THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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CESR's Technical Advice on Level 2 Implementing Measures on the first set of mandates

Markets in Financial Instruments Directive

FEEDBACK STATEMENT

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CESR

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 has been extended by EU Commission to 30 April 2005. Moreover, the deadline for advice relating to professional client agreement and investment research which is a part of conflicts of interest was extended by the Commission to the same date as well. 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-Burkhard 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 had to work on an exhaustive range of mandates in a very tight timeframe. Nonetheless with the important help of the previous CESR Standards on Investor Protection and with extensive consultation CESR presents its proposal for technical advice on major implementing measures of the future EU regulation of intermediaries providing investment services. The range of differences across EU and markets (size and nature of intermediaries, different services and products, different nature of clients, different market practices) made this work very complex.

7. CESR's advice is intended to be consistent with all relevant EU legislation. CESR considered the interactions of the advice with a number of other measures, including:

   a) the provisions of Directive 2003/6/EC on insider dealing and market manipulation ("Market Abuse Directive") and the implementing measures contained in the Directive 2003/125/EC as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest;

   b) the provisions of the Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading;

   c) 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);

   d) the provisions of the E-commerce Directive 2000/31/EC and the Distance Marketing Directive 2002/65/EC;

   e) the provisions of the 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 as to recorded communication.

8. CESR was 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.

9. CESR aimed at ensuring consistency with the work conducted by other international organizations, on aspects by this mandate. In particular, CESR coordinated them cross-sectorally with IOSCO, Basel Committee, CEBS and the Joint Forum.

10. Many respondents raised the issue of the level of details: some considered the advice to be too detailed; others considered that a detailed advice could minimize the risk of divergences of rules across Europe. CESR considered these arguments on an issue by issue basis and tried to respond by deleting all unnecessary details.

11. Many respondents also raised the problem of cost benefit analysis. CESR was fully committed to weighting cost and benefits of its proposals as a general requirement of its work under the

mandates, even if this was very demanding and time-consuming. As to some issues, CESR communicated the results of its considerations to the public; in other instances CESR was not in a position to publish analyses (in particular due to confidentiality reasons). CESR had also invited consultees to provide their cost-benefit analyses when making alternative proposals, which was provided to CESR only in a limited number of responses, though. CESR considers that consultations are part of the overall impact assessment.

12. Many respondents also asked for transitional provisions – going beyond the transitional provisions provided for by the Directive – in areas which would require investment firms to undertake considerable changes to the existing framework, such as the transaction reporting arrangements. CESR is fully aware of this important issue, since the tight timeframe is also applicable to competent authorities when implementing the new requirements in their own systems, but it is a matter for the EU Institutions to cater for additional transitional measures.

SECTION I – DEFINITIONS

Relevant definitions

This section of the feedback statement focuses on certain key definitions that were subject to comment and that are relevant to the substantive issues that are discussed below.

Meaning of "outsourcing"

The scope of CESR's advice is determined by a – relatively wide – definition of outsourcing, as well as a materiality test and a list of excluded arrangements. The three components have been slightly redrafted in order to clarify the scope.

Meaning of "in writing"

Respondents commented that CESR should take into account the fact that more clients use internet applications to invest and that its advice should therefore be media neutral. It was argued that the proposal to require the provision of information under Article 19(3) of the Directive "in writing", should be deleted. Other respondents believed it should be sufficient to provide information by other means, e.g. a diagram or oral information. Similar comments were raised in relation to the format of reports to clients under Article 19(8) of the advice.

Respondents agreed with the proposal that material changes to the information provided under Article 19(3) of the Directive should be communicated to clients but some considered that it should be sufficient for this to be done orally.

Paragraph 20 of the definitions section in the consultation document explained that unless the contrary intention appears, the term "in writing" meant on paper or another "durable medium". Durable medium was given the same meaning as in the Distance Marketing Directive[1] (any 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). The term "in writing" therefore includes internet websites if they fulfil the criteria contained in the definition of a durable medium.

CESR does not believe it is appropriate to allow the provision of information under Article 19(3) to retail clients in oral form as this will not provide them with the ability to refer back to such information.

For the same reason, it does not appear reasonable to allow "written" media that do not qualify as durable media (such as an internet site that is taken down immediately after the client has accessed the information). The same arguments also apply in terms of communicating material changes to information that has already been provided.

In order to prevent misunderstanding, CESR has adopted the term "durable medium" in the body of the advice to more clearly label the cases in which this concept is intended to be used. CESR has also provided a broader definition of "in writing" ("any mode of representing or reproducing words in a

1 Directive 2002/65/EC concerning the distance marketing of consumer financial services.

visible form, including typing, printing, email messages and web pages") to be used in cases where the concept of writing is not intended to be limited to the narrow concept of a "durable medium" For example, see the rows on marketing communications and investment research in the Annex to the advice under Article 13(6) and paragraph 6(b) of the advice under Article 19(2).

Meaning of "in good time"

A couple of respondents argued against the definition of "in good time", claiming it was too generic. Others argued that CESR should replace the concept of "in good time"' with the concept of "an appropriate time" in order to ensure an appropriate level of flexibility.

CESR believes the criteria proposed in paragraph 3 of the advice under Article 19(3) provide appropriate flexibility to reflect the different circumstances in which the information may be provided. It is also desirable to retain the concept of "in good time" to ensure consistency with the Distance Marketing Directive. CESR has, however, removed the proposed reference to the terms of business agreed with the retail client, on the basis that this is not as clearly relevant as the other criteria and may be open to abuse.

Meaning of "depository"

Some respondents felt that the definition of "depository" was too broad, because it would include any kind of third parties, including national or international settlement systems, nominees, or other entities. Respondents were concerned about the practical implication of such a wide definition (for example, in relation to the investment firm's ability to control, supervise or obtain information from a securities settlement system will be very different from its abilities in relation to a nominee). Bearing in mind that the solutions proposed in the advice aim at ensuring that client assets are adequately protected, CESR is of the opinion that the definition of "depository" has to be kept as wide as possible and that it must encompass also securities clearing or settlement systems and central securities depositories. The concerns expressed by respondents in relation to the investment firm's liability vis-à-vis their clients whose assets they hold with third parties are addressed below in the section dealing with Articles 13(7) and (8).

Meaning of "client financial instruments held on an omnibus basis"

One respondent pointed out that the expression of "pooling" of financial instruments used under paragraph 9 of the draft advice in the consultation document was unclear and that this could give rise to legal uncertainties. In response to this comment, a new definition of "financial instruments held on an omnibus basis" has been inserted. In order to cover different situations, the definition refers both to the situation where financial instruments belonging to a number of clients are included in the same account on the books of the depository and to cases where financial instruments are registered under the same designation on behalf of more than one client in the issuer's register. In order to ensure consistency with the requirements under new paragraph 12, the advice has been amended (see paragraphs 7 (a), 12 (a) and 13 (b)) in order to clarify that the investment firm may not hold client assets on an omnibus basis on its own books. In other words, an investment must open a separate account on its own books for each client or group of clients acting jointly, even if those assets are held on an omnibus basis at the level of a depository or the issuer.

SECTION II – INTERMEDIARIES

Compliance and personal transactions (Article 13(2))

The independence of the compliance function

Question 1.1.: *Must the compliance function in every investment firm comply with the above requirements for independence, or should this degree of independence only be required where this is appropriate and proportionate in view of the complexity of its business and other relevant factors including the nature and scale of its business?*

Question 1.2.: *May deferred implementation of requirements for independence be based on the nature and scale of the business of the investment firm?*

Whilst respondents generally supported the concept of an independent compliance function, there were mixed opinions on whether the proposals in the draft advice should be applied to all investment firms. Many respondents queried whether it was the intention of CESR to require a separate compliance function and noted that if so, the requirement would be prohibitively costly for smaller investment firms where the compliance officer would typically undertake other duties for the firm. In particular it was noted that compliance staff often perform other control functions such as money laundering or data protection and in certain cases, are involved in the provision of investment services. Instead, it was suggested that the structure of any compliance department should reflect the nature, size and complexity of the investment firm's business.

In the second consultation on the first set of mandates CESR noted that independence of compliance should be looked at from a functional rather than organisational perspective. CESR also proposed a "four eyes" approach, in which the persons responsible for compliance should perform their duties independently of persons and activities subject to their monitoring. CESR noted that such an approach might not be possible for smaller firms and proposed either the outsourcing of compliance or the provision of additional flexibility to such firms.

Respondents generally welcomed these proposals and the acknowledgement of the need to calibrate requirements for smaller firms. Views were mixed on the proposal to require outsourcing of compliance in such cases. A number of respondents questioned whether there was sufficient depth of expertise to make this a workable solution. Others raised concerns about costs and also suggested that external consultants were likely to be less effective due to their limited knowledge of a firm's business.

In light of these comments CESR has modified the advice on the independence of the compliance function. The advice makes it clear that the compliance function should function independently in all cases. The advice also sets out additional measures to further the independence of the compliance function. These provide that the compliance function personnel should not be involved in the performance of services or activities they monitor and that their remuneration should not, and should not be likely to, undermine their independence. However, in order to address the concerns about smaller firms, the advice proposes that competent authorities may exempt an

investment firm from either or both of these additional requirements where those requirements would not be proportionate in view of the nature, scale and complexity of its business.

To take advantage of this option, the investment firm must be able to demonstrate that its compliance function is, and continues to be, effective, regardless of the operation of the exemption. The explanatory text to the advice indicates that 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.

Respondents also objected to the proposal to prohibit the remuneration of compliance staff being linked to the performance of the business lines that they monitor. Respondents argued that this measure would make it difficult for investment firms to attract high calibre staff to their compliance departments if they could not share in the success of the firm.

CESR has therefore focused on the principle underlying this proposal: that the remuneration of compliance personnel should not (and should not be likely to) undermine their independence. The explanatory text to the advice explains that it should generally be acceptable to relate their remuneration to the financial performance of the investment firm as a whole. However, their independence may be undermined if their remuneration is related to the financial performance of the business line for which they exercise compliance responsibilities.

Responsibility for compliance

A number of respondents commented on the draft requirements for the allocation of compliance responsibility. In particular, comments were made on the relative responsibilities of an investment firm's senior management, its compliance department and, where applicable, its internal audit function. Some respondents suggested that the requirement to report the results of compliance reviews to internal and external audit would undermine the independence of the compliance department or dilute the responsibility of senior management.

In the light of these comments CESR has provided further clarification of the role of each function within the explanatory text and amended its advice to clarify that the requirement for the compliance department to provide reports to the internal audit function (if any) does not mean that the compliance function should have a management reporting line to the internal audit function.

Several respondents also suggested that it was the responsibility of senior management to ensure that compliance deficiencies are remedied and strongly objected to the suggestion that this responsibility should fall to the compliance department. CESR agrees that final responsibility for such matters should rest with senior management and has amended the advice to reflect this.

Following comments received, CESR has also amended the advice to focus on the fact that the compliance function personnel must have the necessary expertise to enable them to carry out their respective duties effectively. The advice clarifies that this expertise may be gained through experience, qualification or a combination of both.

Complaints handling

Several respondents noted that Article 53 of the Directive merely encourages the setting up of efficient and effective complaints and redress procedures by Member States. Such mechanisms could include an investment firm's internal dispute resolution procedures. They argued that the draft advice went beyond the Level 1 text in proposing a requirement to set up such mechanisms.

CESR agrees with these comments and has therefore amended the advice to require effective procedures for the handling and recording of complaints without going as far as requiring a

mechanism for the settlement of disputes. In this context, complaints handling could include, for example, the monitoring of complaints by the compliance department in case they signal underlying compliance concerns.

Outsourcing of investment services

> ***Question 1.3.:*** *Should the current text of CESR standard 127 be retained or should its scope be extended to the outsourcing of all investment services and activities or should paragraph 9(b) be deleted and reliance placed upon the status and responsibilities of the outsourcing investment firm?*

In the first consultation on the first set of mandates, CESR set out three possible approaches to the treatment of the outsourcing of investment services and/or activities. Under all three approaches, the conditions set out in the advice under the first paragraph of Article 13(5) of the Directive would apply to the outsourcing arrangement. The three approaches differed in relation to the treatment of service providers located in third countries.

- One approach involved no additional specific requirements in such cases.
- A second approach involved, for the outsourcing of all investment services and activities, additional requirements for the provider to be authorised in its home country and for there to be a formal arrangement for the exchange of information between the regulators of the investment firm and of the service provider.
- A third approach involved the imposition of these additional requirements only for the delegation of portfolio management functions.

A number of respondents, who favoured the first approach, argued that the second and third options were too restrictive and would constrain valid commercial arrangements. Other respondents favoured the third of these approaches because it was more closely aligned with the requirements concerning the delegation of investment management under Articles 5g (b) and (d) of the UCITS Directive.[2]

Following consideration of these comments, CESR proposed the third of these approaches in its second consultation on the first set of mandates in consistency with the existing CESR Standards no. 127 for investor protection (i.e. that the scope of the requirement should be limited to portfolio management and that the advice should be consistent with the provisions of the UCITS Directive). Respondents were generally in favour of the limitation of the scope of any additional requirements to portfolio management. Opinion was divided as to whether it was appropriate to align the requirements for outsourcing of portfolio management under MiFID with the requirements under the UCITS Directive.

Having considered these responses, CESR has decided to follow the third of the above approaches (alignment with the UCITS Directive) in its advice.

2 Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, as amended.

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

Compatibility with other relevant measures

Respondents from the banking sector expressed concern that certain implementing measures under MiFID, i.e. in respect of their securities business falling within the scope of MiFID, would give rise to duplication of, or even inconsistencies with, requirements applicable to their banking business or their overall business.

CESR is aware that other directives – such as the Directive relating to the taking up and pursuit of the business of credit institutions 2000/12/EC or the proposal for a new Capital Requirements Directive – have or may have provisions that also pertain to organisational requirements. As a consequence, 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.

Calibration

Respondents generally supported the approach of CESR to craft its requirements to the nature, scale and complexity of the investments firms' business, but insisted that such calibration be explicitly mentioned in various sections of the advice, such as in the rules relating to the organisational principles, risk management and business continuity.

CESR has clarified in its advice where such calibration is admissible or appropriate. In this respect, CESR draws the attention of the respondents to the fact that calibration goes both ways, meaning that the gearing can result in less elaborate systems, resources and procedures for very small entities, but also that the requirements applicable to multi-service providers or investment firms with very complex business, may result in correspondingly "greater" practical implications in the assessment of their organisation.

Accounting policies and procedures

Respondents pointed out that the drafting of the rules on accounting policies and procedures were possibly duplicating to some extent, or going beyond, existing accounting standards and rules.

CESR confirms that this is not the intention and has made it clear in the advice that the requirements aim at setting organisational rules which require an investment firm to maintain an adequate internal organization that is consistent with the rules and standards on accounting and annual reports and which enables it to respect its financial reporting obligations towards the competent authorities.

Business continuity

The rules on business continuity have been redrafted in order to emphasize the distinction between the general requirement to take reasonable steps to ensure the provision of services and activities without interruption, on the one hand, and to elaborate a business continuity policy and planning ("BCP") in the event of an unplanned severe interruption, on the other hand. Taking into account the overall aim of the BCP to safeguard, in case of unplanned interruptions or disasters, the clients' rights and interests and to continue to meet its other core regulatory obligations, such BCP's must necessarily be tuned to the nature, scale and complexity of the investment firm's business.

