THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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

1st Set of Mandates

January 2005

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INTRODUCTION

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 European Commission may adopt implementing measures, so-called "Level 2 measures", with respect to a large number of provisions of the MiFID. Before the European 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 European Commission published "*The Provisional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets*" ("first set of mandates"). The European Commission asked CESR to deliver its technical advice in form of an "articulated" text by 31 January 2005.

4. Seventeen substantive areas were covered in the Commission's Provisional Mandates to CESR. These were:
   a) Compliance obligations and treatment of personal transactions (Art. 13.2)
   b) Obligations related to internal systems, resources and procedures (Art. 13.4 and 13.5 second subparagraph)
   c) Obligation to avoid undue additional operational risk in case of outsourcing (Art. 13.5 first subparagraph)
   d) Record keeping obligation (Art. 13.6)
   e) Safeguarding of clients' assets (Art. 13.7 and 13.8)
   f) Conflicts of interest (Art. 18 and 13.3)
   g) Fair, clear and not misleading information (Art. 19.2)
   h) Information to clients or potential clients (Art. 19.3)
   i) Client agreement (Art. 19.7)
   j) Reporting to clients (Art. 19.8)
   k) Transaction reporting (Art. 25)
   l) Obligation to cooperate (Art. 56)
   m) Exchange of information (Art. 58)
   n) Best execution obligation (Art. 21)
   o) Client order handling rules (Art. 22.1)
   p) Market transparency obligations (Art. 28, 29, 30, 43 and 44)
   q) Admission of financial instruments to trading (Art. 39)

   The deadline for preparing advice on the four latter areas, as well as that for the part of the advice on conflicts of interest concerning investment research, has been extended by EU Commission to 30 April 2005. Accordingly, the feedback statement on those substantive areas will be given in April.

5. In order to accomplish its tasks CESR set up three Expert Groups: Expert Group on Markets, chaired by Mr Karl-Buckhard Caspari; Expert Group on Intermediaries, chaired by Mr

Callum McCarthy; Expert Group on Cooperation and Enforcement, chaired by Mr Michel Prada. (The three Expert Groups are coordinated through a steering group, which has been chaired by CESR's Chairman, Mr Arthur Docters van Leeuwen.) The Expert Groups are assisted by a Consultative Working Group formed of 21 market participants by CESR (the complete list of participants is given in Annex 2).

6. CESR published a Call for Evidence on 20 January 2004 (Ref.: CESR/04-021) seeking input on the key issues which it should consider in dealing with the first set of mandates. The deadline for responses was 19 February 2004 and more than 40 responses were received, which are available on CESR's website.

7. Regarding the issues that are dealt with by the Expert Group on Cooperation and Enforcement, which was able to build upon previous CESR work, CESR agreed to start the process by drawing up Concept Paper (Ref.: CESR/04-073b). This Concept Paper followed the Call for Evidence issued by CESR on 20 January 2004 and was divided into two parts: the first part covered the area of transaction reporting requirements; and the second one covered the topic of cooperation and exchange of information between competent authorities.

8. 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 2004, except for mandates on best execution obligation and market transparency obligations for which it closed on 4 October 2004.

9. On 25 June 2004 the European Commission published "*Formal request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments*". For reasons of coherence between the different rules that are designed to ensure a high degree of competition and efficiency in European markets and in particular between the transparency and best execution provisions of the MiFID, the European Commission, in its formal mandate, decided following this request to extend the deadline granted to CESR in the provisional mandate requesting advice on best execution obligation, market transparency obligations and admission of financial instruments to trading to 30 April 2005.

10. On 17 November 2004 CESR published a second consultation paper on the first set of mandates (Ref.: CESR/04-603b). This consultation, which closed on 17 December, focused on key issues of policy identified in the responses to the first consultation and the practical aspects of implementation.

11. On 29 November 2004 by addendum to the formal request for technical advice on possible implementing measures on the MiFID the European Commission decided to accept the request formulated by CESR and extended the deadline 30 April 2005 for preparing the technical advice on client order handling rules (Article 22(1)).

12. The feedback statement (Ref. CESR/05-025) explains the policy options which CESR decided upon in response to the major points raised during the public consultations by market participants.

13. On 22 December 2004 CESR released Call for Opinions (Ref.: CESR/04-689) regarding a single subject: advice to the Commission under Article 19(7) in relation to agreements between the investment firms and their professional clients. The deadline for this mandate has been postponed to end of April 2005. The period for responses to the call for opinions closes on 20 February 2005.

TECHNICAL ADVICE

SECTION 1 – DEFINITIONS

Explanatory text of general application to the advice and relating to the definitions

The definition of "relevant person" clarifies who should be considered as a manager, employee or tied agent of an investment firm for the purposes of the Directive. For these purposes, the term "employee" should be considered to cover both natural persons falling within employment law definitions of this term and, where appropriate, natural persons who perform equivalent roles, including persons whose services are made available to the investment firm by another person.

This definition may include natural persons involved in the provision of services to the investment firm or its tied agent under an outsourcing arrangement. A wide range of arrangements could fall within the concept of an outsourcing and natural persons involved in such arrangements may perform a wide range of roles, entailing differing compliance risks. It is therefore desirable to maintain flexibility in determining whether it is appropriate to include such natural persons within the definition of a relevant person, by reference to the nature of the arrangement and the individual's role.

Where the advice refers to "relevant persons", it is not necessary to draw a distinction between the categories of "managers" and "employees", which are likely to overlap in practice.

The obligations to be placed on investment firms in relation to relevant persons under this advice should not prevent Member States from also directly regulating relevant persons.

The principles set out in this advice are intended to be sufficiently flexible to adapt to the different organisational structures within investment firms, such as those resulting from different legal and governance systems. For example, some investment firms will have a supervisory function with responsibility for oversight of senior management. The application of the relevant provisions should be left to Member States to determine at national level to reflect the fact that the precise structure and functions of such supervisory function may differ from firm to firm and from Member State to Member State. For example, it may involve a separate supervisory board within a two tier board structure. In the case of a firm with a unitary board structure, it may involve the establishment of a non-executive committee within the senior management. However, references to the supervisory function do not include general meetings of the shareholders of an investment firm or equivalent bodies. The provision of information and allocation of responsibility to the supervisory function (if any) of an investment firm should be consistent with the role and responsibilities of the supervisory function under applicable national law and corporate governance codes. The question of whether an investment firm is required to have a supervisory function is outside of the scope of the Directive.

Where the advice is expressed as applying in relation to a "retail client", it is not intended to apply in relation to a professional client.

Where the advice is expressed as applying in relation to a "client", it is intended to apply in relation to both retail and professional clients. Subject to Article 24(1) of the Directive, this includes clients that satisfy the criteria for treatment as an eligible counterparty. Article 24(1) of the Directive only provides for the disapplication or Articles 19, 21 and 22(1) and does not prevent an eligible

counterparty falling within the definition of a client for other purposes. Therefore, where the investment services provided to an eligible counterparty fall within Article 24(1) of the Directive, that eligible counterparty will still be a client for the purposes of other Articles of the Directive (such as Articles 13 and 18).

The definition of a marketing communication is intended to be media neutral. It therefore applies to marketing information communicated by any means, including by way of printed advertising, radio, television, telephone, e-mails, the Internet and electronic media, such as digital and other forms of interactive television, or any combination of these means of communication. Activities and communications potentially covered by the definition of marketing communication include, for example: (a) the distribution of written product brochures; (b) general advertising; (c) the distribution of mail shots (whether by post, facsimile, e-mail or other media); (d) telemarketing activities, including oral communications such as from call centres; (e) presentations to groups of private customers; (f) securities research reports, and tip-sheets; and (g) other publications, which may contain non personal recommendations as to the acquisition, retention or disposal of financial instruments of any description or to the purchase of any investment services relating to such instruments.

The definition of a marketing communication is not however intended to apply to communications that are directed at one specific person or group of persons acting jointly, unless those communications form part of an organised marketing campaign. Examples of persons acting jointly include a husband and wife or the guardians of a minor investing jointly.

The reference to organised marketing campaign would prevent an investment firm from circumventing the requirements relating to marketing communications by slightly personalising each communication sent out in a marketing campaign.

The definition of contingent liability transactions focuses on transactions that expose the client to obligations that are not covered by holdings in his account. Examples of open positions in contingent liability transactions include: selling a call option on an investment not held in the client's portfolio; unsettled sales of call options on currency in amounts greater than the portfolio's holding of that currency in cash or in readily realisable securities denominated in that currency; and transactions having the effect of 'selling' an index at an amount greater than the portfolio's holdings of financial instruments included in that index.

A stock-lease product combining a loan, a cash financial instrument and an option is an example of a compound product.

CESR's advice has been prepared on the basis that Member States may impose additional requirements in relation to its subject matter.

BOX 1

a) References in this advice to the "Directive" mean, unless the context requires otherwise, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments.

b) References in this advice to terms defined in the Directive shall have the meaning given to them in the Directive unless the context requires otherwise. In addition, several further definitions are required to assist in the interpretation of the advice.

c) CESR has adopted the following definitions of certain terms used in the advice to facilitate its

comprehension and simplify its structure:

1. "*senior management*" means the persons who effectively direct the business of the investment firm, as referred to in the first paragraph of Article 9(1) of the Directive;

2. "*supervisory function*" means the function (if any) within an investment firm with responsibility for the supervision of its senior management;

3. "*relevant person*" in relation to an investment firm, means a manager, employee or tied agent of that investment firm, which for these purposes shall include any person who falls within one or more of sub-paragraphs (i) to (v) below:

   (i) a director, partner or equivalent of that investment firm or its tied agent;
   (ii) if a person in (i) is not a natural person, its representative when acting as such and any of the persons who effectively direct its business;
   (iii) a natural person who works for that investment firm or its tied agent (under a contract of employment or otherwise);
   (iv) a natural person whose services are placed at the disposal and under the control of an investment firm or its tied agent under an arrangement between that investment firm or its tied agent and a third party;
   (v) a natural person who is involved in the provision of services to the investment firm or its tied agent under an outsourcing arrangement, where such inclusion is appropriate in view of the nature of the arrangement and the natural person's role,

   where, in the case of paragraphs (iii) to (v), the natural person is involved in the conduct of the investment firm's investment and/or (where appropriate) ancillary services and/or investment activities or those of the tied agent for which the investment firm is responsible. However, external lawyers providing legal advice and external accountants providing audit services should not be considered as falling within this definition;

4. "*personal transaction*" means a transaction in financial instruments that a relevant person effects himself or causes another person to effect, where that relevant person is acting:

   (i) outside of the scope of his professional activities; and/or
   (ii) for his own account or for the account of any person in a domestic relationship with him or with whom he has close links or whose relationship with him is such that he has a direct or indirect material interest in the transaction;

5. "*compliance policies and procedures*" means the policies and procedures established under paragraph 7(a) of the advice under Article 13(2) of the Directive, including the code of conduct referred to in paragraph 11 of that advice, and the policies and procedures required under Articles 13(4) and (5) of the Directive;

6. "*outsourcing*" means all forms of arrangements which involve an investment firm relying on a third party service provider for the performance of a process, a service or an activity that would otherwise be undertaken by the investment firm itself;

7. "*client assets*" means financial instruments and/or funds belonging to clients, and "*client funds*" and "*client financial instruments*" must be read accordingly;

8. references to client assets "*held*" by an investment firm (and similar expressions) include client assets held by a third party on behalf of that investment firm, but exclude client assets held by a third party that has been directly appointed by the client;

9. "*client financial instruments held on an omnibus basis*" means financial instruments of

more than one client that are included in the same account on the books of the depository or financial instruments that are registered under the same designation on behalf of more than one client in the issuer's register;

10. "*depository*" means a third party with whom an investment firm holds client assets including clearing or settlement systems and central securities depositories;

11. "*conflict of interest*" means a conflict of interest falling within Article 18(1) of the Directive, including actual conflicts and circumstances involving a risk of a conflict arising and including the offer or receipt of a permitted inducement, where such actual or potential conflict of interest may cause damage to a client's interests;

12. "*material conflict of interest*" means a conflict of interest that presents a material possibility of damage to the interests of one or more clients;

13. "*conflicts policy*" means the policy maintained by an investment firm under paragraph 1 of the advice under Articles 13(3) and 18;

14. "*information barrier*" means effective procedures to control the flow of relevant information between persons that are to be separated by the barrier, which must specify:

    (i) any circumstances in which any persons can be taken over the information barrier (which must be documented and agreed by the compliance function); and
    (ii) the relevant persons and/or activities involved;

15. "*interested person*", in relation to an investment firm, means a relevant person or any person directly or indirectly linked by control to that investment firm;

16. "*inducements*" means any monies, goods or services (other than the normal commissions and fees for the service) offered or received by an investment firm or any of its relevant persons in relation to business for a client with or through another person, whether on a prepaid, continuous or retrospective basis;

17. "*marketing communication*" means any form of information communicated by or on behalf of an investment firm to the public that advertises, makes a recommendation in relation to, or is capable of acting as a solicitation regarding, investment services, and/or where appropriate ancillary services and/or financial instruments.

    For these purposes, information is issued to the public if it is designed for, directed at and/or addressed to, a number of people. Information is not issued to the public if:

    - it is directed at one specific person or group of persons acting jointly, unless it forms part of an organised marketing campaign; or
    - it is only communicated by the investment firm to other members of its group, provided that the investment firm takes all reasonable steps to ensure that none of the recipients pass the communication to a person who is not a member of its group.

    The following shall not be considered as marketing communications for the purposes of this advice:

    (a) an advertisement that:

        only makes the public aware of an investment firm's existence; and

does not recommend any particular service or instrument;

(b) a prospectus or a supplement to a prospectus prepared in accordance with Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading or comparable documents relating to transferable securities prepared in accordance with other national requirements of a Member State; and

(c) information disseminated by or on behalf of an issuer of shares or debt securities through a mechanism used for the disclosure of regulated information under Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market or through a comparable mechanism for the disclosure of information under national requirements of a Member State concerning the dissemination of information;

18. "*retail marketing communication*" means a marketing communication addressed to or directed at persons who include (or are likely to include) retail clients or potential retail clients;

19. "*direct offer retail marketing communication*" means a retail marketing communication that contains:

(i) an offer by the investment firm or another person through the investment firm to enter into a contract in relation to a financial instrument or investment service with anyone who responds to the communication; or

(ii) an invitation to anyone who responds to the communication to make an offer to the investment firm or to another person to enter into a contract in relation to a financial instrument or investment service,

and which specifies the manner of response or includes a form by which any response may be made;

20. "*compound product*" means a financial product, which consists of a combination of one or more financial instruments and/or financial services;

21. "*derivative*" means a financial instrument specified in any of paragraphs 4 to 10 of section C of Annex I to the Directive;

22. "*contingent liability transaction*" means:

i) a derivative under the terms of which the client will or may be liable to make further payments (other than charges, and whether or not secured by margin) when the transaction falls to be completed or upon the earlier closing out of his position, where those actual or potential liabilities are not covered in the client's account; or

ii) a short position in a financial instrument;

23. "*durable medium*" means on paper or any other instrument which enables the client to store information in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored. Durable media include in particular floppy discs, CD-ROMs, DVDs and the hard drive of the client's computer on which the communication is stored, but they do not include Internet websites unless they fulfil the criteria contained in the definition of a durable medium;

24. "*in writing*" means any mode of representing or reproducing words in a visible form, including typing, printing, email messages and web pages;

25. "*carrying out*" an order (or related expressions) means the execution, and/or the transmission for execution, of an order by the investment firm, including a portfolio manager instructing another to execute or transmit the order;

26. "*order*" means an order received by the investment firm for execution or transmission; and/or a decision by the investment firm to deal when acting as a discretionary portfolio manager;

27. "*group*" in relation to an investment firm, means the investment firm, its parent undertakings, its subsidiaries and the other subsidiaries of its parent undertakings;

28. *"requesting authority"* means the competent authority that makes a request for cooperation or exchange of information;

29. *"requested authority"* means the competent authority that receives a request for cooperation or exchange of information;

30. *"contact point"* means the authority designated in accordance with Article 56(1);

31. *"routine information"* means information that should be maintained by the competent authorities according to the provisions of the Directive or information that a competent authority receives from other competent authorities to allow the free provision of investment services and/or activities throughout the European Union; and

32. "*reporting channels*" mean the entities referred to in Article 25(5).

SECTION II - INTERMEDIARIES

Compliance and personal transactions (Article 13(2))

Extract from Level 1 text

Article 13(2) - An investment firm shall establish adequate policies and procedures sufficient to ensure compliance of the firm including its managers, employees and tied-agents with its obligations under the provisions of this Directive as well as appropriate rules governing personal transactions by such persons.

Extract from the Mandate of the Commission

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

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

CESR Advice

Explanatory text

Explanatory text relevant to CESR advice on Articles 13 and 18

Primary responsibility within the investment firm for compliance, including the maintenance of appropriate and proportionate systems, resources and procedures, should rest with its senior management. The role of the compliance function and, where required, of the risk control function, is to provide senior management with systems, controls and other assistance in the discharge of these responsibilities. Where an investment firm has separate compliance and risk control functions, responsibilities should be clearly allocated between them (paragraph 2(c) of the advice under Articles 13(4) and (5) of the Directive). The internal audit function, where required, should be independent from the business lines and (to the extent it is reviewing them) other business related control functions. The internal audit function should review the performance of the compliance function and risk management function (if any) as well as the business lines on a risk based approach.

Specific introduction to advice on level 2 measures in relation to Article 13(2)

The advice on Article 13(2) is intended to deliver clear principles that can be applied by all types of investment firms under the Directive. It ensures appropriate calibration. For example, smaller firms will not be able, nor will they be required, to devote the same amount of resources to compliance infrastructure as a large investment bank. At the same time there are fundamental requirements that all investment firms should meet irrespective of their size or scope of operation. It is necessary to ensure that responsibility for compliance is accepted at the most senior levels of the business and that the compliance function has a direct reporting line to senior management, even in

cases where the compliance function is outsourced. The compliance function should also function independently.

The outsourcing of compliance functions can be envisaged in appropriate circumstances.

The independence of compliance function personnel may be undermined if their remuneration is related to the financial performance of the business line for which they exercise compliance responsibilities. However, it should generally be acceptable to relate their remuneration to the financial performance of the investment firm as a whole.

It may not be proportionate, in view of the nature and complexity of its business, to require some smaller investment firms to comply with certain structural requirements designed to reinforce the independence of their compliance function where they are able to demonstrate that their compliance arrangements are effective. This may be the case where the effectiveness of the compliance function is subject to regular and appropriate external review or where the person responsible for compliance oversight within the investment firm is personally regulated by its competent authority.

The fact that the person responsible for compliance oversight may be a member of the senior management does not remove the obligation for them to report to other members of senior management in respect of their compliance oversight responsibility.

CESR's Standards for Investor Protection ("CESR Standards") included a requirement for investment firms to ensure the competent authority is informed without undue delay of serious breaches of conduct of business rules. Such a requirement is beyond the scope of the level 2 implementing measures contemplated in the Directive. However, the imposition of such a requirement by Member States is not excluded by the provisions of the Directive on the minimum powers to be given to competent authorities.

It is important that investment firms maintain, publicise and operate effective procedures for handling complaints from clients and maintain records of such complaints and the measures taken for their resolution. Such procedures should further investor protection. Such records may assist firms and competent authorities to identify underlying compliance concerns.

However, the Directive leaves it to Member States to determine whether to implement particular mechanisms for the resolution of disputes between investment firms and their clients, whether within or outside of the investment firm (Article 53). This advice therefore focuses on the handling and recording of complaints and does not address the mechanisms that Member States should implement for the judicial or extra-judicial resolution of disputes. However, it does address the minimum requirements for the provision of information to clients in relation to such mechanisms where they are maintained and for the handling and recording of complaints.

An investment firm's code of conduct should be designed to promote professionalism and integrity within the investment firm. It should therefore provide an explanation of the standards, guidelines, procedures and policies that are of most importance to its relevant persons as a complement to its more general compliance policies and procedures.

