THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref.: CESR/04-603b

CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

1st Set of Mandates

SECOND CONSULTATION PAPER

November 2004

CESR

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INTRODUCTION

Background

1. The Directive on Markets in Financial Instruments (Directive 2004/39/EC - "MiFiD") was adopted by the European Parliament and Council on 21 April 2004 (OJ L145/1 of 30 April 2004). The Directive will replace the Investment Services Directive 93/22/EEC.

2. In accordance with the Lamfalussy Process, the Commission may adopt implementing measures, so-called "Level 2 measures", with respect to a large number of provisions of the Directive. Before the Commission presents a proposal for implementing measures to the European Securities Committee, it seeks the technical advice on these measures from the Committee of European Securities Regulators ("CESR").

3. On 20 January 2004, the Commission published "*The Provisional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets*". The Commission asked CESR to deliver its technical advice in form of an "articulated" text by 31 January 2005. On 25 June 2004, the Commission published "*The formal request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments*". In addition to confirming the provisional mandate, published on 20 January 2004, the Commission asked CESR to deliver its technical advice on additional mandates concerning some new areas of the Directive by 30 April 2005.

4. On 17 June 2004 CESR published its first consultation paper on the first set of mandates under the MiFiD (ref. CESR/04-261b). The public consultation closed on 17 September, except for mandates on best execution and market transparency. The deadline for these mandates has been postponed to end of April 2005. CESR received 78 responses to the consultation.CESR is very grateful to respondents for their work. CESR is considering in detail all the responses to the consultation, and these responses will help to shape CESR's final advice to the Commission. A feedback statement will be published together with the final approval of CESR advice.

5. CESR considers that this second round of consultation be devoted to addressing certain key issues of policy identified in the responses to consultation, and the practical aspects of implementation of the revised proposals.

6. On most of the issues concerning the Expert Group on Intermediaries, CESR consulted on two alternative proposals. This consultation document reflects the current views of CESR on these issues taking into account the general results of consultation; in some cases the document presents a new proposal, in others it narrows the scope of the suggested alternatives.

7. As regards the mandates dealt with by the Expert Group on Cooperation and Enforcement, CESR is inviting comments on the requirements for transaction reporting, and is presenting – following the comments received during consultation – amended drafts for its technical advice to the Commission, and Level 3 recommendations which could be considered by CESR in the future, as well. (It should be noted that the final advice will not include any of these Level 3 recommendations.) During the first consultation, CESR received only a limited number of comments as to the mandates on Article 56 par. 2 and Article 58 dealing with cooperation among competent authorities, because respondents considered these issues as being mainly of relevance to regulators. Since the comments received were mainly supportive of CESR's approach and since no major substantial changes to that draft advice in the first consultation paper are envisaged, CESR takes the view that there is no need for a

second consultation on this subject-matter (except where it is specifically related to transaction reporting).

8. CESR also seeks to receive specific arguments and cases where the practical implementation of the new measures under the MiFiD will be particularly difficult. This will help CESR in its role of advising the Commission to highlight difficulties in the implementation phase of level 2 measures and to overall assess costs of implementation of the new regime.

9. More details on process and CESR's work plan, as well as a list of papers already published by CESR with relevance to this first set of mandates, are given in the Annexes to the consultation paper. A separate consultation paper on draft technical advice under Article 40 (admission to trading) will be published early December.

Areas Covered

10. The consultation paper covers the following aspects:

- The independence of compliance;
- Record keeping and the burden of proof;
- A requirement to keep tape records;
- Outsourcing of investment services;
- Conflicts of interest and the segregation of areas of business;
- Investment research;
- Methods and arrangements for reporting financial transactions;
- Most relevant market in terms of liquidity;
- The minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities.

Call for comments

11. CESR invites comments on its views regarding the issues raised. Market participants are invited to accompany any request for changes with detailed reasoning and practical examples of the impact of the proposals.

Consultation Period

12. Consultation closes on **17 December 2004**. Responses to consultation should be sent via CESR's website in the section "Consultations". Respondents to this consultation paper should post their responses on CESR's Website (www.cesr-eu.org) in the section "Consultations". CESR will publish a feedback statement on the consultations justifying its final choices vis-à-vis the main arguments raised during consultation.

Issues for consultation

1. General questions from the first consultation

a) *Split between Level 2 / Level 3, the degree of detail and the calibration of rules.*

Many respondents to the first consultation considered the consultation document too detailed, and that some parts of the draft advice could be better addressed under the Level 3. Some respondents, but in particular the representatives of the banking industry, made it clear that they wanted CESR to avoid the possibility of national governments imposing additional (super-equivalent) rules to the Levels 1 and 2 requirements.

CESR considers that there is a trade-off between the level of harmonisation and the level of detail of the rules; however, a dogmatic approach on the ideal level of detail and the split between Level 2 and 3 is impractical, and an assessment on a case-by-case basis will be conducted in the process of finalisation of the advice in order to strike the right balance between these different interests and to address various differentiations in the market (e.g. equities/non equities; small/large investment firms; retail/professional clients).

b) L*ack of responses from consumers and retail investors.*

Notwithstanding the questions addressed to retail consumers and retail clients in the executive summary, few responses were received from this side of market participants.

CESR considers that when evaluating the results of the consultation, the comparatively low level of input from consumers and retail investors should be taken into consideration in the final calibration of all various interests at stake.

c) *Transitional issues.*

Most respondents addressed the issue of the implementation costs and time for investment firms to implement due the Level 1 and Level 2 measures; market participants have requested specific transitional measures to allow a smooth transition to the new system.

CESR considers that the Commission should address these questions. However, CESR may advise the Commission on these issues once it better comprehends the extent of changes, particularly systems changes, required by the implementation of Level 1 and Level 2 measures. The current consultation is an opportune occasion to raise specific aspects of implementation (including costs) from market participants and to highlight aspects where transitional measures would be beneficial to market participants.

Consultees are invited to express their views on the proposed way forward for the finalisation of the technical advice.
CESR seeks practical and concrete exemplification of difficulties envisaged by market participants in the implementation of the new proposed advice.In particular CESR wishes to receive information on the timing of what is practicable in terms of systems changes needed to implement these proposals.

2. Independence of compliance

The size of the investment firms is a factor that deserves particular attention in addressing the calibration of regulatory intervention.

Existing CESR Standards on Investor Protection require the compliance function to be independent (Standard no. 9) and that the persons responsible for the compliance function perform their monitoring duties independently of all persons and activities subject to their monitoring. CESR consulted market participants on the basis of two alternatives: one requires independence of compliance as a mandatory requirement for all investment firms; the other states that independence is required when this is appropriate and proportionate in view of the complexity of the business of the firm and other relevant factors, including the nature and scale of the business.

Responses to the consultation document warned CESR to avoid intrusive regulation on internal organisation and structure of intermediaries.

CESR considers that:

- the principle of the independence of compliance is key to ensure effective performance of its role;
- the issue should be approached from a functional rather than organisational perspective;
- independence of compliance, where possible, should be achieved through the "*four eyes*" approach which implies that the persons responsible for the compliance function perform their monitoring duties independently of other persons and activities subject to their monitoring; however, CESR recognises that this may not be possible for "one man firms" or very small firms;
- in the latter case two options are available:
    i. the first is to impose outsourcing of compliance;
    ii. the second is to allow some degree of flexibility to investment firms as regards the means to achieve the objective of independence of compliance; in this case the investment firm has to show alternative systems and means to ensure effective compliance.

Consultees are invited to express their views on the proposed approach and in particular their opinions on the last option, with concrete proposals on the best way to achieve the objective of independence of compliance other than by compulsory outsourcing of the function in case of very small firms. Consultees are also invited to provide criteria to clearly define these small firms.

3. Record keeping and the burden of proof

An existing CESR Standard on Investor Protection (Standard no 10) introduces the obligation on the investment firm to be able to demonstrate that it has not acted in breach of the conduct of business rules. CESR consulted on whether this rule has to be considered as: (a) a reversal of the burden of proof; or (b) whether this rule applies vis-à-vis to the competent authority and/or the client.

Some experts feel that the obligation foreseen in Article 13.6 of the Directive, whereby investment firms have to keep records of all services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with applicable requirements, is sufficient to ensure overall effective compliance. Others argue that the existing CESR Standard puts a positive

obligation on the investment firm, since the firm has to demonstrate that it has not acted in breach of rules. Both alternatives were presented for public consultation.

Respondents to the consultation were generally against introducing such a requirement mainly because they consider that reversal of the burden of proof vis-à-vis the clients should be a matter left to Member States and not be covered by CESR advice; furthermore burden of proof vis-à-vis the competent authorities was alleged to be illegal in two respects: it breached the principles of innocence until guilt is proven; and there was no mandate from the Commission to impose such a requirement.

CESR considers that:

- its proposal does not intend to reverse the burden of proof but, rather, to introduce obligations of record keeping;
- the intensity of these obligations varies according to the nature and complexity of business carried out by investment firms;
- investment firms should always be able to conduct adequate and consistent audit trails to demonstrate compliance of their activity with applicable rules;
- the latter requirement will enable the regulator to ascertain that the investment firm has complied with its obligations, particularly in case of shortcomings (i.e. no assumption of guilt).

Consultees are invited to express their views on the proposed approach.

4. Tape recording requirement

An existing CESR Standard on Investor Protection (Standard no 15) requires investment firms to tape clients' orders originating from phone conversations; for these records a less stringent requirement for record keeping is imposed: one year as opposed to the period of five years for all other records.