Additional requirements

Respondents argued that CESR's advice on the additional measures, especially the requirements on the independent risk control and the internal audit functions, were too detailed. While the drafting has been reviewed in some places in order to ensure internal consistency between the independent functions, including the compliance function, CESR stands by the substance of its advice. CESR considers that the independent functions such as the risk control function and the internal audit function must be considered as necessary tools for the internal control, the governance and the supervision of those investment firms whose range, scale and/or complexity of services and activities are beyond the reach of less sophisticated internal control mechanisms.

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

Relationship with other work relating to outsourcing

Respondents invited CESR, when drafting rules on outsourcing, to take due account of work undertaken by other fora such as CEBS, CEIOPS, IOSCO and the Joint Forum and undertake steps to harmonise its rules with the other rules and standards, or, where this would not be possible within the given timeframe, delay the adoption of level 2 rules pending a common approach. CESR is aware of the work conducted by and, as the case may be, rules set out in this respect by other bodies. In drafting its advice, CESR has duly taken into consideration such work and rules as far as this was compatible with its mandate from the Commission. However, where differences in form or in level of detail do exist, this can be attributed to various factors, including:

- scope of application: Article 13(5) first sub-paragraph of the MiFID relates specifically to operational functions of investment firms, and does not cover investment services and activities referred to in the MiFID, nor services or activities falling within the scope of other Directives (e.g. deposit taking, insurance). The rules set out by other bodies can therefore have different scopes of application and therefore different rules;
- the objective, form and legal status of the implementing measures referred to as level 2 in the Lamfalussy process, are not identical to the ones present in the work conducted under level 3 of the Lamfalussy process which aims, among other things, to converge supervisory practices.

Presentation of the advice

The presentation of the rules under the advice has been slightly changed. The definition of "outsourcing" has been moved to the definitions in box 1, paragraph c (6) of the advice. The scope of the advice is set out in the paragraphs 1 to 4, which clarify the application of the advice to material outsourcing (paragraphs 1 and 2) and to intra-group outsourcing (paragraph 3), as well as the arrangements not included in the advice (paragraph 4).

Intra group outsourcing

Contrary to the suggestion of a number of respondents to exempt intra-group outsourcing from the scope of the advice, CESR does not believe that the simple fact of outsourcing to another entity of the group removes the rationale behind the requirements set in the advice. However, while insisting on the application of the general principles (responsibility of the outsourcing firm, notification, due skill, care and diligence, written agreement), CESR agrees that certain obligations of the outsourcing investment firm can be geared to the group dimension. Examples are the obligations to conduct due diligence and evaluation of the service provider, to monitor the risk and to provide exit strategies. The investment firm must be able to demonstrate to the competent authority that such gearing is proportionate to the existence of factors such as the degree to which the investment firm controls the service provider or has the ability to influence its actions, or the fact that the intra-group service provider is included in the supervision on a consolidated basis of the group, or is itself subject to prudential supervision.

Effect of outsourcing on assumptions and conditions for authorisation

The potential for outsourcing of functions by an investment firm is theoretically almost without limits and does give rise to the question where the bottom line lies. CESR believes that the principle of the responsibility of the outsourcing firm for outsourced functions cannot justify draining the substance of the investment firm to the point where it becomes an "empty box" or a "letter box

company". As respondents expressed doubts about the legal bearing of those concepts, CESR redrafted the rule in order to state clearly the policy objective, which is that outsourcing cannot be undertaken to the extent that it undermines the assumptions and conditions on which the investment firm's authorisation is based.

Notification of intention to outsource

Some respondents misunderstood the scope of the requirement for prior notification to the competent authorities of the intention of an investment firm to outsource. CESR confirms that such notification only refers to outsourcing falling within the scope of the advice (arrangements which are material and which do not fall under any of the exemptions) and that the rule does not require an authorization from the competent authorities. However, investment firms must make available to the competent authorities, on their request, all information they would need to exercise their supervision in respect of the provisions referred to in this advice.

Access rights

A number of respondents noted that the requirement on the investment firm to negotiate access rights 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 could prove unrealistic. CESR believes that the supervision of the investment firm must not be hampered by outsourcing and that the competent authorities must retain all possibilities to exercise the duties laid upon them by the Directive. CESR considers that investment firms which enter into or maintain outsourcing with service providers who impede or render impossible the normal supervision of the investment firm, are in breach of their obligations under the Directive.

Record keeping obligation (Article 13(6))

Proposed requirement for the investment firm to be able to demonstrate that it has not acted in breach of its obligations under the Directive

Question 4.1.: *Should there be a separate obligation for the investment firm to be able to demonstrate that it has not acted in breach of its obligations under the Directive?*

Respondents were generally opposed to the requirement as drafted. A number of arguments were put forward, including the cost of implementation and ongoing monitoring and lack of clarity in direction and application. Respondents stated that it would be an impossible burden to have to prove a negative.

Concern was also raised that the proposals amounted to a reversal of the burden of proof that went beyond the requirements of the Directive and breached general legal principles of due process and the presumption of innocence.

In its second consultation document on the first set of mandates, CESR stated that it was not its intention to reverse the burden of proof but rather to introduce record keeping obligations sufficient to enable firms to construct adequate audit trails to demonstrate compliance. Respondents generally welcomed the clarification although some also requested that the drafting be amended to better reflect these intentions.

CESR has, therefore, amended the advice to focus on the requirement upon investment firms to maintain the records required under Article 13(6) of the Directive in a manner conducive to demonstrating compliance with the requirements under the Directive.

Record keeping requirements relating to capital markets business

Question 4.2.: *What should the nature of the record keeping requirement be in relation to i) capital markets business such as equity IPOs, bond issues, secondary offerings of securities; ii) investment banking business such as mergers and acquisitions; and iii) general financial advice to corporate clients in relation to gearing, financing, dividend policy etc?*

Respondents were of the view that any requirement to make and retain records relating to capital markets business should be reflective of the transaction taking place and be proportionate to the regulator's needs. Respondents also emphasised that the changing nature of the market and the evolving character of the products meant that an overly prescriptive approach was not appropriate. Furthermore, respondents stated that the capital markets sector covered a wide range of activities which necessitated flexibility in the records made and retained.

CESR has clarified that the specific minimum record keeping requirements set out in its advice are not intended to be exhaustive of the general record keeping requirement set out in Article 13(6) or to prevent the imposition of additional specific requirements under that obligation.

Following consideration of the responses received in this area, CESR has not proposed specific requirements enunciating how the general principle will apply in relation to capital markets business at this stage. However, this does not mean that the general principle does not apply to

such activities. The practical implications of the application of this requirement to such activities may be an appropriate area for future work by CESR.

Retention period

The draft advice proposed that investment firms keep records required by the Directive for a period of at least five years.

Many respondents stated that the proposed retention periods were too long and suggested shorter alternatives. Respondents stated that the retention of records beyond the period required for operational reasons would add significant costs with little, if any, benefit to consumers. A request for a proportionate application of retention periods was made.

CESR has considered the arguments made by respondents but notes that the rationale for retention periods extends beyond the operational needs of investment firms. It considers that the retention period proposed in the draft advice remains appropriate to enable competent authorities to monitor compliance with the requirements under the Directive, as already reflected in Article 25(2) of the Directive.

Recording of telephone orders

The draft advice proposed that investment firms should keep records of telephone orders on a voice recording system for at least one year.

Concern was raised by respondents regarding the cost of installation and operation of any voice recording system. Respondents were also of the view that records of voice recordings should only be maintained for a period of time proportionate to the operational needs of the investment firm and the complexity of the firm's business. In particular, a number of respondents stated that voice records only needed to be kept for as long as they were required to resolve any transactional disputes with clients or market counterparties or to resolve internal or external investigations on market abuse conduct that is suspected to constitute market abuse.

In its second consultation paper on the first set of mandates CESR requested that firms provide more information in respect of the marginal cost of the longer retention periods proposed.

Many respondents noted that that the initial set up costs of voice recording systems were equally if not more important than the marginal costs of longer retention periods. This issue was noted to be particularly acute for retail business, where the volume of client calls or number of offices was likely to be higher. Respondents also repeated calls for the requirement to be calibrated such that smaller firms were exempt from the requirements.

Following consideration of these responses, CESR has determined that it is appropriate to maintain the requirement in order to assist competent authorities in monitoring compliance with the requirements under the Directive. 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.

CESR is mindful of the additional cost that may be incurred in establishing recording systems but believes the regulatory benefits of these records outweigh these costs. CESR has also clarified that the requirement is intended to apply to all telephone conversations on lines used for the giving and/or acceptance of orders. 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.

CESR does not believe that the retention period for records maintained pursuant to such a requirement should be less than one year, as such a reduction would significantly reduce the benefit of such records for monitoring compliance with the requirements under the Directive.

Format of records

CESR proposed that investment firms should keep records in such a way that they may be readily reproduced on paper and that allows the competent authority to access and search them. CESR also proposed a requirement that the records retained should permit the competent authority to reconstitute each stage of the processing of all transactions and instructions by the investment firm.

Whilst many respondents agreed with the flexibility provided to retain records in different formats to reflect operational needs, they argued that the requirement for documentation to be capable of being reproduced in paper format in all circumstances was burdensome. Some respondents favoured greater flexibility that would allow transactions to be recorded in a manner appropriate to the nature, scale and complexity of the business whilst maintaining an audit trail for regulatory purposes. More specifically, some respondents queried how the requirement was intended to apply to voice recordings, where the cost of producing paper transcripts could be prohibitive.

CESR does not agree with the arguments that the requirements proposed are unduly burdensome. They do not require records to be maintained in paper format as a matter of course, provided they are capable of being reproduced in paper format. CESR has therefore retained the format requirements as consulted upon. CESR has, however, clarified in the explanatory text that in the context of the requirement to keep voice records of certain telephone conversations, this requirement would be satisfied if the records can be accessed to enable the production of a transcript.

Security of records

CESR proposed a requirement for investment firms to keep records in a manner designed to ensure an appropriate audit trail of amendments and prevent other manipulations or alteration. Respondents expressed their concern that it was not possible to put in place a system that was guaranteed to be tamperproof. CESR has therefore amended the advice to clarify that the obligation should be to keep the records in a manner designed to ensure this result is achieved.

Survival of retention periods

Many respondents raised concerns in respect of the cost and practicality of storing data once the investment firm's authorisation has ceased and noted that the draft requirements may prove impossible or impracticable if the investment firm is liquidated before the end of the retention period.

CESR has therefore modified the draft requirement to clarify that if an investment firm is liquidated before the end of the required record retention period, the retention period would last at least until the liquidation of the firm. CESR has advised that Member States should have the ability to determine whether to extend the requirement beyond the liquidation date.

Records of identical documents or documents in a common format

Respondents questioned the application of the proposed record keeping requirements to cases in which identical documents or documents sharing a common format are sent to a number of clients.

CESR has clarified that the advice is not intended to require multiple copies to be required of identical documents.

Where documents are based on a common format but contain different information for each client, the advice is only intended to require the 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. However, investment firms may, of course, choose to satisfy their obligations by maintaining copies of each document in such cases.

Minimum list of records to be maintained

Respondents were divided over the minimum list of documents contained in the Annex to the draft advice on Article 13(6) of the Directive. Some respondents felt that the list was too long or too prescriptive and lacked clarity in respect of the categorisation of client details to be made and kept.

CESR proposes to retain the minimum list of records as set out in the consultation paper but has clarified the proposed requirements in certain areas, such as the categorisation of clients, the retention periods for retail client agreements, client details, marketing communications and investment research. As noted above, CESR has also clarified that the minimum requirements set out in its advice are not intended to be exhaustive of the general record keeping requirement set out in Article 13(6) of the Directive or to prevent the imposition of additional specific requirements under that obligation.

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

Scope of application

According to one respondent, the advice should clearly exclude from its scope circumstances where the client, independently of the investment firm, deposits directly his assets with a third party depository and then gives the investment firm authority to instruct the depository in relation to those client assets. CESR therefore has altered the advice, to clarify that where such circumstances occur, the advice does not apply.

CESR believes that the adequate arrangements an investment firm has to put in place to safeguard its clients' ownership rights have to include not only organisational and procedural, but also contractual requirements. Therefore, the advice contains specific provisions providing for a written agreement with the client, setting out the rights and obligations of the investment firm in relation to the holding clients' assets and defining some specific aspects to be dealt with by such an agreement. The advice also clarifies that such requirements apply in addition to any applicable requirement in or under Article 19.

Use of client assets

Respondents felt that requiring the investment firm to inform clients about the risks involved when using the assets it holds on behalf of its clients for its own account and/or for the account of other clients would be excessive. CESR believes that the risk warning requirement is necessary at least where the agreement involves retail clients, who must be adequately informed about the possible risks of the counter-party in transactions in which the investment firm employs such client assets. CESR has therefore amended its advice in order to limit the application of the requirement to retail client agreements.

In order to ensure a better understanding of the requirements provided for in the case the investment firm wishes to use client assets it holds, formal changes to the relevant provisions in the advice have been introduced (see new paragraphs 6 to 8).

Use of depositaries

Some respondents felt that, where client funds are deposited under the form of deposits held on in the books of credit institutions or banks, the applicability of the requirements provided for in paragraph 7 (due diligence requirements) of the draft advice in the consultation document to such credit institutions or banks should be verified. Following these comments, CESR amended the advice, to identify the conditions that are not applicable in such cases.

CESR amended the advice to consider the comments of some respondents that felt that it was excessive requiring both an annual and periodic review of the continuing appropriateness of the selection of the depository. The new text now requires only a periodic review of the depository.

Guarantee/ensure

Some respondents felt that the text should not use the expression "guarantee" where a formal guarantee is not meant, since this could be misinterpreted. CESR shared this concern and amended the advice by using instead the expression "ensure".

Receipt of client funds

CESR considered the suggestion of some respondents, according to which it is excessively burdensome requiring investment firms that receive client funds to distinguish the funds they received that are payments to the investment firm or to third parties from those necessary for the performance of investment services.

Information about protection of client assets

One respondent was of the opinion that, from a cost benefit perspective, the obligation provided for in paragraph 12(d) of the draft advice of June 2004; to supply clients with a description of the way in which client assets held by an investment firm are protected in the relevant Member State was unnecessary, as this would not be a meaningful information for most clients. Whilst CESR considers that this is an important information to be provided to investors, especially the information on the investment protection and deposit guarantee schemes, the text now clarifies under the new paragraph 13(d) that only a general description of such legal methods of protection is required.

Use of unregulated depositories

Question 5.1: Where the jurisdiction in which financial instruments have to be held regulates the holding and safekeeping of financial instruments, should investment firms be required to sub-deposit their clients' financial instruments with such institutions in all cases or are there cases in which overriding considerations to the contrary mean that it would be permissible to use an unregulated depository?

Several respondents believed that it should be permissible to use an unregulated depository, whilst others considered that only the use of a regulated depository provides comfort that adequate asset protection and compliance measures are in place. One respondent suggested that the selection of a regulated depository should be mandatory unless no such regulated depository exists in the relevant jurisdiction. Some asked for clarification of the term "regulated" entity".

CESR believes that investment firms must avoid situations which may jeopardise the appropriate protection of client assets they hold. Accordingly, the advice requires an investment firm to exercise due skill, care and diligence in the selection, appointment and review of the depository. In addition, the advice now requires (paragraph 10 (a)(i) of the advice), where in a given jurisdiction the holding and safekeeping of client financial instruments is subject to specific regulation and supervision, investment firms shall only be permitted to deposit client financial instruments with entities in that jurisdiction that are subject to such a specific regulation and supervision. This would not exclude - without prejudice of the other requirement provided for in the advice for the selection, appointment and review of depositories - that the investment firm may deposit client assets with depositories in jurisdictions in which the holding and safekeeping of financial instruments is not subject to specific regulation and supervision.