The principles on personal transactions under the Directive are limited to transactions by relevant persons. However, they should apply both where such persons are acting for their own account and, in appropriate cases, where they are acting for the account of others.

The advice on personal transactions is designed to recognise that different types of investment firm will wish to impose internal controls on staff trading that are appropriate for the particular conditions under which they operate, while imposing a minimum standard for mechanisms used to control personal transactions. These requirements are intended to complement the provisions of

Directive 2003/6/EC on insider dealing and market manipulation ("Market Abuse Directive"). It is desirable to provide a proportionate range of exemptions from the requirements on the investment firm under the Directive. These exemptions do not affect the scope of the obligations under the Market Abuse Directive.

This advice addresses outsourcing arrangements or intended outsourcing arrangements pertaining to investment services and/or activities. Such arrangements should be subject to the same requirements that apply to the outsourcing of operational functions under the first paragraph of Article 13(5).

Level 2 Advice

BOX 2

Supervisory function: general provision relevant to advice under Article 13

1. Where the advice under Article 13 states that an investment firm must ensure that:

   (a) responsibilities are placed upon senior management, the competent authority may require the investment firm to ensure that such responsibilities are also placed upon the supervisory function (if there is one and within the limits of the supervisory function's powers) without derogation from the responsibilities to be placed on senior management;

   (b) reports are made to senior management, the competent authority may require the investment firm to ensure that such reports are also to be made to the supervisory function (if there is one and within the limits of the supervisory function's powers), without derogation from the requirement to make such reports to senior management.

Compliance function

2. An investment firm must maintain a permanent and effective compliance function, which must function independently and have documented status and the necessary authority within the investment firm to discharge its functions.

Compliance function: measures to foster independence

3. An investment firm must ensure that:

   (a) the compliance function personnel are not involved in the performance of services or activities they monitor; and

   (b) their remuneration does not, and is not likely to, undermine their independence.

4. The competent authority may exempt an investment firm from one or more of the requirements in paragraph 3 where the imposition of that requirement would not be proportionate in view of the nature, scale and complexity of its business, provided that the investment firm is able to demonstrate that its compliance function is, and continues to be, effective regardless of any disapplication of such requirements.

Compliance function: other measures to promote effectiveness

5. An investment firm must ensure that:

   (a) the compliance function has sufficient resources;

   (b) the compliance function personnel have the necessary expertise (gained through either or both of experience and completion of professional training) to enable them to carry out their respective duties effectively; and

   (c) the compliance function personnel are given full access to all information relevant to the performance of their duties.

Role of the compliance function

6. An investment firm must ensure that the compliance function:

   (a) monitors and assesses on an ongoing basis:

      (i) the adequacy and effectiveness of the investment firm's compliance policies and procedures;

      (ii) the investment firm's compliance with its compliance policies and procedures and with its obligations under the Directive; and

      (iii) the adequacy and effectiveness of measures taken to address any compliance deficiencies;

   (b) reports on a frequent and ongoing basis to senior management on the matters under (a), including whether the appropriate measures have been taken in the event of any compliance deficiencies;

   (c) provides senior management with reports on at least an annual basis setting out an overview of the results of the monitoring and assessment during the relevant period, copies such reports to the internal audit function (if any) and makes them available to the external auditors (if any); and

   (d) provides advice and support to the business areas of the investment firm on compliance with the investment firm's obligations under the Directive and the relevant persons' obligations under the code of conduct referred to in paragraph 11.

If an investment firm has another control function (such as risk control or internal audit) it may allocate a matter falling under paragraphs (a) to (d) to such other control function instead of its compliance function if that matter properly falls within the responsibilities of that other function.

Compliance policies and procedures

7. An investment firm must:

   (a) establish and maintain policies and procedures that are designed to ensure compliance with the investment firm's obligations under the Directive, identify and assess compliance risk and foster a compliance culture within the investment firm and that are appropriate and proportionate in view of the nature, scale and complexity of its business; and

   (b) be able to demonstrate it has effectively implemented its compliance policies and

procedures.

Role of senior management in compliance

8. An investment firm must ensure that:

   (a) in establishing its internal allocation of functions, its senior management is responsible for compliance with its obligations under the Directive; and

   (b) its compliance policies and procedures are approved and periodically reviewed by its senior management to ensure that they remain appropriate.

Person responsible for compliance oversight

9. An investment firm must:

   (a) appoint a natural person, who is either a member of its senior management or who has a direct reporting line to its senior management, to be responsible for:

      (i) oversight of its compliance with its obligations under the Directive; and

      (ii) reporting to its senior management in respect of that responsibility;

   (b) promptly fill any vacancy in that position; and

   (c) notify the competent authority promptly upon any person:

      (i) being appointed to that position; or

      (ii) ceasing to hold that position.

Complaints handling

10. An investment firm must:

   (a) maintain effective and transparent procedures for handling complaints in a reasonable and timely way;

   (b) keep a record of each complaint and the measures taken for its resolution; and

   (c) regularly verify whether complaints are effectively processed.

   In this paragraph, "complaint" means a complaint received from a client or potential client regarding the provision by the investment firm of investment services or, where appropriate, ancillary services or related matters.

Code of conduct

11. An investment firm must establish a code of conduct for its relevant persons. The code of conduct must be a set of principles designed to promote professionalism and integrity. As a minimum it must contain:

   (a) the investment firm's standards of integrity and confidentiality;

   (b) guidelines on proper compliance within the legal and regulatory framework in which the

investment firm operates;

(c) guidelines on co-operation with the investment firm's regulatory authorities; and

(d) a reference to the investment firm's procedures for carrying out personal transactions and conflicts policy, including details of how these procedures and the policy can be accessed by relevant persons.

Personal transactions: requirements

12. An investment firm must, in relation to each of its relevant persons who has access to price-sensitive information or who is subject to conflicts of interest (such as traders, analysts, corporate finance personnel, portfolio managers and compliance personnel):

(a) take all reasonable steps to prevent such a relevant person entering into a personal transaction in circumstances where:

(i) that transaction conflicts or is likely to conflict with the investment firm's duties under the Directive; or

(ii) the relevant person has or is likely to have price sensitive information that is relevant to financial instruments to which that transaction relates;

(b) take all reasonable steps to ensure that such a relevant person does not (except in the proper course of his employment):

(i) counsel or procure any other person to enter into a transaction that such relevant person is prevented from entering into; or

(ii) communicate any information or opinion to any other person if he/she knows, or reasonably ought to know, that such person will as a result, be likely to enter into such a transaction, or counsel or procure another person to do so;

(c) take all reasonable steps to ensure it receives prompt notification of the execution of any personal transaction entered into by such a relevant person or is otherwise able to identify it, and makes a record of it; and

(d) make a record of any notifications, authorisations and prohibitions given in connection with such steps.

Successive personal transactions

13. Where successive personal transactions by a relevant person referred to under paragraph 12 are effected in accordance with pre-determined instructions, without any further intervention by the relevant person, the steps under paragraph 12 are only required to apply to the issue of, and any subsequent amendment to, those instructions, provided that they are not required to apply to their termination without the disposal of any of the financial instruments acquired pursuant to them.

Personal transactions: exemptions

14. The requirements in paragraph 12 do not apply in relation to:

    (a) discretionary transactions, provided:

        (i) they are effected by a discretionary portfolio manager (other than the relevant investment firm) that is an investment firm or is regulated by legal or regulatory provisions or a code of ethics governing the provision of such management services; and

        (ii) there is no prior communication by the portfolio manager with the relevant person or any other person for whose account the transactions are effected;

    (b) transactions in units in collective investment undertakings provided:

        (i) such undertakings comply with the conditions necessary to enjoy the rights conferred by Council Directive 85/611/EEC of 20 December 1985, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) or are subject to supervision on a national basis providing for an equivalent level of risk spreading in their assets; and

        (ii) the relevant person and any other person for whose account the transactions are effected are not involved in the management of that undertaking; and

    (c) transactions in instruments issued by national governments unless the relevant person has access to price sensitive information or is subject to other conflicts of interest in connection with those instruments.

Outsourcing pertaining to investment services and activities

15. Where outsourcing arrangements or intended outsourcing arrangements pertain to investment services and/or activities:

    (a) paragraphs 3 and 5 to 8 of the advice on the first paragraph of Article 13(5) of the Directive shall apply to such arrangements; and

    (b) where the outsourcing involves the delegation of the portfolio management function to a service provider located in a third country:

        (i) that service provider must be authorised in its home country to provide that service; and

        (ii) there must be an appropriate formal arrangement between regulators that enables them to exchange material information concerning both cross-border outsourcings and the service provider.

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

Extract from Level 1 text

Article 13(4): "An investment firm shall take reasonable steps to ensure continuity and regularity in the performance of investment services and activities. To this end the investment firm shall employ appropriate and proportionate systems, resources and procedures."

Article 13(5), second sub-paragraph: "An investment firm shall have sound administrative and accounting procedures, internal control mechanisms, effective procedures for risk assessment, and effective control and safeguard arrangements for information processing systems."

Extract from the Mandate of the Commission

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

Establish the minimum basic criteria that competent authorities should take into account for determining when the investment firm has taken reasonable steps to ensure that:
(1) their administrative procedures are to be considered as sound;
(2) their accounting procedures are to be considered as sound; in respect of this request CESR should take account of or refer to any relevant provision of Community Law;
(3) their internal control mechanisms are to be considered as sound;
(4) their risk assessment procedures are to be considered as effective. For the definition of the various risks, their categorizations, as well as the means for their assessment, CESR should take account of any relevant provision of Community Law as well as relevant or similar work carried out in the field of financial services in other European and International fora.
(5) their control and safeguard arrangements for information processing systems are to be considered as effective.

CESR Advice

Explanatory text

The CESR advice on Article 13(4) and the second sub-paragraph of Article 13(5) of the Directive is intended to provide a set of criteria for assessing the adequacy of the internal systems, resources and procedures of the investment firm in the light of a range of factors, including the nature, scale and complexity of its business.

CESR is aware that other directives – such as the Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions or the proposal for a new Capital Requirements Directive – have or may have provisions that also pertain to organizational requirements on investment firms. CESR has given due consideration to these provisions and drafted its advice in such a way that where overlaps were unavoidable, given the text of the MiFID and the mandate from the Commission, the advice would not give rise to incompatibilities for the investment firms having to comply with those other provisions.

Given the considerable diversity of investment firms falling into the scope of application of the Directive, ranging from large multi-service entities to very small mono-service firms, the advice deliberately avoids either a rigid set of rules for all investment firms without any differentiation, or

an elaborate and pre-defined stratification of investment firms in terms of their nature, scale or complexity, with allocation of requirements with which an investment firms belonging to one of the defined categories would have to apply.

The advice defines a set of requirements that an investment firm is expected to satisfy in maintaining in its systems, resources and procedures. These requirements are calibrated in an appropriate and proportionate manner, which duly reflects the nature, scale and complexity of the services and activities the investment firm provides.

The requirements for systems, resources and procedures cover general organisational principles, record keeping procedures, accounting policies and procedures, risk management policy, business continuity, information processing systems and procedures, as well as internal control mechanisms.

The advice on accounting policies and procedures is not intended to duplicate existing standards and rules in respect of accountancy or annual reporting. The advice requires an investment firm to maintain an adequate internal organisation that is consistent with the said applicable rules and standards and which enables it to respect its financial reporting obligations towards the competent authorities.

The advice also determines the content of more sophisticated mechanisms of internal control, such as the segregation of duties, the independent risk control and internal audit functions and external auditing of accounting records and financial reports by an external auditor.

Level 2 Advice

BOX 3

Factors to take into account for systems, resources and procedures

1. When determining whether its systems, resources and procedures are appropriate and proportionate, an investment firm must take into consideration all relevant factors, including the nature, scale and complexity of the investment firm's business.

Organisational principles

2. The organisation of an investment firm in respect of its administration, accounting, systems and controls must reflect the factors referred to in paragraph 1. The principles, on which it must be based, should include:

   (a) clear and documented decision making processes;

   (b) employment of staff with appropriate skills, knowledge and expertise, relevant to the services provided and the activities performed by the investment firm;

   (c) clear and documented allocation of responsibilities and mapping of reporting lines;

   (d) regularly updated written procedures which are communicated throughout the investment firm;

   (e) internal control mechanisms designed to ensure compliance with internal decisions and procedures at all levels of the investment firm, such as hierarchical controls, cross-checking and dual control; and

   (f) effective and appropriate internal reporting and communication of information at all

relevant levels of the investment firm.

Record keeping procedures

3. An investment firm must maintain administrative procedures that are designed to maintain adequate and orderly records of its business and internal organisation.

Accounting policies and procedures

4. An investment firm must adopt and operate effective:

   (a) accounting policies that enable it to submit timely financial reports to the competent authority reflecting a true and fair view of its financial position in compliance with applicable accounting standards and rules;

   (b) documented accounting records, systems and procedures that are designed to ensure at least that:

      (i) transactions are only entered into the accounting systems of the investment firm with appropriate authority; and

      (ii) internal records are regularly reconciled with confirmations provided by third parties; and

      (iii) proper and sufficient audit trails exist; and

   (c) systems and procedures for the establishment and verification of:

      (i) the adequacy of the internal reporting arrangements, and

      (ii) the external financial reports.

Risk management policy

5. An investment firm must establish and regularly review a risk management policy, which is proportionate to the nature, scale and complexity of the investment firm's business and which includes:

   (a) the identification of the risks relating to the investment firm's activities, processes and systems, including operational risk;

   (b) the level of risk tolerance set by the investment firm; and

   (c) effective arrangements, processes and mechanisms to manage the risks referred to in (a) in light of the level of risk tolerance referred to in (b).

Business continuity

6. An investment firm must take all reasonable steps to ensure that:

   (a) its investment services and activities can be performed without interruption; and

   (b) its organization, systems and procedures are designed in such a way that in the event of an unplanned severe interruption, the investment firm is able to safeguard the clients' rights and interests and continue to meet its other core regulatory obligations.

7. To that end, the investment firm must adopt and keep up-to-date a comprehensive business continuity policy and planning process which duly take into account the nature, scale and complexity of its business, and include:

   (a) the identification of its critical systems and functions, including centralized and decentralized systems as well as outsourcing arrangements;

   (b) the definition of its business continuity objectives, budgets and means;

   (c) allocation of responsibilities and mapping of reporting lines for business continuity purposes;

   (d) implementation of preventative and risk mitigating measures where possible;

   (e) maintenance and regular testing of systems and procedures which are designed to safeguard its critical data and functions in case of an unplanned severe interruption, or to enable recovery and resumption of such data and functions as soon as possible, and to enable the resumption of its investment services and activities as soon as reasonably practicable.

Information processing systems and procedures

8. An investment firm must maintain information processing systems and procedures that reasonably ensure the safeguarding of the security, integrity and confidentiality of information.

Internal control mechanisms

9. An investment firm must regularly assess whether its internal control mechanisms are adequate. Unless the investment firm is required to set up an independent risk control function and an independent internal audit function as referred to in paragraph 10(b) and (c), it must appoint a staff member or a member of its senior management to be responsible for:

   (a) taking reasonable steps to ensure the consistency and effectiveness of the internal control mechanisms of the investment firm, including its risk management; and

   (b) reporting on such matters on a regular basis to senior management and, at least once a year, making those reports available to the external auditors (if any).

Additional requirements

10. Where appropriate and proportionate in view of the nature, scale and complexity of its business, including the services provided and activities performed by it, an investment firm must maintain an adequate:

   (a) segregation of duties at individual level and between functions to mitigate operational risk;

   (b) independent risk control function in accordance with paragraph 11;

   (c) independent internal audit function in accordance with paragraph 12; and/or

   (d) external auditing of the accounting records and financial reporting by an external auditor.

Risk control function

11. Where an investment firm is required to maintain an independent risk control function, it must ensure that:

(a) the risk control function:

(i) implements the risk management policy referred to in paragraph 5;

(ii) is separated and independent from the risk taking functions;

(iii) advises senior management on risk management;

(iv) regularly reports on risk management to senior management; and

(v) provides senior management with reports on at least an annual basis setting out an overview of risk management during the relevant period and sends a copy thereof to the internal audit function (if any) and make them available to the external auditors (if any); and

(b) senior management approves and periodically reviews the investment firm's risk management policy and risk control function.

Internal audit function

12. Where an investment firm is required to maintain an independent internal audit function, it must ensure that:

(a) the internal audit function:

(i) examines and evaluates the adequacy and effectiveness of the investment firm's systems and internal control mechanisms, including the compliance and risk control functions, on the basis of an audit plan that it draws up and implements;

(ii) provides those responsible within the investment firm with information, analyses, assessments and recommendations in this regard;

(iii) verifies compliance with the recommendations it issues;

(iv) reports regularly on the adequacy and effectiveness of systems and internal control mechanisms within the investment firm to senior management or, where national law requires so, to the supervisory function, and, at least once a year, make its reports available to the external auditors (if any); and

(v) is separated and independent from operational activities it audits, has documented status and the necessary authority within the organization;

(b) the person(s) in charge of the internal audit function are competent in terms of knowledge (including up-to-date knowledge of auditing techniques and the relevant regulated activities under the Directive) and experience and have access to systematic continuing training;

(c) senior management or, where national law so requires, the supervisory function regularly verifies, taking due account of the internal audit reports, whether the investment firm's internal control is adequate and, at least once a year, assesses the internal audit function and the audit plan.

CESR

Obligations to avoid undue additional operational risk in case of outsourcing (Article 13(5) first subparagraph)

Extract from Level 1 text

Article 13(5), first sub-paragraph: "An investment firm shall ensure, when relying on a third party for the performance of operational functions which are critical for the provision of continuous and satisfactory service to the clients and the performance of investment activities on a continuous and satisfactory basis, that it takes reasonable steps to avoid undue additional operational risk. Outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the supervisor to monitor the firm's compliance with all obligations."

Extract from the Mandate of the Commission

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:
(1) Determine what is meant by operational functions; establish the criteria for determining which functions are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis.
(2) Establish the conditions to which the firm is subject and the arrangements to put in place, when outsourcing its operational functions.
(3) Specify what is to be considered as outsourcing for the purposes of this rule.

CESR Advice

Explanatory text

The CESR advice on Article 13(5) first sub-paragraph of the Directive delivers principles to be applied by investment firms when outsourcing material operational functions.

For the general purpose of the advice, "outsourcing" is defined as all forms of arrangements which involve an investment firm relying on a third party service provider for the performance of a process, a service or an activity that would otherwise be undertaken by the investment firm itself.

However, the rules set out in the advice regarding the obligation to avoid undue additional operational risk in case of outsourcing only apply to material outsourcing and exclude arrangements pertaining to non-material operational functions, to the outsourcing of investment services and activities or to the use of depositories falling within Article 13(7) and (8) of the Directive.

Outsourcing of investment services and activities is addressed in the advice under Article 13(2) of the Directive. The principles set out here are, where appropriate, incorporated by reference into that advice.

Outsourcing arrangements do not affect the investment firm's regulatory obligations, nor its relations with, and obligations towards, its clients under the Directive. Moreover, outsourcing may not be undertaken in such proportions that the investment firm loses substance to the extent that the assumptions and conditions on which its authorization was based are no longer fulfilled ("empty box").

The advice requires an investment firm to notify the competent authority of its intention to enter into an outsourcing falling within the scope of the advice (arrangements that are material and do not fall under

any of the exemptions). The rule does not mean that authorization is required from the competent authority. However, investment firms must make available to the competent authority, on its request, all information it would need to exercise its supervision in respect of the provisions referred to in this advice.

An investment firm should conduct a due diligence process before entering into an outsourcing and should monitor the adequacy of the performance of the outsourced functions and, finally, should manage the risks involved in the outsourcing. Outsourcing arrangements must be designed in a way that does not affect negatively the sound and prudent management of the investment firm and does not hamper its supervision by the competent authority.

The outsourcing investment firm and the service provider must allocate the respective responsibilities in relation to the outsourcing in a written agreement, which can take the form of a contract and, where appropriate, a separate legally binding service level agreement ("SLA") which typically carries the technical specifications of the outsourcing. The advice specifies the minimum provisions which must be included in the contract or in the SLA (if any).