Respondents to the consultation generally opposed this requirement on grounds of cost (without, however, presenting data on the marginal costs implied by the different periods for record-keeping), legality (potential contrast to the legislation on data protection) and policy (effective benefits of imposing such requirements against costs).

A clear majority of CESR members favours this obligation. CESR is also interested in collecting more elements as regards marginal costs for a shorter or longer period of record-keeping requirement than one year.

Consultees are invited to express their views on the proposed approach and in particular to provide evidence of marginal costs for a shorter or longer period of record-keeping requirement than the one proposed.

5. Outsourcing of investment services

An existing CESR Standard on Investor Protection (Standard no 127) states that an investment firm may only delegate the individual portfolio management function to another investment firm if the delegate firm is authorized in its home country to provide management services on an individual basis and is qualified and capable of undertaking the function in question. In addition, it provides that the mandate shall not prevent the effectiveness of supervision over the delegator, and that delegation may only take place to a non-EEA investment firm if an appropriate formal arrangement

between regulators enables them to exchange material information concerning both cross border delegations and the delegate.

CESR consulted on three possible approaches in respect of outsourcing:

a) retaining the current scope and wording of the CESR Standard; or

b) extending its scope to cover the outsourcing of some or all of the other investment services and activities; or

c) taking an approach whereby the outsourcing firm retains regulatory responsibility for the outsourced function, but emphasis is placed on the outsourcing firm's obligation to conduct due diligence in appointing a service provider, and its regulatory obligation to ensure the competent authority can exercise the rights to cooperation and access under the contract between the service provider and the outsourcing investment firm.

Respondents generally considered that CESR should not extend rules on outsourcing to other services than portfolio management and supported option c). Most respondents argued that it is common practice to delegate individual portfolio management to third countries intermediaries and that this had not been a cause of problems. Representatives from the asset management industry with few exceptions generally requested consistency with rules applicable to investment companies under the UCITS Directive[1] and the MiFiD.

CESR believes that:

- the highest degree of convergence should be ensured, where possible, with works conducted by CEBS and other international fora on outsourcing;
- the scope of any parity with the UCITS Directive should be confined to the delegation of individual portfolio management;
- the technical advice should be consistent with the provisions of the UCITS Directive, particularly as regards the distinction between delegate located in other EU countries or non-EU jurisdictions.

Consultees are invited to express their views on the proposed approach.

6. Conflicts of interest and the segregation of areas of business

CESR consulted on whether some areas of business should always be segregated to the fullest extent possible (e.g. through information barries) from other areas of business (proprietary trading, portfolio management and corporate finance business, including underwriting and/or selling in an offering of securities and advising on mergers and acquisitions), or whether CESR should recommend a list of examples of possible methods within which investment firms may choose the most appropriate in consideration of their internal organisation.

Respondents, with few exceptions, generally favoured the second approach, leaving more flexibility on the internal organisation and the measures to manage conflicts of interests.

CESR believes that:

[1] Article 5.g) of the UCITS Directive provides that "*where the mandate concerns the investment management and is given to a third-country undertaking, cooperation between the supervisory authorities concerned must be ensured*" and that "*having regard to the nature of the functions to be delegated, the undertaking to which functions will be delegated must be qualified and capable of undertaking the functions in question*".

- strong emphasis should be put on the clarity of objectives of prevention and management of conflicts;
- some discretion may be introduced as regards the means to manage conflicts;
- the list of examples suggested in the consultation document should not be considered as exhaustive;
- information barriers, such as Chinese Walls, should not be mandatory, but other means should at least be as effective;
- if alternative means were used by investment firms, there should be clarity about this use.

Consultees are invited to express their views on the proposed approach.

7. Investment research

In its first document CESR consulted on whether we should differentiate between the treatment of research held out to be objective and other forms of research; it presented two alternatives: a) the first considers that investment firms should always make all efforts to comply with all requirements foreseen by the IOSCO Standards; b) the second relates to the possibility for firms to produce "non objective" research when some of the measures foreseen by IOSCO and designed to promote that objectivity have not been taken; in the latter case a clear disclaimer to clients should be put in the research.

Responses from consultation were not unanimous.

CESR believes that:

- in reality there are different situations which deserve different treatment;
- clear disclosure should be imposed where firms do not fully comply with all requirements.

Consultees are invited to express their views on the proposed approach.

TRANSACTION REPORTING

General foreword

A. The MiFiD on transaction reporting

Pursuant to Article 25(3) first sub-paragraph, 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, whether or not such transactions were carried out on a regulated market. Article 25(3) second sub-paragraph 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 Article 32(7), in case of branches, transactions reports have to be made to the competent authority of the host Member State.

Finally, Recital 45 states that Member States should be able to apply transaction reporting obligations of the Directive to financial instruments that are not admitted to trading on a regulated market.

B. General objectives of transaction reporting

Promotion of market integrity in 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, 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, or to assess whether trading venues are functioning in an orderly manner.

C. General approach by CESR

In carrying out this work CESR has paid special attention to existing arrangements for transaction reporting and has refrained from proposing unnecessary new requirements that would involve radical changes to the existing arrangements and would bring about excessive additional costs for the entities concerned.

The work of CESR regarding the reporting of financial transactions is an opportunity for aligning, where appropriate, existing arrangements in order to ensure a more consistent and efficient approach for the reporting of financial transactions across Europe.

The proposed Level 2 advice for reporting financial transactions will apply to all investment firms (or approved reporting channels), all financial instruments admitted to trading on a regulated

market and all financial transactions on these financial instruments, whether or not carried out on a regulated market).

As regards the general philosophy of approach, CESR has systematically considered not only the Level 2 advice, but also possible Level 3 measures. The recommendations for Level 3 may be addressed in more detail by CESR in the future.

8. Methods and arrangements for reporting financial transactions

Respondents, with few exceptions, agreed with the approach proposed as to minimum requirements with which reporting channels would have to comply with, although most of the consultees did not see the need for CESR to include the requirement of a standard-level agreement between investment firms and reporting channels in its Level 2 advice. A majority of submissions were in favour of allowing investment firms to report transaction reports in non-electronic format as a matter for each Member State, even though this should be the case only in exceptional cases (e.g. occasional trading, exotic transactions, system failures). It was mentioned by some respondents that allowing reporting in non-electronic form could conflict with the requirement that CESR Members would be obliged to exchange information contained in transaction reports on an automatic basis. As regards the possible future convergence between national reporting systems, most of the submissions received were in favour of CESR investigating this issue in more detail, but only on a medium- or long-term basis. Some respondents alerted CESR to give its advice on the issue of reporting channels that would require authorisation in a number of Member States (e.g. where a regulated market reports transactions on behalf of its remote members, this could mean that it would require authorisation in all Member States which are the home Member States of the remote members), which in their view would require a practical approach.

Explanatory text

1. The purpose of this technical advice is to establish a proportionate general framework for the methods and arrangements for reporting financial transactions, to ensure the quality and timeliness of transaction reports in order for regulators to be adequately able to fulfil their duties and, in particular, their supervisory and investigatory responsibilities.

2. Pursuant to Article 25(5), Member States shall provide for the reports of financial transactions to be made to the competent authority by any of the following reporting channels:

    a) by the investment firm itself, or by a third party acting on its behalf;
    b) by a trade-matching and reporting system approved by the competent authority;
    c) by the regulated market through whose systems the transaction was completed;
    d) by an MTF through whose systems the transaction was completed.

3. CESR holds the view that the objective of the present advice is not to provide detailed and inflexible advice regarding the conditions with which all reporting channels have to comply in order to be approved, but should aim at proposing a good and workable framework of general minimum conditions.

4. CESR considers that in order to be able to ensure the quality and timeliness of the reports, a set of general minimum conditions, with which all reporting channels have to comply in order to be approved, needs to be established. This also reflects submissions to the Call for Evidence, the Consultative Concept Paper and the first Consultation Paper.

5. According to the provisions of the Directive, it is the competent authority that approves the reporting channel(s) in its jurisdiction. The competent authority shall approve any reporting channel that complies with the set of general minimum conditions.

6. Differences between Member States regarding specific national requirements could be considered to be acceptable, but it is important that the set of general minimum conditions is fulfilled by all reporting channels in order to have a satisfactory level of quality of the transaction reports, which is necessary for the exchange of transaction reports between competent authorities.

7. CESR would explore greater convergence of national reporting channels in the future, taking into account cost-benefit implications for markets, investment firms and competent authorities.

8. CESR would like to clarify that a market operator who offers reporting to the competent authority is considered to be an accepted reporting channel, regardless of whether these trades are done "through its systems" or not, once it has been approved by the competent authority as a reporting channel and hence complies with the general minimum conditions.

9. If a reporting channel wants to offer reporting to competent authorities in different Member States, its reporting system needs to comply with national requirements in different Member States as regards, for example, the content and format of transaction reports. Therefore, the reporting channel would need approval by all those different Member States.
CESR considers that Level 3 measures would be necessary to ensure that competent authorities in Member States follow the same "approach" when approving and monitoring different reporting channels. The reporting channel would need a system that can properly communicate with the system of the competent authority and the competent authority needs to be notified that this reporting channel would like to start sending transaction reports. But the intention would be that the approval process for conditions a) to e) of the draft Level 2 advice will usually be routine.

10. CESR has not been requested by the Commission to give its technical advice on the definition of trade-matching and reporting systems.

11. As mentioned before, in carrying out this work CESR has paid special attention to existing arrangements for transaction reporting and has refrained from proposing unnecessary new requirements that would involve radical changes to the existing arrangements and would bring about excessive additional costs for the entities concerned. For this reason, the proposed set of general minimum conditions reflects the requirements that competent authorities have for different reporting channels today.