Systems and controls relating to stock lending

Question 5.2: [Stock lending arrangements in the case of financial instruments held on an omnibus basis for more than one client] Which appropriate systems and controls an investment firm has to put in place to ensure that only financial instruments belonging to clients who have given their consent are used in those arrangements?

Several respondents noted that there was no need to specify the relevant systems and controls, since what is appropriate in each case will depend on the circumstances and the nature of the applicable national laws. Others suggested that an investment firm should maintain internal accounting records which record individually and reconcile on an ongoing basis the total amount of lent assets

making up pooled assets of those clients who have given consent to enter into lending arrangements. And that requirements should be imposed on investment firms to ensure that adequate audited bookkeeping procedures are in place to ensure that individual and aggregate lending records are reconciled continuously. Some respondents suggested that investment firms could operate two separate accounts, one for those clients that have "consented" and one for those that have not. A limit of the value of the instruments that could be used could be imposed which would be set at the value of the assets of the clients that have consented; or a blocking filter could be implemented so that the assets of clients that had not consented could not be used.

In consideration of these comments, CESR believes that, although the specific solutions suggested by certain respondents could be considered adequate to ensure that only the assets of those clients that have consented are used, it is preferable to focus on the result to be achieved by the systems and controls, rather than specifying the particular systems and controls to be established. This approach is without prejudice to other applicable parts of the advice on systems and controls and record keeping.

Record keeping requirements concerning depositories

Question 5.3: *Should a requirement be imposed that the records of the investment firm must indicate for each client the depository with which the relevant clients' assets are held, or is it sufficient that the investment firms should maintain records of the amount of each type of asset held for each client and of the amount of each type of asset held with each depository and ensure that the aggregate figures correspond with each other in accordance with paragraphs 11(c) and 13 (b)?*

The single client identification requirement was considered too burdensome or impracticable by most respondents. Some other respondents noted that it is preferable to keep detailed records in order to ensure investor protection and to prevent disputes with clients.

In consideration of comments received, no such additional requirement has been added to paragraph 12 (a) of the advice, which provides for the establishment of a separate account in the investment firm's records for each client or group of clients acting jointly, CESR underlines the importance of adequate internal control procedures and especially of the requirement under paragraph 14(b), according to which an investment firm must regularly carry out reconciliations between its internal accounting records and those of any third parties with whom client assets are held.

Liability for depositories

Question 5.4: *If the client's assets may be held by a depository on behalf of the investment firm, should:*
(a) the investment firm be (i) prohibited from purporting to exclude or limit its responsibility for losses directly arising from its failure to exercise all due skill, car and diligence in the selection and periodic review of the depository; and (ii) required to accept the same responsibility for a depository that is a member of its group as it accepts for itself; or
(b) must the contract between the investment firm and the client state that the investment firm will:
(i) in any event be wholly liable for any losses the client suffers where the investment firm is directly or indirectly linked to the depository, and
(ii) be liable in whole or in part, according to the circumstances, for any such losses unless the investment firm shows that it has exercised all due skill, care and diligence in the selection and periodic review of the depository?

Whilst some respondents could agree in principle that an investment firm should not be permitted to limit or exclude by contract its liability, most respondents felt that neither of the proposed options could be considered appropriate. Some respondents firmly opposed option (b) (ii), as in their view it would introduce a reversal of burden of proof which would imply for the investment firm to provide a sort of guarantee in relation to the assets held with a third party and which would have capital adequacy implications. Other respondents suggested that the advice should not contain rules specifying the extent of an investment firm's liability.

On the basis of the comments received, CESR discussed in depth the issue of investment firms' liability vis-à-vis their clients when holding client assets and in particular in the case where client assets are sub-deposited with third parties. CESR came to the conclusion that it is not advisable to include in the advice specific provisions on the kind and level of investment firm's liability, including the liability for acts, omissions and insolvency of third parities acting as depositories, as this matter will depend on the different national laws and regulations in this field.

Instead, CESR is of the opinion that it is necessary to require an investment firm that holds clients assets to disclose, in the written agreement with the client, its rights, responsibilities and obligations with respect to the holding of clients assets and to specify the responsibility it accepts to the client where the client's assets are held with depositories, for the acts, omissions and insolvency of such depositories. CESR points out that the contractual definition of the investment firm's liability must be compliant with the applicable national law and regulation. Finally, CESR recalls that the advice provides that an investment firm that deposits client assets with a depository must agree with the depository the level of liability the latter accepts.

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

The responses on the draft advice on conflicts of interest were mixed. Although many respondents were largely in favour of the high-level principles, there were overriding objections to the prescriptive nature of the proposed advice. There was strong support for CESR's objective of setting out flexible principles of general application across the whole range of business models. However, it was argued that the proposed advice was too prescriptive "to allow for the efficient conduct of business and management of conflicts". It was also argued that the proposed advice did not take proper account of the wide variety of size and type of business of the regulated firms.

Respondents were concerned that many of the proposed Level 2 measures as drafted would give rise to unnecessary constraints and administrative burdens, without obvious resulting benefits to clients, and stressed the importance of cost/benefit analysis being conducted before the Commission proposes draft legislation, since additional costs will eventually have to be paid for by investors. Respondents also argued that compromising the efficiency of markets by imposing onerous and impractical requirements would reduce market participants' ability to resolve conflicts, perhaps leaving them unresolved or in need of settlement in the law courts.

There was some support for the general approach proposed by CESR in relation to inducements. However, there were also many concerns raised on the specific provisions and details in the advice.

General application to counterparties

Respondents asked for clarification of the scope of application of the requirements relating to counterparties. It was argued that as recital 31 to the Directive states that measures to protect investors should be adapted to the particularities of each category of investor, it was suggested that the conflicts policy and disclosure requirements setting out in the draft advice should not be applied to arms-length own-account trading between clients that are eligible counterparties.

CESR believes that the Level 1 text makes it clear that there is no exemption from Articles 13(3) and 18 for business done with clients that are eligible counterparties. The conflicts policy under Article 13(3) and the disclosure obligations under Article 18(2) cover all categories of clients. The concept of client in these requirements is a broad concept and the advice is consistent with the tenor of the Directive.

Identification of conflicts

The key issue was the scope of the conflicts that should be subject to identification, management and disclosure, which was felt to be too wide and imprecise. However, there was no consensus about the level of detail that the criteria for the identification of conflicts should include. Although some respondents argued that the proposed criteria for the identification of conflicts were too broad, some asked for more detailed or restricted criteria, others asked for clarification of the scope of the criteria, whilst others criticised the level of details in CESR's draft advice.

Respondents were concerned that the criteria in the advice would include any circumstance in which there is a mere difference in the interests of the relevant parties even if there is no material risk of damage to clients.

Some respondents argued that the scope of the advice should be limited to actual conflicts, excluding potential conflicts. They argued that the proposal that firms should be required to identify conflicts of interest in advance should be subject to a rigorous cost-benefit analysis. They

argued that there is no clear benefit in identifying conflicts in advance and suggested that it is more appropriate that conflicts are properly managed when they arise.

One respondent proposed the establishment of quantitative thresholds to assess the materiality of the conflicts to be managed. Other respondents suggested that CESR's advice should not go beyond general principles requiring firms to manage potential conflicts of interest, avoiding references to specific activities in paragraph 2 of the draft advice in the consultation document (paragraph 3 of the advice).

CESR believes that the detailed criteria for the identification of conflicts in paragraphs 2 and 3 provide important clarification. However, CESR believes that it is not appropriate to go into further level of detail in Level 2 measures.

CESR does not agree that the advice should be limited to cover actual conflicts of interest. Such an approach would mean that the conflicts management policy would exclude conflicts of interests that had not materialised at the date on which it is written, but are likely to emerge in the near future. It is important for an investment firm to consider the conflicts of interest that are likely to arise as well as those that have actually arisen in designing its conflict management procedures. However, in addition to this up front analysis, the firm should have ongoing procedures for identifying conflicts as they arise.

However, as the obligation in Article 13(3) of the Directive is only to take "reasonable steps" to identify conflicts of interest, there is an inherent limitation on the scope of this obligation. The firm does not need to continue identifying theoretical conflicts indefinitely. Also, for the purpose of establishing procedures the identification process does not need to drill down to the level of each specific conflict.

A number of respondents asked for clarification about the relationship between the criteria to identify conflicts of interest and the profit motive of the investment firm.

Concerns were raised that, to the extent that paragraph 1(a) of the consultation document referred to any situation in which the investment firm stands to profit or avoid a loss to the detriment of the client, it was intended to cover all genuine profit making activities. It was suggested that the concept of detriment to a client or counterparty should be more clearly distinguished from a situation in which a conflict of interest arises, to avoid the inclusion of principal trades with an investment firm's client where there is no advisory or fiduciary relationship.

CESR's intention was to point out that fees and other profit motives of the investment firm can be a source of conflicts of interest. Rather than altering its advice on the criteria, CESR has inserted some wording in the explanatory memorandum to clarify that damages to client interests implies more than the mere fact that the client may loose money on an investment.

A number of respondents were concerned that the proposed requirements concerning records of categories of conflicts were unclear and would imply very detailed records to be maintained and continuously updated.

This was not CESR's intention. CESR has therefore altered paragraph 5 of the advice so that it applies at the level of "categories" and "types" of conflicts, rather than at the level of specific conflicts falling with these types and categories.

One respondent considered that investment firms should identify as a potential conflict area the activity of managing a MTF due to the fact that they may develop simultaneously that management and their intermediation activity. It was suggested that CESR's advice should expressly mention that activity within the section of the identification of conflicts.

CESR is the opinion that it is not necessary to go into this level of detail because the criteria in the advice already cover the conflicts of interest that these activities may involve.

Conflicts policy

It was suggested that the proposed requirement that the conflicts policy should "include all reasonable steps to identify" conflicts of interest should be removed, because the process through which the policy is made might be able to include all reasonable steps to identify conflicts but the policy itself cannot.

CESR does not agree with these comments. The arrangements that the investment firm uses to identify conflicts of interest should form part of the conflicts policy. This will allow the supervisor to establish the methods that the investment firm uses to identify conflicts, which is the essential first step in the conflicts management process.

A number of respondents called for a reference to the type of client. It was suggested that an additional sub-paragraph (d) might be added to the list in paragraph 5 of the draft advice in the consultation document (paragraph 6 of the advice) as follows: "the level of sophistication of the investment firm's clients". It was argued that the less sophisticated the client, the more likely that conflicts of interest will damage its interests and that the conflicts policy of an investment firm which deals with professional investors or eligible counterparties should not have to be the same as the policy of a firm that deals mainly with retail investors.

CESR believes that the obligations relating to the conflicts policy under Article 13(3) of the Directive should cover the management of conflicts affecting to any category of client and it was not considered appropriate that the advice on the conflicts policy should introduce this new element.

Respondents argued that the provisions on independence in paragraph 7 of the draft advice in the consultation document were too prescriptive. They criticised the proposed requirement to implement information barriers between the activities listed in paragraph 2 of the draft advice in the consultation document. They argued that having identified conflicts of interest, it must be possible for the firm to choose how to prevent or manage those conflicts.

A number of respondents suggested limiting the scope of the proposed requirements concerning the use of information barriers. There was concern that independence through separation by information barriers would invariably require full isolation with "physical barriers." This was not CESR's intention. Depending on the circumstances, it may be appropriate for information barriers to be augmented by physical arrangements. In some cases, it may be appropriate to rely on policies and procedures. CESR therefore has altered the requirements in paragraphs 7 and 8 of the consultation document. The revised provisions in the final advice are less prescriptive in this regard and do not refer to separation by information barriers but to the establishment of information barriers where relevant.

A number of respondents suggested that when dealing with a client that is an "'eligible counterparty" or "professional investor", it should be possible to manage the conflict of interest using disclosure and consent, as opposed to setting up information barriers or other measures, as there should be circumstances in which the investment firm may continue to act if the client expressly consents to the firm acting where it knows that the firm is not acting independently.

Article 13 (3) of the Directive establishes the obligation for investment firms to operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest from adversely affecting the interest of its clients. CESR believes that this is the first overarching principle as far as conflicts management is concerned. According to Article 18 (2) of the Directive disclosure and express consent should only cover those cases in which these organisational arrangements are unable to prevent, with reasonable confidence, risks

of damage to clients, without distinction of the nature of the client involved. CESR does not believe that disclosure and consent requirements, either general or limited to some categories of clients, can replace or be a waiver for the conflicts management obligations in paragraphs 5, 7 and 8 of the CESR advice.

Inducements

There were some questions about the meaning of "normal" commissions and fees for a service and the difference between such fees and commissions and an inducement (as defined in paragraph 11 of the definitions section of the draft advice in the consultation document).

Some respondents thought that the definition of this concept needed to be supplemented to specify that it does not include "retrocession" or commission" rebates", which are considered a technical form of compensation for an investment service. Some ask for clarification that inducements do not comprise commissions paid to and investment firm by another party as a professional fee of that investment firm.

CESR believes it is helpful to consider some examples. Where a fund producer pays basic commissions to a fund distributor for distributing a fund, this would potentially be a normal commission or fee for the provision of services (although this would depend on the fee structure used) falling outside of the definition of an inducement.

A different example would be where a broker pays money to a portfolio manager, not because the manager has provided a service to the broker or because the manager has provided a service to the client. Instead, the broker is paying money to the manager because the manager has channelled business to the broker. This should not be seen as the "normal" commission or fee for providing fund management services and would therefore fall within the definition of an inducement.

CESR does not believe it is appropriate to be more precise about the definition of "inducements" since the advice has to apply to a wide range of different structures of business relationships in different jurisdictions and it cannot deal with every possible scenario.

Some respondents argued that there is no legal basis for the prohibition of certain categories of inducements in paragraph 9 of the draft advice set out in the consultation document and for the general disclosure requirements that were set out in paragraph 11 of that draft advice. A number of respondents also expressed concern about the impracticality of the frequency and level of detail of such disclosure, suggesting that clients be permitted to opt out of receiving disclosure or that disclosure to professionals upon request should be allowed. Some also suggest that the annual disclosure could be made in the annual report of the investment firm.

As stated in the explanatory text to CESR's advice, inducements are a particular area of concern to supervisors. Permitted inducements should be limited to those that can reasonably assist the firm in the provision of investment services to clients and that 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. CESR has also stated that this limitation could be better addressed under the advice on Article 19 (1).

CESR is of the opinion that the requirement for the disclosure of inducements should be maintained for investor protection reasons. It is felt that permitted inducements could give rise to conflicts of interest and could therefore be relevant for the conflicts policy. However, the revised provisions on the disclosure of inducements is now provided under the advice on Article 19(3), which better addresses the respondents' concerns about the recipients and content of this information, and facilitates the provision of alternative means for disclosure.

A substantive consequence of including these alignments under Article 19 is that it will not apply to business done within the scope of the eligible counterparties' regime. However, the effects of this

will be limited by the fact that the eligible counterparty regime is limited to dealing services (for example, it does not cover the provision of investment advisory or portfolio management services).

One respondent suggested that disclosure of inducements should exclude the cases where inducements are not charged to clients and therefore do not lead to higher costs.

CESR does not agree that just because the client does not directly pay for the inducement it will not cause that client harm. For example, a manager may choose a less efficient broker because they receive inducements. The net effect of this is that the client is likely to end up receiving a worse deal or paying more in brokerage commissions.

Disclosure obligations relating to conflicts policy

A number of respondents argued that CESR's proposals relating to the disclosure of the conflicts policy was not consistent with Articles 13 or 18 and that the disclosure obligation under Art. 18 (2) should be limited to individual conflicts of interest, not to the general conflicts policy. Some respondents complained about the impracticality of such requirement and the uncertainty about the content of the conflicts policy to be disclosed.