The advice requires an investment firm to negotiate access to its data and premises, not only for itself (including, where appropriate, its compliance and internal audit functions and its external auditors), but also for the competent authorities. This provision is essential to the investment firm's supervision which must not be hampered by outsourcing. The competent authorities should be able to exercise the duties laid upon them by the Directive notwithstanding the outsourcing. An investment firm that enters into an outsourcing with service providers who impede or render impossible the normal supervision of the investment firm, would be in breach of its obligations under the Directive.

Level 2 Advice

BOX 4

Application to material outsourcing only

1. This advice only applies to outsourcing arrangements pertaining to operational functions where a weakness or failure in the performance of the outsourced functions would cast serious doubt upon the investment firm's continuing compliance with the conditions and obligations of its authorization and/or upon its financial performance, financial position or continuity of operations.

2. Subject to paragraphs 1 and 4, outsourcing of the following functions is included in the scope of application of this advice: accounting, back office, information technology and information system management and maintenance, marketing and research, services related to the internal audit, compliance and risk control functions.

Application to intra-group outsourcing

3. This advice also applies to intra-group outsourcing where the arrangements meet the conditions set out in paragraph 1 subject to paragraph 4. However, the measures to be taken by the investment firm in accordance with paragraph 8 of this advice in respect of due diligence (indent b), monitoring of risk (indent c) or exit strategies (indents d(vii) and e), may take into account the group dimension, including factors such as the degree to which the investment firm controls the service provider or that it has the ability to influence its actions, or the fact that the service provider is included in the supervision on a consolidated basis of the investment firm's group, or is itself subject to authorisation or supervision. The investment firm must be able to demonstrate to the competent authority that the gearing of the measures implemented by the firm referred to under paragraph 8 is appropriate and proportionate to the factors taken into account.

Arrangements not included

4. Notwithstanding the paragraphs 1 to 3, this advice does not apply to outsourcing of the following:

   (a) discrete advisory services, such as the provision of legal advice, procurement of specialized training, billing and physical security;

   (b) supply arrangements and functions, such as the provision of electricity, water, catering, and cleaning;

   (c) investment services and activities;

   (d) the purchase of standardised services such as market information services and provision of prices; and

   (e) the use of depositories under arrangements falling within Articles 13(7) and (8) of the Directive.

Effect of outsourcing on the position of the investment firm

5. Outsourcing does not release the investment firm from its regulatory obligations and cannot result in the delegation of senior management's responsibility. Outsourcing does not alter the relationship and obligations of the investment firm under the terms of the Directive towards its clients. Outsourcing must not be undertaken in such a way that it undermines the assumptions and conditions on which the investment firm's authorisation is based.

Notification of material outsourcing to competent authority

6. Subject to paragraphs 1 and 4, an investment firm must provide the competent authority with prior notification of its intention to outsource and make available on request of the competent authority all relevant information, enabling it to effectively exercise its supervision in respect of the provisions referred to in this advice.

General obligation of due skill, care and diligence

7. An investment firm must exercise due skill, care and diligence in planning, entering into, managing and exiting from any outsourcing. To this end it must identify, assess, monitor and manage the risks inherent in outsourcing and take reasonable steps to avoid or mitigate the impact that outsourcing might have on its exposure to operational risk.

Specific obligations

8. In complying with its obligations under paragraph 7, the measures to be taken by the investment firm include the following:

   (a) the investment firm must ensure that senior management approves and periodically reviews the investment firm's policy for outsourcing operational functions; this includes the assessment of feasibility, of risk and of the impact on business and costs, as well as the definition of criteria for selecting the service providers;

   (b) the investment firm must ensure that the service provider has the ability and capacity to perform the outsourced functions reliably and professionally. To that end, the investment firm must evaluate the service provider and its services at the start and during the life cycle of the

outsourcing. In performing this evaluation, the matters of which the investment firm should take particular account include where relevant, whether the service provider is regulated, to what extent and by whom, including whether the provision of the outsourced functions is subject to specific regulation or supervision, and the risk that the requested services are not available due to the number of other persons using the same service provider;

(c) the investment firm must retain the required expertise to effectively supervise the outsourced functions and manage the risks associated with the outsourcing; senior management should take appropriate action if cause for concern arises;

(d) the parties' respective responsibilities in relation to outsourcing must be clearly allocated in a written agreement; such agreement must also include, if applicable and where appropriate having regard to the function outsourced:

(i) the law applicable to the contract;

(ii) the relevant code of conduct and the compliance function in charge of monitoring its application;

(iii) the obligation to protect confidential information;

(iv) the obligation for the service provider to disclose material developments that may have an impact on the outsourced functions;

(v) the contingency procedures;

(vi) where permitted by national law and by the contract, the rules for subcontracting for the service provider;

(vii) the termination rights of both parties; and

(viii) the methods for measuring, and procedures for reporting, the quantitative and qualitative performance by the service provider, in order to enable the investment firm to assess the adequacy of the services provided under the arrangement.

(e) the investment firm must have a comprehensive exit strategy, including where appropriate and proportionate taking into account the nature of the function subject to the outsourcing, partial exit and step-in clauses, and contingency plans;

(f) the investment firm, including its compliance function and internal audit function (if any), should have complete access to its data; such access should also be provided to its external auditors (if any); and

(g) the investment firm must ensure that the terms of the contract with the service provider require the latter to deal in a open and cooperative way with the competent authorities in the discharge of their functions under the Directive, including permitting access to the relevant data and its business premises, and that the competent authorities can exercise those rights.

Record keeping obligation (Article 13(6))

Extract from Level 1 text

Article 13(6): "An investment firm shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with the requirements under this Directive, and in particular to ascertain that the investment firm has complied with all obligations with respect to clients or potential clients".

Extract from the Mandate of the Commission

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:
(1) Establish the conditions with which the arrangements that an investment firm has to put in place in respect of its records have to comply in order to be considered as sufficient to enable the authorities to verify the investment firm's compliance with the applicable rules
(2) Specify which records are covered by this obligation
(3) Specify the period of time for keeping the records
In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to data protection.

CESR Advice

Explanatory text

CESR has received a second set of mandates to advise on Level 2 measures relating to the Directive. The subjects to be covered will include the requirements under Article 19(4) to (6), and the provisions of Article 24, of the Directive. The deadline for the provision of CESR's advice under Article 22(1) of the Directive has been harmonised with the deadline for its advice on the second round mandates. CESR has also issued a request for opinions on professional client agreements. In anticipation of the completion of that further work, the provisions in the Annex to the advice that are relevant to those Articles may need to be revisited.

CESR's advice is intended to be consistent with existing EU legislation on the processing of personal data and the protection of privacy. In particular, CESR has taken account of Directive 95/46/EC of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data and Directive 2002/58/EC of 12 July 2002 concerning the processing of personal data and the protection of privacy in the electronic communications sector.

In relation to the processing of personal data, recital 23 to Directive 2002/58/EC indicates that recorded communications should be erased as soon as possible and in any case at the latest by the end of the period during which the transaction can be lawfully challenged. The requirements concerning the maintenance of records of telephone orders on voice recording systems represent the minimum requirements necessary for the resolution of possible disputes between investment firms and their clients and to assist competent authorities in the discharge of the supervisory, enforcement and investigatory functions.

Where an investment firm is required to maintain records on a voice recording system, the fact that such records can be accessed to enable the production of a transcript will satisfy the requirement that they may be readily reproduced on paper.

The recording of conversations on telephone lines used for the giving and/or acceptance of orders is necessary both for investor protection and market integrity purposes. The requirement to record conversations on such lines will help competent authorities to conduct investigations of suspected cases of market abuse and to verify compliance with rules applying to the relationships between investment firms and their clients. However, where in view of the low frequency of orders given and/or accepted by the investment firm, either globally or on a particular telephone line, it would be disproportionate to impose such a requirement, the competent authority may exempt the firm from this requirement, as applicable, on a global basis or in respect of that telephone line.

Level 2 Advice

BOX 5

Minimum requirements

1. The following provisions of this advice are without prejudice to any powers of competent authorities to require the maintenance of records for the purposes of discharging their enforcement and investigatory obligations.

Specific requirements

2. An investment firm must, as a minimum, maintain the records set out in the Annex to this advice. This list is not a complete list of specific record keeping requirements and is not exhaustive of the general requirement contained in Article 13(6) of the Directive. In complying with Article 13(6) of the Directive an investment firm must arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with the requirements under the Directive.

General requirements

3. An investment firm must keep records conducive to demonstrating compliance with the requirements under the Directive. In particular it must:

(a) keep records required under the Directive for a period of at least five years;

(b) keep records in such a way, including the format, organisation and completeness of such records, that:

(i) they may be readily reproduced on paper; and

(ii) the competent authority is able to readily access and search them and reconstitute each stage of the processing of all transactions and instructions by the investment firm; and

(c) keep records in a manner designed to ensure that:

(i) any corrections or other amendments as well as the contents of the records prior to any such corrections or other amendments can be easily ascertained; and

(ii) the records cannot otherwise be manipulated or altered.

Telephone orders

4. In addition, an investment firm must keep records of all telephone conversations on lines used for the giving and/or acceptance of orders on a voice recording system for a period of at least one year.

Where, in view of the low frequency of orders given and/or received by an investment firm on a global basis or on any of its telephone lines, the requirement in the previous subparagraph would not be proportionate, the competent authority may exempt that investment firm from that requirement on a global basis, or as applicable, in respect of that telephone line.

Termination of authorisation

5. The minimum retention periods under paragraphs 3(a) and 4 shall survive the termination of the investment firm's authorisation. Member States may determine whether those retention periods should survive the liquidation of an investment firm or a former investment firm.

Records of identical documents

6. This advice is not intended to require an investment firm's records to include multiple copies of identical documents (for example, identical marketing communications sent to a number of clients).

Records of documents sharing a common format

7. Where different documents are based on a common format (for example, periodic statements sent to a number of clients that share the same format but contain different information for each client), this advice is only intended to require an investment firm's records to include the common format and details of how each document differs from the common format, so that each document can be recreated if required.

Annex - Minimum list of records to be maintained

Type of record	contents of record must include	time at which record must be created
Categorisation and identity of each client	The identity of each client and sufficient information to support categorisation as a retail client, professional client and/or eligible counterparty	when the client relationship begins or upon re-categorisation, including as a result of any review
Retail client agreements	records provided for under paragraph 7 of the advice under Article 19(7)	at the time and for the period provided for under paragraph 7 of the advice under Article 19(7)
Client details (Article 19(4))	the information about the client's or potential client's knowledge and experience, financial situation and investment objectives obtained by the investment firm in complying with its obligation under Article 19(4) of the Directive	on giving advice or being appointed as a portfolio manager
Client details (Article 19(5))	the information about the client's or potential client's knowledge and experience obtained by the firm in complying with its obligation under Article 19(5) of the Directive	upon providing the relevant service
Records required under Article 25(2)	The information required under Article 25(2) of the Directive	Such records should be kept for the period required by Article 25(2)
Aggregated transaction that includes a client order	identity of each client; whether transaction is in whole or in part for discretionary managed investment portfolio and any relevant proportions	on executing an aggregated transaction
Aggregation of one or more client orders and an own account order	the intended basis of allocation	before the transaction is executed
Allocation of an aggregated transaction that includes the execution of a client order	the date and time of allocation; relevant financial instrument; identity of each client and the amount allocated to each client	date on which the order is allocated
Re-allocation	the basis and reason for any re-allocation	at the time of the re-allocation
a) Order received or arising	the records provided for under paragraphs 17(a) and 18 of the advice under Article 22	at the time provided for in paragraph 17(a) of the advice under Article 22
b) Order carried out (other than those falling under the following row) and transactions effected for own account	the records provided for under paragraphs 17(b)(i) and 19 of the advice under Article 22	at the time provided for in paragraph 17(b)(i) of the advice under Article 22
Transmission of order received by the investment firm	the records provided for under paragraphs 17(b)(ii) and 20 of the advice under Article 22	at the time provided for in paragraph 17(b)(ii) of the advice under Article 22
Periodic statements to clients	any periodic statement issued to a client by the investment firm in respect of services provided	on date on which it is provided
Client financial instruments held by an investment firm	The records required under paragraph 12 of the advice under Articles 13(7) and (8))	on commencement of the holding
Client financial instruments available for, and subject to, stock lending activities	the identity of client financial instruments that are available to be lent, and those which have been lent (note also the requirements under paragraph 7 of the advice under Articles 13(7) and (8), where applicable)	on such assets being made available for lending and on such assets being lent
Client funds	sufficient records to show and explain investment firm's transactions and commitments (note also the requirements under paragraph 12 of the advice under	as soon as monies received and paid out

	Articles 13(7) and (8))	
Marketing communications	each marketing communication • addressed by the investment firm to clients or potential clients; or • for which it confirms compliance with the applicable requirements under Article 19(2) for the purposes of paragraph 2 of the advice under Article 19(2), that is communicated in writing or through television, radio or another such medium and a description of the group or groups of person to whom the marketing communication is directed or addressed	at the time the investment firm first issues the marketing communication or confirms compliance
Name of the person confirming the compliance of marketing communications	the name of the person that confirmed compliance with the applicable requirements under Article 19(2) in accordance with paragraph 2 of the advice under Article 19(2) for each such marketing communication addressed by the investment firm to clients or potential clients that is communicated in writing	at the time the investment firm first issues the marketing communication
Investment research	each item of investment research issued by the investment firm in writing	at the time the investment firm first issues the item of investment research
Compliance policies and procedures	the investment firm's compliance policies and procedures	on the policies and procedures being established or amended (in respect of each version the period in paragraph 3(a) of the advice under Article 13(6) shall commence is the date on which the relevant version is amended)
Compliance reports	each compliance report to senior management	at time of the relevant report
Internal audit reports	each internal audit report to senior management	at the time of the relevant report
Complaints records	each complaint referred to in the advice under Article 13(2) received	on receipt of complaint
Complaints handling	the measures taken for the resolution of each such complaint	as measures are taken

Safeguarding of client assets (Article 13(7) and 13(8))

Extract from Level 1 text

Article 13:
"(7) An investment firm shall, when holding financial instruments belonging to clients, make adequate arrangements so as to safeguard clients' ownership rights, especially in the event of the investment firm's insolvency, and to prevent the use of a client's instruments on own account except with the client's express consent.
(8) An investment firm shall, when holding funds belonging to clients, make adequate arrangements to safeguard the clients' rights and, except in the case of credit institutions, prevent the use of client funds for its own account."

Extract from the Mandate of the Commission

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

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

CESR Advice

Explanatory text

The measures proposed in the advice are generally relevant to all cases where an investment firm holds client assets, including where it deposits them with a third party. CESR believes that the proposed measures are consistent with the CESR-ESBC Standards on Securities Clearing and Settlement Systems adopted in September 2004.

Credit institutions receiving funds from, or on behalf of, a client in the course of providing investment services to the client are not subject to this advice where the receipt and holding of those funds also constitute the holding of a deposit. However, if a credit institution chooses not to hold the client's funds on its own books in the form of a deposit, but instead places such funds with a third party on behalf of the client, this advice shall apply.

This advice identifies the organisational, procedural and contractual requirements that have to be put in place by investment firms to safeguard clients' ownership rights, especially in the event of their insolvency or actions brought against them by their creditors or by creditors of one or more of their clients. In view of the present lack of harmonisation within the European Union of national insolvency or property laws and of safekeeping and administration services, there cannot be uniformity as to the manner in which effectiveness of such requirements on the insolvency of an investment firm is achieved.

Furthermore, the proposed implementing measures take account of the possibility of transactions through EU investment firms in financial instruments that are subject to the laws and regulations of third countries. As a consequence, CESR believes that the implementing measures would be better described as requiring particular outcomes to be achieved rather than specifying particular arrangements in all circumstances.

The requirements concerning the use of depositories that are subject to specific regulation and supervision do not prevent the use of unregulated depositories in jurisdictions in which the holding and safekeeping of client financial instruments is not subject to specific regulation and supervision nor do they prevent the proper use of nominees by the investment firm or by regulated depositories.

For the purpose of protecting clients' ownership rights, it is of the utmost importance that an investment firm maintains its records in a way that allows the prompt identification of ownership rights and ensures correspondence between those records and the actual assets held by the investment firm on behalf of its clients. The investment firm's records shall also enable a client's assets to be properly distinguished from the investment firm's proprietary assets and the assets held by the investment firm on behalf of other clients. Consequently, the investment firm shall maintain a separate account on its books for each client (or group of clients holding their assets under a joint arrangement) and should not record the assets of other clients in that account.

The advice on the terms of the agreement to be entered into with the client are not intended to prevent the client requesting amendments to the terms of an agreement provided to it by an investment firm or suggesting his own terms of the agreement.

The advice requires that appropriate internal control procedures and review mechanisms and external review shall be regularly carried out to verify effective operation of records and procedures to secure clients' ownership rights.

Where financial instruments of more than one client are held on an omnibus basis with a depository or are registered under the same designation in the issuer's register, this does not in itself constitute the use of one client's assets for the account of another client for the purposes of the Directive.

The provisions contained in this advice are without prejudice to the ability of the competent authority to determine whether an investment firm is permitted to receive, handle or to provide safekeeping and administration services in relation to client assets.

Level 2 Advice

BOX 6

Interpretation and scope

1. The following provisions do not apply to an investment firm where the client himself deposits his assets with a third party and authorises the investment firm to operate on his behalf the account held with such third party. The following provisions will apply however in these circumstances to the third party if such third party is an investment firm.

2. Funds held by a credit institution on behalf of a client in the course of providing investment services to that client must not be treated as belonging to the client for the purposes of Article 13(8) and are not subject to the advice under Article 13(8) provided that those funds are held as a deposit on the books of the credit institution.

3. The requirements in this advice for the provision of information to, and the entering into

of agreements with, the client apply in addition to any applicable requirements in or under Article 19.

Arrangements designed to protect client assets

4. An investment firm that holds client assets must exercise due skill, care and diligence in making arrangements for the protection of those assets in each jurisdiction in which they are held.

5. Such arrangements:

(a) to the fullest extent practicable in accordance with the relevant systems of law, must ensure, as against a liquidator or creditor of the investment firm or in case of any judicial actions brought against the investment firm, that client assets are not available for satisfying an obligation of the investment firm itself;

(b) to the fullest extent practicable in accordance with the relevant systems of law, must ensure, as against a creditor of a client, or in the case of any judicial actions brought against a client's assets held by the investment firm, that other clients' assets are not available for satisfying any such claim;

(c) must include appropriate measures designed to prevent:

(i) the unauthorised use of client assets, including such use for the account of or by other clients; and

(ii) the misappropriation of client assets.

The above requirements do not prevent the investment firm or a depository, taking or enforcing a lawful security interest or lien, or exercising a lawful right of set off over client assets in accordance with applicable law and regulation nor do they prevent the exercise of any rights granted to other persons by the client in relation to his assets in accordance with such applicable law and regulation.

Use of client assets

6. An investment firm is allowed to use for its own account and/or for the account of any of its other clients, the financial instruments it holds on behalf of a client only if:

a) that client has given his prior express consent as evidenced by signature or an equivalent alternative mechanism;

b) the use of that client's financial instruments is restricted to the terms agreed by him; and

c) the document in which that client's consent is requested by the investment firm, or the document to which it refers, provided such documents are provided to him in a durable medium, gives clear information to him on:

(i) the obligations and responsibilities of the investment firm and/or of the other clients for whose account the investment firm is to be allowed to use the client's financial instruments, with respect to the use of the client's financial instruments (including the terms for the restitution of the financial instruments); and

(ii) in the case of a retail client, the risks involved.

7. If, where permitted by national law, client financial instruments are held on an omnibus basis, the investment firm may not enter into arrangements for the lending of any of such financial instruments unless:

a) all of the clients whose financial instruments are held together on an omnibus basis have consented as evidenced by signature or an equivalent alternative mechanism to those financial instruments being used in such arrangements for lending; or

b) the investment firm has appropriate systems and controls in place to ensure that only financial instruments belonging to clients who have given their prior consent as evidenced by signature or an equivalent alternate mechanism are used in those arrangements for lending.