12. For the same reason, under certain conditions an investment firm could be granted an exemption from the requirement to report in electronic format by the competent authority. However, it has to be noted that granting such an exemption should be exceptional (e.g. for investment firms effecting reportable transactions only on an occasional basis) and/or temporary (e.g. in case of failures of the investment firm's reporting systems), and at the discretion of the competent authority, which should take into consideration that the granting of such exemption must not have adverse effects on its obligation and ability to electronically exchange information on transaction reports with other competent authorities. At level 3, CESR could align the way of granting exemptions in the different Member States in order to get a common view on when exceptions from an electronic format could be considered to be acceptable.

<u>Draft Level 2 Advice</u>

The methods and arrangements for reporting financial transactions

1) The general minimum conditions with which all reporting channels have to comply in order to be approved would be:

   a) electronic form of the transaction reports (an investment firm may be granted an exemption from this requirement by the competent authority in case of exceptional and/or temporary circumstances);
   b) timeliness (capacity to provide the competent authority with the transaction reports within the timeframe imposed by the Directive);
   c) sufficient data safety, including confidentiality of the data;
   d) reliability/quality control mechanisms/existence of validation tools and correcting mechanisms in order to modify an erroneous transaction report;
   e) appropriate precautionary measures in case of system failures;
   f) capacity to report the minimum content of transaction reports in the standard/format required by the competent authority;
   g) capacity to report additional information, if required by the competent authority.

2) Reporting channels approved by the competent authority would have to be operated by an entity that is subject to monitoring by the competent authority in respect of compliance with the conditions set out in paragraph 1.

3) The arrangements put in place by a regulated market, an MTF or a trade-matching and reporting system in a Member State could be considered to be sufficient to allow the waiver of the obligation to report directly by investment firms, as provided for in Article 25(5), if these arrangements comply with the set of general minimum conditions provided for in paragraph 1.

Recommendations for possible future Level 3 work by CESR

CESR would explore greater convergence of national reporting channels in the future, taking into account cost-benefit implications for markets, investment firms and competent authorities.

1. If an investment firm reports through another reporting channel, there might need to be an appropriate service-level agreement between the investment firm and the reporting channel in order to define and ensure the responsibility issues regarding the effectiveness and/or correctness of the transaction reports. CESR could work on such responsibility issues at Level 3 in order to get a common view among the competent authorities in Member States.

2. Work to ensure that competent authorities in Member States use the same "approach" when approving and monitoring different reporting channels, in order to align, where appropriate, the practice of when the minimum general conditions are considered to be fulfilled, so as to facilitate the operations of cross-border activities.

3. Ensuring that, in order to avoid unnecessary double reporting, competent authorities are expected to waive the obligation for an investment firm to report directly to the competent authority provided that the investment firm reports via a reporting channel approved by the competent authority.

Consultees are invited to express their views on the proposed approach.

9. Criteria for assessing liquidity in order to determine the most relevant market in terms of liquidity for financial instruments

Generally, respondents to the first consultation paper expressed their support for the proxy approach proposed by CESR. Some comments recommended changes to the bonds and commodity derivatives proxy. As to the revision procedure, the general view was in favour of CESR's proposal, although it was suggested that the revision periods should not be too short and that issuers and markets should also be allowed to trigger the revision process. The proposed publication of a list of competent authorities being the competent authorities of the most liquid market for a specific financial instrument met opposition from market operators, which raised the point of anti-competitive effects the publication of the list could have.

Explanatory Text

1. The purpose of this technical advice is to provide criteria for assessing liquidity in order to define the most relevant market in terms of liquidity. The criteria should take into account:

    a) the markets to be considered;
    b) the mechanisms for analysing and checking liquidity;
    c) the revision procedures.

2. Article 25(3) subparagraph 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 (admitted to trading on a regulated market) also receives the transaction reports for these instruments executed on trading venues situated in another Member State in accordance with the provisions of Article 58, thereby providing it with a broader picture as to that instrument.

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

4. In CESR's view, 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. Therefore, liquidity refers to the ability of investors to trade quickly at prices that are reasonable in light of underlying demand and supply conditions. This definition is in line with the academic literature on the subject.

5. When considering the issue of liquidity more precisely, CESR has taken into account that 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 market models be easily calculated and compared.

6. As a consequence and taking also into account the responses to the Call for Evidence, to the Consultative Concept Paper and to the first public consultation on the draft CESR Technical Advice on MiFID implementation (ref CESR/04-261b), CESR has formulated general conditions in order to find criteria for the assessment of liquidity:

    a) the concept should allow for a comparison of activities in very different markets/market models;
    b) the concept should be easy to implement;
    c) the concept should provide for consistency over time;
    d) the concept should take into account cost-benefit issues.

7. CESR considered and discussed different specific criteria for measuring liquidity and eventually retained two :

   a) volume: amount of financial instruments being traded in a defined period of time;
   b) turnover: amount of financial instruments being traded in a defined period of time, multiplied with the respective prices.

   All other criteria, in particular frequency of transactions concluded in a defined time period and all concepts related to spreads, have not been considered suitable since there have been significant problems with regard to the availability of such data, their quality and comparability. In addition, there have been severe conceptual problems in applying these criteria to different market models.

8. CESR has through fact-finding exercises found that computing liquidity is not only difficult but also time-consuming and costly. In order to facilitate the assessment of liquidity and to avoid the annual computation of liquidity for every single financial instrument admitted to trading on a regulated market within the EEA for determining the most relevant market, CESR proposes the use of "liquidity proxies", as for example the use of the market where a share was first admitted to trading or the domicile of the issuer for bonds (excluding third country issuers as explained below). The use of proxies to determine the most relevant market in terms of liquidity will also facilitate a competent authority's obligations under Article 27 by identifying the financial instruments for which each competent authority will need to make the appropriate calculations.

9. In its fact-finding, CESR tested whether the proxies provided for a reliable identification of the most relevant market in terms of liquidity, by computing liquidity for different instrument using the criteria of volume, turnover and number of transactions (in 2003).

10. With respect to shares, the results of the fact-finding analysis indicated that, in an overwhelming number of cases, the most relevant market in terms of liquidity, measured by the criteria "volume" and "turnover", was indeed the market that was suggested by the proxy (i.e. market of primary listing). It suggests that the existence of multiple trading platforms/markets did not seem to have significant effects on liquidity. Or to put it another way: the existence of multiple trading platforms has not yet led to fragmentation of liquidity.

11. In addition, the analysis also led to consider that prioritisation between the computing criteria volume and turnover is neither possible nor necessary, but could be conclusive on the criterion 'number of transaction" as some CESR Members had problems in reporting relavant data.

12. For other financial instruments, obtaining reliable data was more difficult; hence, being realistic and pragmatic, CESR strongly recommends using proxies for assessing the most relevant market in terms of liquidity instead of computing a liquidity measurement for each financial instrument in Europe in order to determine who is the competent authority for the most relevant market in terms of liquidity for each of these financial instruments.

13. In relation to bonds, both CESR and market participants acknowledge the specificity of the bonds issued by third country issuers admitted to trading on a regulated market of a Member State. A possible proxy could have been to use the Home Member State as defined in the Prospectus Directive. However, this proxy would not take into account that most of the trading in these bonds does not occur on the regulated market where the bonds have been listed. Therefore, CESR does not recommend a proxy for bonds of third country issuers.

14. With respect to commodity derivatives, CESR considers them as unique contracts being designed and listed by a specific regulated market, and only traded there. Therefore, as they are not traded on multiple markets throughout Europe, CESR recommends that the proxy for determining the most relevant market in terms of liquidity is the regulated market where the specific contract is admitted to trading.

15. Nevertheless, CESR acknowledges that there might be cases in which the proxy approach does not provide the correct result. Therefore, where the proxy approach proves to be not accurate or no longer valid, CESR recommends applying an alternative approach based on the computation

of "volume" and/or "turnover" for a specified period of time, for each individual financial instrument concerned. In addition, CESR recommends setting up revision procedures providing for some flexibility.
For example, in case of an Initial Public Offering that would take place in more than one Member State, the competent authorities of the Member States concerned should come to a mutual agreement as to which competent authority should be considered to be the competent authority of the most relevant market in terms of liquidity for an initial period of time. After a sufficient period of time the most relevant market in terms of liquidity shall be determined in accordance with the revision procedures described below. A similar approach can be followed in case of cross-border mergers between issuers whose shares are admitted to trading to regulated markets in more than one Member State. Such specific cases are to be dealt with at Level3 in order to provide for the necessary flexibility.

16. For all the financial instruments that will be reported in accordance with the Directive but not covered by the proxy approach (e.g. bonds from third country issuers), CESR recommends not to compute liquidity on an annual basis for those financial instruments, considering that neither the cost for doing so nor the confusion that might arise from keeping track of the most relevant market for every single financial instrument in Europe would be justified. An initial computation exercise should be carried out to determine the most relevant market in terms of liquidity for each of those financial instruments that are not covered by the proxy approach. Any subsequent change in the identification of the most relevant market in terms of liquidity shall be conducted in accordance with the revision procedures described below.

17. Whatever the approach to be used to determine the most relevant market in terms of liquidity, CESR recommends setting up revision procedures that allow, first, for any challenge to the position of the most relevant market in terms of liquidity with respect to a specific financial instrument, and second, for regular and global testing of the accuracy of the proxy approach.