Some other respondents who also disagreed with the general obligation to disclose to clients the conflicts of interest policy felt that if there is a need for this level of protection, it should be confined to retail clients. One respondent asked for consideration to the "nature of the recipients", with a preference on the distinction between retail and professionals.

CESR's draft advice under both Articles 19(3) and Articles 13(3) and 18 proposed that an outline of the conflicts policy should be disclosed in all cases. Following comments, CESR has retained this proposal in its advice under Article 19(3), with modifications to address the costs of disclosure. It has removed this requirement from its advice under Articles 13(3) and 18.

Therefore, CESR considers that the requirements on disclosure of the conflicts policy proposed in paragraph 12 of the draft advice in the consultation document can be better addressed in the advice under Article 19(3) and the advice has been revised accordingly (see paragraph 16 of the advice under Article 19(3)).

As to the obligation to provide disclosure in writing, some respondents pointed out that an alternative mean might be the publication of details regarding conflicts of interests on the intermediary's web site, to which the client could be advised to refer.

The revised CESR advice under Article 19(3) requires information to be provided or accessible to the client in a "durable medium". However, it also proposes an alternative mechanism for disclosure of information about the conflicts policy via the investment firm's website. This should address concerns about the costs of sending this information to every client.

Questions

***Question 6.1.**: Should other examples of methods for managing conflicts of interest be referred to in the advice?*

The overwhelming majority of respondents was that a list of examples should be given because this prevents legal uncertainty. It was also felt that it will not be practicable for CESR to helpfully mandate the appropriate measures that must be taken by all firms all of the time. Therefore, respondents were almost unanimous that there is no need for including other examples of methods for managing conflicts and that it would be neither desirable nor possible to produce an exhaustive

list. One respondent emphasised that it should be clarified that the list is not exhaustive, so that other methods of managing conflicts may, in certain circumstances, be effective too.

Just one respondent proposed that disclosure and express consent should be added to the list of measures. CESR does not believe this is appropriate for the reasons explained under the heading "conflicts policy".

Therefore, CESR's final advice does not add any other method to the list, which is however considered in the advice as a non-exhaustive list.

Question 6.2.:
(a) Should paragraphs 8(a) to (f) (or the final list of measures for managing conflicts of interest adopted in response to question 1) be stated as examples of arrangements that may, depending on the circumstances referred to in paragraph 5, be effective methods of providing an appropriate degree of independence in respect of persons engaged in different business activities?

(b) Alternatively, should there be a requirement for an investment firm to include these measures in its conflicts policy to the fullest extent possible unless it is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients?

(c) If the answer to question (b) is yes, which of these measures should be subject to the requirement referred to in that question?

The vast majority of respondents considered that paragraphs 8(a) to (f) of the draft advice in the consultation document should be examples for guidance only and that there should be a degree of flexibility and discretion, according to the nature, scale and complexity of the business itself and be appropriate to that model. One respondent warned that by giving examples, there is a danger that investment firms will interpret these as fixed and will be discouraged from finding other possible more appropriate and proportionate methods for conflicts management. There was also some sentiment in favour of addressing this part of the advice as Level 3.

Two respondents appeared to prefer a more prescriptive option (Q6.2 (b)).

CESR therefore has altered the advice in this area (see paragraph 8 of the final advice) and believes that the revised advice reflects the consensus view of respondents. However, it should be pointed that the intention of the revised CESR's advice is also to stress its opinion on the importance of the firm's consideration of, at least, all the suggested methods when establishing an effective policy on independence.

CESR believes that whichever methods are selected by firms, it is clear that there is a general principle requiring firms to put in place organisational requirements to manage conflicts, and that this extends beyond any specific examples of conflicts of interest or of conflicts management techniques specified in level 2. To this end, the revised advice on the conflicts policy (paragraph 5 of the final advice) also provides that the written policy must include a clear description of the relevant types of conflicts subject to such policy, the measures taken for their prevention and management and the reasons why these measures were selected.

Respondents also provided detailed drafting comments, mainly regarding paragraphs 8(b) (separate supervision) and 8(c) (remuneration structures) of the consultation document.

It was suggested that the reference to different "senior executives" in paragraph 8(a) should be replaced with a reference to "direct supervision" since ultimately supervision of all of the activities

within the investment firm will fall to the Senior Management. CESR agrees that there should be some limitation and has adopted the concept of "direct supervision" in its advice.

It was argued that CESR's advice should not be prescriptive in relation to remuneration structures. A number of respondents suggested that the effect of this provision would be to prevent the payment of bonuses by reference to the overall performance of the firm. There were some calls for removal of this requirement or for its clarification.

CESR is of the opinion that the way in which remuneration structures are established can be an important element of the management of conflicts in an institution providing different investment services. Thus, the remuneration policy merits particular attention by investment firms. On the other hand, it is recognised that measures reflecting this principle should not be too restrictive. The revised provision in paragraph 8(c) of the advice intended to allow remuneration that depends on the global performance of the firm and is focused on direct interactions between revenues of conflicting activities and the remuneration of the relevant persons.

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

Appropriate level of convergence

Whilst a number of respondents supported the need for an element of flexibility to allow Member States to regulate particular products/services, others suggested that the proposed discretion was inappropriate.

In line with its general approach to the preparation of its advice on Level 2 measures under the Directive, CESR's advice is intended to set out the minimum requirements for ensuring protection of investors from misleading marketing. Given the wide scope of products within the Directive, it is not practicable within the Level 1 measures to develop material that is appropriate to all products, services, circumstances and jurisdictions subject to the requirements in the Directive. It is, therefore, appropriate that Member States should not be prevented from adopting additional measures elaborating on the basic requirements within the Level 1 and 2 measures where they have jurisdiction over the relevant matters under the Directive.

Distinction between retail and professional clients

The vast majority of respondents endorsed the proposed distinction between retail and professional clients. As set out in the explanatory text, CESR notes that the absence of detailed requirements for professional clients should not be interpreted as providing exemptions from the general principle in Article 19(2) of the Directive that all information addressed by the investment firm to clients or potential clients should be fair, clear and not misleading.

Concern was expressed by one sector representative as to the potential for smaller businesses to be inappropriately classified as professional clients and that certain requirements should therefore extend to all clients. A number of other respondents proposed that further adjustments be made to the classification so as to create a distinction between different types of retail client, based on levels of expertise and/or whether they are new or existing clients.

CESR has generally retained the approach to the allocation of the Level 2 proposals between retail and professional client business that was proposed in the consultation document (although it has extended the requirement for marketing communication to include the name of the relevant investment firm to professional client business). CESR notes that professional clients may request treatment as retail clients and that the general principle in Article 19(2) of the Directive will continue to apply. CESR is also unconvinced of the case for any sub-classification of retail clients, believing this to be sufficiently addressed by the provision under Annex II, Part II for certain retail clients to be reclassified upon request as professional clients and paragraph 4(a) of the advice, which recognises the relevance of the intended audience.

Annex 4 to this feedback statement contains a table highlighting those provisions in the advice that are intended to apply only in relation to retail clients and those provisions that are intended to be of wider application.

Potential overlap and inconsistency with existing Community measures

A number of comments on the draft advice under Article 19(2) of the Directive raised the issue of the inter-relationship between MiFID and existing Community legislation. Respondents also questioned the justification for creating a distinct regime for investment products. It was suggested that there was a need to ensure a level playing field and to avoid investment firms having to work to alternate sets of rules for different products (see "horizontal issues").

Article 19(2) of the Directive provides the basis for a specific regime regulating the marketing of financial instruments and investment services to retail clients. This is desirable in view of the increased risks inherent in such products and services in comparison to other consumer products and services.

CESR has, however, clarified that the requirements for marketing communications should not overlap with requirements for the preparation of prospectuses under the Prospectus Directive[3] or comparable requirements relating to transferable securities under national law, for the dissemination of information pursuant to mechanisms established under the Transparency Directive[4] or comparable mechanisms under national requirements concerning the dissemination of information or for the marketing of UCITS established under the UCITS Directive as amended.

Confirmation of compliance by another person

Respondents identified the need for clarification of responsibilities where more than one firm is involved in the provision of a marketing communication.

CESR has revised the advice to set out the circumstances in which an investment firm may be permitted to communicate a marketing communication in reliance on the fact that another firm has confirmed compliance with provisions under Article 19(2) of the Directive.

Requirements as to the contents of retail marketing communications

A number of respondents suggested that the proposed requirements under Article 19(2) of the Directive inappropriately brought forward information requirements under other provisions, such as Article 19(3), jeopardising high level marketing by investment firms. It was suggested that certain of the requirements were inappropriately detailed for a marketing communication, it being sufficient that information was required to be provided at a later stage.

CESR does not accept that relying solely on the provision of information in a single pre-contractual disclosure will provide sufficient protection for investors in all cases. Such disclosure may be insufficient to counteract the initial message portrayed in a marketing communication and on which the investment decision will often be based. Subject to the amendments it has proposed, CESR does not believe the proposed level of detail to be unduly onerous or inappropriate or that a less detailed approach would not achieve the desired level of investor protection.

General requirements

The general requirements proposed in paragraph 4 of the advice under Article 19(2) of the Directive (paragraph 3 of the consultation draft) are considered to represent the basic minimum criteria for ensuring information addressed to retail clients is "fair, clear and not misleading". It is generally appropriate to require an investment firm to ensure compliance with these criteria, on the basis that they will be within its control. CESR does, however, accept the concerns expressed by respondents as to the practicality of the requirement, proposed at paragraph 3(a) of the draft advice in the consultation document, that an investment firm must "ensure that a communication is likely to be understood by the average member of the group" to which it is targeted. The text of this provision has therefore been revised to require an investment firm to "take all reasonable steps" to achieve this outcome (see paragraph 4(a) of the advice).

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3 Directive 2003/71 on the prospectus to be published when securities are offered to the public or admitted to trading.
4 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.

CESR also accepts the views of respondents that the proposed mandatory content requirements at paragraph 6(b) of the advice may not be necessary and/or appropriate in every marketing communication. CESR has therefore revised the text to propose that these requirements should not apply to retail marketing communications with restricted contents that fall under paragraph 10 of the advice ("marketing communications with restricted content") or to marketing communications that are not made in writing.

Consistency of information

Some respondents questioned the requirement concerning the consistency of information in retail marketing communications with other information provided to retail clients, including the extent of this requirement.

CESR has clarified that this requirement (now contained in paragraph 5 of the advice) is intended to apply for the period in which the retail marketing communication is in use by the investment firm.

Factual claims

A number of respondents commented on the requirements for the provision of evidence as to the accuracy of factual claims, suggesting that they constituted a new and unwarranted reversal of the burden of proof.

Such requirements are already contained in the Misleading and Comparative Advertising Directive[5]. CESR believes it is beneficial for the requirements under MiFID to be aligned with the requirements under that Directive.

Additional requirements for specific retail marketing communications

In addition to the general comments concerning the relationship with the requirements under Article 19(3) of the Directive discussed above, some respondents suggested that the requirements were too detailed. More specifically, concerns were raised about:

- the subjective nature of the proposed disclosure requirement for marketing communications relating to illiquid financial instruments; and
- the potentially misleading nature of the proposed disclosure requirement about the existence or absence of a right of withdrawal where a right of withdrawal would not normally exist.

The requirements proposed in paragraph 9 of the advice about retail marketing communications that refer to a specific financial instrument reflect the fact that where an investment firm chooses to make a retail marketing communication that refers to a specific financial instrument or investment service, it will generally need to include certain information within the marketing communication to ensure that it is fair, clear and not misleading. CESR does not believe that relying on information being provided at a later stage will be sufficient to ensure that such marketing communications are fair, clear and not misleading.

CESR does however accept the views of respondents that the specific express requirements relating to illiquid financial instruments and rights of withdrawal are not necessary and may, in some cases, be inappropriate. CESR has, therefore, not included these specific requirements in the final advice

5 Article 6 of Directive 84/450/EEC concerning misleading and comparative advertising. CESR notes that similar requirements are included in Article 12 of the 9 November 2004 Common position adopted by the Council with a view to the adoption of a directive concerning unfair business-to-consumer commercial practices in the internal market.

(under Article 19(3) (paragraph 9). However, it has retained the reference to withdrawal rights in paragraph 3(g) of the advice under Article 19(7), "to the extent that this is possible and relevant at the provision of the terms of the agreement to the client". The obligations are not otherwise thought to be unduly onerous and (as clarified in the explanatory text) compliance with these obligations 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.

Direct offer retail marketing communications

Respondents questioned the relationship between the requirement concerning direct offer retail marketing communications in the advice under Article 19(2) of the Directive and the requirements to provide information in the advice under Article 19(3) of the Directive.

The requirement concerning direct offer retail marketing communications could be seen as a modification of the requirements concerning the timing of the provision of information under Article 19(3). However, it is also relevant to the "fair, clear and not misleading" requirement under Article 19(2).

CESR has clarified in the explanatory text to its advice that where information has already been provided to clients and is not therefore required to be provided under Article 19(3), it will also not be required to be included in the direct offer retail marketing communication pursuant to paragraph 11 of the advice under Article 19(2). However, such communications will still be subject to the other requirements of and under Article 19(2).

CESR has also noted that while a direct offer retail marketing communication must contain the information required under Article 19(3) of the Directive (subject to the above observations), the requirements to provide information under that provision will not be discharged by the inclusion of such information in the direct offer retail marketing communication unless that communication is made in a durable medium (as defined in the advice). If this is not the case, the applicable requirements under Article 19(3) should be complied with separately by provision of the relevant information in a durable medium.

Simulated historic returns, information on past performance and forecast of future performance

A number of respondents opposed the breadth of the proposed prohibition on the use of simulated historic data (paragraph 13 of the advice on Article 19(3)). They argued that this would be contrary to current practice, and is not appropriate and/or necessary for certain instruments or where past performance data is not available (such as conversion of a UCITS in the form of a common fund or unit trust into a UCITS in corporate form). It was suggested that use of simulated returns be permitted either subject to the overriding obligation to be fair, clear and not misleading and/or within specified parameters.

CESR accepts that it may be appropriate to allow an investment firm to use simulated returns in relation to the conversion or cloning of funds, although, the requirements relating to the presentation of past performance and the general obligation to ensure information is fair, clear and not misleading will continue to apply. However, CESR believes that the use of simulated historic data for tracker funds or other passive products is potentially misleading and should not be permitted.

Some respondents suggested relaxation of the minimum period of 12 months for past performance data (paragraph 14 of the advice). CESR does not believe that such a relaxation would be appropriate as data provided over a shorter period is more likely to be misleading.

CESR has accepted comments that it is only necessary to state the assumptions on which estimates, forecasts or promises are based that are capable of having a material impact.

Information to clients (Article 19(3))

Standardisation

Some respondents argued that the Level 2 measures under Article 19(3) of the Directive may not require the provision of product specific information because the Level 1 text refers to the provision of information in a "standardised format".

CESR does not believe that a requirement to provide product specific information is inconsistent with the Level 1 text. However, CESR accepts that in many cases, the information requirements in Article 19(3) of the Directive should apply at a certain level of generality (for example, one would not expect a broker dealing in shares traded on a regulated market to provide specific information on each share that could be purchased through that service as opposed to providing information on the type or types of instruments that could be so purchased). However, there are appropriate cases in which specific information requirements should be included in the Level 2 measures and there may be cases in which such requirements will be appropriate to meet particular demands or developments in local markets.