In either case, the records of the investment firm must include details of the clients for whom the loans have been effected and the number of securities lent for each client, which would enable the correct allocation of any loss.

8. Without prejudice to the provisions in the previous paragraphs, an investment firm may dispose of client assets that it holds only:

   i) for the account of the relevant client;

   ii) in so far as this is necessary for the performance of its services for the client; or

   iii) in accordance with the client's instructions.

Deposit and sub-deposit of client assets

9. An investment firm which is not a credit institution must promptly deposit client funds into one or more accounts opened with:

i) a central bank;

ii) a credit institution authorised in accordance with Directive 2000/12/EC of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions; or

iii) a bank authorised in a third country.

Such accounts may be either individual or omnibus accounts, provided that they are identified separately from any accounts used to hold funds belonging to the investment firm. Where the investment firm resolves not to deposit client funds with a central bank, the choice of the credit institution or of the bank should comply with the conditions set out in the following paragraph (other than letter (a)(i) and (iii) when the credit institution or the bank holds such funds as deposits on its books) on the basis that references in that paragraph to "financial instruments" must be read as references to "funds".

10. Without prejudice to the provisions in the previous paragraph, an investment firm may sub-deposit client financial instruments into accounts opened with a depository provided that the investment firm:

a) exercises all due skill, care and diligence in the selection, appointment and review of the depository, including a periodic review of the continuing appropriateness of its selection of the depository in light of an appropriate risk assessment. In selecting the appropriate depository, the investment firm must take account of all relevant factors including, to the extent they are applicable or relevant:

i. in the case of financial instruments, whether the depository is regulated, to what extent and by whom, including whether the holding and safekeeping of client financial instruments is subject to specific regulation and supervision. If the holding and safekeeping of client financial instruments is subject to specific regulation and supervision in a jurisdiction, the investment firm must sub-deposit the client financial instruments with a depository in that jurisdiction that is subject to specific regulation and supervision;

ii. the investment firm's experience of the depository's performance of its services to the investment firm;

iii. the arrangements which are or will be made by the depository for the holding and safekeeping of client financial instruments;

iv. the expertise and market reputation of the depository; and

v. in the case of client assets held by an institution located in a third country, any legal requirement or appropriate market practice about the use of particular depositories;

b) ensures that, to the fullest extent practicable in accordance with applicable law and market practice, client financial instruments are separately identifiable from the proprietary financial instruments of the investment firm and of the depository by virtue of distinctly titled accounts on the books of the depository and by virtue of the way such financial instruments are held by the depository; and

c) ensures that it and the depository agree:

i. what services are to be provided by that depository and the level of responsibility accepted by the depository; and

ii. the arrangements for the termination of the depository's appointment.

For the purpose of complying with the requirements in letter (a), the following circumstances may be taken into account:

i) that the client has given instructions to the investment firm to select the depository where the investment firm would not otherwise have selected that depository; and/or

ii) that the legal or market conditions in the relevant jurisdiction prevent the investment firm from making a different choice of depository.

Appropriate record keeping/clarity of ownership identification

11. An investment firm that receives funds from a client must be able to identify which of those funds are client funds.

12. The records of an investment firm that holds client assets must:

a) include for each client (or group of clients acting jointly) an account enabling a client's assets (or the assets of the group of clients acting jointly) to be promptly identified and distinguished from the proprietary assets of the investment firm and from the assets which the investment firm holds on behalf of other clients. For this purpose, as a minimum requirement, the investment firm must record a separate position in each relevant currency and financial instrument for each client (or group of clients acting jointly); and

b) be maintained in a way that ensures their correspondence to the actual financial instruments and funds held for clients. The total amount of client funds of each currency and client financial instruments of each description held by the investment firm must always be no less than the sum of the amounts of each held for individual clients.

Agreement with the client

13. Without prejudice to the advice under Article 19(7), an investment firm that holds client assets must:

- provide to the client the terms of the agreement in a durable medium, setting out the rights, obligations and responsibilities of the investment firm with respect to the holding of clients' assets, and

- obtain the client's consent to the terms of the agreement as evidenced by signature or an equivalent alternative mechanism.

Where the rights, obligations and responsibilities of the investment firm are determined by a particular law or regulation, a reference to the relevant provision shall be sufficient.

This contract must include:

a) if the client's assets may be held by a depository on behalf of the investment firm, that this is the case and the responsibility the investment firm accepts to the client, in accordance with the applicable national law, for the acts, omissions or insolvency of the depository.

b) if any of the client's financial instruments may, in accordance with national law, be held on an omnibus basis, that this is the case and a description of the risks arising as a result of that fact ;

c) if there are any circumstances in which it will not be legally possible or practicable because of local market practices for client financial instruments held with a depository to be separately identifiable from the proprietary financial instruments of that depository or of the investment firm, that this is the case and an appropriate, prominent warning of the risks arising as a result of that fact;

d) a general description of the way in which client assets held by the investment firm are protected in the Member State whose rules apply to it in relation to its holding of the client assets (including the relevant investor compensation scheme and deposit guarantee scheme) and, if the assets of the relevant client are likely to be held in another jurisdiction, a statement of the fact that different client protection arrangements may apply to those assets and that a description of these arrangements (including the aforementioned types of schemes) will be provided on request; and

e) the terms of any security interest or lien taken over, or right of set off in relation to, the client's assets by the investment firm and, if this is the case, notification of the fact that a depository may have a security interest or lien over, or right of set-off in relation to, client assets.

Appropriate controls

14. An investment firm that holds client assets must:

a) have internal control procedures to ensure that its arrangements to safeguard the

ownership rights of its clients are operating effectively;

b) check its records regularly, for example by conducting reconciliations between its internal accounting records and those of any third parties with whom those assets are held; and

c) subject its records and procedures to an appropriate periodic independent review, for example by its compliance function or internal audit function.

External review of records and procedures

15. An investment firm that holds client assets must have the records provided for in paragraphs 6, 7 and 12 audited by an external auditor on at least an annual basis.

16. External auditors must report on at least an annual basis to the competent authorities on the adequacy of the investment firm's arrangements and on its ability to comply with the rules provided for in this advice.

Conflicts of interest (Article 13(3) and 18)

Extract from Level 1 text

Article 13(3): "An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 18 from adversely affecting the interests of its clients".

Article 18(1): "Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves, including their managers, employees and tied agents, or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services, or combinations thereof".

Article 18(2): "Where organisational or administrative arrangements made by the investment firm according to Article 13(3) to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the investment firm shall clearly disclose the general nature and/or sources of conflicts of interest to the client before undertaking business on its behalf".

Extract from the Mandate of the Commission

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

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

CESR Advice

Explanatory text

The advice in relation to Articles 13(3) and 18 has been taken together in view of the close connection between these two Articles.

The Level 2 measures proposed in this advice include criteria for investment firms to develop their internal and specific organisational arrangements in order to comply with both Articles. This entails having in place the necessary arrangements for the identification, prevention, management and/or disclosure of the relevant conflicts of interest. This approach is practicable also because both Articles are within the competence of the investment firm's home Member State.

A balance needs to be struck between measures that fall under Articles 13(3) and 18, and those that are best dealt with under other Articles. In particular, many conduct of business provisions address the prevention and management of conflicts of interest in various ways. For example, rules addressing best execution, client order handling, front running, soft commission, allocations, payment for order flow and other types of inducements, can all be seen as relating to conflicts of interest as well as to the

requirement to act in the best interests of the client. To the extent that these issues need to be addressed at Level 2, some of them could more readily fall under measures under Articles 19, 21 or 22 as appropriate, rather than Articles 13(3) and 18. Compliance with conduct of business rules contributes to the management of the conflicts of interest in the firm.

Nothing in this advice is intended to derogate from any specific obligation (of a conduct of business nature or otherwise) that an investment firm may be under by reason of any other provision of the Directive or under any other relevant directive.

The emphasis of the advice is on general obligations to identify and manage conflicts of interest that are capable of application to investment firms of different size and type. Such an approach would avoid setting rules that could not be of universal application.

Following on from this, the advice avoids trying to provide a detailed list of particular conflicts of interest.

The obligation for the firm under Article 13(3) of the Directive is not to prevent conflicts of interest from arising, it is for the firm to take all reasonable steps to prevent conflicts adversely affecting the interests of its clients.

The investment firm's profit motives, which include its fees, can be a source of conflicts of interest. For example, if a portfolio manager deducts a fee from the portfolio for each transaction effected, it will have an incentive to enter into unnecessary transactions to increase its fees, and this incentive conflicts with its duty towards the client. The rules on suitability and churning proposed in the advice under Article 19(4) should contribute of the management of the conflict of interest. Another example is an investment firm that sells a security to a client on an execution only basis (i.e. without providing any advice). It may have an incentive to delay the execution of the order to get a higher price. This will be addressed in part by the rules on best execution and prompt order handling.

The advice only catches cases in which there is conflict between the interests of the firm (or its associates) and the duty the firm owes to the client or between the interests of one or more of its clients. It is not enough that the firm stands to make money or that the client stands to loose money, this must then involve a conflict with a duty the firm owes to the client. Also, the advice indicates that the profit of the firm must be to the detriment of the client. There is also a difference between profits arising from an investment firm's normal commercial activities and profits arising from its failure to manage properly conflicts of interest.

The advice does not assume that standard business structures exist, or propose measures that investment firms could only comply with if they adopted particular structures. Instead, it seeks to set out flexible principles of general application across the whole range of business models. This is consistent with encouraging innovation in financial products and business models.

Article 18(1) refers to conflicts of interest between an investment firm (including certain related persons) and its clients, or between one client and another, that arise in the course of providing any investment and ancillary services or combinations thereof. Under this advice, the factors to be taken into account in determining the appropriateness of an investment firm's conflicts policy include the business it, and where applicable the other members of its group, conduct. This includes business that does not constitute an investment or ancillary service. However, an interest arising in relation to such "non-investment business" is only relevant where it leads to a conflict with the interests of a client that arises in the course of the provision of an investment and/or ancillary service.

It is suggested that for large, multi-function investment firms, the occurrence of conflicts of interest will be inevitable. Regulators should not require such firms to disaggregate in order to prevent conflicts of interest arising, as similar conflicts can be expected to emerge at the group level, and the costs associated with disaggregation cannot be shown to outweigh the benefits to clients.

The advice on the conflicts policy includes a non-exhaustive list of measures that an investment firm must take into consideration when complying with its obligations of providing an appropriate degree of independence in respect of persons engaged in different activities that present a material possibility of damage to the interests of one or more clients. In this context, activity is a narrower concept than the concepts of investment service or business activity. This is because CESR understands that either the provision of investment services or the performance of business areas very often involve different activities that may be treated differently, in order to achieve an appropriate degree of independence in respect of persons engaged in different activities that present a material possibility of damage interests of one or more clients.

Article 18(2) provides that investment firms should not provide services before disclosing conflicts that cannot be reasonably managed so as to prevent risk of damage to the client's interests, including the interests of a client having the status of an eligible counterparty within the meaning of Article 24 of the Directive, and not to act where the client does not consent. This provides an additional method of preventing significant conflicts from adversely affecting the interests of the client.

Although it is recognised that Article 19(1) of the Directive may provide for a more appropriate legal basis, paragraphs 9 and 10 of this advice relates to the acceptance and provision of inducements by investment firms. This is because inducements are a particular area of concern in relation to conflicts of interest.

This area is under consideration by a number of regulators and market participants. As this is an area of developing practices, it is desirable for the Level 2 measures to provide competent authorities with flexibility to update current provisions to reflect those changing practices. The advice therefore suggests that as a minimum, the offer or receipt of inducements may only be permitted by competent authorities if those inducements can reasonably assist the investment firm in the provision of services to its clients and do not conflict with its duty to act in the best interests of the client.

Level 2 Advice

BOX 7

Conflicts policy

1. An investment firm must establish, maintain and effectively implement an effective written conflicts policy that sets out the details of its organisational and administrative arrangements for identifying conflicts of interest and for preventing and managing material conflicts of interest in order to prevent damage to the interests of its clients.

Identification of conflicts

2. Without limiting the generality of Article 18(1) of the Directive, an investment firm must ensure that its conflicts policy includes all reasonable steps to identify at least conflicts of interest arising in the following situations and that these steps are effectively implemented:

(a) the investment firm or an interested person stands to profit, or avoid a loss, to the detriment of one or more of the investment firm's clients;

(b) the investment firm or an interested person has a financial or other incentive to favour the interests of one of the firm's clients or groups of clients over another, particularly where the interests of different clients may diverge or compete;

(c) the investment firm or an interested person has a financial or other incentive to favour

its own or such other person's interests above those of one or more of the firm's clients, in particular, where the firm or an interested person:

i. carries on the same business as one or more of the investment firm's clients (for example, by dealing on own account);

ii. has an incentive to provide investment advice or investment research to its clients that is not impartial; and/or

iii. stands to gain from volumes of business transacted with or for clients, for example, through portfolio management fees, marketing fees, commission, fee-sharing arrangements (such as fee rebates or soft commission) or other consideration for order-flow.

3. In complying with its obligation under Article 18(1) the investment firm must pay special attention to at least the following business activities, particularly where the firm or a person directly or indirectly linked by control to the firm performs a combination of two or more of them:

- Proprietary trading;

- Portfolio management; and

- Corporate finance business, including underwriting and/or selling in an offering of securities and advising on mergers and acquisitions.

This provision is without prejudice to the general obligation for the identification of conflicts of interest arising from or within any business activity or other combination of business activities, according to the criteria in paragraph 2 above.

4. The investment firm must maintain updated records of the types of actual or potential conflicts of interest arising under the criteria in paragraphs 2 and 3 above, with details, where relevant, of: the categories of interested persons; business activities; types of financial instruments; and types of transactions involved in those types of conflict.

Content of the conflicts policy

5. An investment firm's conflicts policy must include a clear description of the types of material conflicts of interest to be prevented or managed, the measures taken for their prevention or management and, where they are managed, the reasons why the relevant methods were selected.

6. An investment firm's conflicts policy must be appropriate to the nature, scale and complexity of its business, in particular:

(a) its organisational structure and business model;

(b) the investment and ancillary services it provides to its clients, and the type of financial instruments involved; and

(c) the business it conducts on its own account.

Where the investment firm is a member of a group the firm shall take account of the size, structure and business of the other members of the group.

7. The arrangements set out in the conflicts policy must, to the fullest extent practicable, include effective methods of providing an appropriate degree of independence in respect of relevant

persons engaged in different business activities involving a material conflict of interest.

8. The investment firm must take into consideration at least the following measures when complying with its obligations under paragraph 7:

(a) establishing information barriers between business activities giving arise to material conflicts of interest, including at least the business activities referred to in paragraph 3, and any other than those listed in paragraph 3 involving a risk of a conflict arising;

(b) separating supervision, such as requiring persons principally engaged in activities servicing different client groups or otherwise representing different interests (including those of the firm) that may come into conflict, to be supervised by different persons;

(c) removing direct linkages between the remuneration of relevant persons principally engaged in one activity and the remuneration of relevant persons principally engaged in, or revenues generated by, another activity;

(d) limiting undue influence from either within or outside the investment firm, for example, by preventing relevant persons principally engaged in one activity from having inappropriate influence upon relevant persons principally engaged in another activity;

(e) limiting involvement in extraneous activities, for example, by preventing relevant persons principally engaged in one activity from being involved in the activities of relevant persons principally engaged in another activity, where such involvement may impair proper conflicts management; and

(f) limiting the opportunity for clients of the investment firm in relation to one activity to unduly influence relevant persons engaged in another activity.

Inducements

9. An investment firm and its relevant persons may be permitted to offer or receive inducements only if they can reasonably assist the investment firm in the provision of services to its clients and do not, and are not likely to, impair compliance with the duty of the investment firm to act in the best interests of the client.

10. An investment firm must take all reasonable steps to ensure that relevant persons do not offer or accept inducements prohibited under paragraph 9.

Disclosure

11. Where an investment firm is required to provide any disclosure under Article 18(2) of the Directive it must:

(a) provide that disclosure in a durable medium; and

(b) obtain the client's consent before undertaking the relevant business with it.

The frequency and content of the disclosures that are required to be made under this advice may take into consideration the nature of its recipients, according to the Directive.

The content of the notification should be fair, clear and not misleading, prepared in accordance to Article 19(2) of the Directive. The relevant details included in this disclosure should be sufficient to enable the client to take informed decisions with respect to the relevant business.

Fair, clear and not misleading information (Article 19(2))

Extract from Level 1 text

Article 19(2) - All information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading. Marketing communications shall be clearly identifiable as such.

Extract from the Mandate of the Commission

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:
(1) Specify the criteria for assessing the fairness, clearness and not misleading character of marketing communications and of any other promotional/publicity communication addressed to clients or potential clients.
(2) Specify what is to be considered as a marketing communication in the context of this provision.
In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to publicity and marketing communications.

CESR Advice

Explanatory text

Marketing communications may have a material effect on a client or potential client's decisions concerning financial instruments or investment services. This effect may outweigh the counterbalancing effect of other information produced at a different stage of the sales process. Therefore, where the content of a retail marketing communication referring to a financial instrument or investment service is not limited to certain basic information, the same retail marketing communication should contain an adequate and balanced description of that financial instrument or investment service to ensure that it is fair, clear and not misleading. While this description should be adequate and cover the key characteristics of the financial instrument or investment service, including the nature of the financial commitment and the risks involved, it does not need to contain extensive detail. It may involve the use of presentation techniques, such as tables, bullet points or diagrams, provided that it is fair, clear and not misleading to do so. The details of the financial commitment will depend on the nature of the financial instrument being promoted and may include: the minimum amount that can be invested; details of additional commitments that may be required in the future; the minimum or maximum period of investment; and/or the fact that it could be some time before an investor may see a return on his investment.

Most of the detailed principles set out in the advice under Article 19(2) are only applicable in relation to retail clients or potential retail clients. In view of the different information requirements and bargaining power of professional clients and the fact that they may request a higher level of protection as a retail client, it is generally sufficient in the case of professional clients to rely on the general principle in Article 19(2) that information must be fair, clear and not misleading. This reflects the fact that some information that would be fair, clear and not misleading when provided to a professional client may not meet that standard for a retail client. Retail clients will generally have information needs different from professional clients, and the compliance costs entailed by a more detailed approach are therefore justified. However, the absence of detailed principles for

professional clients should not be interpreted as providing exemptions from the general principle in Article 19(2).

The general principles set out in this advice under Article 19(2) are intended to apply to all information addressed to clients or potential clients, including information provided under Articles 19(3) and (7) of the Directive.

The advice under Articles 19(2) and (3) is without prejudice to any requirements for the provision of information on withdrawal rights under community legislation or the law of a Member State.

The provisions in the advice on direct offer retail marketing communications are without prejudice to the investment firm's other conduct of business obligations, such as any applicable suitability or appropriateness requirements.

A direct offer retail marketing communication enables a client to provide its consent to the provision of a financial instrument or investment service by responding to that communication. Any additional information to be provided in relation to that financial instrument or investment service under Article 19(3) should therefore be contained in that communication in addition to the information required under Article 19(2), and may not simply be provided at a later time.

The requirement to include such additional information in a direct offer retail marketing communication should only apply to the extent that this information is required to be provided under Article 19(3). For example, such additional information need not be included if it has already been provided to the relevant retail client. This allows an investment firm that has already commenced its relationship with a client and provided it with the information required under Article 19(3) of the Directive to communicate subsequent direct offer retail marketing communications to that client without repeating the information required under Article 19(3). However, this is conditional upon the subsequent communications falling within the scope of the original disclosure under Article 19(3) and is without prejudice to the other requirements that apply to that direct offer retail marketing communication under Article 19(2) or the requirement to notify the retail client of certain changes to information provided under Article 19(3).

The requirement to provide information under Article 19(3) of the Directive will not be discharged by the inclusion of such information in a direct offer retail marketing communication unless that communication is made in a durable medium. Where this is not the case, the applicable requirements of Article 19(3) will need to be complied with by providing the information again in a durable medium.

