through the avoidance of multiple hits from the same or different clients.

In respect of multiple hits the ISD2 has balanced the necessity for investors (and for investment firms when providing best execution to their clients) to rely on the investment opportunities that quotes are deemed to offer them and the need to protect the stability and financial soundness of systematic internalisers. To this end CESR, when examining this issue, might wish to take into account aspects such as the characteristics of the investment firm, the characteristics of the market in which it is acting, the risk mitigation methods that the investment firm uses, etc.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on

- Which market circumstances that could be considered as exceptional that could allow a systematic internaliser to withdraw its quotes.
- The conditions under which quotes can be updated.
- The criteria for determining what constitutes considerably exceeding the norm in order to limit the total number of transactions from different clients.

3.7.2.6 Transactions exempted from the quote firmness (27.3)



The Directive provides that in case that an investment firm executes portfolio transactions or other type of orders subject to conditions other than the current market price it will not be obliged to execute them at its quotes prices.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on specifying the general criteria for determining those transactions where execution in several securities is part of one transaction or orders that are subject to conditions other than current market price;

3.7.2.7 Retail size orders (27.3)

The Directive provides that under certain conditions orders from professional clients of a size bigger than the size customarily undertaken by a retail investor can be executed at a price different than the quoted one.

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30/04/2005 on specifying the criteria for determining what is a size customarily undertaken by a retail investor.