CESR also notes that the specific requirements proposed in paragraphs 3 and 4 of its advice under Article 19(2) of the Directive are capable of applying to all communications with retail clients and potential retail clients (in addition to the application of the general principle in Article 19(2)) and are not limited to marketing communications. For example, if a broker dealing in shares traded on a regulated market highlighted a potential benefit of a particular share to a retail client in a communication falling outside of the definition of a marketing communication, it would also need to give a fair indication of the risks and ensure that the method of presentation of the information does not disguise, diminish or obscure those warnings, even if the communication falls outside of the definition of a marketing communication.

In response to comments received, CESR has removed the proposed specific requirement to identify where the relevant financial instruments are illiquid. However, it has retained the proposed requirement to provide a retail client or potential retail client with appropriate guidance on, and warnings of, relevant risks when providing investment services in relation to transactions in illiquid financial instruments (paragraph 13(a) of the advice).

Telephone communications

Respondents were unclear whether the information set out in paragraph 4(a) of the section of the consultation document dealing with Article 19(3) of the Directive was to be communicated at the beginning of any conversation. Respondents argued that this requirement should not apply if the telephone conversation is part of the normal (already existing) relationship between the investment firm and the client. Some argued that this provision was only relevant to cold calling.

CESR does not believe that this requirement should benefit from the general exemption to cover circumstances in which the information has been provided before. It is reasonable that the information listed in that paragraph should be provided each time as it is not onerous. For example, it may be sufficient to start the call to the retail client or potential retail client by saying "This is Mrs X from firm Y calling about your account". This also means that this requirement should not be limited to cold calling. (This requirement is now contained in paragraph 15 of the advice under Article 19(3)).

Some respondents believed the proposals in paragraph 4(b) of the section of the consultation document on Article 19(3) were too onerous and recommended a reference to the relevant provisions of the Distance Marketing Directive.

These proposals are intended to reflect the approach in Article 3(3) of the Distance Marketing Directive, which provides a temporary derogation from the information requirements under that Directive. The proposed measures (now contained in paragraph 5 of CESR's advice under Article 19(3) of MiFID) are intended to provide a consistent temporary derogation from the information requirements under Article 19(3) of the Directive. This should avoid the risk of the information requirements under Article 19(3) of MiFID preventing the investment firm benefiting from the derogation under Article 3(3) of the Distance Marketing Directive.

CESR recognises that the provisions relating to voice telephone communications under each of these Directives will overlap to a certain extent. Whilst they are generally intended to apply in a consistent manner, there will be some differences. For example, as noted below, paragraph 5 of the advice under Article 19(3) of the Directive no longer requires the disclosures provided during a voice telephone communication to deal with the existence or absence of withdrawal rights. However, this will not prevent such a disclosure being required under the fifth indent of Article 3(3) (b) of the Distance Market Directive, where this requirement is applicable.

Commissions and taxes

Some respondents argued that because the information required in relation to commission and taxes would be subject to frequent change, an investment firm could provide no more than an estimate, or in some cases give a general description, of the type of costs that arise.

The requirement to disclose the total price to retail clients has been removed and the advice now concentrates on the basis of calculation of the fees and costs. The advice has also been amended to provide that investment firms should make clients aware of the possibility of further expenses and provide further details on the request of the retail client. However, it was considered appropriate to retain the general warning about the possibility of other taxes payable via other channels. The client may otherwise be under the impression that the taxes paid through the investment firm (which the firm is required to disclose) are the only taxes it will have to pay.

Withdrawal rights

Some respondents did not agree with the proposed requirement to disclose the existence or absence of any right of withdrawal. They were of the view that if there is no right of withdrawal, investment firms should not be under an obligation to state this fact.

CESR has removed the reference to withdrawal rights in the advice under Article 19(3). However, it notes that the information requirements about the cancellation rights under the Distance Marketing Directive will continue to apply where relevant, in addition to any information requirements relating to national cancellation schemes under the law of Member States.

The prevention of financial crime

Two respondents questioned how the measures on telephone communications fit together with the current regulations on prevention of the use of the financial system for the purposes of financial crime.

As is the case with Article 3(3) of the Distance Marketing Directive, the investment firm will still need to comply with the applicable requirements concerning the prevention of financial crime if it is to take advantage of the provisions concerning telephone communications.

Information about the investment firm and methods of redress

Some respondents questioned whether the information requirements concerning the investment firm and methods of redress were appropriate. Some argued that they lacked legal basis. They asked that the requirements be revised keeping in mind the competing provisions of the Distance Marketing Directive.

Some respondents questioned the time at which information should be provided about out of court complaint and redress mechanisms, arguing that this is only necessary when the complaint is first received.

Some respondents did not believe that the requirements relating to the languages to be used were justified.

The information requirements are intended to be consistent with the provisions of the Distance Marketing Directive. CESR also believes the proposed requirements are consistent with the requirement in Article 19(3) of the Directive to provide "appropriate information … to clients or potential clients about the investment firm and its services."

However, consideration was given to each provision proposed in the consultation document. Following this, it has been clarified that the proposed requirement concerning information about dispute resolution mechanisms applies to both the investment firm's dispute resolution mechanisms and to external ones. It should also cover the methods and conditions for having access to such schemes. This requirement is relevant to both voluntary and mandatory schemes. CESR believes it is therefore consistent with the fact that Article 53 of the Directive encourages the setting-up of such schemes.

CESR believes it is appropriate to retain the provisions concerning the language to be used for communications, even for cases that do not fall within the scope of the Distance Marketing Directive. This is to counter the risk of an investment firm selling products or services to a retail client in the client's language and then insisting on only using the firm's language for future communications. However, CESR has clarified that the requirement proposed in paragraph 7(h) of the advice under Article 19(3) of the Directive is intended to apply to the provision of information in the future.

Limits on the period of validity of information

Some respondents argued that the proposed obligation to provide information about any limitation on the period for which the information provided is valid was unnecessary and burdensome.

CESR believes this provision should be retained. It is not intended to be unduly onerous and is intended to reflect the fact that some investment firms may choose to place limitations on the period for which information they provide will be valid.

Retail client agreement (Article 19(7))

Most of the advice was already in CESR standards from April 2002 "A European Regime of Investor Protection – The Harmonisation of Conduct of Business Rules".

Overlaps with advice on information requirements

Several respondents objected to the duplication in the advice under Article 19(7) of a certain number of information requirements proposed under Article 19(3).

It is true that 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 endeavors however to reduce the overlap as much as possible, and to eliminate any inconsistency between the two parts of the advice on implementing measures for this article. A certain amount of duplication is however unavoidable because some of the information provided by the firm forms part of the basis for the agreement concluded with the client.

Legal basis

Some respondents thought that there was no clear legal basis in Level 1 for requiring a retail client agreement, or for defining its content or form ("in writing" or "in a durable medium") or the form of consent ("signature" or equivalent). Many respondents also raised the issue of interference with the unharmonised civil and contract law of the Member States.

CESR considers the legal basis to be adequate, and the European Commission appears to agree.

The advice seeks to minimize conflict with national legal systems as far as possible, but the proposal for a mandatory retail client agreement in writing and for identifying its minimum content will necessarily have an impact on national practices relating to agreements with retail clients.

Grandfathering and other transitional measures

The high cost of implementing the advice, especially where satisfactory client agreements are already in place with existing retail clients, was thought by many respondents to be unjustifiable in view of the limited degree of additional investor protection that implementation would bring.

Transitional measures, in particular for the client agreement, are being discussed with the European Commission. The European Commission is also examining the possibility of an amendment to the Directive in order to provide more time for implementation generally.

Exemption requested for certain services

Several respondents argued that a retail client agreement was unnecessary for certain services, namely investment advice and execution-only dealing services.

CESR disagrees with this opinion and sees no justification for such an exemption for the following reasons:

a) the contract of investment advice is necessary to identify the scope of service that an investment firm provide to its clients;
b) the service of execution-only is not an investment service *per se* and therefore needs to be treated as all other services.

Professional client agreement

Some respondents asked whether CESR intended to propose advice on the professional client agreement.

CESR published a "call for opinions" on the professional client agreement in December 2004. CESR will deliver its technical advice on this subject by the end of April 2005.

Clear and understandable "standard"

Several respondents objected to the impractical and subjective standard for the clarity of the client agreement.

This requirement is now worded in more objective terms and has been integrated into the advice on Article 19(2).

Incorporation by reference

A number of respondents asked CESR to clarify, in line with the Level 1 text, that "legal texts" may be incorporated into the client agreement by reference.

This has now become explicit in the advice.

Framework agreement

Several respondents asked CESR to clarify that the advice only applies to the framework agreement with the retail client.

The new explanatory text indicates that the investment firm may use a framework agreement if it so wishes, but also that the firm may choose to use separate agreements for different services.

Risk warning for derivates trading

Several respondents argued that the risk warning has no place in a contract and cannot in any event be individualized.

CESR has decided to delete this proposed requirement.

Benchmark for portfolio management

A number of respondents objected to the proposal to include a benchmark, for information purposes, in the agreement for portfolio management, saying that it would be difficult to find an appropriate benchmark in many situations and that this would entail unjustifiable costs.

CESR has decided to maintain this part of its advice since it is a useful tool for investors to measure and compare the performance of their portfolio managed by the investment firm. It should be recalled however that an alternative measure of performance is allowed where it is not feasible to establish a benchmark in view of specific client objectives.

Reporting on portfolio management losses

A few respondents objected to the proposal for a specific reporting requirement in the event of portfolio management losses, especially in the light of the requirement for periodic reporting on portfolio management.

CESR has nevertheless decided to maintain this proposal since the standard reporting period may be as long as six months and significant losses may be incurred over this period. The level of losses that would trigger the report is however to be determined by the client agreement, as initially proposed in the consultation paper.

Reporting to clients (Article 19(8))

Investment advice

Question 10.1.: *What type of reporting requirements relating to the provision of investment advice should be included in the advice to the Commission? When should such requirements apply and what concrete requirements should be imposed?*

The majority of the responses to this question stated that no reporting requirements should be imposed for investment advice. The reason for this view differed amongst respondents. One argument was that a report should only be required where an investment firm had taken an action that the client would otherwise be unaware of. In the case of investment advice, where any resulting action would be taken by the client, such a report was said to be unnecessary. Other respondents suggested that the value of investment advice existed at the moment it was given and there was no value in recording it for later. Finally, other respondents stated that investment advice tended to be a more tailored service and that therefore it was more appropriate that requirements be set at a national level.

Having considered these responses CESR has not proposed specific reporting requirements in relation to investment advice as in many cases the provision of the advice will itself constitute an adequate report to the client. However, Member States should have the flexibility to introduce and maintain national reporting requirements relating to investment advice.

Format of reports

Some respondents stated that investment firms should be able to meet their reporting requirements through the use of electronic communication or by placing information on a website, rather than being required to send written reports in all cases. In addition, one respondent stated that a client should be able to choose whether to receive information in hard copy or via the internet.

CESR believes that the definition of a "durable medium" provides sufficient flexibility for the use of electronic communication in appropriate cases and guidance on the circumstances in which a website would be an acceptable method of providing reports.

Right to vary information received

A number of respondents requested that greater flexibility be built into the reporting requirements. Some of these respondents believed that a client should be able to specify the content of the material it wants to receive or be able to waive the right to receive a report at all. In other cases respondents indicated that timescales for the provisions of reports should be extended to conform to existing national practices.

On consideration, CESR does not believe that it is appropriate for a client to be able to waive its rights to receive reports or to be able to request less information than specified in the draft advice. CESR believes that such amendments would make clients vulnerable to pressure from investment firms to agree to a lesser standard of information. CESR also believes that the proposed timescales for the provision of information remain appropriate.

Contract notes and confirmation notices: execution venue

The draft advice proposed that a contract note should include details of the regulated market or MTF on which the relevant transaction was carried out or the fact that it was carried out outside of a regulated market. A number of respondents argued that such a requirement would require extensive system changes by investment firms but would not give rise to significant benefits for clients. Other respondents argued that the importance of this information in protecting the client and in securing best execution rights outweighed any cost arguments.

CESR has decided to retain this provision in its advice as important information that enables clients to monitor the execution of the orders, with an amendment aimed at transactions on a third country market.

Connected counterparties

CESR's draft advice suggested that contract notes for retail clients should indicate whether the investment firm or any person in its group was the client's counterparty. Whilst this requirement was not opposed by the majority of respondents, a number suggested that an exception to the requirement should be made for transactions entered into through anonymous trading systems and for agreed price transactions.

CESR has amended the advice to propose that transactions entered into through anonymous trading systems should not be subject to this requirement. CESR does not believe the same potential for conflicts of interest exists for such trades. However, CESR believes this requirement should apply to agreed price transactions, because these involve a conscious decision to act as the client's counterparty.

Average or tranche-by-tranche price

The draft advice under Article 22(1) of the Directive included a requirement to inform a retail client of the price of execution of each tranche of an order unless the retail client had requested an average price. Respondents argued that such requirements were impractical.

CESR believes this requirement falls more logically under Article 19(8) of the Directive and has modified its advice accordingly. On reflection, CESR also believes that the choice of whether to receive an average price or a tranche by tranche price should be left to agreement between the investment firm and its client. However, where an average price is supplied, a retail client should have the right to request a tranche by tranche price. This amendment will reduce the administrative burden on investment firms, whilst ensuring that additional detail is available where required.

CESR will provide its advice under Article 22(1) together with its advice on the second set of mandates.

Statement of clients' assets

The draft advice proposed that investment firms that hold client assets should be required to send their clients a statement that includes details of the movements of the assets held over the period.

Several respondents stated that such a requirement would require the provision of information that would already have been received through the provision of contract notes.

CESR agrees with these comments and has modified the advice so that it does not require such statements to show movements on client assets over the relevant period.

Requirement for the immediate confirmation of transactions in derivatives and warrants

CESR has moved the proposed requirement for the immediate confirmation of transactions in derivatives from the advice under Article 19(7) to the advice under Article 19(8) of the Directive. This appears to be the more appropriate place to deal with this requirement. CESR has also clarified that, consistent with the definition of a "derivative" under the CESR Standards, this requirement is also intended to apply to transactions in warrants.

Notification obligations

Respondents pointed out the inconsistency between the proposed requirement to inform clients "immediately" if an investment firm does not accept or decides not to carry out a retail client order but to inform the client "as soon as possible" if it is unable to carry out a client order.

CESR agrees with respondents' comments that the timing requirements for these two obligations should be conformed and has changed both to require the investment firm to inform the client "as soon as practicable".

In addition to this point, respondents noted that the definition of an "order" included a decision to deal by a discretionary manager and therefore the requirement under paragraph 14 of the consultation document (paragraph 15 of the final advice) would require a manager to report to a client on a transaction that the client had not initiated. CESR agrees with this comment and has clarified that the advice is not intended to apply to orders undertaken by discretionary managers.

CESR has also amended the advice to clarify that these requirements only apply to orders received from established clients and do not require investment firms to contravene any legal prohibitions on the disclosure of such information (for example, those relating to the prevention of the use of the financial system for the purposes of financial crime).

Non-executed trades

In the consultation document, CESR proposed a requirement for investment firms to send written confirmation of an order to a retail client if that client's order had not been executed within one business day of receipt. The confirmation should include client order details, date and time of receipt and, where applicable, date and time of transmission.

Respondents tended to disagree with this requirement for a number of different reasons. In particular, a number of respondents noted that the requirement would be too burdensome and expensive for investment firms and would not result in useful information for clients. Respondents also noted that if the requirement is retained, it should not apply to 'good for day' orders and that the requirement to record the date and time of transmission should be dropped.