The advice under Articles 19(2) and (3) of the Directive is without prejudice, where applicable, to: the provisions concerning advertisements relating to an offer to the public of securities or to an admission to trading on a regulated market under Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading and; the provisions concerning the provision of information set out in Council Directive 85/611/EEC of 20 December 1985, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

Some marketing communications may also constitute recommendations for the purposes of Directive 2003/125/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest. This advice is without prejudice to the requirements of that Directive, where applicable.

It is also without prejudice to the provisions relating to mere conduits, caching and hosting of Directive 2000/31/EC on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market.

Level 2 Advice

BOX 8

Interpretation

1) In this advice and the advice under Article 19(3), references to an investment firm addressing, directing or making a communication or otherwise communicating or providing information include an investment firm:

a) causing a third party to do so; or

b) (other than in paragraph 5) confirming that a marketing communication complies with the applicable requirements under Article 19(2) for the purposes of paragraph 2.

These provisions are without prejudice of the provisions of the Directive 85/611/EEC as subsequently amended, with respect to the marketing and disclosure requirements.

Confirmation of compliance by another person

2) An investment firm ("A") may distribute a marketing communication in writing or in a pre-recorded format through television, radio or another such medium without having to comply with the requirements set out in this advice (other than the requirement in paragraph 5) where that marketing communication was issued or approved by another investment firm or other person regulated by a competent authority of a Member State ("B") provided that:

a) A takes reasonable care to ensure that:

i) B has confirmed that the marketing communication complies with the requirements that would have applied had A confirmed compliance itself; and

ii) B was subject to the same requirements when doing so;

b) A takes reasonable care to establish that it only communicates the marketing communication to recipients of the type for whom it was intended at the time that B confirmed compliance; and

c) so far as A is, or reasonably should be, aware:

i) the marketing communication has not ceased to be fair, clear and not misleading since that time; and

ii) B has not withdrawn the marketing communication.

Presentation of benefits and risks

3) In order to give a fair and adequate description of the investment service or financial instrument, an investment firm must avoid accentuating the potential benefits of an investment service or financial instrument in any communication with a retail client or potential retail client without also giving a fair indication of the risks.

Information addressed to retail clients

4) When an investment firm directs or addresses any information (including a marketing communication or the terms of an actual or proposed client agreement) to its retail clients or potential retail clients it must:

a) take all reasonable steps to ensure the purpose, and to the extent practicable, the content, of the information or communication are likely to be understood by the average member of the group to whom the communication is directed or to whom it is addressed;

b) ensure key items contained in the information are given due prominence;

c) ensure the method of presentation of the information does not disguise, diminish or obscure important warnings or statements; and

d) ensure the communication does not omit information that is material to ensure it is fair, clear and not misleading.

Consistency of information

5) An investment firm must take all reasonable steps to ensure that the information provided by it in a retail marketing communication is consistent with the information it provides to its retail clients in the course of the provision of the investment services. Without prejudice to the other requirements under the Directive concerning the provision of information to clients, this specific requirement should apply at least for the period in which the retail marketing communication is in use by the investment firm.

Marketing communications: basic requirements

6) An investment firm must ensure that any marketing communication communicated by it contains at least:

a) the name of the investment firm; and

b) in the case of a retail marketing communication in writing:

i) the investment firm's telephone number or other appropriate contact details; and

ii) the fact that the investment firm is authorised and/or registered and the name of the competent authority that has authorised and/or registered it.

Use of competent authority's name

7) An investment firm must not use the name of the competent authority in such a way that would indicate endorsement or approval of its products or services.

Factual claims

8) The competent authority may:

a) require an investment firm to furnish evidence as to the accuracy of factual claims in any marketing communication made by that investment firm if, taking into account the legitimate interest of the investment firm and the client or potential client, such a requirement appears appropriate on the basis of the circumstances of the particular case; and

b) consider factual claims as inaccurate if the evidence demanded in accordance with (a) is not furnished or is deemed insufficient by the competent authority.

Specific retail marketing communications

9) When an investment firm makes a retail marketing communication referring to a financial instrument and/or investment service, that communication must contain at least:

a) a balanced and adequate description of the main characteristics of the financial instrument and/or service to which it refers, including the nature of the financial commitment and the risks involved in the financial instrument and/or investment service; and

b) if the communication refers to a financial instrument or service of a person other than the investment firm, the name of that person.

Retail marketing communications with restricted contents

10) Paragraphs 6(b) and 9 do not apply to retail marketing communications that only contain one or more of the following:

a) the name of the investment firm (or its tied agent);

b) the name of one or more financial instruments;

c) a contact point;

d) a logo;

e) a brief factual description of the investment firm's (or its tied agent's) activities;

f) a brief factual description of the investment firm's (or its tied agent's) fees;

g) a short generic description or statement about the financial instruments; and

h) the price and yields of financial instruments and the charges.

Direct offer retail marketing communications

11) In addition to the information required under paragraph 9, any direct offer retail marketing communication must also contain any additional information required under Article 19(3) in relation to the investment services and/or financial instruments to which it relates.

References to tax treatment

12) When information provided to a retail client or potential retail client refers to a particular tax treatment, the investment firm must advise the retail client or potential retail client that the tax treatment depends on his personal situation and is subject to change and that he may wish to obtain independent tax advice.

Simulated historic returns

13) An investment firm may not use simulated historic returns in information provided to a retail client or potential retail client.

References to past performance and forecasts of future performance

14) If information provided by an investment firm to a retail client or potential retail client:

a) refers either to the past performance or to a forecast of the future performance of a financial instrument and/or investment service, this information must be relevant to the financial instrument and/or investment service being promoted and the source of the information must be stated;

b) contains a reference to past performance of a financial instrument and/or investment service:

i) it must be clearly expressed that the figures refer to the past and that they may not constitute reliable guidance as to the performance of that financial instrument and/or investment service in the future;

ii) the reference period must be stated and must not be less than one year;

iii) where a benchmark is used to compare returns, it must be identified and its reference period must be relevant, clear and sufficient to provide a fair and balanced indication of performance of the investment service or financial instrument being promoted;

iv) if the return figures are not denominated in local currency, the currency used must be stated and reference shall be made to the currency risk for the return in local currency; and

v) the information for the comparison should be based on net performances or if it is based on gross performances, commissions, fees or other charges have to be disclosed;

c) contains information on forecasted future returns:

i) it must at least be clearly indicated that these future returns are forecasts and may not constitute reliable guidance as to future performance; and

ii) such forecasts must be based on objective and realistic assumptions of investment returns.

References to past performance: conversion and cloning of collective investment undertakings

15) If a collective investment undertaking ("A") is converted into a different collective investment undertaking ("B") or a new collective investment undertaking ("B") is established as a clone of an existing collective investment undertaking ("A"), the use of information about the past performance of A in relation to B will not constitute simulated historic returns under paragraph 13. However, it will constitute a reference to past performance under paragraph 14.

Estimates, forecasts and promises

16) Any estimate, forecast or promise contained in information provided by an investment firm to a retail client or potential retail client on financial instruments and/or investment services must at least:

a) be clearly expressed;

b) state the assumptions on which it is based that are capable of having a material impact on it; and

c) be relevant.

Comparisons

17) If information provided by an investment firm to a retail client or potential retail client contains comparisons, the requirement of being fair, clear and not misleading means at least that:

a) the comparisons must be based either on data from attributed sources or disclosed assumptions;

b) the comparisons must be presented in a fair and balanced way; and

c) the investment firm must take reasonable steps to ensure the comparisons do not omit any fact that is material to the comparison.

Information to clients (Article 19(3))

Extract from Level 1 text

Article 19(3): "Appropriate information shall be provided in a comprehensible form to clients or potential clients about:

- *the investment firm and its services,*
- *financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies,*
- *execution venues, and*
- *costs and associated charges so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format".*

Extract from the Mandate of the Commission

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

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

CESR Advice

Explanatory text

This advice specifies the content of the appropriate minimum information that the investment firm should supply to its clients and potential clients under Article 19(3) of the Directive. It also addresses the timing and form of the provision of that information.

An investment firm may generally be deemed to have complied with the obligation to provide information under Article 19(3) of the Directive where the client has been given the information on a previous occasion and that information is still up to date. The provision of certain information in the case of voice telephone communications allows an investment firm, with the explicit consent of

a retail client or potential retail client, to delay the provision of other information under Article 19(3) of the Directive. Therefore, if the investment firm has already given the information required under Article 19(3) to the client on a previous occasion and it is still up to date, it should generally not be necessary for the investment firm to provide such information at the start of the voice telephone communication. However, the requirement to make the identity of the investment firm and the commercial purpose of the call explicitly clear should apply to each voice telephone communication to a retail client or potential retail client initiated by the investment firm.

The advice on voice telephone communications is intended to be without prejudice to any applicable restrictions on cold calling by investment firms.

The advice is intended to ensure a consistent relationship between the requirements under the Directive for investment firms to provide information to clients so that they are reasonably able to understand the nature and risks of the investment service and financial instrument offered and the document or documents agreed between the investment firm and the client that set out the terms on which the investment firm will provide services to the client. Therefore, such information may be incorporated in such documents as long as the timing requirements for the provision of the information are complied with.

The requirement to provide information about geographical addresses relevant for the retail client's relations with the investment only requires the provision of information about addresses that are particularly relevant for the retail client's relations with the investment firm and is not intended to cover every address that could potentially be relevant.

Level 2 Advice

BOX 9

Timing and form of information provision

1) Subject to paragraphs 5 and 6, a retail client or potential retail client must be provided with the information required under Article 19(3) of the Directive in a durable medium in good time, before:

a) the commencement of the provision of services to a new client; and

b) the commencement of the provision of:

i) new services in relation to new or existing types of financial instruments; and/or

ii) existing services in relation to new types of financial instruments,

to an existing retail client.

Information given on a previous occasion

2) With the exception of the requirement under paragraph 15, an investment firm may be deemed to have complied with the obligation to provide information under Article 19(3) of the Directive where the client has been given the information on a previous occasion and that information is still up to date.

Meaning of "in good time"

3) For the purposes of paragraph 1 and 4, the meaning of "in good time" should be determined taking into consideration:

a) the urgency of the situation; and

b) the time necessary for the retail client or potential retail client to absorb and react to the information provided.

Changes to information

4) An investment firm must notify a retail client in good time when any change occurs to the information provided under Article 19(3), where such change is material to the ongoing provision of services by the investment firm to the retail client.

Derogation for voice telephone communications

5) By way of derogation from paragraph 1, in the case of voice telephone communications with a retail client or potential retail client, subject to the explicit consent of the retail client or potential retail client and without prejudice to the requirement in paragraph 15, only the following information needs to be given:

a) the identity of the person in contact with the retail client or potential retail client and his link with the investment firm;

b) a description of the main characteristics of the relevant types of investment services and/or financial instruments;

c) the basis for the calculation of the price to be paid by the retail client or by another person to the investment firm for the financial instruments and/or investment services, including all fees, commissions, charges and expenses and all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service and notice of the possibility that other taxes and/or costs may exist that are not paid via the investment firm or imposed by it.

The investment firm shall inform the retail client or potential retail client that other information is available on request and of what nature this information is. In any case, the investment firm shall provide the full information it is required to provide under Article 19(3) in a durable medium immediately after starting to provide the service to the retail client.

Means of distance communication not enabling the provision of information in a durable medium

6) By way of derogation from paragraph 1, the investment firm may provide the information required under Article 19(3) immediately after starting to provide a service to the retail client if the arrangements leading up to the commencement of the provision of the service were concluded at the retail client's request using a means of communication:

a) without the simultaneous physical presence of the parties;

b) that does not enable the provision of that information in a durable medium in conformity with paragraph 1; and

c) that is not a voice telephone communication.

Information about the investment firm and methods of redress

7) The information about the investment firm to be provided to a retail client or potential retail

client under Article 19(3) includes the following:

a) the identity and the main business of the investment firm;

b) the geographical address at which the investment firm is established and any other geographical address relevant for the retail client's relations with the investment firm;

c) the investment firm's telephone number or other appropriate contact details;

d) the fact that the investment firm is authorised and/or registered and the name of the competent authority that has authorised and/or registered it;

e) where the investment firm is registered in a trade or similar public register, the register in which the investment firm is entered and its registration number or an equivalent means of identification in that register;

f) a general description of the services to be provided by the investment firm and the types of instrument to which such services relate so that the retail client or potential retail client is able to assess the scope of the investment firm's responsibilities;

g) whether or not there is an out-of-court complaint and redress mechanism for the retail client that receives the investment services (whether provided by the investment firm or a third party) and, if so, the methods and conditions for having access to it or to them;

h) the language or languages in which any documents referred to in Article 19(7) and the information required under Article 19(3) will be supplied in the future; and

i) the language or languages in which the investment firm, with the agreement of the retail client, undertakes to communicate during the provision of the investment services.

Information about services, financial instruments and costs and charges

8) The information about:

- the investment firm's services;

- financial instruments; and

- costs and associated charges,

to be provided to a retail client or potential retail client under Article 19(3) includes the following:

a) a description of the main characteristics of the specific types of financial instruments and/or investment services, including:

i) the nature of the financial commitment;

ii) an explanation of the extent to which the services will or may relate to instruments:

(1) that are traded on a regulated market;

(2) that are traded on an MTF; and/or

(3) that are neither traded on a regulated market nor on an MTF,

and a brief general description of the material implications of this for the retail client or potential retail client; and

iii) the risks involved;

b) if the retail client or potential retail client envisages undertaking transactions in warrants or derivatives, the information provided must include an explanation of their characteristics (especially the leverage effect and the liquidity and volatility of the market) and where potentially relevant, must make it clear that such financial instruments instrument can be subject to sudden and sharp falls in value and, where the retail client or potential retail client may not only lose his entire investment but may also be required to pay more later, he must also be warned about this fact and the possible obligation to provide extra funding;

c) the basis of the calculation of the price, to be paid by the retail client or by another person to the investment firm for the financial instruments and/or investment services, including:

i) all fees, commissions, charges and expenses; and

ii) all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service;

d) the arrangements for payment and for performance of the contract;

e) where applicable, notice of the possibility that other taxes and/or costs may exist that are not paid via the investment firm or imposed by it; and

f) any limitation on the period for which the information provided is valid.

Information about the basis of calculation of the price

9) Where applicable, the information required under paragraph 5(c) or 8(c) must include:

a) the percentage or rate applicable;

b) the frequency with which the percentage or rate is applied;

c) any maximum or fixed minimum fees;

d) where the commission or fee must be paid in foreign currency, the currency involved; and

e) notice of the possibility that, in addition to the fees charged by it, the investment firm may recover expenses, charges or other costs incurred by the investment firm or another person from the retail client and, where this is the case, notice that the investment firm will provide the retail client with the relevant details of such expenses, charges or other costs on request.

Compound products

10) The information provided to a retail client or potential retail client under paragraph 8(a) in relation to a compound product must contain all the relevant and material characteristics of the instruments and/or services comprising the product and an adequate description of the way in which they interact.

Guarantees

11) Where an investment firm has provided information to a retail client or potential retail client

that states or implies that the performance of investment services or of the financial instruments is guaranteed by a third party, the information provided to that retail client or potential retail client under paragraph 8 in relation to those investment services or financial instruments must include sufficient detail about the guarantor and the guarantee to enable the retail client or potential retail client to make a fair assessment of the guarantee.

Presentation of risk warnings

12) Risk warnings provided to a retail client or potential retail client must be given due prominence. They must not be concealed or masked in any way by the wording, design or format of the information provided.

Examples of areas where risk warnings required

13) Without limitation to the general obligation contained in the second indent of Article 19(3) of the Directive or the requirement in paragraph 8(b) of this advice, an investment firm must provide a retail client or potential retail client with appropriate guidance on, and warnings of, relevant risks when providing investment services in relation to:

a) transactions in illiquid financial instruments;

b) leveraged transactions;

c) financial instruments subject to high volatility in normal market conditions;

d) securities repurchase agreements or securities lending agreements;

e) transactions which involve credit, margin payments or the deposit of collateral;

f) transactions involving foreign exchange risk; and/or

g) financial instruments that involve a high level of credit risk.

Information relating to public offers of securities

14) In the case of orders received in connection with public offers of securities, an investment firm may transmit such orders provided that it offers the relevant prospectus to the retail client or informs the retail client where it is available.

Information to be provided at the beginning of voice telephone communications

15) The identity of the investment firm and the commercial purpose of the call shall be made explicitly clear at the beginning of any voice telephone communication with a retail client or potential retail client initiated by the investment firm.

Information on the investment firm's conflicts policy

16) At the same time as it is required to provide other information under Article 19(3) of the Directive an investment firm must either:

a) provide the client or potential client with a general and adequate description of its conflicts policy in a durable medium; or

b) if it has made the general and adequate description of its conflicts policy available on its website and provides a hard copy to its clients and potential clients on request, notify the clients or

potential clients of the details of the website at which the general description can be accessed and inform them that a hard copy version will be made available on request.

Information about inducements

17) Where inducements are permitted in accordance with paragraph 9 of the advice under Articles 13(3) and 18, the investment firm must inform its client in a durable medium:

a) at the same time as it is required to provide other information under Article 19(3) of the Directive, of its policy on inducements; and

b) at least once a year, of the relevant details of such inducements.

Retail Client Agreement (Article 19(7))

Extract from level 1 text

Art 19(7): "The investment firm shall establish a record that includes the document or documents agreed between the firm and the client that set out the rights and obligations of the parties, and the other terms on which the firm will provide services to the client. The rights and duties of the parties to the contract may be incorporated by reference to other documents or legal texts".

Extract from the Mandate of the Commission

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

CESR Advice

Explanatory text

Since records in general are addressed in the advice under Article 13(6), it is necessary to deal only with the records relating to the client agreement in the advice under Article 19(7).

The present advice on Article 19(7) deals with the minimum content of the retail client agreement. This may take the form of a framework agreement under which one or more services or products are provided to the retail client. An investment firm may however prefer to use separate agreements for different services or even for separate transactions.

The advice proposes requiring a signed, written agreement (or equivalent) with retail clients for the provision of all investment services and the most significant ancillary services. It also proposes defining the items that must be included in the basic agreement, and the additional items that must be included in agreements for trading in derivatives and agreements for portfolio management.

CESR intends to provide advice to the Commission subsequently on the issue of the professional client agreement. It therefore published a call for opinions on the professional client agreement in December 2004 (CESR/04-689).

The advice follows closely the CESR Standards on Investor Protection published in April 2002. A few additions and amendments are proposed in order to take into account the E-commerce Directive and the Distance Marketing Directive, and the advice under Article 19(3) on information requirements.

The advice is not intended to interfere with national contract law any more than is necessary for the implementation of the proposed level 2 provisions. In particular the advice is not intended to interfere with the way in which contracts are concluded, amended, renewed or terminated under the applicable law of the Member States.

Nor is the advice intended to interfere with national legislation and regulations implementing other parts of the Directive. In particular the advice allows the contract to refer to national legal texts, but it also allows for situations where the contractual obligations go further than required by law, for example in terms of reporting obligations to the client (within the meaning of Article 19(8)), or where the contract specifies the characteristics of the investment advisory service to be provided ("investment advice" within the meaning of Article 19(4)).

The advice on the terms of the agreement to be entered into with the client are not intended to prevent the client requesting amendments to the terms of an agreement provided to it by an investment firm or suggesting his own terms of the agreement.

The advice is intended to be consistent with the information requirements in Directive 2002/65/EC on distance marketing of consumer financial services. In particular, it is envisaged that an investment firm will normally provide information under Article 19(3) at the same time as providing the terms of a retail client agreement under Article 19(7) and that it will not normally be necessary to provide further information in relation to successive operations or a series of separate operations of the same nature performed over time under the retail client agreement.

Some of the items that CESR is proposing to be included in the retail client agreement are also items of information to be provided to the client under Article 19(3) of the Directive. The advice on Article 19 endeavours to reduce the overlap as much as possible, and to eliminate inconsistency between the two parts of the advice on implementing measures for this Article. Some of the information provided by an investment firm to its clients also forms part of the basis for the agreement concluded with the client. These two sets of requirements serve different purposes: that of making clients aware of the services offered and that of agreeing on rights and obligations concerning the provision of these services. However, provided the applicable timing requirements are complied with, investment firms will be able to satisfy the obligation to provide information under Article 19(3) by incorporating into its agreement with the client.