18. CESR suggests that only when the competent authority of a Member State, for a specific financial instrument, has doubts on whether the most relevant market in terms of liquidity is/remains valid, or wants to challenge the applicable proxy, the situation has to be reconsidered. Consequently, that authority should contact the other competent authority identified at that time as the competent authority of the most relevant market in terms of liquidity. They will both compute the liquidity in accordance with the alternative approach to proxies. Depending on the result of the computation, which will be determined by the market where "volume" or "turnover" has been the highest for an appropriate period of time, the identification of the most relevant market will change. (As to cases of disagreement between competent authorities concerning the results of the computation, following a similar approach as provided for in Article 16(2) and (4) of the Market Abuse Directive, a mechanism for finding solutions might be considered by CESR at Level 3.)

19. In case the revision procedures result in a change of the most relevant market in terms of liquidity for a financial instrument such as an equity or bond, which is the underlying instrument for a derivative contract, then the most relevant market for the derivative contract will also change. CESR considers that the competent authority of the most relevant market in terms of liquidity for a particular financial instrument should also receive transactions reports for derivatives referenced to that financial instrument.

20. With a view to take into account further developments in the securities markets resulting from the implementation of the Directive and its implementing measures, CESR also recommends proceeding to a general and complete review of the criteria and procedures implemented in order to determine the most relevant market in terms of liquidity, including the proxies. The review shall be conducted, through CESR, within a 5-year time period from the implementation of the Level 2 measures. CESR may propose any modifications considered as necessary to improve the situation.

21. Considering the criteria and approaches for the determination of the most relevant market in terms of liquidity and being aware of some of their drawbacks, CESR recommends to publicly identifying neither those markets nor the competent authority that has been designated as the competent authority of the most relevant market in terms of liquidity for a specific financial

instrument, in order to avoid interfering with competition between markets and to avoid unwanted impact on the industry.

22. CESR recommends that each competent authority, with respect to the financial instruments for which it is identified as the competent authority of the most relevant market in terms of liquidity, must inform all other competent authorities about the financial instruments for which it should receive information on transaction reports.

23. As soon as the revision procedures result in a change of the identification of the most relevant market in terms of liquidity for a financial instrument or other changes occur (e.g. admission to trading of a new financial instrument), all the other competent authorities must be informed without undue delay of the change by the competent authorities of both (if applicable) the relevant market prior to the change and the new relevant market.

Draft Level 2 Advice

Assessing liquidity in order to determine the most relevant market in terms of liquidity

1. For the assessment of the most relevant market in terms of liquidity, it is appropriate to use proxies instead of computing a liquidity measure for each financial instrument admitted to trading on a regulated market, unless otherwise specified in the present text. The proxies differ regarding the type of these financial instruments.

2. For determining the most relevant market in terms of liquidity with regard to shares, the regulated market where the share was first admitted to trading should be used as the proxy.

3. For determining the most relevant market in terms of liquidity with regard to equity linked derivatives, the regulated market where the underlying share was first admitted to trading should be used as the proxy.

4. For determining the most relevant market in terms of liquidity with regard to derivatives on equity indexes, a distinction as to the kind of index should be made:

   a) in case of indexes comprising solely companies from one country: the proxy would be the regulated market in which this index is computed;
   b) in case of indexes comprising companies from several countries: the proxy would be the regulated market which has been made the derivative available for trading;

5. For determining the most relevant market in terms of liquidity with regard to bonds, the domicile of the issuer (or if there is a parent company, the domicile of the parent of the issuer), if domiciled in a Member State, should be used as the proxy.

6. For determining the most relevant market in terms of liquidity with regard to interest rate linked derivatives, a distinction between the kinds of underlying instruments would have to be made:

   a) in case of interest-rate linked derivatives on government bonds: the proxy would be the regulated market of the domicile of the issuing government or government agency;
   b) in case of interest-rate linked derivatives on corporate bonds, the proxy would be the regulated market of the domicile of the issuer (or if there is a parent company, the domicile of the parent of the issuer).

7. For determining the most relevant market in terms of liquidity with regard to commodity derivatives, the regulated market where the specific contract is admitted to trading should be used as the proxy.

8. As an alternative to the proxies for determining the most relevant market in terms of liquidity for a financial instrument as set out above, the measure of liquidity to retain for

the assessment should be the computing of the criteria "turnover" and/or "volume" for a financial instrument, so that the most relevant market in terms of liquidity would be the market in which the highest turnover and/or volume in the respective financial instrument occurred over an appropriate time period.

The decision on whether turnover or volume should be used is left to the competent authorities which have to do the respective computation. The competent authorities are advised to choose the criterion for which data are available at a minimum of cost and effort.

This alternative computation would be used for:

a) determining the most relevant market in terms of liquidity with regard to all financial instruments for which no proxy has been defined (e.g. bonds from third country issuers);
b) with respect to a specific financial instrument, for questioning the position as most relevant market in terms of liquidity.

9. For the computation of liquidity in order to determine the most relevant market in terms of liquidity, the competent authorities need to consider trading on all markets, not just regulated markets.

10. The position as the most relevant market in terms of liquidity for a specific financial instrument, hence the identification as the competent authority of this market, can be questioned by the competent authority of this market or by the competent authority of another market and should be revised, provided that:

a) the questioning competent authority informs the identified competent authority of the most relevant market in terms of liquidity of its intention;
b) the competent authorities concerned compute the liquidity criteria (volume and/or turnover) for the respective market covering an appropriate period of time;
c) the results of computation clearly demonstrate the change in position as most relevant market in terms of liquidity.

11. Each competent authority should make the (updated) list of financial instruments for which it is the competent authority of the most relevant market in terms of liquidity available to the competent authorities being designated as contact point in accordance with Article 56 in all Member States, and to update the list as soon as changes occur.

12. In case of change of the identification of the most relevant market in terms of liquidity for a financial instrument used as underlying instrument for derivatives, the most relevant market in terms of liquidity for all those derivatives changes accordingly.

13. Within five years from the entry into force of the implementing measures adopted by the Commission on the basis of this technical advice, CESR should consider reviewing the whole process of assessment of the most relevant market in terms of liquidity, and, where necessary, propose changes.

Recommendations for possible future Level 3 work by CESR

CESR considers that, since there is no reliable data yet available for many financial instruments in order to compute liquidity and because it is important to have flexible procedures accommodating different markets and changes to market structures, the following issues should be dealt with at Level 3 rather than at Level 2. This would allow to adapt to market realities within a shorter period of time, and could eventually be "up-graded" to Level 2, if need be.

1. Finalising the revision procedures:

a) Determine the definitions in the revision procedures for determining the most relevant market in terms of liquidity:
   i. volume (amount of shares traded) over the specified period , single counted;
   ii. turnover (nominal value of shares traded in Euro) over the specified period. In case of non-Euro-members, the average exchange rate over the specified period as published by the European Central Bank shall be used to convert non-Euro-currency into Euro.

b) Determine the definition of the phrase "appropriate period of time" in the revision procedures for determining the most relevant market in terms of liquidity including whether it shall be agreed only between the two competent authorities concerned or determined at EU level. The time period for the criteria (turnover/volume) should be long enough to illustrate a structural change in terms of liquidity allocation.

c) Issues to consider for the work on the revision procedures at Level 3: timing for the launching of the revision procedure and its duration; need for drafting standard format documents (e.g. for questioning the assessment of the most relevant market), information policy of the other competent authorities/CESR about the on-going revision procedure or existence of a formal opening/closing of the procedure.

d) Address the specific cases, such as a simultaneous IPO in more than one Member State or cross-border mergers, where the proxy approach does not work, and find appropriate solutions on a case-by-case basis.

2. Determining the procedures for establishing the list of the competent authorities of the most relevant market for each financial instrument, and the procedures for up-dating that list, that include in particular questions related to the mechanisms for up-dating that list and a possible centralisation of the list.

3. To ensure that the Member State where the transaction took place also receives information about this transaction, CESR could consider at Level 3 whether any competent authority should be able to request transaction data (in accordance with the cooperation arrangements of the Directive) on a regular basis from other competent authorities where that instrument is listed even if it is not the competent authority of the most liquid market.

Consultees are invited to express their views on the proposed approach.

Draft advice on Cooperation and Exchange of Information related to transaction reporting (Article 58)

During the first consultation, CESR received only a limited number of comments as to the mandates on Article 58 dealing with cooperation among competent authorities, because respondents considered these issues as being mainly of relevance to regulators. Since the comments received were mainly supportive of CESR's approach and since no major substantial changes to that draft advice in the first consultation paper are envisaged, CESR takes the view that there is no need for a second consultation on this subject-matter (except where it is specifically related to transaction reporting).The following revised draft technical advice relates to transaction reporting only.

Explanatory Text

1. 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 also receives those transaction reports that concern financial instruments for which it is the competent authority of the most relevant market in terms of liquidity.

2. The wording of the indicative elements in the mandate on Article 58 suggests that, when delivering its advice on the procedures for the exchange of information between competent authorities designated as contact points, CESR should pay particular attention to the transmission of information on the transactions in financial instruments as to establishing the criteria in order to identify those particular cases where information should be immediately supplied to the competent authority of the most relevant market in terms of liquidity without mediating any request.

3. The Directive itself does not explicitly say when or how often the competent authority of the most relevant market in terms of liquidity should receive transaction reports.