On consideration, CESR believes that that the requirement is appropriate and notes that the majority of retail clients' orders will be of a size that will normally be executed within one business day. CESR does agree however that good for day transactions should be excluded from the requirement and that the time of transmission should only be provided on request. It also agrees that this requirement should not apply to orders undertaken by discretionary managers. It has amended the advice accordingly.

Duplication of information

CESR's draft advice proposed that an investment firm should be exempted from the requirement to provide a contract note to a client if it would duplicate a contract note to be promptly despatched by someone else. Respondents noted that whilst they agreed with the intention of the requirement, they felt that the use of the word "duplicate" would unduly limit the circumstances in which it could be used. Other respondents noted that the exemption should also apply if the investment firm had

reasonable grounds to believe that the contract note had been promptly despatched by someone else (even if the contract note had not actually been despatched by that other person).

CESR agrees with the comments of the respondents and has changed the wording of the exemption so as to apply when the contract note would "contain the same information" as a contract note provided by someone else.

However, CESR does not agree with the extension of the requirement to cases where an investment firm has reasonable grounds to believe prompt despatch has occurred. Instead, the responsibility for ensuring the information is despatched to the client should rest with the investment firm.

SECTION III – COOPERATION AND ENFORCEMENT

Transaction reporting (Article 25)

Methods and arrangements for transaction reporting

Regarding the methods and arrangements for transaction reporting, CESR had proposed a list with minimum criteria that all reporting channels would have to comply with, in order to be considered valid as reporting channels. Respondents generally supported this approach.

Key Issues

A majority of the respondents agreed with most of the proposed general minimum conditions.

Most of the respondents were of the opinion that exceptions from the electronic format could be considered to be acceptable. A number of respondents objected to any exemption, in particular, because this could conflict with the obligation of CESR Members to exchange transaction reports on an automatic basis. CESR proposed that 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), provided that the granting of such exemption does not have adverse effects on the competent authorities' ability to electronically exchange information on transaction reports with other competent authorities.
Following comments from respondents, CESR could work at Level 3 to align the way of granting exemptions from an electronic format in the different Member States in order to develop a common view on when exceptions could be considered to be acceptable.

As regards the proposal for a standard service level agreement between an investment firm and the reporting channel, most respondents thought that this was a matter for Level 3, and that this requirement should be deleted from Level 2. For this reason, CESR amended its advice and moved the issue of a standard level agreement to Level 3.

Some respondents considered that a reporting channel, for example a regulated market or an MTF, that has operations in several Members States should not need approvals from 25 different authorities and should not be subject to monitoring by 25 different Member States. CESR did not fully agree: If a reporting channel would want to offer reporting to competent authorities in different Member States, its reporting system needs to comply with national requirements in different Member States as regards, for example, the content and format of transaction reports. Therefore, the reporting channel would need approval by all those different Member States. Instead CESR considered that Level 3 measures would be necessary to ensure that competent authorities in Member States follow the same "approach" when approving and monitoring different reporting channels. The reporting channel would need a system that can properly communicate with the system of the competent authority and the competent authority needs to be notified that this reporting channel would like to start sending transaction reports. However, the intention would be that the approval process for conditions a) to e) of the minimum general conditions in the Level 2 advice could usually be routine.

Most respondents agreed that aligning the process for approving reporting channels would be work at Level 3 rather than Level 2.

Other Comments

One of the respondents wanted CESR to give clarification that a market operator who offered reporting to the competent authority for trades that were not done "through its systems" would also be seen as an approved reporting channel if they would meet the general minimum conditions. CESR agreed with this respondent and made such a clarification in its advice.

Some consultees had pointed out that the wording used by CESR as to the scope of the transaction reporting with respect to financial instruments covered could suggest an extension of the scope provided for by the Directive. Since this had not been CESR's intention, the wording has been clarified accordingly.

QUESTIONS[6]

Question 15.2: *In respect of bond markets and commodity derivatives markets, new systems for reporting financial transactions will probably have to be put in place in many Member States, in order for investment firms to be able to meet the requirements of the Directive and Level 2 advice. (Note that Article 20(1)(b)) of ISD1 already requires investment firms to report all the transactions covering bonds and other forms of securitised debt to competent authorities, though Member States have the right to provide that this obligation only applies to aggregated transactions in these instruments.) To what extent should the implementing measures allow market participants more time to implement these proposals ("transitional regime")? What could be legitimate reasons for such a possibility?*

Generally, respondents believed that there was – mainly for technical reasons – a great need for some kind of transitional regime. CESR has pointed this out to the EU Commission, as this is not part of CESR's mandate to give advice on.

Question 15.3: *To what extent should CESR investigate the possibility for future convergence between national reporting systems? What are the advantages and disadvantages of harmonising at EU level the conditions (including format and standards) with which all the reporting methods and arrangements have to comply in order to be approved, instead of, as proposed by CESR, harmonising the conditions at a national level? What impact might harmonisation have on existing national reporting channels, national monitoring systems and on the industry?*

Most respondents were in favour of CESR trying to move towards greater convergence on a medium to long term, paying special attention to already existing arrangements for transaction reporting and refraining 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 proposed that differences between Member States regarding specific national requirements could be considered to be acceptable, but it is important that a 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. It was also 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.

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6 Questions 15.1 to 15.5 were asked during the first consultation which started in June 2004 and ended in September 2004 (Ref. CESR/04-261b).

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

Regarding the definition of criteria for assessing liquidity in order to determine the competent authority of the most relevant market in terms of liquidity, CESR had suggested to apply a so-called "proxy approach", supplemented by computation where necessary and a revision procedure. This approach was generally supported by respondents. Some respondents proposed changes with respect to specific proxies or financial instruments.

Key Issues

All respondents shared CESR's view that computing and comparing liquidity in different markets was a huge and complex task. Respondents in general supported the concept of using proxies instead of trying to find a computation formula. The proxy approach was considered both pragmatic and cost-efficient. A number of respondents suggested that the approach might become inadequate in case of major structural changes or because of the implementation of other EU Directives (e.g. Prospectuses Directive). Since the concept of the most relevant market in terms of liquidity is a new concept, CESR's technical advice contains a review clause as to the proxy approach, so that inadequacies of the proxy approach, if any, can be addressed. In addition, the revision procedures proposed, which provide for the computation of volume and/ or turnover for financial instruments, should reduce the risk of error.

Many respondents argued that the arrangements ensuring, that the competent authority of the most relevant market in terms of liquidity also receives transaction reports from the home competent authority of the investment firm, should not put any additional burden on reporting parties. CESR clarified that it was not CESR's intention that these arrangements would impose any additional requirements on investment firms with respect to their reporting obligations.

CESR had conducted fact-finding exercises in order to test whether the proxies provided for reliable identification of the most liquid market, by computing liquidity for different financial instruments. In general, the results of the fact-finding exercises had demonstrated that the proxies provided the correct results. Since there might be cases in which the results of the proxy approach could be not accurate or no longer valid, CESR's technical advice provides for a flexible alternative approach based on the computation of volume or turnover for financial instruments concerned ("revision procedures"). As to these revision procedures, respondents were generally in favour of CESR's proposal. Some respondents proposed additional criteria for assessing the most liquid market. CESR did not change its concept since it had found in its fact-finding exercises that it was extremely difficult or even impossible to obtain data other than volume and turnover, and, had not found evidence from the academic literature that better result could be achieved with more complex concepts.

A number of respondents thought that CESR should try to have a common approach for the calculation of liquidity under Article 25 and Article 27 (systematic internalisation). Since the issue of transaction reporting and systematic internalisation have different objectives, CESR decided to have different approaches for the determination of liquidity.

A substantial number of respondents urged CESR either not to publish the list of most liquid markets at all or to explain in more detail the use and purpose of such a list, because they were concerned that the list might have unintended consequences for the competition between markets. Since the only purpose of the list was to address the issue of which authority is the competent authority of the most liquid market in a specific financial instrument, so that – in line with Article 25(3) – that competent authority receives transaction reports, and it was not the intention of CESR to unduly interfere with competition, CESR decided not to propose the publication of the list.

Other Comments

Some respondents asked CESR to take only regulated markets, MTFs and internalisers for the purposes of computing liquidity into consideration. Even though the approach could be both practical and sufficiently precise, the wording of the MiFID does not allow for such a narrow definition. Therefore, CESR did not change its proposal.

QUESTIONS[7]

Question 16.1: *Do you agree with the approach to use proxies as suggested above? If you do not agree, what other approach would be more appropriate in your view?*

Most respondents agreed without any further comment. Some even explicitly welcomed CESR's approach as easy to implement, consistent and cost-efficient.

A number of respondents advocated the use of more sophisticated tools in order to compute liquidity (e.g. a kind of "best execution" criterion, free float, number of firms willing to buy/sell, number of market makers, or the average traded size). CESR considered these proposals carefully, but came to the conclusion that any of these approaches would not produce more accurate results than the proxy approach and would be rather complex thereby contradicting CESR's criteria of simplicity, cost-effectiveness and comparability. Therefore, CESR took these concerns into account and decided not to use those approaches.

Question 16.2: *Do you agree with the suggested proxies? If you do not agree, what other proxies would be more appropriate in your view?*

With regard to shares all respondents were in favour of the proposed proxy approach.

With regard to bonds of non-EU issuers some respondents requested CESR to provide a specific proxy. CESR considered – as suggested in some responses – to use the regulated market where the bonds of a non-EU issuer were first admitted to trading as proxy, but came to the conclusion that the results would not be satisfactory (in particular, as the most liquid market would often not be the regulated market where it was first admitted to trading). As a consequence, it was clarified in the Technical Advice that the proxy approach applies only to bonds of issuers that are domiciled in a Member State, so that the most liquid market for bonds of non-EU issuers has to be computed using the criteria volume and/or turnover. However, it is still possible to change the approach during the proposed review process.

Some respondents asked for a proxy for derivatives contracts based on commodities. CESR included this suggestion and proposed using the regulated market where the specific contract is admitted to trading as proxy.

One respondent questioned whether the proxy approach might work for derivatives contracts at all, while another respondent was of the view that the proxy approach could lead to strange results given the ongoing consolidation between regulated markets. In case of doubts about the accuracy of the proxy in specific cases, the revision procedure might come into play.

7 Questions 16.1 to 16.5 were asked during the first consultation which started in June 2004 and ended in September 2004 (Ref. CESR/04-261b).

Question 16.3: *Do you agree with the suggested revision procedures? If you do not agree, what other revision procedures would be more appropriate in your view? In particular, do you agree that the launch of the review procedure should be at the discretion of competent authorities? If not, what other factors should trigger the launch of the review procedure? Do you agree that the time period to be taken into account when applying the criteria "turnover" and/or "volume" and the definitions of such criteria can vary according to the finacial instrument under consideration? Do you agree, therefore, that the time-period cannot be determined in a Level 2 legal text and should be defined under Level 3 arrangements for cooperation between competent authorities? If not, please provide suggestions regarding the time period that should be taken into account.*

Some respondents proposed additional criteria for assessing liquidity under Article 25(3) (e.g.: frequency of transactions, spread-related criteria, number of shares issued and outstanding, number of investment firms willing to purchase or sell the share or willingness of dealers to make a market in the security). CESR did not change its concept, because there had been significant problems with regard to the availability of such data, their quality and comparability. In addition, there had been severe conceptual problems in applying these criteria to different market models, and, academic literature suggested that more complex concepts usually would not deliver more precise results than the basic volume or turnover approach chosen by CESR.

A number of respondents proposed to prioritise the criteria for computing liquidity, i.e. turnover and volume. CESR's technical advice does not establish a prioritisation among the two criteria, but instead leaves that decision to competent authorities, as one criterion might be more appropriate in one instance, and the other criterion could be more appropriate in another instance. However, CESR clarified in the Level 2 advice that competent authorities should choose that criterion for which data is available at a minimum of cost and effort.

Regarding the triggering of the revision procedure, some respondents were of the opinion that CESR should be competent to initiate the revision procedure. Such a responsibility would not seem practical, as this could require CESR to monitor each financial instrument on a permanent basis, for which it has not the necessary resources. However, CESR has decided to establish a general mediation mechanism, which could also be applicable in case competent authorities cannot agree on which market is the most liquid one.

In addition, regulated markets proposed that triggering the revision procedure should be possible not only for competent authorities, but also for regulated markets and issuers. However, since CESR proposes that the list of most liquid markets shall not be made public (this was a request from most respondents), it can only be competent authorities that could be in a position to trigger the revision procedure.

Respondents urged CESR to propose – in the interest of stability – that changes in the designation of the most liquid market should happen as rarely as possible. Others requested that an annual review of the list of the most liquid markets should take place. CESR's technical advice does not provide for a periodic update. On the contrary, a revision might only be triggered on case-by-case basis, given that clear evidence is being presented by competent authorities that there has been a change in the position as most liquid market.

Moreover, there was a proposal in the consultation responses that the overall review process of the proxy approach should take place within 3 years instead of 5 years. However, CESR recommends keeping the 5-year deadline (as a maximum) in order to have sufficient time to assess whether this approach works. If evidence would clearly suggest the inappropriateness of the approach, CESR would commence the review at an earlier stage. Finally, the European Commission is competent to request technical advice from CESR for updating Level 2 measures, if felt necessary.

Question 16.4: There are specific cases, such as a simultaneous IPO in more than one Member State, where the proxy approach does not work. Should such cases be addressed at Level 2, and if so, in more general terms leaving the details to Level 3, or in a more detailed way already at Level 2? Are there other cases similar to the one mentioned?

Some respondents were of the opinion that there could be cases in which the proposed proxies would not be accurate. But either they did not provide alternatives or they were confident that the computation as proposed by CESR using "volume" and/or "turnover" would be sufficient.

Most respondents considered that such specificities should not be addressed at Level 2.

Question 16.5: What other issues, if any, should CESR take into account when responding to the Mandate concerning the "criteria for assessing liquidity in order to define the most relevant market in terms of liquidity for financial instruments"? Is there further information which is material, relevant and disclosable in relation to commodity derivatives markets?

Some respondents warned of too much "routine" data traffic with regard to non-EU bonds. They also warned that CESR's proposal that competent authorities should be able to request transaction data on a regular basis from other competent authorities might trigger unnecessary traffic. However, weighting the arguments (quality and completeness of market supervision vs. complexity) and the requirements of the Directive CESR decided not to amend its proposal.

Some respondents asked CESR to address cross-border mergers. Since respondents did not provide any proposal CESR decided to use the computation process as already proposed. Additionally, the review process proposed by CESR would be an opportunity to provide for a more specific approach, once sufficient experience with this issue will have been accumulated.

Minimum Content of a Transaction Report

In its advice CESR has proposed a set of minimum requirements that represent the information that competent authorities, as a minimum, should know about a reportable transaction undertaken by an investment firm. The minimum information proposed by CESR exceeds the information set out in Article 25(4) because CESR did not believe that the information set out in the Level 1 text would be sufficient for the detection, investigation and enforcement of market abuse, as well as for the other regulatory purposes transaction reports are used for. The minimum information that should be obtained by each competent authority is set out in Annex A. CESR has also set out the information that will be exchanged between competent authorities (Annex B).

Key Issues

Some respondents did not believe that CESR could require additional information fields to those set out in Article 25(4) and that the only fields that could be included in a transaction report were the names and numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the investment firms concerned.
CESR does not believe that this is sufficient information to allow authorities to make full use of the transaction data they receive and more detailed information is also required to properly interpret the fields set out in the Level 1 text. Moreover, restricting Member States to fields set out in the Level 1 text would mean many competent authorities and investment firms would have to make changes to their existing national reporting systems which would be contrary to CESR's approach that these systems remained in use in the short to medium term.
In addition, Recital 45 does explicitly allow for Member States to apply transaction reporting rules to financial instruments not admitted to trading on a regulated market, an approach which recognises that

transaction reporting obligations may differ across Member States. CESR considers that, in the long-term, competent authorities should work toward greater convergence in the content of a transaction report and the methods and arrangements for reporting including the format of the report. However, CESR also agrees with many respondents to the Consultation Papers who commented that any steps towards further convergence should be subject to detailed cost-benefit analysis.