CESR would like to draw the attention of the Commission to practical problems that transition to the new regime might create in some jurisdictions for existing client agreements. To facilitate a smooth transition to this new regime CESR proposes that the Commission adopts practical solutions.

Level 2 Advice

BOX 10

Retail client agreement

1. In good time prior to providing any investment service or the ancillary service of safekeeping financial instruments to a retail client, an investment firm must:

- provide to the client the terms of the agreement in a durable medium, setting out the rights and obligations of the parties and any other contractual terms or items of information necessary for the proper understanding and performance of the contract, and

- obtain the client's consent to the terms of the agreement as evidenced by signature or an equivalent alternative mechanism.

Derogation for certain means of communication

2. By derogation from paragraph 1, the investment firm may provide the terms of the retail client agreement in a durable medium and/or obtain the consent of the retail client as evidenced by signature or an equivalent alternate mechanism immediately after starting to provide a relevant

service, other than portfolio management, trading in warrants or derivatives or safekeeping of financial instruments, if that service has been provided at the client's request using a means of communication, without the simultaneous physical presence of the parties, which does not enable the provision of the terms of the agreement in a durable medium and/or the obtaining of such evidence of the consent of the client.

Minimum contents of the retail client agreement

3. The retail client agreement must contain the following items as a minimum:

a) the identity of each of the parties, including any trade registration number or equivalent of the investment firm;

b) the geographical address and telephone number or other appropriate contact details of the investment firm;

c) the fact that the investment firm is authorised and the name of the competent authority that has authorised it;

d) where relevant for the service to be provided, the identity and geographical address of any relevant representative of the investment firm established in the client's Member State of residence;

e) the address and/or other contact details that are to be used by the investment firm to contact the client;

f) the names of any persons authorised to represent the client for the purposes of the agreement, in particular the names of the natural persons authorised to represent a client who is a legal entity;

g) to the extent that this is possible and relevant at the time of the provision of the terms of the agreement to the client, a description of any withdrawal right or cooling-off period;

h) a description of the investment services and, where appropriate, ancillary services to be provided by the investment firm, the types of financial instruments to which such services relate, the firm's general terms of business for such services and any relevant express particular terms;

i) where applicable, the terms of any credit or loan to be granted to the client by the investment firm to allow him to carry out a transaction;

j) where applicable, the types of orders and instructions that the client may place with the investment firm;

k) the reports to be given by the investment firm to the client regarding the performance of services including the type, frequency and rapidity of the information to be sent;

l) the forms of communication to be used between the investment firm and the client for sending and receiving orders, instructions and/or information generally and the alternative media to be used when normal media are unavailable;

m) adequate details of the investment firm's fees and prices for the relevant investment services and ancillary services, including information on how they are to be calculated, the frequency with which they are to be charged and the manner of payment;

n) the law applicable to the contract and the competent national jurisdiction or jurisdictions, as ascertained to the best of the knowledge of the investment firm or as agreed between the parties;

o) where such a procedure exists, a description of the mechanism for settling disputes between the parties such as an out-of-court complaint and redress procedure including the methods and conditions for accessing such a mechanism;

p) the duration of the agreement and the procedures for amending, renewing, terminating or withdrawing from it;

q) the actions that the investment firm shall or may take to dispose of or appropriate any assets of the client in the event the client does not honour his obligations, including the timeframe for doing so and the information to be given to the client in such circumstances; and

r) the languages in which the client will be able to communicate with the investment firm.

4. Rather than containing all the above items itself, the retail client agreement may refer either to other documents containing certain items, such as the general terms of business of the investment firm, the types of investment services and ancillary services offered, the types of orders to be sent by the client and the fee schedule, or to legal texts containing certain items such as relevant withdrawal rights and reporting obligations provided that all the contractual documents and legal texts so referred to are provided to the client in a durable medium in good time prior to the provision of the relevant services in accordance with paragraph 1, or immediately after the commencement of provision of the relevant services in accordance with paragraph 2, where applicable.

5. Without prejudice to the advice under Articles 13(7) and 13(8), where an investment firm:

a) holds client financial instruments for a retail client;

b) acts as a portfolio manager for a retail client; or

c) provides investment advice to a retail client on the basis that it will keep that client's portfolio under review,

the client agreement must contain an adequate indication of the rights and obligations of the parties relating to the exercise of corporate actions (such as takeover bids and other tender offers, capital reorganisations and conversion or subscription rights) and the exercise of voting rights attaching to the financial instruments to which the service relates.

Modification of the retail client agreement

6. The retail client agreement must require the prior notification of the client before the coming into effect of any material modification of the contract by the investment firm to the detriment of the client, and a sufficient opportunity for the client to terminate the agreement at no additional cost (other than the payment of fees and expenses due under the existing client agreement).

Record keeping

7. A copy of the retail client agreement signed by the client (or to which the client provided evidence of consent by an equivalent alternative mechanism), any related contractual documents or legal texts and any amendments to such agreement or related documents or texts, must be kept by the investment firm for the duration of the client relationship and for at least five years after the termination of the agreement; a copy of the retail client agreement must be provided to the client immediately after signing (or after such other provision of evidence of consent), and at any time subsequently during the contractual relationship on request. Where contractual documents and/or legal texts are incorporated by reference in the agreement, such documents and texts may be kept

by the firm for each relevant group of clients provided it is able to identify the documents and texts that are relevant for each client at any time.

Retail client agreement involving trading in warrants or derivatives

8. In good time prior to providing the services of reception/transmission and/or execution of orders involving warrants or derivatives to a retail client, an investment firm must enter into a signed (or equivalent) agreement in a durable medium with the client, within the meaning of paragraph 1, containing (or incorporating by reference in accordance with paragraph 4) all the relevant provisions of the retail client agreement mentioned in paragraph 3 as well as the following additional provisions.

a) the types of instruments and types of transactions envisaged. The contract must mention in particular whether the relevant instruments are admitted to trading on a regulated market or not, and whether the client is able to undertake transactions giving rise to contingent liabilities. It must refer to the documentation provided by the investment firm to the client on the types of envisaged instruments and transactions for information purposes;

b) the obligations of the investment firm with respect to the envisaged transactions, in particular its reporting and notice obligations to the client; and

c) the obligations of the client with respect to the envisaged transactions, in particular his financial commitments toward the investment firm and the time allowed for honouring such commitments. The contract must provide adequate details on any margin requirements or similar obligations, regardless of the source of such requirements and must indicate in sufficiently precise terms how margin will be calculated and charged, the types of assets accepted as margin, the frequency of margin calls and the timetable for delivery or payment of margin by the client. The contract must require immediate notification to the client of any material change in margin requirements.

Retail client agreement for portfolio management

9. In good time prior to providing the service of portfolio management to a retail client, an investment firm must enter into a signed (or equivalent) agreement in a durable medium with the client, within the meaning of paragraph 1, containing (or incorporating by reference in accordance with paragraph 4) all the provisions of the client agreement mentioned in paragraph 3 as well as the following additional provisions:

a) the management objectives, including the level of risk agreed upon, and any specific constraints on the investment firm's discretion;

b) the types of financial instruments that may be included within the portfolio and types of transactions that may be carried out in such instruments, including any limits. If the investment firm is mandated to invest in financial instruments not admitted to trading on a regulated market, derivatives, illiquid or highly volatile instruments, or to undertake short sales, purchases with borrowed funds, securities repurchase or lending agreements, or any transactions involving margin payments, deposit of collateral or foreign exchange risk, the contract must state so explicitly and provide adequate information on the scope of the firm's discretionary authority regarding these instruments and transactions;

c) for information purposes with respect to the client, an appropriate benchmark, based on financial indicators produced by third parties, in common use and consistent with the management objectives, against which performance will be compared. Where it is not feasible to establish a benchmark in view of specific client objectives, this must be stated clearly in the contract and an alternative measure of performance must be indicated;

d) the basis on which the financial instruments are to be valued at the date of valuation. The contract must state whether the instruments are to be valued with respect to a market price (opening or closing price, bid/ask or offer or mid-market price or other, including any relevant currency exchange rates), or where relevant by reference to indicators such as yield curves or other pricing models and the methodology to be used to value equity instruments that are not admitted to trading on a regulated market or MTF; and

e) adequate details regarding any delegation of the discretionary management of all or part of the assets in the client's portfolio, where this is envisaged. The contract must state that the delegator retains full responsibility for the protection of the client's interests, and that the client will be informed prior to any material change regarding the delegation of portfolio management.

Retail client agreement for portfolio management: reporting of losses

10. The retail client agreement referred to in paragraph 9 must define a specific reporting requirement in the event of losses, defined as a marked-to-market decrease in the value of the portfolio as compared to the value of the portfolio stated in the most recent periodic report (after neutralisation of any contributions or withdrawals). The contract must set a percentage threshold and a time period to inform the client accordingly.

Retail client agreement for portfolio management: variable management fee

11. If the retail client agreement referred to in paragraph 9 provides for a variable management fee based on the performance of the portfolio, the method of calculation must be clearly defined in the client agreement.

Termination of retail client agreement for portfolio management

12. The retail client agreement referred to in paragraph 9 must allow the client to terminate the agreement with immediate effect, subject only to the completion of all transactions already commenced and the time necessary to liquidate the portfolio where this is required by the client. The agreement must require that the investment firm provide at least two weeks' notice (or such longer period as agreed by the parties) before terminating the agreement, provided however that where the portfolio cannot be liquidated (where so required by the client) within this timeframe, the agreement may be extended for the necessary additional period, and provided that where the client so agrees after being informed of the firm's intention to terminate, the agreement may be terminated in the timeframe agreed between the parties. In both cases contemplated by the two previous sentences, the termination must take place on terms that are fair and reasonable for both parties.

Reporting to clients (Article 19(8))

Extract from Level 1 text

Article 19(8): "The client must receive from the investment firm adequate reports on the service provided to its clients. These reports shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client."

Extract from the Mandate of the Commission

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

CESR Advice

Explanatory text

The advice on Article 19(8) is intended to specify the minimum requirements investment firms must comply with when providing adequate reports on the services provided to their clients.

Article 19(8) refers to a report being received by the client. However, there may be circumstances in which a client will wish to appoint another person to receive reports on his behalf (for example, the client's accountant or legal adviser). This should be permitted unless that other person is the investment firm, its tied agent, or a member of its group. Where an investment firm that is a portfolio manager ("A") instructs another investment firm ("B") to execute or transmit an order, B's client is A, unless B is directly appointed by A's client or has agreed to be treated as so appointed.

Where an investment firm provides a portfolio management service for a client and also holds the client assets to which that service relates, the reports it provides to that client on one activity should also be taken to satisfy the reporting obligation for the other activity where those reports would have contained substantially the same information. However, the ability of an investment firm to include information required in different statements in the same document is without prejudice to its obligation to ensure that all information addressed to clients is fair, clear and not misleading.

Without prejudice to the obligation to ensure that all information addressed to clients is fair, clear and not misleading, a report required under Article 19(8) may consist of more than one document.

An investment firm does not need to provide a contract note or confirmation notice or a periodic statement that would duplicate a document provided by another person. By way of example, this would be relevant where one broker carries out a client order through a second broker and the second broker provides a contract note or confirmation notice to the client. However, it is not intended to cover the outsourcing by an investment firm of its client reporting function, which would be subject to the advice on outsourcing.

An investment firm should notify a retail client if it does not accept an order received from that client, decides not to carry such an order out or is unable to do so. However, this should not require the investment firm to disclose such information in breach of any applicable legal restrictions on the disclosure of information.

The requirements relating to the provision of information to retail clients on unexecuted or unaccepted orders are not intended to apply to an investment firm that is a portfolio manager in relation to its decisions to enter into a transaction in the exercise of its discretion.

The specific reporting requirements set out in this advice are not exhaustive of the general requirement in Article 19(8) of the Directive, which requires the provision of adequate reports on the service provided to clients. CESR has not proposed specific reporting requirements in relation to the provision of investment advice. This is because in the majority of cases, the provision of the advice to the client will itself constitute an adequate report to the client for the purposes of Article 19(8). However, this should not prevent Member States imposing specific reporting requirements in relation to the provision of investment advice where appropriate.

Level 2 Advice

BOX 11

Contract notes and confirmation notices

1. Subject to the derogation referred to in paragraph 19 for portfolio management, an investment firm that carries out an order for a client must ensure that the client is provided promptly with the essential information concerning the carrying out of the order in a durable medium.

Contract notes and confirmation notices: retail clients

2. Subject to the derogation referred to in paragraph 19 for portfolio management, an investment firm that carries out an order for a retail client must, no later than the first business day following the execution of the order, or receipt of confirmation of execution of the order by a third party, send to the retail client, a contract note or confirmation notice in a durable medium that includes the following information:

a) the name of the investment firm;

b) the name or other designation of the retail client's account;

c) the time of execution, if available, or a statement that the time of execution will be supplied on request;

d) the date of execution;

e) the nature of the order (such as subscription, buy, sell or exercise);

f) the regulated market or MTF on which the transaction was carried out or the fact that it was carried out outside of a regulated market or MTF or, where appropriate, the third country market place or trading facility on which the transaction was carried out or the fact that it was carried out outside of such a market place or trading facility;

g) the financial instrument and the quantities involved in the transaction;

h) the unit price applied and the total consideration;

i) whether the retail client's counterparty was the investment firm itself or any person in the investment firm's group;

j) the commissions and expenses charged; and

k) the client's responsibilities in relation to the settlement of the transaction, such as the time limit, details (name and number) of the bank account and financial instruments account (unless such arrangements have been notified to the client in advance).

Use of anonymous trading systems

3. If an order is executed through an anonymous trading system, the contract note or confirmation notice does not need to indicate whether the retail client's counterparty was the investment firm itself or any person in the investment firm's group.

Execution of an order in multiple tranches for a retail client

4. If orders may be executed in multiple tranches for a retail client, the investment firm must agree with that retail client whether the contract note or confirmation notice is to contain the price of execution of each tranche or an average price. The investment firm must provide such reports accordingly. Where an average price is provided, the investment firm must notify the retail client of the price of execution of each tranche if requested to do so.

Unexecuted open orders received from retail clients

5. If an order from a retail client is not executed within one business day of its receipt, an investment firm must send a confirmation of the order in a durable medium to the retail client. The order confirmation notice must include client order details, date and time of reception. Where applicable, the investment firm must also provide the date and time of transmission if requested to do so. If an investment firm has only been able to execute part of an order from a retail client, the contract note or confirmation notice for the executed part of the order may also function as the confirmation of the unexecuted part of the order. The requirement to provide confirmation of unexecuted orders does not apply to orders that:

a) are only valid for one business day; or

b) result from decisions to deal by the investment firm when acting as a portfolio manager.

Provision of information to an agent of the client

6. For the purposes of this advice, an investment firm may despatch a contract note, confirmation notice, periodic statement or any other information to an agent nominated by the client in a durable medium, provided that the agent is not:

a) the investment firm;

b) its tied agent; or

c) a member of its group.

Duplication of information: contract notes or confirmation notices

7. An investment firm does not need to provide a contract note or confirmation notice under paragraphs 1 (and where applicable 2 and 5), if it would contain the same information as a contract note or confirmation notice that is to be promptly despatched by another person.

Arrangement for a series of purchases of units or shares in a collective investment undertaking

8. An investment firm does not need to send a contract note or confirmation notice in relation to

orders carried out under an arrangement for the client to make a series of payments for the purchase of units or shares in a collective investment undertaking (including one off payments made in addition to those in the series) provided details of those transactions are provided to the client at least every 6 months.

Failure by another person to supply required information

9. If anyone fails to supply information that an investment firm requires for inclusion in a contract note or confirmation notice, the investment firm may omit this information from that document provided the fact of its omission is stated with an indication that it is to be supplied later (or that it cannot be supplied at all if that is the case). The relevant information must then be supplied to the client promptly after receipt. This paragraph is not intended to apply where the person who fails to supply the information is providing services to the investment firm under an outsourcing arrangement falling within the advice under Article 13(5) of the Directive.

Statements of client assets

10. An investment firm that holds client assets for a client must send to its client at least once a year, or as often as agreed with that client, a statement in a durable medium of all client assets held by the investment firm for that client. The statement must also:

a) identify any such client assets that have been provided as collateral via the investment firm (whether or not to the investment firm and under any form of agreement, including a title transfer collateral arrangement or a security collateral arrangement);

b) identify any such client assets that have been lent; and

c) be based on either trade date or settlement date clearly and consistently.

Duplication of information: statements of client assets

11. An investment firm may include the information required by paragraph 10 in any periodic statement provided by the investment firm to the client as long as all sets of information:

a) are prepared in relation to the same date and period; and

b) are due to be delivered to the client within a reasonable period of one another.

Deposits with investment firms that are credit institutions

12. Paragraph 10 shall not apply to funds held by a credit institution as a deposit on its books.

Contingent liability transactions

13. An investment firm that operates a client account that includes an open position in a contingent liability transaction, must provide regular statements of any such position.

Contingent liability transactions: retail clients

14. If the statement referred to in paragraph 13 is to be provided to a retail client, it must be sent at least monthly and include:

a) adequate information about the open positions in all contingent liability transactions in the client's account at the end of the period;

b) the amount of each payment made by the client during the period as a result of the margin requirements in respect of all such open positions and the amount of the unrealised profit or loss attributable to those positions; and

c) the resulting profit or loss arising from all such positions closed during the period.

Failure to accept or execute an order received from a retail client

15. If an investment firm:

a) does not accept an order received from an established retail client;

b) decides not to carry out an order received from a retail client after it has accepted that order; or

c) is unable to carry out an order received from a retail client after it has accepted that order,

it must notify the client as soon as practicable. This requirement does not apply to orders that result from decisions to deal by the investment firm when acting as a portfolio manager.

Periodic information for portfolio management clients

16. An investment firm must send to a client for whom it provides portfolio management services periodic statements in a durable medium to enable the client to assess the performance of the service.

Periodic information for retail portfolio management clients

17. If the statement in paragraph 16 is to be sent to a retail client it must include:

a) the name of the investment firm;

b) the name or other designation of the retail client's account;

c) a statement of the contents and valuation of the portfolio, including details of:

i) each financial instrument held and its market value and the cash balance, at the beginning and at the end of the reporting period; and

ii) the performance of the portfolio during the reporting period.

d) a management report (to be provided at least yearly) on the strategy implemented during the period covered by the management report;

e) the total amount of fees and charges incurred during the reporting period and an indication of their nature; and

f) the total amount of dividends, interest and other payments received during the reporting period in relation to the client's portfolio.

Portfolio management: change in basis for valuing assets

18. If the basis for valuing any of the assets in a client's portfolio has changed (whether from the basis agreed in the portfolio management agreement or subsequently) the statement required in paragraph 17 must include appropriate details of the change, including its impact on profits

and/or losses.

Portfolio management: provision of contract notes or confirmation notices in the periodic statement

19. Where, in derogation to paragraphs 1 (and, where applicable, 2), a client has chosen not to receive information on each transaction in due course carried out by the portfolio manager, the relevant information must be provided in the periodic statement.

Portfolio management: timing of periodic statements for retail clients

20. Where a retail client makes the choice referred to in paragraph 19, the investment firm must provide a periodic statement at least every three months. Where the information on each transaction is provided to a retail client after each transaction, the investment firm must provide a periodic statement at least every six months. This derogation is not available in relation to transactions in warrants and derivatives that are effected for a retail client.

Portfolio management: periodic statements for retail clients: leveraged portfolios

21. Where the retail client agreement for a portfolio management service authorises a leveraged portfolio, the retail client must receive a periodic statement at least once a month, including an assessment of the risks.

Duplication of information: periodic statements

22. An investment firm need not provide a periodic statement under paragraphs 10, 13 (and where applicable 14), 16 (and where applicable 17) or 21 if it would contain the same information as a periodic statement that is to be sent by another person, according to the required frequency where applicable.