4. CESR is of the view that, although there could be merit in keeping the Level 2 advice flexible as to when and how often transaction reports should be transmitted to the competent authority of the most relevant market in terms of liquidity, it should be pointed out that, for practical and cost-benefit reasons, it would be desirable to find only one "universal" flexible solution, which has the validity for every competent authority and every financial instrument, so that the transmission of information according to Article 25(3) and (6) should in particular be simple and workable. There could neither be the flexibility for each authority to say when or how often the transaction reports should be transmitted, nor flexibility for each financial instrument, since that would make the exchange of transaction reports too complicated and probably too expensive. Therefore, CESR proposes that transaction reports from investment firms and branches should be forwarded to other competent authorities in accordance with Article 25(3) and (6) immediately after the details of these reports have been transformed into the harmonised format of transaction reports.

5. CESR is of the opinion that in order to be able to ensure the quality and timeliness of transaction reports that are to be exchanged between competent authorities designated as contact points, and to facilitate the exchange of information between regulators, in accordance with Article 58, a set of conditions, with which all competent authorities designated as contact points have to comply, needs to be established.

6. Bearing in mind the different legal force of Level 2 and Level 3 measures, CESR proposes a more general approach at Level 2, drawing the distinction between the different categories of information and the need for identifying differentiated procedures.

7. CESR envisages undertaking work at Level 3 to define effective procedures concerning the exchange of information under the Directive with the aim of avoiding duplications with the work already carried out by CESR-Pol.

8. In accordance with Article 25, remote members should report their transactions to the competent authority of their home Member State. The contact point in the home Member State should then make sure that the competent authority of the most relevant market in terms of liquidity also receives this information. If the competent authority of the Member State where the transaction took place is not the competent authority of the most relevant market in terms of liquidity, it would not receive any information about this trade, even though it took place in its own jurisdiction.

9. Since many regulated markets have quite a substantial amount of remote members, the Directive (if interpreted in an overly narrow sense) would cause the regulators to take a step backwards in their supervision of the trading activities on its markets and it could interfere with the discharging of the responsibilities entrusted to the competent authority of the regulated market as provided for in Directive 2003/6/EC (Market Abuse Directive), an outcome which cannot have been the goal of the Directive. (Article 57 par. 1 could also be of relevance in this respect.)

10. During consultation of the draft CESR Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments, CESR was asked to propose practical solutions to this issue by a number of respondents. One proposal invites CESR to make use of the wording in Article 25(3), which requires only that it has to be ensured that the competent authority of the most relevant market in terms of liquidity also receives this information - and not how or from whom it receives it.

11. The basic idea would be to let the competent authority of a regulated market where the transaction took place receive information about the transaction from the remote members of a regulated market in their jurisdiction. The competent authority of the market where the transaction took place would then forward this information to the competent authority of the home Member State and to the competent authority of the most liquid market in terms of liquidity. A consequence of this approach would be to waive the obligation on a remote member to report to his home Member State.

    CESR has tried to illustrate this approach in **Annex C**.

12. Although CESR considers this approach as being practical, as the results would be in line with the objectives of the Directive, the proposal could face legal constraints. However, it is essential to find a workable solution for the reporting of remote members in order to ensure that the competent authority of the market where the transaction took place also receives the transaction reports.

Draft Level 2 advice

Special procedure for the transmission of information on transactions reporting

1. Competent authorities are obliged to establish necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity also receives details of transaction reports that concern financial instruments for which it is the competent authority of the most relevant market in terms of liquidity. The competent authority of the most relevant authority in terms of liquidity should receive this information without mediating any request, immediately after it has been transformed into the harmonised format of details of transaction reports to be exchanged between competent authorities.
2. When a branch reports to the competent authority in the host Member State, the competent authority of the host Member State should transmit the details of these transaction reports to the competent authority of the home Member State without mediating any request, immediately after having transformed the details of transaction reports received into the harmonised format of details of transaction reports to be exchanged between competent authorities, unless the competent authority of the home Member State decides that it does not want to receive this information.

The methods and arrangements for exchanging information on transaction reports between competent authorities designated as contact points

3. The arrangements put in place by a contact point, in accordance with Article 58, could be considered to be sufficient, as provided for in Article 25(3) and Article 25(6), when the arrangements comply with these conditions:
    a. electronic form of the transaction reports;
    b. timeliness (capacity to provide the receiving competent authority with the transaction reports within a given timeframe);
    c. sufficient data safety, including the confidentiality of the data;
    d. existence of correcting mechanisms (to ensure the transmission of information related to a modification of an erroneous transaction report transmitted by an investment firm to its competent authority);
    e. capacity to report the minimum content of transaction reports exchanged between competent authorities in the harmonised format.

Recommendations for possible future Level 3 work by CESR

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1. In light of increasing cooperation, CESR may consider a solution where information to be exchanged electronically between competent authorities, such as information of transaction reports, could be shared through a common database.

2. CESR considers that the Level 3 work could include determining the maximum time period, in particular as concerns the techniques, as to the supply of transaction reports to the competent authority of the most relevant market in terms of liquidity "immediately after having transformed the details of transaction reports into the harmonised format details of transaction reports". The reason for not determining this at Level 2 is that no techniques or systems are yet in place for exchanging transaction reports, as required by Article 25(3), whereas Level 3 allows for more flexibility to adapt to new situations. This would then also cover the exchange of information related to details of transaction reports under Article 25(6).

Consultees are invited to express their views on the proposed approach.

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

Some respondents to the first consultation paper were of the view that CESR could not require information fields additional to those set out in the Level 1 text and that the only fields that could be included in a transaction report were 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. Some of the responses with respect to the nationally harmonised list of the minimum content of transaction reports (Annex A) found the list too long and commented that in order to report some of these fields firms would have to make substantial changes to existing reporting systems. It was also argued that some of the fields were included without an appropriate justification for inclusion of a number of fields, or clarification on the meaning of some of the fields (e.g. "agent/proprietary", "trade value") was requested. Respondents generally were in support of harmonisation of Annex A at national level, however some other comments suggested that harmonisation of this list should take place at EU level as a step to the creation of the Single Market, even if undertaken on a gradual, medium-term basis. On the point of a client-identification code, most of the responses supported CESR's approach to give flexibility to Member States on this highly political issue. It was the general view that a pan-European client identification code did not seem to be feasible for the time being.
On the issue of remote members, CESR was urged to give particular attention to this question, and proposals on how to avoid duplication of reporting obligations of remote members were provided, which require further analysis, in particular as to legal feasibility.

Explanatory Text

1. Article 25(4) states that a transaction report should include, in particular, 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. However, this is not sufficient information to facilitate the use of transaction reports for the detection, investigation and enforcement of market abuse and the other regulatory purposes transaction reports are used for.
2. In particular, the minimum requirements set out in Article 25(4) do not include information concerning the trading capacity of the investment firm concerned, the counterparties or clients that they dealt with or on behalf of, or the identification of the trading venue on which the transaction took place. Moreover, additional, more detailed information, is required to appropriately interpret the content set out in paragraph 4.
3. Therefore, at Level 2, CESR has proposed a set of minimum requirements that represent the information that competent authorities, as a minimum, would need for the detection, investigation and enforcement of market abuse, as well as for the other regulatory purposes transaction reports are used for.
4. In this work, CESR has strived to identify and harmonise the core elements of transaction reporting. However, different market models, different approaches to market monitoring and different existing monitoring systems mean that CESR does not think full convergence is possible in the short or medium term. There are issues where CESR Members do not agree on what information is essential for the detection, investigation and enforcement of market abuse. CESR is of the view that in the long term greater convergence should be an objective, but as stated above, in the short to medium term this would not be useful neither from a data-quality perspective nor from a cost-benefit point of view.
5. Consequently, CESR is of the view that the implementing measures should set out the minimum information that should be included in a transaction report submitted by or on behalf of an investment firm regardless of the reporting mechanism used to submit the information.
6. As regards the format of transaction reports, CESR is of the view that transaction reports should be transmitted in an electronic format (except in exceptional and/or temporary circumstances), and it was agreed to leave the technical IT aspects to Level 3, as it should be up to competent authorities to determine how these requirements are met driven by the existing reporting mechanisms and arrangements. (For details on this proposal reference should be made to par. 12 of the explanatory text and par. 1 a) of the draft advice as to methods and arrangements for reporting financial transactions.)
7. Art 25(3) also requires competent authorities to exchange information received in transaction reports, but CESR believes that not all the information received by competent authorities needs to be exchanged and that the sharing of information between authorities is a matter for the competent authorities and would not require any further involvement of investment firms.
8. In order to take a first step towards greater convergence between Member States, CESR has considered that the information to be exchanged between competent authorities should indeed be harmonised. This information should be the information that competent authorities, as a minimum, would need for the detection, investigation and enforcement of market abuse, as well as for the other regulatory purposes transaction reports are used for. This information has been set out in Annex B of the Level 2 advise.
9. Annex A on the other hand is intended to set out the minimum information a competent authority should know about a transaction in order to be able to exchange the information in Annex B. The information in Annex A is the minimum information that competent authorities would receive from investment firms at national level. CESR is of the opinion that this information should indeed be minimum and should not be strictly harmonised, in order for competent authorities with high-developed reporting systems and supervisory methods to not have to take a step backwards in their supervision and in order to be able to use already-existing systems and arrangements taking into account cost-benefit considerations.
10. The approach to not fully harmonise the content of Annex A in order to make use of existing systems and arrangements, on the short to medium term, has been generally supported in the responses to the Consultative Concept Paper and to the Consultation Paper. Moreover, Recital 45

of the Directive explicitly recognises that competent authorities may require additional information over and above that set out in Art 25(4) or in the implementing Level 2 measures given by CESR to the Commission.