Some respondents also expressed concern about the number of fields that were set out in Annex A and commented that in order to report some of these fields, firms would have to make substantial changes to existing reporting systems. CESR is aware of this cost factor, but, as mentioned before, is of the view that those fields set out in Annex A is the minimum information necessary for competent authorities for the detection, investigation and enforcement of market abuse, as well as for the other regulatory purposes transaction reports are used for.

Other Comments

Some respondents felt that CESR should only request the information that was needed to initiate an investigation and that other information could be obtained subsequently. CESR has taken this consideration into account in its proposal and is of the view that the list proposed in Annex A is the minimum authorities need to meet the objectives of transaction reporting (such as to initiate investigations).

There also appeared to be some confusion amongst some respondents about the difference between Annex A and Annex B. CESR has tried to clarify this in more detail in the explanatory text of its advice.

QUESTIONS[8]

Question **17.1:** *Do you agree with the approach to standardise/harmonise the list in Annex A to this draft advice only at a national level in order to be able to keep reporting systems that are already in place? If you do not agree, what approach do you think would be more appropriate?*

Question 17.2: *What are advantages/disadvantages of moving towards harmonisation at EU level as regards the standards or format of the list in Annex A to this draft advice? To what extent would harmonisation at EU level of the standards or format of the list in Annex A to this draft advice impact the existing national data collection mechanisms and national transaction databases? Do you see merits in having an EU harmonised regime for the content and format of transaction reports, taking into consideration whether future and immediate long-term benefits could compensate the initial costs of harmonising the transaction reports?*

Respondents were generally in support of CESR's approach not to fully harmonise the information required in Annex A in the short to medium term at EU level. Some respondents were of the view that either from a legal point or from a practical point of view full harmonisation should be the goal. CESR believes that greater convergence could be only achieved in the long term; otherwise existing reporting systems could not be maintained wherever possible, which would raise serious cost-benefit concerns, and CESR Members could be forced to take a step backwards in their supervision, which would be extremely harmful to market integrity. Finally, it should be borne in mind that the level of harmonisation is raised by the list of minimum content in Annex A, which is more than is required in a number of Member States under the current regime, and it could also be the case that national reporting requirements could steadily move towards the list required under Annex B.

8 Questions 17.1 to 17.5 were asked during the first consultation which started in June 2004 and ended in September 2004 (Ref. CESR/04-261b).

As to the harmonisation of the standards and formats of transaction reports at EU level, most respondents urged CESR to consider the considerable costs such a change would have and thus to keep any changes at a minimum at Level 2, and, if necessary, to issue guidance only at Level 3. As regards Annex A, CESR proposed (with limited exceptions) electronic format at Level 2, since this is a necessary requirement for the smooth functioning of transaction reporting. However, as to other standards and format CESR agreed that for cost-benefit considerations this should be determined at national level. As regards Annex B, CESR will conduct further work at Level 3 in order to have a common format for the exchange of transaction reports between competent authorities, which is important for being able to exchange information in an efficient and effective way.

Question 17.3: *Do you agree with the proposed fields in Annex A and B to this draft advice? If you do not agree, what other fields would be more appropriate in your view?*

In general, respondents agreed with the fields proposed by CESR. Some comments concerned the Instrument Identification, where the use of ISIN was not felt to be sufficient. CESR does not propose a single code regarding Annex A, but provides examples of unique codes to be used.

Regarding the item "trade value" and "value notation" some respondents did not see the need to include these fields, as the information covered was already available through other fields in the list. CESR agreed with these comments, and has therefore deleted these fields.

There were also some other individual fields that respondents objected to. CESR has changed the drafting of some of these fields to reflect the comments made during the consultation process. In addition, it was not intended that all information fields in Annex A need to be reported in all transaction reports. Some fields are only applicable to certain types of transactions: for example, 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 an authority may use the "instrument security code" to obtain other details about a security's characteristics such as its "maturity" or "derivative type". Consequently, CESR has agreed that it is possible for a competent authority to waive the obligation on an investment firm to report some of the individual fields in Annex A. In the short-to-medium term, it will be up to individual competent authorities to determine how they obtain the information set out in Annex A. The information in Annex B only concerns competent authorities and, depending how a competent authority obtains the information it needs to exchange, it does not impose any further obligations on investment firms.

A number of respondents suggested including a field in the minimum content list which would give an indication whether a transaction report was a cancellation. CESR agreed with this comment, as this is useful information for CESR Members when they deal with transaction reports, and has included this field in its final advice.

Question 17.4 *How would you define the field "agent/propriety"?*

CESR has received some very useful comments on the issue of trading capacity. The amended definition of this field establishes what information has to be required in Member States as a minimum, but leaving it up to competent authorities to require more detailed information on this field.

Question 17.5 *What are your views on making the client/customer identification field mandatory in transaction reports? What are your views on the idea to promote a pan-European code for client/customer identification? Do you see any legal impediment to the introduction of such a code in your Member State?*

One of the most contentious fields in the discussions was the "client identification" field. Respondents were divided as to whether this field should be reported. Some took the view that such a requirement could be useful for the detection of market abuse and financial crime. Others believed that the costs of requiring this information in all Member States would not be justified by the possible improvements in market surveillance. CESR Members were also divided on this issue. 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 CESR Members 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 CESR Members 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 has recommended in its advice that the field would be included where required by national law.
Regarding a pan-European client identification code, almost all respondents thought that such a step could only be taken at Level 1 by the EU Institutions, as this would require massive investments in all Member States and would touch on important issues, such as data protection.

Obligation to cooperate (Article 56)

In general, the input received from respondents on this area of work was limited, in particular as this was considered relevant to the competent authorities rather than to the industry by many of the respondents, even though it was emphasised by some that close operation between competent authorities was seen as an important objective. It was also commented in some responses that this issue would be better dealt with at Level 3. CESR's general approach to this mandate was that it was necessary to ensure that such criteria provided competent authorities with a sufficiently flexible framework so as to be able to take account of future market developments (both strategic and technological) and to respect the vastly different nature of securities markets across Member States.

Key Issues

In CESR's view, 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, so that the need for specific proportionate arrangements and the time during which they may be implemented should be assessed on a case-by-case basis.

Moreover, since a number of respondents were confused, according to the Commission Mandate, CESR was not required to provide advice on the specific form or content of such cooperation arrangements, and it was stressed that CESR's advice on Article 56(2) related only to cooperation between competent authorities and was not intended to question investment firms' right to freely provide cross-border services through remote access/membership.

Other Comments

Most of the respondents objected the consideration of the economy of the host Member State or other economic factors (e.g. employment figures) for the assessment if the operations of a regulated market have to be considered as of substantial importance in the host Member State, so that CESR did not include these factors explicitly in its Level 2 advice.

A number of respondents questioned the usefulness of Article 56(2), which is not for CESR to decide as it is an obligation introduced by the Directive itself.

Exchange of information (Article 58)

The purpose of CESR's advice was to establish a general framework for cooperation between the competent authorities, in order to facilitate the fulfilling of their duties under the Directive.

Key Issues

CESR did not receive many specific comments on the area of exchange of information, because this was considered an issue being mainly of interest to competent authorities. However, some comments referred to the methods and arrangements for exchanging transaction reports between competent authorities.

Regarding the methods and arrangements for exchanging transaction reports between competent authorities, CESR proposed a list with minimum criteria that all competent authorities would have to comply with. Respondents generally supported this approach.

Other Comments

One respondent requested a clarification by CESR on the issue of trading suspension, whether this would also include MTFs. CESR has tried to clarify this by including a specific reference to Article 41 in its advice.

Question 19.3[9] *What other issues, if any, should CESR take into account when responding to the Mandate concerning the "exchange of transaction reports between competent authorities designated as contact points"?*

One issue that was commented on in a few responses concerned the reporting by remote members and CESR was asked to propose practical solutions. In accordance with Article 25, remote members should report their transactions to the competent authority of their home Member State. The contact point in the home Member State should then make sure that the competent authority of the most relevant market in terms of liquidity also receives this information. But 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 could not have been the goal of the Directive. (Article 57 par. 1 could also be of relevance in this respect.)

One proposal invited CESR to make use of the wording in Article 25(3), which required only that it would have to be ensured that the competent authority of the most relevant market in terms of liquidity also received this information - and not how or from whom it received it.

9 Question 19.3. was asked during the first consultation which started in June 2004 and ended in September 2004 (Ref. CESR/04-261b).

The basic idea of this proposal was 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 considered this approach practical, and although most respondents in the last consultation were in favour of this approach, as the results would be in line with the objectives of the Directive, the proposal would face legal constraints.

Therefore, CESR suggested 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 Member State(s) of the investment firms which participated in the transaction), all would 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), did not whish to receive this information since it could obtain this information by other means, it may waive the obligation of the competent authority of the home Member State to submit information about the transaction. CESR considered this solution to be preferable from a legal point of view, as it would also be a satisfactory solution for investment firms, since an investment firm would only have to report to its home Member State.

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 expert 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 2004 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. 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 this call for opinions closes on 20 February 2005. CESR will publish a feedback statement justifying its final choices vis-à-vis the main arguments expressed.

14. 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). This work plan is now updated as follows:

CESR Work Plan for the mandates under the MiFiD

As of 27th January 2005

Date	Activity
20 January 2004	Provisional mandates - 1st set of mandates
19 February 2004	Deadline for comments to the "call for evidence" for the 1st set of mandates
1 March 2004	Consultative Concept Paper on Transaction Reporting, Cooperation and Exchange of Information between Competent Authorities
12 April 2004	Deadline for responses to the Consultative Concept Paper on Transaction Reporting, Cooperation and Exchange of Information between Competent Authorities
17 June 2004	First consultation on the 1st set of mandates
29 June 2004	Formal mandates – 2nd set of mandates
29 July 2004	Deadline for comments to the "call for evidence" for the 2nd set of mandates
17 September 2004	Deadline for comments on the 1st set of mandates
4 October 2004	Deadline for comments on the 1st set of mandates (best execution and market transparency)
21 October 2004	First consultation on the 2nd set of mandates
Mid-November 2004	Second consultation on the 1st set of mandates
Early December 2004	Second consultation on the Art. 40
Mid-December 2004	Deadline for the second consultation 1st set of mandates
20 December 2005	Call for Opinions on Professional Client Agreement (Art. 19.7)
Early January 2005	Deadline for second consultation on the Art. 40
21 January 2005	Deadline for comments on the 2nd set of mandates
31 January 2005	Final approval – 1st set of mandates
Early February 2005	Second consultation on Best Execution (one month)
20 February 2005	Closure of Call for Opinions on Professional Client Agreement (Art. 19.7)
Early March 2005	Second consultation on the 2nd set of mandates (one month) (where necessary)
30 April 2005	Final approval - 2nd set of mandates

Completed

To be completed

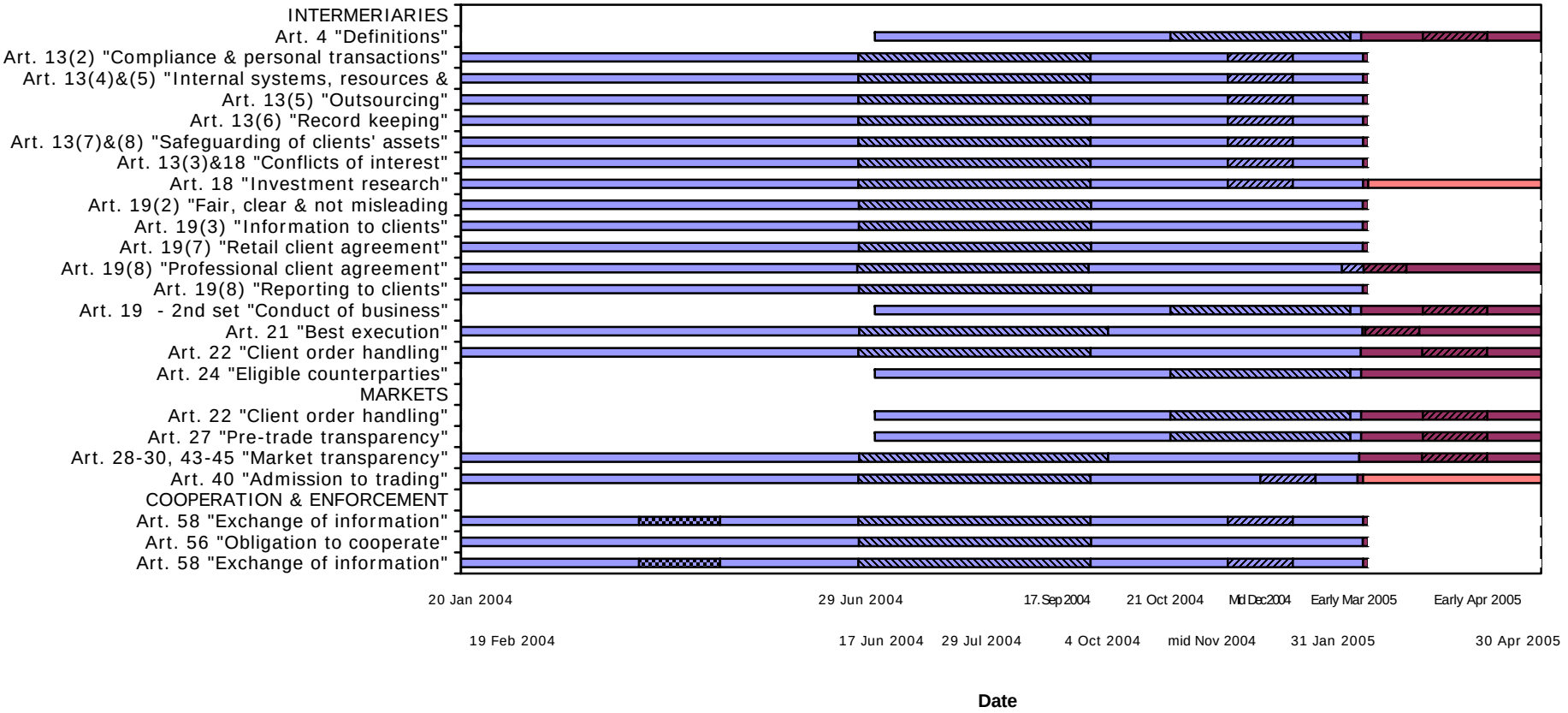
Likely to be extended by the Commission

Period of first consultations

Period of second consultations

Consultative Concept Paper

CESR Work Plan for the mandates under the MiFiD



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

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ANNEX 3

LIST OF RESPONDENTS TO VARIOUS CONSULTATIONS

3.1. Respondents to the Call for Evidence (Ref.: CESR/04-021)

Activity	Name of the respondent
Banking	ABI
Banking	Association of German Banks (BDB)
Banking	Barclays Bank
Banking	BDB - dealings in securities
Banking	BDB - letter
Banking	BDB - staff transactions
Banking	British Bankers' Association
Banking	BVR
Banking	Danish Bankers' Association
Banking	DSGV
Banking	European Banking Federation (FBE)
Banking	European Savings Bank Group
Banking	FBE - Annex
Banking	Royal Bank of Scotland
Banking	VBA
Banking	VÖB
Banking	ZKA
Banking	ZKA - annex 1
Banking	ZKA - annex 2
Banking	ZKA - letter