SECTION III – COOPERATION AND ENFORCEMENT

Transaction reporting (Article 25)

Extract from Level 1 text

Article 25(3) to (5)

"3. Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day. This obligation shall apply whether or not such transactions were carried out on a regulated market.
The competent authorities shall, in accordance with Article 58, establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for those financial instruments also receives this information.

4. The reports shall, in particular, include details of the names and numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the investment firms concerned.

5. Member States shall provide for the reports to be made to the competent authority either by the investment firm itself, a third party acting on its behalf or by a trade-matching or reporting system approved by the competent authority or by the regulated market or MTF through whose systems the transaction was completed. In cases where transactions are reported directly to the competent authority by a regulated market, an MTF, or a trade-matching or reporting system approved by the competent authority, the obligation on the investment firm laid down in paragraph 3 may be waived."

Extract from the Mandate of the Commission

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

(1) the methods and arrangements for reporting financial transactions.
2) the criteria for assessing liquidity in order to define a relevant market in terms of liquidity for financial instruments.
(3) the minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities.

General Foreword

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.

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.

General approach by CESR

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.

However, 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.

CESR is of the opinion that the level of harmonisation proposed in this advice, both through the content required according to Annex A and the information of transaction reports to be exchanged according to Annex B is an important first step towards greater convergence for transaction reporting requirements among Member States.

As a second step, CESR proposes to steadily move towards greater convergence in an evolutionary process at Level 3.

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.

Methods and arrangements for reporting financial transactions

CESR Advice

Explanatory text

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.

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:

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

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.

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 both Consultation Papers.

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.

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.

However, it is CESR's view that all reporting channels within a Member State should comply with the same requirements in order to have a level playing-field between different types of reporting channels.

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

In CESR's view, a market operator that 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 complies with the general minimum conditions and has been approved by the competent authority as a reporting channel..

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 will need approval by the competent authorities in all those different Member States. CESR considers that all competent authorities should follow the same "approach" when approving and monitoring different reporting channels.

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

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.

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 an exemption must not have adverse effects on its obligation and ability to electronically exchange information on transaction reports with other competent authorities.

Level 2 Advice

BOX 12

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 should 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.

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

CESR Advice

Explanatory text

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:

- the markets to be considered;
- the mechanisms for analysing and checking liquidity;
- the revision procedures.

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 (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.

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.

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.

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 Commission 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.

As a consequence and taking also into account the responses to the Call for Evidence, to the Consultative Concept Paper and to two Consultation Papers, CESR has formulated general conditions in order to find criteria for the assessment of liquidity:

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

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

- volume: amount of financial instruments being traded in a defined period of time;

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

All the 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.

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.

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.

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.

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 relevant data.

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 what the competent authority for the most relevant market in terms of liquidity for each of these financial instruments is.

In relation to bonds, both CESR and market participants acknowledge the specificity of 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.

With respect to commodity derivatives, CESR considers them as unique contracts being designed and listed by a specific regulated market, and generally 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.

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.
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 Level 3 in order to provide for the necessary flexibility.

For all the financial instruments that will be reported in accordance with the Directive but are 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.

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.

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.

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, 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 would also want to receive transactions reports for derivatives referenced to that financial instrument in accordance with the Directive.

Taking 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 implementing measures. CESR may propose any modifications considered as necessary to improve the situation.

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 proposes to publicly identify 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 un-wanted impact on the industry.

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.

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.

Level 2 Advice

BOX 13

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, proxies would be used 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 on which the derivative has been made 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 of a

Member State;

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), if domiciled in a Member State.

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 that have to do the respective computation. The competent authorities are 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, competent authorities need to consider trading on all 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 should 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.

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

CESR Advice

Explanatory Text

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.

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 Article 25(4).

Therefore, 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.

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.

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. In the short to medium term, competent authorities will be able to require investment firms to report additional information over and above the minimum required by the Directive.

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). Competent authorities will be able to define the format of the transaction reports made to them, driven by the existing reporting mechanisms and arrangements in each Member State.

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 is set out in Annex B.

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 should receive from investment firms at national level. This information should be a minimum and should not be strictly harmonised, in order for competent authorities with highly-developed reporting systems and supervisory methods to not have to take a step backwards in their supervision and in order to ensure

that competent authorities and investment firms are able to continue using existing systems and arrangements for transaction reporting. Such an approach minimises the costs of implementing the reporting obligations of the Directive.

The approach to not fully harmonise the content of Annex A in order to make use of existing systems and arrangements in the short to medium term, has been generally supported in the responses to the Consultative Concept Paper and to the Consultation Papers. Moreover, Recital 45 of the Directive explicitly recognises that competent authorities may impose transaction reporting obligations on financial instruments not covered by Article 25, an approach which acknowledges that reporting requirements may differ across the EU.

Furthermore, all of the information fields in Annex A do not need to be reported by investment firms 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.

CESR is of the opinion that the level of harmonisation proposed in this advice, both through the content required according to Annex A and the information of transaction reports to be exchanged according to Annex B is an important first step towards greater convergence for transaction reporting requirements among Member States.

As a second step, CESR proposes to steadily move towards greater convergence in an evolutionary process at Level 3.

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 reduces the number of transactions that need to be reviewed; it permits reviews on a client's trading profile; it allows for 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/customer identification codes from the investment firm when required for investigatory purposes; potential problems as to data protection/confidentiality considerations).

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.

A broader perspective for client/customer identification would be to envisage a unique, European-wide code for a client/customer identification to be used by every investment firm reporting a transaction. However, CESR does not consider itself being 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.

Level 2 Advice

BOX 14

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 and competent authorities may require the reporting of additional information. In accordance with Recital 45 of the Directive, national authorities may extend their reporting obligations to financial instruments not covered by Article 25.

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.

CESR

Annexes to the 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. 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 of the competent authority to which the transaction will be reported.
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 capacity in which the investment firm acted when executing the transaction. At a minimum it should explain whether the investment firm dealt as principal (i.e whether the instrument/contract was on the firm's balance sheet) or in an agency capacity on behalf of a customer or client. However, competent authorities may require further details of the trading capacity of the 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 codes. Competent authorities will determine which codes they will accept. 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 and/or the characteristics of the contract.
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 codes. 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 where the counterparty is an investment firm, regulated market, central counterparty or MTF covered by the Directive. It could either be the name of the counterparty or a code that identifies the counterparty. Appropriate codes would include regulatory or exchange codes or BIC where available, otherwise investment firms could use their own internal code for their counterparty. Competent authorities will determine which codes they will accept. For transaction reporting purposes, any counterparties to the trade who are not investment firms, regulated markets, central counterparties or

	MTFs should be treated as a customer/client.
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 regulated market or trading venue on which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC or regulatory code for the MTF or off-exchange (OFF) for other transactions not executed on a regulated market or MTF.
Transaction Reference Number	A unique identification number for the transaction provided by the investment firm or reporting party.
Cancellation Flag	Information about whether the transaction was cancelled.

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 harmonized 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 regulated market or trading venue on which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC or regulatory code for the MTF or off-exchange (OFF) for other transactions not executed on a regulated market or MTF.
Transaction Reference Number	A unique identification number for the transaction reported by the investment firm.

Cancellation Flag	Information about whether the transaction was cancelled.

Obligation to Cooperate (Article 56(2))

Extract from Level 1 text

Article 56(2): "When, taking into account the situation of the securities markets in the host Member State, the operations of a regulated market that has established arrangements in a host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, the home and host competent authorities of the regulated market shall establish proportionate cooperation arrangements."

Extract from the Mandate of the Commission

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31January 2005 on:
The criteria under which the operations of a regulated market in a host member state could be considered as of substantial importance for the functioning of the securities markets and the protection of investors in the host member state.

CESR Advice

Explanatory text

Purpose and rationale

The purpose of this technical advice is to provide criteria under which the operations of a regulated market could be considered as of substantial importance for the functioning of the securities markets and the protection of the investors in a host Member State. The Commission Mandate does not contain any indicative elements which CESR might wish to have regard to in providing its advice.
Article 56(2) is intended to cover situations, to be considered as exceptional, whereby a regulated market established in a Member State (home Member State) provides access to its facilities in another Member State (host Member State) and the operations of the regulated market are considered to be of such importance for the functioning of the securities markets and the protection of the investors in that Member State that proportionate cooperation arrangements may be required between the competent authorities of the two Member States. The need for specific proportionate arrangements should be assessed on case-by-case basis.

According to the Commission Mandate, CESR is not required to provide advice on the specific form or content of such cooperation arrangements.

In providing this advice, CESR believes it is necessary to ensure that such criteria provide competent authorities with a sufficiently flexible framework so as to be able to take account of future market developments (both strategic and technological) and respect the vastly different nature of securities markets across Member States.

It must be stressed that CESR's advice on Article 56(2) relates only to cooperation between competent authorities and is not intended to question investment firms' right to freely provide cross-border services through remote access/membership.

Situations envisaged by Article 56(2)

In order to provide the Commission with this advice, CESR believes it is necessary to first examine what situations Article 56(2) is intended to cover, and in particular what is meant by the term "established arrangements".

The activities of a regulated market, according to Recital 49, encompass "the display, processing, execution, confirmation and reporting of orders from the point at which such orders are received by the regulated market to the point at which they are transmitted for subsequent finalisation, and to activities related to the admission of financial instruments to trading." Article 4(1)(21) and Article 42(6) provide further clarification in that appropriate arrangements provided by a regulated market in a host Member State should aim at facilitating access to trading on the regulated market's system by remote members or participants established in that host Member State.

Article 56(2) therefore might envisage situations whereby a regulated market is offering access to its trading facilities in another Member State (host Member State).

Article 56(2) should not cover other commercial activities per se, which aim at competing with other regulated markets (i.e. marketing and promotional activities aimed at attracting issuers in another Member State) or at developing technical activities or cooperation (e.g. selling and maintenance of trading systems).

Furthermore, Article 56(2) should not be triggered by the mere fact that a market operator or a regulated market in Member State A acquires a shareholding in a regulated market (or a market operator) in Member State B. However, where a market operator operates regulated markets in different Member States using a common platform/system and/or common market rules/procedures, or where such an operator has decided to reorganise or change the nature of the particular market(s), then it may be necessary for a competent authority to invoke Article 56(2).
It may also be necessary to take into consideration any decision of an acquiring market operator or regulated market that may impact on the admission to trading policies or organisation of the regulated market or markets to be acquired.

Arrangements

In the Commission Mandate, CESR has not been requested to provide technical advice on the interpretation of "established arrangements". Nevertheless, it appears useful for a better understanding to set out here what the meaning of "established arrangements" might be.
Remote access/membership (i.e. the arrangements established by the regulated market include the provision of access to trading by remote members or participants established in that host Member State (cf. Article 4(21)) is a necessary condition for the application of Article 56(2).

The additional factors may be instructive in determining substantial importance of a regulated market:
Additional factors: in addition to remote access/membership, arrangements established by the regulated market in the host Member State may include *inter alia* the following:

- the admission to trading of securities of issuers that are registered or established in the host Member State;
- the admission to trading of securities that were first admitted to trading on a regulated market in the host Member State;
- the use and operation in the host Member State of a platform/system and/or market rules/procedures that are integrated in or shared with the ones the regulated market uses and operates in the home Member State.

Determining what "substantial" importance constitutes

The 'trigger' for the operation of Article 56(2) is whether the operations of a regulated market that has established arrangements in a host Member State are of "substantial importance" for the

functioning of that host Member State's securities market and the protection of investors. As previously highlighted, it is essential that the criteria to be used in determining such a broad concept remain as flexible as possible and do not impinge on competent authorities' ability to adopt pragmatic, risk sensitive and fit-for-purpose approaches to the supervision of such entities. This is even more the case, since it is considered that Article 56(2), as described in the second paragraph above, applies on a case-by-case basis. Therefore, CESR does not consider it appropriate to establish an exhaustive list of criteria to be applied when determining "substantial importance".

In order to take account of the diverse nature of markets across Member States, it is necessary to consider both quantitative and qualitative measures as possible criteria. However, such measures/criteria need not be applied cumulatively.

Factors relating to the access and trading on the regulated market

The factors to be taken into account when determining what constitutes "substantial importance" might usefully be divided into two broad categories. The first category concerns those factors which are directly related to the access and the trading on a regulated market operating in another Member State. The second one concerns more general factors such as the nature of securities market in the Member State in question.

Whilst it is not possible to identify each and every factor that may be relevant to a specific situation, there may be a number of indicative quantitative measures that help guide competent authorities in their assessment of whether a regulated market's operations in their territory provide sufficient grounds to invoke Article 56(2).

In light of the underlying rationale of Article 56(2), a key test will be whether or not the regulated market in question represents a significant centre of liquidity for securities of issuers that are located in another Member State (host Member State).

The most obvious factors likely to be of relevance in this respect, from the host Member State perspective, include:

- the number of remote members/direct participants active on the regulated market in question, and their respective trading volumes;
- the number of financial instruments also admitted to trading on the regulated market in question and their respective trading volumes in the host Member State;
- the number of financial instruments of issuers located in the host Member State admitted to trading on the regulated market in question and the extent of trading in those instruments by remote members located in the same Member State as the issuer.

In assessing such quantitative factors, it is necessary to have regard not only to absolute figures, but also relative figures:

- for remote members/direct participants: their overall trading volumes resulting from their activities on a regulated market in another Member State as compared to the overall trading volume on that market;
- for financial instruments also admitted to trading on a regulated market in another Member State: a comparison of the overall trading volumes for the instrument concerned. (This issue is interrelated with the determination of the most relevant market in terms of liquidity as far as only regulated markets are concerned.)

Qualitative factors

In addition to the above quantitative factors, there may be other, more general qualitative factors which are relevant in determining "substantial importance". This could be the nature of the market (i.e. the extent to which retail/wholesale investors are active in a particular market) and whether cross-membership agreements or access agreements exist between the regulated markets in question.

As regards the general philosophy of approach, CESR has systematically considered not only Level 2, but also Level 3, in particular the importance of cooperation and coordination of day-to-day decisions by CESR Members. In this regard, CESR does not believe it is appropriate at this stage to propose – at Level 3 – detailed measures to be taken by competent authorities when a regulated market's operations are considered to be of 'substantial importance' for the functioning of another Member State's securities market.

Level 2 Advice

BOX 14

Substantial importance - factors to be taken into account

1. In assessing, on a case-by-case basis, whether the operations of a regulated market that has established arrangements in a host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, competent authorities may have regard to one or more factors, such as the following:

   a) existence of cross-membership agreements or cross-access agreements between regulated markets of the host and home Member States;
   b) the overall trading volumes carried out by remote members established in a host Member State;
   c) the overall trading volume of financial instruments admitted to trading on the host regulated market which have been also admitted to trading on a regulated market in another Member State;
   d) the number of investors from the host Member State holding securities that are traded on the regulated market, including the value of their holdings;
   e) the migration of a substantial part of the listings on a regulated market in the host Member State of securities of issuers established in that host Member State, to a regulated market in another Member State.

2. When assessing one or more of these factors, the competent authority of the host Member State shall have regard to the overall context of the quantitative information rather than in respect of individual market participants or a specific financial instrument, and shall have regard, not only to absolute figures, but also to relative figures. In particular, it would have to examine these figures in the light of:

   a) the overall trading volume on the securities markets of the host Member State, including regulated markets and other trading venues;
   b) the compared trading volumes of financial instruments admitted to trading both on the host regulated market and on the regulated market in question;
   c) the need for protection of the investors in the host Member State.

Exchange of Information (Article 58)

Extract from Level 1 text

Article 58 (1): "Competent authorities of Member States having been designated as contact points for the purposes of this Directive in accordance with Article 56(1) shall immediately supply one another with the information required for the purposes of carrying out the duties of the competent authorities, designated in accordance to Article 48(1), set out in the provisions adopted pursuant to this Directive."

Extract from the Mandate of the Commission

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

CESR Advice

Explanatory text

The purpose of this technical advice is to establish a general framework for cooperation between the competent authorities, in order to facilitate the fulfilling of their duties under the Directive.
CESR holds the view that the issue of cooperation among regulators requires striking a balance between greater clarity and legal certainty, on the one hand, and retaining flexibility to cater for different scenarios, on the other hand.

CESR considers that the objective of the present advice is not to provide advice which would cater for each and every eventuality, but to propose a workable, fit-for-purpose, framework for cooperation.

The work of CESR on the procedures for the exchange of information under this Commission Mandate is an opportunity for aligning, where appropriate, existing procedures in order to ensure a consistent approach for the exchange of information between competent authorities.

Article 58 represents an overarching principle on the exchange of information between competent authorities which, by virtue of Article 56, are obliged to cooperate by using their powers. The requirement to render assistance in accordance with Article 56(1) second sentence envisages in particular that competent authorities exchange information and cooperate in any investigation or supervisory activities.

In order to facilitate and accelerate cooperation, and more particularly exchange of information, Member States must designate one single competent authority as a contact point for the purposes of this Directive and must communicate to the Commission and to the other Member States the names of the authorities which are designated to receive requests for exchange of information or cooperation (Article 56(1) third sentence).

Article 58 establishes the obligation of competent authorities designated, in accordance with the Directive, as "contact points" to immediately supply one another with the information required for

the purposes of carrying out the duties of the competent authorities set out in the provisions adopted pursuant to the Directive.

As a consequence, exchange of information and cooperation between competent authorities of different Member States should take place via the "contact point" referred to above. In this sense, all requests for exchange of information or cooperation received under the provisions of the Directive by competent authorities with powers in these matters should be processed through the contact points. The contact point of the requested authority shall provide the response to the contact point of the requesting authority; this response may be copied directly to the requesting authority.

In jurisdictions where more than one competent authority is designated to carry out the duties provided for in the Directive in accordance with Article 48(1), the Member State must choose one of these authorities to act as a single point of contact for the exchange of information on a cross-border basis. In light of the need for enhanced cooperation between competent authorities at Level 3, CESR recommends that Member States designate an authority which is a CESR Member as contact point.

As stipulated in Article 58, the technical advice CESR is requested to provide to the Commission as regards cooperation and exchange of information is limited to cooperation and exchange of information between competent authorities for the purposes of this Directive. Therefore, in particular, it does not cover inter-authority consultation prior to authorisation between competent authorities for the purposes of this Directive, on the one hand, and competent authorities responsible for the supervision of credit institutions or insurance undertakings, on the other hand (Article 60).

There are certain common characteristics between the exchange of information for the purposes of the Directive and the exchange of information under other Directives, such as the Market Abuse Directive 2003/6/EC or the Prospectus Directive 2003/71/EC, which could provide useful guidance for cooperation.
In carrying out this work CESR paid special attention to existing frameworks, such as the CESR Multilateral Memorandum of Understanding ("MoU"), and the practice developed within CESR-Pol and the IOSCO Multilateral MoU, as well as the experience gained in the field of exchange of information within the European Union and in a broader context by cooperating with third-country competent authorities.

As regards the general philosophy of the approach, CESR has considered not only Level 2, but also Level 3, in particular the importance of cooperation and coordination of day-to-day decisions by CESR Members.

As requested in the Commission Mandate, CESR has identified provisions of the Directive the implementation of which will require the exchange of information between competent authorities. An indicative list of these provisions is annexed to the advice. The list is not exhaustive, since the Directive requires competent authorities to cooperate and to assist each other whenever necessary for the fulfilment of their duties under the Directive.

In general terms, the exchange of information required under the Directive can be divided into three broad categories:

(1) "automatic information" to be supplied to one or more competent authorities without mediating any request (such as information on transaction reporting, notification, etc.);

(2) transmission of information where consultation among competent authorities is provided for in the Directive;

(3) exchange of information "upon request" under the blanket clauses of Article 56(1) and Article 58(1) ("whenever necessary for the purpose of carrying out their duties under this Directive").

In addition, it should be recalled that, in accordance with Article 56(4), a competent authority is required to notify any suspicion of violations of the provisions of the Directive by entities not subject to its supervision to the competent authorities of another Member State.