11. To further explain Annex A, all of the information fields in Annex A do not need to be reported in a unanimous way or in all transaction reports. For example some fields are only applicable to certain types of transactions (for instance, the "maturity" field would not apply to trades in ordinary shares). Similarly, the information in other fields may be obtainable through other means (for example, a competent authority may use the "instrument security code" to obtain other details about a security's characteristics such as its "maturity" or "derivative type"). Consequently, it should be possible for a competent authority to waive the obligation on an investment firm to report some of the individual fields in Annex A. Any such waiver should, however, not adversely affect the competent authority's ability to comply with its obligations regarding cooperation and exchange of information with other competent authorities.

12. With respect to the content of transaction reports, both CESR Members and market participants remain divided as to whether the "client/customer identification" field should be included in the list of information required in the transaction reporting from investment firms. Indeed, this type of information is already required in some Member States – usually in the form of the reporting firms' internal code for a client - and the competent authorities concerned find it necessary for their supervisory activities; these and other Members States are in favour of receiving this information for a number of reasons (it would reduce the number of transactions that need to be reviewed; it would permit reviews on client's trading profile; it would permit reports on leading clients in products; etc.). Other Member States do not request this information and do not consider it to be essential for the preliminary supervision conducted on the basis of the transaction reports received for several reasons (in particular, because of limited interest of a code that varies from firm to firm as there is no unique code for a particular client such as the social security number; ability to obtain client IDs from the investment firm when required for investigatory purposes; potential problems as to data protection/confidentiality considerations).

13. Consequently, CESR recommends that investment firms need only report this information if it is required to do so by national law in the Member State of the competent authority to which they are reporting.

14. A broader perspective for a client/customer identification would be to envisage a unique, European-wide code for a client/customer to be used by every investment firm reporting a transaction. However, CESR does not consider that it is in a position to propose advice on this issue considering, first, the technical and cost-related aspects of building from scratch such a pan-European identification code and, second, the political sensitivity of this issue.

Draft Level 2 Advice

1. Annex A sets out the minimum information that should be submitted by or on behalf of an investment firm in a transaction report and the definition of each field. The format of this information will be determined at national level.

2. Annex B sets out the information that should be exchanged between competent authorities and some recommendations on the format for those fields. Convergence on the format of these fields will be achieved at EU level through Level 3 measures.

Recommendations for possible future Level 3 work by CESR

1. CESR considers that, since there are not yet sufficient systems in place for the reporting of all financial instruments admitted to trading on regulated markets and for the exchange of

transaction reports between competent authorities and because it is important to have flexible arrangements in place for different markets and changes to market structures, the following work should be conducted at Level 3 rather than at Level 2:

2. Standardisation of the format and content of transaction reports exchanged between competent authorities. For information subject to Article 25 that is exchanged between competent authorities CESR believes that the precise format of the information should be defined at Level 3 in order to provide some flexibility if the techniques or standards used in the market would change. Amongst the issues that will need to be discussed are:
    a) the date and time format;
    b) the definition of own account and agency transactions;
    c) the categories of instrument types;
    d) definition of the codification for the authority key;
    e) the potential need for dictionaries necessary for interpreting the fields, e.g. a consolidated list of the trading venues;
    f) mechanisms to exchange information on cancelled or amended transactions.

Consultees are invited to express their views on the proposed approach.

CESR

Annexes to the draft technical advice on Transaction Reporting

Annex A– Minimum content of a transaction report

Fields marked with an asterix (*) can be waived at the option of the competent authority to whom the reports are being made. Any such waiver shall not adversely affect the competent authority's ability to comply with its obligations regarding cooperation and exchange of information with other competent authorities.

Field name	Field Description
Reporting Firm Identification	A code to identify the reporting firm which effected the transaction. The code should be unique for the reporting firm and could be a regulatory code, an exchange code or a BIC code. Reports made by agents on behalf of an investment firm should identify the investment firm using the appropriate code.
Trading Day	The business day on which the transaction took place.
Trading Time	The time at which the transaction took place. This should be the local time in the jurisdiction in which the transaction took place.
Time Identifier*	This field describes the relevant time zone of the transaction and this should be expressed as GMT +/_ hours.
Buy/Sell Indicator	The field defines whether the transaction was a buy or sell.
Trading Capacity	This field should identify the trading capacity of the reporting firm. At a minimum it should detail whether the firm is trading as principal or is acting on behalf of a client, but competent authorities may require further details of the trading capacity of the investment firm.
Instrument Identification	A unique code applicable to the security or derivative contract. Applicable codes could include ISIN numbers, exchange codes or other suitable product code. Firms may also need to specify which code they are using but this will be subject to national discretion All financial instruments that are subject to the transaction reporting rules should have a unique product code (or a series code in the case of derivative contracts). However, in the event that they do not then investment firms will need to report the name of the instrument.
Underlying Instrument Identification*	A unique code applicable to the security that is the reference asset in a derivative contract. Applicable codes could include ISIN numbers, exchange codes or other suitable product code. Firms may also need to specify which code they are using but this will be subject to national discretion.
Instrument Type*	The classification of the instrument that has been traded. Competent authorities can define the granularity of the descriptions but they must include whether the instrument is one of the following

	• Equity • Bond • Equity derivative • Bond derivative • Commodity derivative • Interest rate derivative • Index derivative • Others
Maturity Date*	Required for most bond and derivative transactions. It should be the maturity date of the bond or the exercise date/maturity date of the derivative contract.
Derivative Type*	Whether the derivative is an option, future, warrant or other.
Put/Call*	Whether the option or warrant is a put or call
Strike Price*	The strike price of the option or warrant contract.
Price Multiplier*	The number of pieces of the financial instrument concerned in a trading lot, e.g. the number of derivatives or securities represented by one contract.
Price	This is the price per security or derivative contract excluding items like commission and accrued interest. Subject to national discretion investment firms may also need to specify how the price is being expressed, i.e the relevant currency or whether it is expressed as a percentage (for debt instruments).
Quantity	The number of pieces of the financial instruments, the nominal value of bonds, or the number of derivative contracts in the transaction.
Counterparty	This field identifies the counterparty to the transaction. It could either be the name of the counterparty or a code that identifies the counterparty. Appropriate codes would include regulatory, exchange or BIC codes where available, otherwise investment firms could use their own internal code for their counterparty.
Customer/Client Identification	This field contains the identification of the client or customer on whose behalf the reporting firm was acting. This is likely to be the reporting firm's own internal code for its client/customer. Investment firms need only report this information if it is required to do so by the national law of the competent authority to whom it is reporting.
Trading Venue	An identification of the stock exchange or trading venue in which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC code or regulatory code for the MTF or off-exchange for other transactions.
Transaction Reference Number	A unique identification number for the transaction provided by the investment firm or reporting party.

Annex B – Information that should be exchanged between competent authorities

Field name	Field Description
Authority Key	The identification of the competent authority providing the information.
Reporting Party Name and Identification	Competent authorities should translate the code used by the reporting firm and provide other authorities with the full name of the authorised firm that has made the transaction report.
Trading Day	The business day on which the transaction took place.
Trading Time	The time, including hours, minutes and, where available, seconds at which the transaction took place. This should be the local time in the jurisdiction where the transaction took place,
Time Identifier	This field describes the relevant timezone of the transaction and this should be expressed as GMT +/_ hours,
Buy/Sell Indicator	The field defines whether the transaction was a buy or sell and should be expressed from the perspective of the reporting firm,
Trading Capacity	When exchanging information this field should confirm whether the investment firm is trading for its own account on a principal or proprietary basis or whether it is acting as agent for a customer or client. For these purposes a firm will have traded on a principal or proprietary basis if it takes the asset onto or off its own balance sheet. An agency transaction would be one where the asset is never owned by the investment firm.
Instrument Identification	The unique harmonised code applicable to the security or derivative contract. If the security code used by the investment firm is not a harmonised code then competent authorities will need to provide the name of the security. Similarly if the security does not have a unique product code then competent authorities will need to exchange the security name provided by the investment firm.
Instrument Security Code Type	The code type used by the investment firm to report the security code of the asset.
Underlying Instrument Identification	The unique harmonised code applicable to the security that is the reference asset in a derivative contract. If the security code used by the investment firm is not the harmonised code then competent authorities will need to provide the name of the security. Similarly if the security does not have a unique product code then competent authorities will need to exchange the security name provided by the investment firm.
Underlying Instrument Security Code Type	The code type used by the investment firm to report

	the underlying asset in the derivative contract.
Instrument Type	The classification of the instrument that has been traded. Even if competent authorities obtain more detailed classifications they should aggregate instrument types into one of the following categories when exchanging information with other authorities • Equity • Bond • Equity derivative • Bond derivative • Commodity derivative • Interest rate derivative • Index derivative • Others
Maturity Date	Required for most bond and derivative transactions. It should be the maturity date of the bond or the exercise date/maturity date of the derivative contract.
Derivative Type	Whether the derivative is an option, future or warrant
Put/Call	Whether the option or warrant is a put or call
Strike Price	The strike price of the option or warrant contract.
Price Multiplier	The number of pieces of the financial instrument concerned in a trading lot, e.g. the number of derivatives or securities represented by one contract.
Price	This is the price per piece of the financial instrument excluding items like commission and accrued interest.
Price Notation	The currency in which the price is expressed or percentage for debt instruments.
Quantity	The number of pieces of financial instruments, the nominal value of bonds, or the number of derivative contracts in the transaction,
Quantity Notation	Confirmation of whether the quantity is the number of pieces of financial instruments, the nominal value of bonds or the number of derivative contracts.
Counterparty Name and Code	Where possible competent authorities will need to translate the counterparty code reported by the investment firm and provide other authorities with the name of the counterparty. If the code reported by the investment firm is an internal code which cannot be translated then the code should remain.
Customer/Client Identification	This field contains the identification of the client or customer on whose behalf the reporting firm was acting. This is likely to be the reporting firm's own internal code for its client/customer. Competent authorities would only report this information if it is available in accordance with national law of the competent authority.
Trading Venue	An identification of the stock exchange or trading venue in which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC code or regulatory code for the MTF or off-exchange for other transactions.
Transaction Reference Number	A unique identification number for the transaction reported by the investment firm.
Cancellation/Amendment Indicator	Information required to cancel or amend a previously reported transaction.

ANNEX C

Scenario 1: Who reports to whom according to the MiFiD regime? The transactions take place on the MS A Regulated Market.

Origin of Instrument / Origin of Investment Firms	MS A***	MS B***	MS C***	Non-EU
1. MS A*	- Firm to MS A (CA + CAL + CAR)** - End	- Firm to MS A (CA + CAR) - MS A to MS B (CAL) - End	- Firm to MS A (CA + CAR) - MS A to MS C (CAL) - End	- Firm to MS A (CA + CAR) - End
2. MS B*	- Firm to MS B (CA) - MS B to MS A (CAL + CAR) - End	- Firm to MS B (CA + CAL) - End	- Firm to MS B (CA) - MS B to MS C (CAL) - End	- Firm to MS B (CA) - End
3. MS C*	- Firm to MS C (CA) - MS C to MS A (CAL + CAR) - End	- Firm to MS C (CA) - MS C to MS B (CAL) - End	- Firm to MS C (CA + CAL) - End	- Firm to MS C (CA) - End

* MS = Member State
** CAL = Competent authority of the most liquid market. CA = Competent authority of investment firm. CAR = Competent authority of the regulated market. Please note that MS A is the CAR in each case.
*** For MS A instruments the MS A authority is the authority of the most liquid market (CAL). With regard to MS B instruments it is the MS B authority that is the authority of the most liquid market (CAL) and for MS C instruments it is the MS C authority that is the authority of the most liquid market (CAL).

Observations:

- In 6 cases MS A would not receive any data regarding its regulated market at all (light grey fields). Consequence: The CAR MS A would not be able to cover its own market completely.
- Neither MiFiD nor this alternative proposal consider the reporting by non-EU remote members. This issue is usually dealt with at a national level.

Scenario 2: Who reports to whom according to the alternative **proposal**? The transactions take place on the MS A Regulated Market.

Origin of Instrument / Origin of Investment Firms	MS A***	MS B***	MS C***	Non-EU
1. MS A*	- Firm to MS A (CAR + CAL +	- Firm to MS A (CAR + CA)	- Firm to MS A (CAR + CA)	- Firm to MS A (CAR + CA)

	CA)** - End	- MS A to MS B (CAL) - End	- MS A to MS C (CAL) - End	- End
2. MS B*	- Firm to MS A (CAR + CAL) - MS A to MS B (CA) - End	- Firm to MS A (CAR) - MS A to MS B (CAL + CA) - End	- Firm to MS A (CAR) - MS A to MS B (CA) - MS A to MS C (CAL) - End	- Firm to MS A (CAR) - MS A to MS B (CA) - End
3. MS C*	- Firm to MS A (CAR + CAL) - MS A to MS C (CA) - End	- Firm to MS A (CAR) - MS A to MS C (CA) - MS A to MS B (CAL) - End	- Firm to MS A (CAR) - MS A to MS C (CAL + CA) - End	- Firm to MS A (CAR) - MS A to MS C (CA) - End

* MS = Member State
** CAL = Competent authority of the most liquid market. CA = Competent authority of investment firm. CAR = Competent authority of the regulated market. Please note that MS A is the CAR in each case.
*** For MS A instruments the MS A authority is the authority of the most liquid market (CAL). With regard to MS B instruments it is the MS B authority that is the authority of the most liquid market (CAL) and for MS C instruments it is the MS C authority that is the authority of the most liquid market (CAL).

Observations:

- In each case MS A would receive all data on the trading on the regulated market (in a uniform format, since remote members would report in compliance with the reporting requirements of MS A). Consequence: As the competent authority of MS A would have direct access to all trades on its market.
- In 4 cases the reporting lines are the same as under the MiFiD regime (light grey fields).
- In 2 cases the sequence of reporting would change but the authorities involved would be the same as under the MiFiD regime (dark grey fields).
- In 6 cases there would be an additional authority involved (white fields). These are exactly those cases in which MS A would not receive any data under the MiFiD regime.
- The system to put in place for exchanging information between regulators should take into account that not only CAL but also CA shall receive the information on transaction reports.
- Neither MiFiD nor this alternative proposal considers the reporting by non-EU remote members. This issue is usually dealt with at a national level.

ANNEX 1

PROCESS AND WORK PLAN

1. On 20 January 2004, the European Commission published its first set of provisional mandates requesting CESR's technical advice on possible implementing measures for the MiFiD by 31 January 2005 (Ref. CESR/04-021). A second set of mandates from the Commission was published by the Commission on 25 June 2004 ("*The formal request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments*"). In addition to confirming the provisional mandate, published 20 January 2004, the Commission asked CESR to deliver its technical advice in form of an "articulated" text concerning some new areas of the Directive by 30 April 2005.

2. The mandate from the Commission asks that CESR should have regard to a number of principles and a working approach agreed between DG Internal Market and the European Securities Committee in developing its advice. These are as follows:

   - 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 form 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.

3. CESR decided to establish three Expert Groups in order to be able to deliver CESR's technical advice to the Commission in an appropriate and timely way:

   - **Expert Group on Intermediaries**: The Expert Group is chaired by Mr Callum McCarthy (Chairman of the UK's Financial Regulator, the Financial Services Authority [FSA]);

rapporteur of the group is Mr Carlo Comporti. This Expert Group covers the mandates related to: article 4 on the definition of investment advice and the list of financial instruments; article 19.1 on the general obligations to act fairly, honestly and professionally; article 19.4 on the suitability test; article 19.5 on the appropriateness test; article 19.6 on the execution only business and article 24 on the transactions executed with eligible counterparties.

- **Expert Group on Markets:** This Expert Group is chaired by Mr Karl-Burkhard Caspari (Vice President at the German Regulator, the Bafin); rapporteur of the group is Mr Jari Virta. This Expert Group covers the mandates relating to: article 22.2 on limit order display and article 27 on pre-trade transparency of internalizers.

- **Expert Group on Cooperation and Enforcement**: This Expert Group is chaired by Mr Michel Prada (President of the French Securities Regulator, the Autorité des Marchés Financiers [AMF]); rapporteur of the group is Mr Alexander Karpf.

A Steering Group has been established to consider horizontal issues and to ensure overall consistency in the advice prepared by each Expert Group. This Group is composed of the three chairmen of the experts groups and chaired by CESR's Chairman, Arthur Docters Van Leeuwen.

4. In line with CESR's commitment to transparent working procedures and in order to have the technical input for the Expert Groups from external experts already at an early stage, CESR formed a specific Consultative Working Group of market participants drawn from across the European Markets. They are not intended to represent national or a specific firms' interest and do not replace the important process of full consultation with all market participants. The Consultative Working Group has already met twice with the Expert Groups and provided most valuable assistance to them for developing drafts of this consultation paper. The Consultative Working Group will continue to offer its views and advice to CESR as work progresses.

   The following 21 external experts are members of the Consultative Working Group:

   Dr Heiko Beck, General Counsel DekaBank Deutsche Girozentrale
   Dr Michele Calzolari, Chairman of Assosim and CEO of BIPIELLE SIM
   Mr Jean-François Conil-Lacoste, CEO of Powernext SA
   Mr Henri de Crouy-Chanel, Administrateur Délegué of Aurea Finance Company
   Mr Peter De Proft, Member of the Executive Committee of the Bank Nagelmackers
   Mr Mark Harding, Group General Counsel of Barclays Bank Plc
   Mr Brian Healy, Director of Trading of the Irish Stock Exchange
   Mr Henrik Hjortshøj-Nielsen, Senior vice president Nykredit
   Mrs Marianne Kager, Chief Economist of Bank Austria
   Mr Socrates Lazaridis, Vice-President of the Athens Stock Exchange
   Mr Jacques Levy-Morelle, Secretary General of Solvay SA
   Mr Gyorgy Mohai, Advisor to the Budapest Stock Exchange
   Mr Peter Norman, Executive President of Sjunde AP-fonden
   Mr Anthony Orsatelli, CEO of CDC Ixis
   Mr Joao Martins Pereira, Compliance officer and Adviser to the Board of Directors of Banco Espírito Santo
   Mr Frede Aas Rognlien, Chief Legal Counsel in the Association of Norwegian Stock broking Companies
   Mr Roger Sanders (OBE), Joint Chairman of FSA-SBPP Deputy Chairman of the Association of Independent Financial Advisers
   Dr Jochen Seitz, Senior expert for European Regulatory Affairs from Deutsche Börse Group
   Mr Juan Carlos Ureta, Chairman and CEO of Renta 4
   Mr Renzo Vanetti, CEO of SIA S.p.A
   Mr Jan-Willem Vink, General Counsel ING Group

5. CESR has undertaken to consult widely all interested parties according to the principles set out in the Final Report of the Committee of Wise Men and as set out in CESR's "Public