Moreover, taking into account the nature of the information CESR considers that information subject to exchange under the Directive can be divided on the basis of whether it is of routine nature or not. Information could be considered as routine when it concerns basic information that should be maintained by the competent authorities according to the provisions of the Directive or information that a competent authority receives from other competent authorities to allow the free provision of investment services and/or activities throughout the EU (e.g. passport notifications). Considering the categories of exchange of information and the nature of the information to be exchanged, CESR holds the view that different procedures and different timing should be envisaged, including for exchange of information "upon request", depending on whether it is of "routine nature" or not.

Article 25(3) second sub-paragraph 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.

The wording in the Technical Annex of the Commission 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.

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.

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.

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.

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.

The communication between the concerned authorities should be by the most expedient means, taking due account of confidentiality considerations, correspondence times, the volume of material to be communicated and the ease of access to the information by the requesting authority.

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.

CESR is of the view that in case a branch reports to the competent authority of 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 – in accordance with Article 25(6) – the competent authority of the home Member State decides that it does not want to receive this information.

In accordance with Article 25, remote members have to report their transactions to the competent authority of their home Member State. The contact point in the home Member State has then to 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.

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 their 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(1) could also be of relevance in this respect.)

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 invited 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.

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.

Although CESR considers this approach practical, as the results would be in line with the objectives of the Directive, the proposal does face legal constraints.

Therefore, CESR suggests to impose an obligation on the competent authority of the home Member State, to ensure that the competent authority of the most relevant market in terms of liquidity as well as the competent authority of the trading venue where the transaction took place (or, if the transaction took place outside of a trading venue, the competent authority(ies) of the investment firms which participated in the transaction), will receive information about the transaction. However, if the competent authority of the trading venue where the transaction took place (or, if the transaction took place outside of a trading venue, the competent authority(ies) of the investment firms which participated in the transaction), does not whish to receive this information, since it can obtain this information by other means, it may waive the obligation of the competent authority of the home Member State to ensure that it receives information about the transaction.

CESR considers this solution to be preferable from a legal point of view, which at the same time serves as a satisfactory solution for investment firms, since an investment firm only has to report to its home Member State.

Following a similar approach as provided for in Article 16(2) and (4) of the Market Abuse Directive, a mechanism for finding solutions in situations where a competent authority does not receive the expected communication from another competent authority is envisaged by CESR at Level 3. Such a mediation mechanism for cases of disagreement between competent authorities would be part of a more general approach, i.e. not only covering this Directive, of CESR at Level 3.

The advice also includes provisions regarding the need to identify a plan for urgent cases, as requested in the Technical Annex of the Commission Mandate, and steps that a competent authority may take in case it does not receive the expected communication.

Level 2 Advice

BOX 15

1. Annex C to this advice contains an indicative and non-exhaustive list of the provisions of the Directive the implementation of which will require cooperation or the exchange of information between competent authorities.

2. The contact point is primarily responsible for ensuring the smooth transmission of requests and replies to requests.

3. Different procedures and timing may be envisaged between competent authorities for (1) "automatic information", (2) transmission of information in case of consultation among competent authorities provided for in the Directive and (3) other exchange of information "upon request". The nature of the information, routine or not, shall also be duly considered.

Automatic information

4. Automatic exchange of information relates to information which has to be provided to the competent authority of another Member State, in accordance with the Directive, without prior specific request. It includes, among others:

   a) the information on the transactions in financial instruments as required pursuant to Article 25 (3) and (6) of the Directive;
   b) the notification of the withdrawal of the license or the change of status of the license to the competent authority of the Member State where the investment firm provides services and;
   c) the notification of suspension or removal of financial instruments from trading to the competent authorities of the Member States (Article 41).

In these cases, the information has to be supplied immediately to the other competent authorities.

Special procedure for the transmission of information on transaction reporting

5. Without mediating any request, immediately after the information contained in transaction reports has been transformed into the harmonised format of transaction reports to be exchanged between competent authorities, competent authorities shall establish necessary arrangements in order to ensure that:

a) the competent authority receives details of a transaction that concerns a financial instrument for which it is the competent authority of the most relevant market in terms of liquidity;
b) the competent authority receives details of a transaction that concerns a financial instrument for which it is either the competent authority of the trading venue where the transaction took place, or, in case the transaction took place outside of a trading venue, for which it is the competent authority of the investment firm(s) that participated in the transaction, unless it decides that it does not want to receive this information;
c) the competent authority of the home Member State of a branch receives details of a transaction reported by this branch to the competent authority of the host Member State, 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

6. 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.

Requests for cooperation and exchange of information

7. Paragraph 8 to 15 are applicable to the transmission of information in case of consultation among competent authorities provided for in the Directive and to exchange of information "upon request" under the provisions of Article 56(1) and Article 58(1) "whenever necessary for the purpose of carrying out their duties under this Directive".

8. The contact point of the requesting authority would be expected to send the request for cooperation or exchange of information to the contact point of the requested authority. Requests would be forwarded by the contact point of the requested authority to the appropriate competent authority. In case the requested authority is not the contact point, the contact point of the requesting authority may copy the request to the requested authority.

9. Requests for cooperation and exchange of information should be made in writing.

10. In case of urgency, requests and replies to such requests may be transmitted orally provided that the requests are confirmed in writing.

11. The requesting authority should ensure that the request contains sufficient information to enable the requested authority to fulfil the request.

Execution of requests for cooperation and exchange of information

12. Requests should be acknowledged without undue delay.

13. The contact point of the requested authority shall transmit the reply to the request to the contact point of the requesting authority. The reply to the request may be copied by the contact point of the requested authority to the requesting authority.

14. As regards information already internally available, this information should be immediately transmitted. In all other cases the requested authority would be expected to take immediately any necessary step, including forwarding the request to other national competent authorities, to gather the requested information.

15. If the requested authority is not able to supply the requested information immediately, the contact point of the requesting authority would be informed about the reasons.

Annex C to this draft advice: List of provisions whose implementation will require cooperation or exchange of Information between competent authorities

(indicative and non-exhaustive)

MiFID Article	Kind of behaviour required	Matters /Conditions/ Situations
6(2) (and 56(1) or 58(1))	Exchange of information	to IF initial scope of authorisation - for examination of the change in status
6(2) (and 56(1) or 58(1))	Transmission of information (without prior request)	an IF seeking authorisation to extent its business to additional services or activities shall submit a request for extension
7 (and 56(1) or 58(1))	Exchange of information	procedures for granting and refusing requests of authorisation
8 (and 56(1) or 58(1))	Transmission of information (without prior request)	circumstances for a withdrawal of authorisation of an IF
9(1) ((and 56(1) or 58(1))	Exchange of information	when person is not a resident in MS where IF is seeking authorisation
9(2) (and 56(1) or 58(1))	Exchange of information	when, at the time the authorisation is sought, a change in management has been notified to the CA which has to grant authorisation, in case the new management is non resident in that MS
9(2) (and 56(1) or 58(1))	Exchange of information	change in management after initial authorisation if the newly appointed staff is a resident of another MS
9(2) (and 56(1) or 58(1))	Transmission of information (without prior request)	accepted change in management (after initial authorisation) in case of FPS or branch
10(1)(1) (and 56(1) or 58(1))	Exchange of information prior to authorisation	if shareholders or members with qualifying holdings in an IF are residents of other MS
10(3) (and 56(1) or 58(1))	Exchange of information in case of change of status	person proposes to acquire qualifying holding of IF is resident of other MS
10(4) (and 60)	Consultation prior to authorisation	(1) if acquirer of a qualifying holding referred to in 10.3 is a) IF, CI, IU or UCITS authorised in other MS, or b) parent undertaking thereto, or c) person controlling IF, CI, IU, UCITS authorised in other MS and if (2) the undertaking would become acquirer's subsidiary or come under his control

10(6)	Transmission of information (without prior request)	when shareholding problems or when failure to provide prior information in relation to acquisition or increase of holding, or, acquisition without consent of authorities, in case of FPS or branch
13(3) (and 56(1) or 58(1))	Exchange of information	assessment of conflict of interests organisational and administrative requirements
13(5) (and 56(1) or 58(1))	Exchange of information prior to authorisation	if IF is relying on third party for the performance of operational functions/outsourcing and third party is resident of other MS
13(6) (and 56(1) or 58(1))	Exchange of information	if information about services and transactions is relevant in own investigation
16(2) (and 56(1) or 58(1))	Exchange of information	if an IF has notified the CA of any material changes to the conditions for the initial authorisation. In case of FPS or branch, the matters to notify are covered by art. 31-4 (for information related to art. 31-2 and by art.32-9 (for information related to Art. 32-2)
18(1) (and 56(1) or 58(1))	Exchange of information	MS requires IF to take all reasonable steps to identify conflicts of interest with managers, employees and tied agents, when located/resident abroad or when it concern the branch of an IF
19 (and 56(1) or 58(1))	Exchange of information	ongoing supervision of conduct of business obligations (branch excepted) or investigation
20 (and 56(1) or 58(1))	Exchange of information	IF is allowed to rely on information transmitted by other IF if it provides services through the medium of an IF (in another MS)
21 (and 56(1) or 58(1))	Exchange of information	best execution obligations when client not located in home MS (except for branch)
22 (and 56(1) or 58(1))	Exchange of information	client order handling rules
23 (and 56(1) or 58(1))	Exchange of information	obligations of an IF when appointing tied agents
24(2)(1) and 24(3) (and 56(1) or 58(1))	Exchange of information	transactions executed with eligible counterparties (located in another MS)
24(2)(2) and 24(3)(2) (and 56(1) or 58(1))	Exchange of information	request from eligible counterparty to be treated as "normal client" or express confirmation from prospective counterparty that it agrees to be treated as eligible counterparty, when located in another MS
25(3)(2) (and 58)	Transmission of information (without prior request)	CAs shall establish necessary arrangements in order to ensure that the CA of the most relevant market in terms of liquidity for those financial instruments also receives the transaction reports ("minimum content")

25(6)	Exchange of information	if host MS of branch receives transaction reports and home MS did not "opt out" of receiving those reports
31(2)(1)(with 31(3))	Notification	if IF wants to provide FPS in another MS for first time or in case of changes in range of service or activities
31(2)(2)	Exchange of information	if IF wants to provide FPS in another MS for first time and intends to use tied agents in the host MS
31(4) (with 31(2))	Notification	in case of changes of any of the information received under 32(2)
31(6)(1)	Notification	if MTF intents to provide arrangements in other MS
31(6)(2)	Exchange of information	if MTF intends to provide cross-border arrangements
32(3) (with 32(2))	Notification	if a) an IF intends to establish a branch in another MS and b) the CA of the home MS has no reason to doubt the adequacy of the administrative structure or the financial situation of an IF
32(4)	Notification	for the first time, or in the event of a change, in the particulars of the accredited compensation scheme of which the IF is a member
32(7)	No exchange of information provided for	CA of host MS shall assume responsibility for ongoing supervision in regard to Art. 19, 21, 22, 25, 27 and 28
32(8)	Notification prior to on-site inspection	if CA of home MS of the IF intends to carry out on-site inspections in a branch of the IF in another MS
32(9)	Notification	in the event of a change in any information communicated in accordance with 32.2
35(2) (and 56(1) or 58(1))	Exchange of information (for authorisation ; in case of changes)	if MTF decides to use a central counterparty, a clearing house and/or a settlement system from another MS
37(1) (and 56(1) or 58(1))	Exchange of information('prior to authorisation and for changes)	if the persons who will effectively direct the business and the operations of the RM are residents of another MS
37(2) (and 56(1) or 58(1))	Exchange of information prior to authorisation	if the persons who effectively direct the business and the operations of a RM are residents of another MS and/or they effectively direct the business and the operations of an already authorised RM , in particular in another MS
38(1) (and 56(1) or 58(1))	Exchange of information prior to authorisation	if the persons exercising significant influence over the management are residents of another MS
38(2)(lit.b) and 38(3) (and 56(1) or 58(1))	Exchange of information	if a transfer of ownership of the RM results in the change of identity of persons exercising significant influence over the operation of the RM-When these persons are residents of another MS

39. lit.a (and 56(1) or 58(1))	Exchange of information	in relation with the assessment of potential conflicts of interest with owners or market operators when the latter are residents/located in another MS
41(1)(2)	Notification	if operator of RM has suspended or removed a financial instrument from trading and has communicated the relevant information to the CA
41(2)	Notification	if CA demands the suspension or removal of a financial instrument from trading
42(3)	Exchange of information	if person wishes to participate in a RM it has to be fit and proper, sufficient level of trading ability, adequate organisational arrangements and sufficient resources
42(6)(2)	Notification	if RM has communicated to the CA of the home MS the intention to provide arrangements for remote membership in another MS
42(6)(3)	Exchange of information	if a RM provides arrangements for remote members or participants from another MS
46(2) (and 58(1))	Exchange of information (for authorisation; in case of changes)	if RM enters into arrangements with the central counterparty or clearing and settlement system of another MS
47	Notification	MS draw up a list of RM for which it is the home MS; changes of the list
48(1)	Notification	designation of competent authorities which are to carry out each duty under the FIMD
48(2)	Notification	arrangements entered into with regard to delegation of task
56(1) and 56(3)	Cooperation	general provision to cooperate, whenever it is necessary under the FIMD; especially exchange of information for purpose of supervision and investigations
56(2)	Cooperation	if operations of RM has established arrangements in host MS which are of substantial importance for the functioning of securities markets and investor protection in host MS
56(4)	Unsolicited information transmission	if MS has reasons to believe that violations of the FIMD are carried out by entity that is not under its supervision in the territory of another MS
56(4)	Notification (of feed back)	if MS was informed of suspicion that violations of the FIMD are carried out by entity its territory that is not under supervision of the informing CA
57 1st sentence	Cooperation	generally in cases of supervisory activities for an on-the-spot verification or investigations or information exchange
57 2nd sentence	Exchange of information	when IF is remote member of a RM and CA of RM chose to address the IF directly
58(1)	Exchange of information	general clause about the way and details of an exchange of information required for the purposes of carrying out the duties of CA under the FIMD
59	Notification	refusal to cooperate

60(1)	Exchange of information (Consultation prior to authorisation)	conditions : a) if IF is a subsidiary of IF/CI in other MS or b) a subsidiary of the parent undertaking of IF/CI in another MS or c) when IF is controlled by the same persons which control IF/CI in another MS
60(2)	Exchange of information (consultation prior to authorisation of CA of MS responsible for supervision of CI or UI)	conditions: a) if IF is a subsidiary of CI/IU in other MS or b) a subsidiary of a parent undertaking of a CI/IU in the Community or c) when CI/IU is controlled by same persons which control CI/IU in the Community
60(3) (with 9 and 10(4))	Exchange of information (consultation)	when assessing suitability of shareholders or members and reputation and experience of persons directing the business of another entity of the same group (fit and proper test)
62(1)(1)	Notification	if the CA in host MS has reasons to believe that an IF operating cross boarder (FPS) or has established a branch in the host MS is in breach of obligations under FIMD
62(1)(2)	Notification	if CA of host MS intends to take appropriate measures against violation
62(2)(2)	Notification	if measures are taken to stop violation of national law by branch in host MS
62(2)(3)	Notification	if branch of IF in host MS is violating the laws of the host MS despite measures under 62.2 sub-para.2
62(3)(1)	Notification	if the CA of the host MS of a RM or MTF has reasons to believe that the RM or the MTF is in breach of the obligations under the FIMD
62(3)(2)	Notification	if, despite the measures taken by the CA of the home MS, the RM or MTF persists in violation the interests of the investors an the markets of the host MS

Glossary:	CA	Competent Authority
	CI	Credit Institution
	FPS	Free Provision of Services
	home	CA of the home Member State
	host	CA of the host Member State
	IF	Investment Firm
	IU	Insurance Undertaking
	COM	EU Commission
	MS	Member State
	MTF	Multilateral Trading Facility
	RM	Regulated Market

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).

2. The mandate from the Commission asked 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 were as follows:

   - CESR should have taken account of the principles set out in the Lamfalussy Report and mentioned in the Stockholm Resolution of 23 March 2001.

   - CESR should have responded 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 determined its own working methods, i.e. by creating expert groups depending on the content of the provisions dealt with. Nevertheless, horizontal questions should have been dealt with in a way ensuring coherence between the work carried out by the various expert groups.

   - CESR should have addressed 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 does not take the form of a legal text. However, CESR should have provided 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 have provided an advice which takes account of the different opinions expressed by the market participants during the various consultations. In case it deviated form the opinion generally expressed it should have informed 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' issues: The expert group has been 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 covered the provisional mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best execution; prompt, fair and expeditious execution of client orders and client consent prior to executing orders outside the rules and systems of a regulated market or MTFs.

Expert Group on cooperation and enforcement issues: This expert group has been 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. This expert group covered the provisional mandates related to: transaction reporting between competent authorities and exchange of information.

Expert Group on market issues: This exper group has been 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 admission of financial instruments to trading, post-trade transparency disclosure by investment firms, pre-trade transparency requirements for MTFs, post-trade transparency requirements for MTFs, pre-trade transparency requirements for Regulated Markets and post-trade transparency requirements.

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 were 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 met three times with the Expert Groups and provided most valuable assistance to them for developing drafts of the final technical advice on first set of mandates.

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).

6. CESR published a Call for Evidence on 20 January 2004 (Ref.: CESR/04-021) seeking input on the key issues which it should consider in dealing with the first set of mandates. The deadline for responses was 19 February 2004 and more than 40 responses were received, which are available on CESR's website.

7. Regarding the issues dealt with by the Expert Group on Cooperation and Enforcement, unlike the other two Expert Groups, which were able to build upon previous CESR work, CESR had to start its work basically from scratch. Therefore, complementing the Call for Evidence, CESR agreed to start the process by drawing up a so-called "Concept Paper", in which the general approach and the main orientations addressing the Mandates were set out, and to publish it for consultation (Ref. CESR/04-073b). Consultation started on 1 March 2004, and more than 25 submissions by interested parties were received during the six-week consultation period; these are available on CESR's website.

8. 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 obligation and market transparency obligations (see the next paragraph). 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.

9. On 25 June 2004 the European Commission published "*Formal request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments*" ("second set of mandates"). For reasons of coherence between the different rules that are designed to ensure a high degree of competition and efficiency in European markets and in particular between the transparency and best execution provisions of the Directive, the European Commission, in its formal mandate, decided *inter alia* by this request to extend the deadline granted to CESR in the provisional mandate requesting advice on best execution obligation, market transparency obligations (post-trade transparency disclosure by investment firms, pre-trade transparency requirements for MTFs, post-trade transparency requirements for MTFs, pre-trade transparency requirements for Regulated Markets and post-trade transparency requirements for Regulated Markets) and admission of financial instruments to trading to 30 April 2005.

10. By addendum of 29 November 2004 to the formal request for technical advice on possible implementing measures on the MiFID of 29 November 2004 the European Commission decided to accept the request formulated by CESR and extended the deadline granted to CESR for preparing advice on client order handling rules to 30 April 2005.

11. On 17 November CESR published a second consultation paper on the first set of mandates (Ref.: CESR/04-603b). This consultation, which closed on 17 December 2004, focused on key issues of policy identified in the responses to the first consultation and the practical aspects of implementation. The CESR received 34 responses to the consultation.

12. All responses were taken into consideration by the two Expert Groups in the development of the overall process.

13. CESR published a work plan for handling the first set of mandates that has been accomplished. Furthermore, in November CESR published a work plan describing the different works conducted under the different articles of the MiFID (Ref.: CESR/04-614).

ANNEX 2

LIST OF MARKET PARTICIPANTS OF CONSULTATIVE WORKING GROUP

The members of the Consultative Working Group are:

Dr Heiko Beck, General Counsel DekaBank Deutsche Girozentrale
Dr Michele Calzolari, Chairman of Assosim and CEO of CENTROSIM
Mr Jean-François Conil-Lacoste, CEO of Powernext SA
Mr Henri de Crouy-Chanel, Administrateur Délegué of Aurea Finance Company
Mr Peter De Proft, General Manager, Fortis Investments
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, Head of Legal and Compliance, Enskilda Securities ASA
Mr Roger Sanders, Joint Chairman of FSA-SBPP Deputy Chairman of the Association of Independent Financial Advisers
Dr Jochen Seitz, Senior Associate at Norton Rose
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