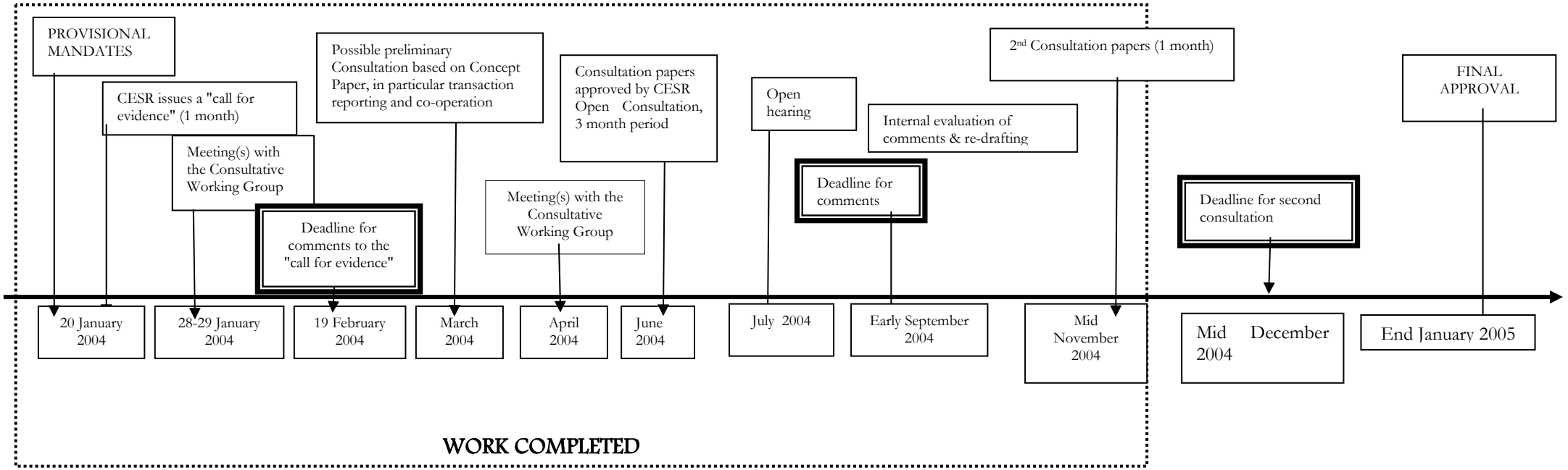
Statement on Consultation Practices" (Ref. CESR/01-007c). The first step in CESR's consultation process began with the launch of a Call for Evidence from all interested parties on 29 June 2004 (Ref. CESR/04-323). Views from all interested parties on any or particular parts of the mandates were invited by 29 July 2004. CESR received more than 40 responses from a wide range of market participants, which are available on CESR's website.

6. On 17 June 2004 CESR published its first consultation paper on the first set of mandates under the MiFiD (ref. CESR/04-261b). The public consultation closed on 17 September, except for mandates on best execution and market transparency. The deadline for these mandates has been postponed to end of April 2004. On 8 and 9 July, a public hearing was held by CESR. CESR received 78 responses to the consultation, which are available on CESR's website.

7. All these responses were taken into consideration by the two Expert Groups in the development of the consultation paper.

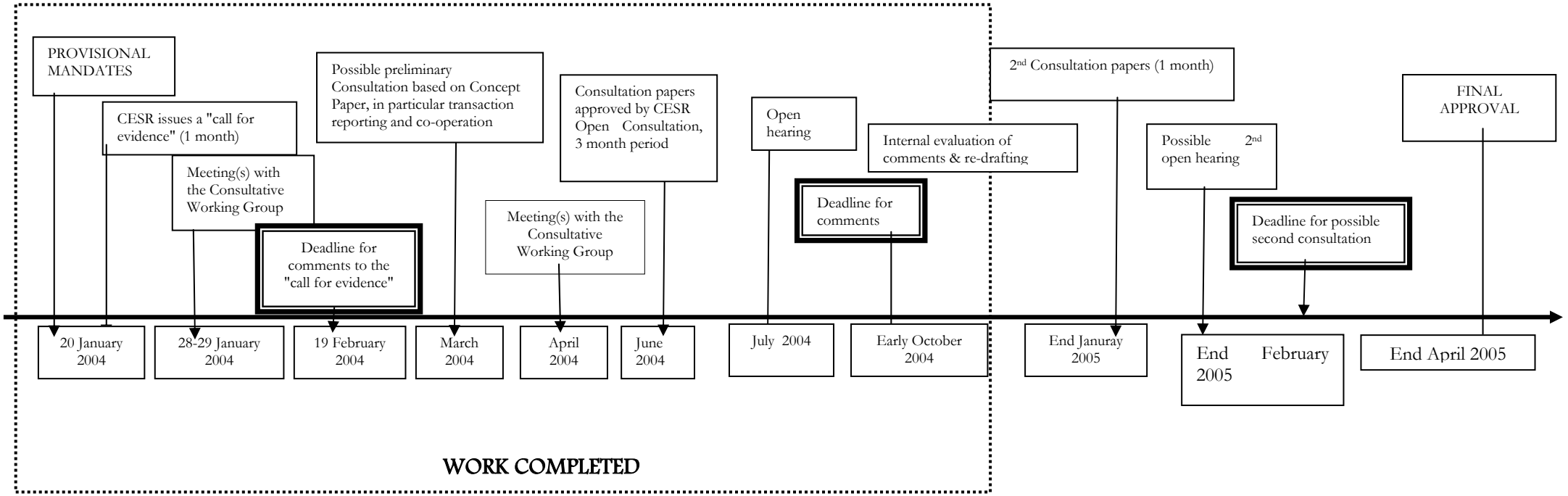
8. The work plan for handling the first set of mandates, which has been accomplished up to now, can be found below.

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

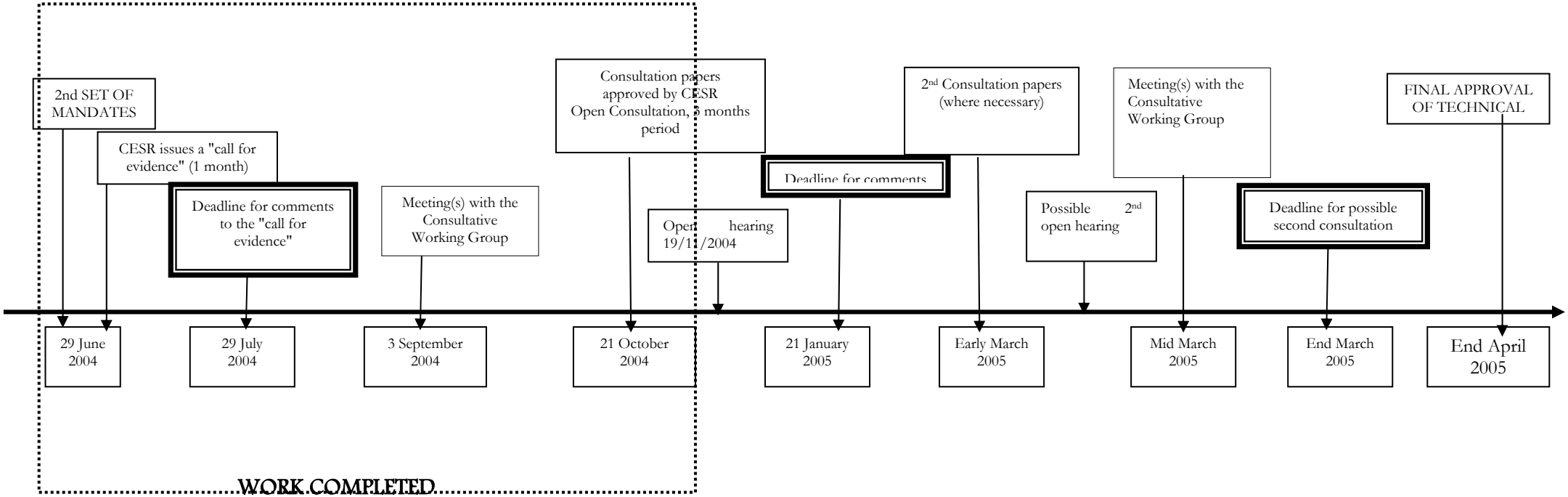


CESR

Indicative CESR Work Plan for mandates on best execution and article 22(1) under the MiFiD



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



ANNEX 2

LIST OF RELEVANT WORK ALREADY CONDUCTED BY CESR IN THIS AREA

Already in the past, CESR undertook a number of initiatives in areas now covered by the MiFiD, which were taken into account in the EU legislative process as to the MiFiD, and also included in the MiFiD, to a considerable extent. In addition, a large number of these initiatives will also be used for CESR's work on the technical advice for Level 2 measures as requested by the Commission.

- **Standards on Investor Protection** ("A European Regime of Investor Protection - The Harmonization of Conduct of Business Rules" [CESR/01-014d], "A European Regime of Investor Protection – The Professional and the Counterparty Regimes" [CESR/02-098b])

- **Standards for Alternative Trading Systems** (CESR/02-086b)

- **Standards for Regulated Markets under the ISD** (99-FESCO-C)

- **First Interim Report by the Review Panel on the Status of Implementation of the CESR Standards on Investor Protection and for Alternative Trading Systems** (CESR/03-414b)

- **Report of CESR on Market Transparency and Efficiency** (CESR/02-179b)

- **The Regulation of Alternative Trading Systems in Europe – A paper for the EU Commission** (FESCO-00-064c)

- **Implementation of Article 11 of the ISD: Categorisation of Investors for the Purpose of Conduct of Business Rules** (00-FESCO-A)

- **CESR's advice on possible implementing measures of the Directive 2004/30/EC on Markets in Financial Instruments, Consultation Document, June 2004** (CESR/04-261b)