Insurance, pension & asset management	Professional Insurance Brokers Association
Insurance, pension & asset management	Professional Insurance Brokers Association - Ireland
Investment services	APCIMS
Investment services	Association Française des Entreprises d'Investissement
Investment services	Assoreti
Investment services	Bank of Ireland
Investment services	British Venture Capital Association
Investment services	Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V.
Investment services	Fédération Européenne des Conseils et Intermédiaires Financiers
Investment services	Fédération Européenne des Fonds et Sociétés d'Investissement (Fefsi)
Investment services	Fefsi - Annex
Investment services	Investment Management Association
Investment services	Investment Technology Group
Investment services	LIBA, on behalf of ISDA, ISMA, FOA, NFMF, BSDAI, DSDA, FASD and SSDA
Investor relations	Association of Independent Financial Advisers
Issuers	AFEP
Issuers	Futures and Options Association
Press	Reuters
Regulated markets, exchanges & trading systems	Borsa Italiana
Regulated markets, exchanges & trading systems	Euronext
Regulated markets, exchanges & trading systems	Federation of European Securities Exchanges
Regulated markets, exchanges & trading systems	London Metal Exchange
Regulated markets, exchanges & trading systems	London Stock Exchange
Regulated markets, exchanges & trading systems	the International Petroleum Exchange
Regulated markets, exchanges & trading systems	Virt-x

3.2. Respondents to the concept paper on transaction reporting (Ref.: CESR/04-73b)

Activity	Name of the respondent
Banking	British Bankers' Association
Banking	Bundesverband deutscher Banken
Banking	DVFA
Banking	EFFAS European Federation of Financial Analysts Societies
Banking	European Savings Banks Group
Banking	ITALIAN BANKING ASSOCIATION (ABI)
Banking	Société Générale
Banking	UBS Investment Bank
Banking	Zentraler Kreditausschuss
Government regulatory & enforcement	Comité Marché Valeurs Mobilières
Insurance, pension & asset management	CFA Institute
Insurance, pension & asset management	Investment Management Association
Insurance, pension & asset management	Irish Association of Investment Managers
Investment services	AFEI
Investment services	Assosim
Investment services	Danish Bankers Association
Investment services	International Securities Market Associaiton
Investment services	International Swaps and Derivatives Association, Inc.
Investment services	London Investment Banking Association
Issuers	MEDEF
Regulated markets, exchanges & trading systems	BME Spanish Exchanges
Regulated markets, exchanges & trading systems	Federation of European Securities Exchanges
Regulated markets, exchanges & trading systems	International Petroleum Exchange
Regulated markets, exchanges & trading systems	London Metal Exchange
Regulated markets, exchanges & trading systems	London Stock Exchange
Regulated markets, exchanges & trading systems	virt-x Exchange Limited

3.3. Respondents to the first consultative paper (Ref.: CESR/04-261b)

Activity	Name oif the respondent
Banking	ABN Amrok
Banking	Banca Intesa
Banking	Banco Popular Español S.A.
Banking	Barclays Capital
Banking	British Bankers' Assocation
Banking	Bundessparte Bank und Versicherung
Banking	Bundesverband der Deutschen
Banking	Bundesverband deutscher Banken
Banking	Danish Shareholders Association
Banking	Euroclear Bank
Banking	European Association of Co-operative Banks
Banking	European Association of Public Banks
Banking	European Banking Federation
Banking	European Savings Banks Group
Banking	Italian Bankers Association
Banking	Netherlands Bankers Association
Banking	The Central Securities Depository of the Slovak Republic
Banking	VAB
Banking	ZKA
Insurance, pension & asset management	Association of British Insurers
Insurance, pension & asset management	BVI Bundesverband Investment und Asset Management e.V.
Insurance, pension & asset management	FEFSI
Insurance, pension & asset management	Investment Management Association
Insurance, pension & asset management	Verband unabhängiger Vermögensverwalter
Insurance, pension & asset management	Vereinigung österreichischer Investmentgesellschaften (VÖIG)
Investment services	AFEI and FBF

Investment services	APCIMS
Investment services	APCIMS
Investment services	Asociacion de Sociedades Gestoras de Carteras Independiente(SPAIN)
Investment services	ASSIOM
Investment services	Association of Dutch Brokers
Investment services	Assogestioni
Investment services	ASSOSIM
Investment services	Bloomberg L.P.
Investment services	Bundesverband der Wertpapierfirmen an den deutschen Börsen e.V.
Investment services	BVCA
Investment services	Danish Bankers Association
Investment services	Deutsche Bank AG
Investment services	Febelfin
Investment services	ICAP
Investment services	ISDA, ISMA, IPMA, ANSC, BSDAI, BMA, DSDA, FASD, FOA, LIBA, SSDA
Investment services	Italian Association of Financial Analysts
Investment services	Raad van de Effectenbranche
Investment services	Society of Investment Professionals in Germany
Investment services	Teather & Greenwood
Investment services	The Association of Norwegian Stockbroking Companies
Investment services	UBS
Investment services	V/F/I/ Verband der Finanzdienstleistungsinstitute e.V.
Investment services	Van der Moolen Holding NV
Investment services	VBA
Investor relations	Verbraucherzentrale Bundesverband
Issuers	AFEP
Issuers	AFEP
Issuers	Association Luxembourgoise des Professionnels du Patrimoine

Legal & Accountancy	City of London Law Society Regulatory Committee
Legal & Accountancy	Clifford Chance LLP
Legal & Accountancy	Euro-associations of Corporate Treasures
Legal & Accountancy	Linklaters
Others	European Federation of Financial Analysts Societies
Press	Reuters
Regulated markets, exchanges & trading systems	BME
Regulated markets, exchanges & trading systems	Borsa Italiana
Regulated markets, exchanges & trading systems	Börse München
Regulated markets, exchanges & trading systems	Copenhagen Stock Exchange
Regulated markets, exchanges & trading systems	Deutsche Börse
Regulated markets, exchanges & trading systems	Euronext
Regulated markets, exchanges & trading systems	Federation of European Securities Exchanges
Regulated markets, exchanges & trading systems	HELEX
Regulated markets, exchanges & trading systems	Iceland Stock Exchange
Regulated markets, exchanges & trading systems	London Stock Exchange
Regulated markets, exchanges & trading systems	Nord Pool ASA
Regulated markets, exchanges & trading systems	Norex alliance
Regulated markets, exchanges & trading systems	OMX Exchanges
Regulated markets, exchanges & trading systems	Oslo Børs
Regulated markets, exchanges & trading systems	The London Metal Exchange
Regulated markets, exchanges & trading systems	TLX S.p.A.
Regulated markets, exchanges & trading systems	virt-x Exchange Limited
Regulated markets, exchanges & trading systems	Warsaw Stock Exchange

3.4. Respondents to the second consultative paper (Ref.: CESR/04-603b)

Activity	Name of the respondent
Banking	ABN AMRO Bank
Banking	Banca Intesa
Banking	British Bankers' Association
Banking	Danish Bankers Association
Banking	EFFAS European Federation of Financial Analysts Societies
Banking	European Association of Public Banks
Banking	FBF
Banking	Febelfin
Banking	Italian Banking Association (ABI)
Banking	Netherlands Bankers' Association
Banking	Spanish Banking Association
Banking	UBS Investment Bank
Banking	WKO
Banking	Zentraler Kreditausschuss
Banking	Zentraler Kreditausschuss - Annex
Insurance, pension & asset management	British Venture Capital Association
Insurance, pension & asset management	FEFSI
Insurance, pension & asset management	Investment Management Association
Insurance, pension & asset management	Morley Fund Managment
Insurance, pension & asset management	Parallel Ventures Managers Limited
Investment services	AFEI
Investment services	APCIMS
Investment services	Association of British Insurers

Investment services	Barclays PLC
Investment services	ISDA,ISMA,IPMA,ANSC,BSDAI,BMA,DSDA,FASD,FOA,LIBA,SSDA
Legal & Accountancy	City of London Law Society
Regulated markets, exchanges & trading systems	Budapest Stock Exchange
Regulated markets, exchanges & trading systems	Deutsche Börse AG
Regulated markets, exchanges & trading systems	FESE
Regulated markets, exchanges & trading systems	London Stock Exchange
Regulated markets, exchanges & trading systems	OMX Exchanges
Regulated markets, exchanges & trading systems	The London Metal Exchange
Regulated markets, exchanges & trading systems	virt-x Exchange
Regulated markets, exchanges & trading systems	Warsaw Stock Exchange

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ANNEX 4

PROVISIONS APPLYING TO BUSINESS WITH RETAIL CLIENTS

Advice	Paragraph number	Title (where applicable)	Application by client type	
			Applies to retail clients only	*Applies generally*
Article 13(2)	1	Supervisory function: general provision relevant to advice under Article 13		X
Article 13(2)	2	Compliance function		X
Article 13(2)	3	Compliance function: measures to foster independence		X
Article 13(2)	4			X
Article 13(2)	5	Compliance function: other measures to promote effectiveness		X
Article 13(2)	6	Role of the compliance function		X
Article 13(2)	7	Compliance policies and procedures		X
Article 13(2)	8	Role of senior management in compliance		X
Article 13(2)	9	Person responsible for compliance oversight		X
Article 13(2)	10	Complaints handling		X
Article 13(2)	11	Code of conduct		X
Article 13(2)	12	Personal transactions: requirements		X
Article 13(2)	13	Successive personal transactions		X
Article 13(2)	14	Personal transactions: exemptions		X
Article 13(2)	15	Outsourcing pertaining to investment services and activities		X
Article 13(4) and (5)	1	Factors to take into account for systems, resources and procedures		X
Article 13(4) and (5)	2	Organisational principles		X
Article 13(4) and (5)	3	Record keeping procedures		X
Article 13(4) and (5)	4	Accounting policies and procedures		X
Article 13(4) and (5)	5	Risk management policy		X
Article 13(4) and (5)	6	Business continuity		X
Article 13(4) and (5)	7			X
Article 13(4) and (5)	8	Information processing systems and procedures		X
Article 13(4) and (5)	9	Internal control mechanisms		X
Article 13(4) and (5)	10	Additional requirements		X
Article 13(4) and (5)	11	Risk control function		X
Article 13(4) and (5)	12	Internal audit function		X
Article 13(5)	1	Application to material outsourcing only		X
Article 13(5)	2			X
Article 13(5)	3	Application to intra-group outsourcing		X
Article 13(5)	4	Arrangements not included		X
Article 13(5)	5	Effect of outsourcing on the position of the investment firm		X
Article 13(5)	6	Notification of material outsourcing to competent authority		X
Article 13(5)	7	General obligation of due skill, care and diligence		X
Article 13(5)	8	Specific obligations		X
Article 13(6)	1	Minimum requirements		X
Article 13(6)	2	Specific requirements		X
Article 13(6)	3	General requirements		X
Article 13(6)	4	Telephone orders		X
Article 13(6)	5	Termination of authorisation		X
Article 13(6)	6	Records of identical documents		X
Article 13(6)	7	Records of documents sharing a common format		X
Article 13(7) and (8)	1	Interpretation and scope		X
Article 13(7) and (8)	2			X
Article 13(7) and (8)	3			X
Article 13(7) and (8)	4	Arrangements designed to protect client assets		X
Article 13(7) and (8)	5			X
Article 13(7) and (8)	6(c)(ii)	Use of client assets	X	
Article 13(7) and (8)	6 (remainder)	Use of client assets		X
Article 13(7) and (8)	7			X
Article 13(7) and (8)	8			X
Article 13(7) and (8)	9	Deposit and sub-deposit of client assets		X

Advice	Paragraph number	Title (where applicable)	Application by client type	
			Applies to retail clients only	*Applies generally*
Article 13(7) and (8)	10			X
Article 13(7) and (8)	11	Appropriate record keeping/clarity of ownership identification		X
Article 13(7) and (8)	12			X
Article 13(7) and (8)	13	Agreement with the client		X
Article 13(7) and (8)	14	Appropriate controls		X
Article 13(7) and (8)	15	External review of records and procedures		X
Article 13(7) and (8)	16			X
Articles 13(3) and 18	1	Conflicts policy		X
Articles 13(3) and 18	2	Identification of conflicts		X
Articles 13(3) and 18	3			X
Articles 13(3) and 18	4			X
Articles 13(3) and 18	5	Content of the conflicts policy		X
Articles 13(3) and 18	6			X
Articles 13(3) and 18	7			X
Articles 13(3) and 18	8			X
Articles 13(3) and 18	9	Inducements		X
Articles 13(3) and 18	10			X
Articles 13(3) and 18	11	Disclosure		X
Article 19(2)	1	Interpretation		X
Article 19(2)	2	Confirmation of compliance by another person		X
Article 19(2)	3	Presentation of benefits and risks	X	
Article 19(2)	4	Information addressed to retail clients	X	
Article 19(2)	5	Consistency of information	X	
Article 19(2)	6(a)	Marketing communications: basic requirements		X
Article 19(2)	6(b)	Marketing communications: basic requirements	X	
Article 19(2)	7	Use of competent authority's name		X
Article 19(2)	8	Factual claims		X
Article 19(2)	9	Specific retail marketing communications	X	
Article 19(2)	10	Retail marketing communications with restricted contents	X	
Article 19(2)	11	Direct offer retail marketing communications	X	
Article 19(2)	12	References to tax treatment	X	
Article 19(2)	13	Simulated historic returns	X	
Article 19(2)	14	References to past performance and forecasts of future performance	X	
Article 19(2)	15	References to past performance: conversion and cloning of collective investment undertakings	X	
Article 19(2)	16	Estimates, forecasts and promises	X	
Article 19(2)	17	Comparisons	X	
Article 19(3)	1	Timing and form of information provision	X	
Article 19(3)	2	Information given on a previous occasion		X
Article 19(3)	3	Meaning of "in good time"	X	
Article 19(3)	4	Changes to information	X	
Article 19(3)	5	Derogation for voice telephone communications	X	
Article 19(3)	6	Means of distance communication not enabling the provision of information in a durable medium	X	
Article 19(3)	7	Information about the investment firm and methods of redress	X	
Article 19(3)	8	Information about services, financial instruments and costs and charges	X	
Article 19(3)	9	Information about the basis of calculation of the price	X	
Article 19(3)	10	Compound products	X	
Article 19(3)	11	Guarantees	X	
Article 19(3)	12	Presentation of risk warnings	X	
Article 19(3)	13	Examples of areas where risk warnings required	X	
Article 19(3)	14	Information relating to public offers of securities	X	
Article 19(3)	15	Information to be provided at the beginning of voice telephone communications	X	
Article 19(3)	16	Information on the investment firm's conflicts policy		X
Article 19(3)	17	Information about inducements		X
Article 19(7)	1	Retail client agreement	X	
Article 19(7)	2	Derogation for certain means of communication	X	
Article 19(7)	3	Minimum contents of the retail client agreement	X	

Advice	Paragraph number	Title (where applicable)	Application by client type	
			Applies to retail clients only	*Applies generally*
Article 19(7)	4		X	
Article 19(7)	5		X	
Article 19(7)	6	Modification of retail client agreement	X	
Article 19(7)	7	Record keeping	X	
Article 19(7)	8	Retail client agreement involving trading in warrants or derivatives	X	
Article 19(7)	9	Retail client agreement for portfolio management	X	
Article 19(7)	10	Reporting of losses	X	
Article 19(7)	11	Variable management fee	X	
Article 19(7)	12	Termination of retail client agreement for portfolio management	X	
Article 19(8)	1	Contract notes and confirmation notices		X
Article 19(8)	2	Contract notes and confirmation notices: retail clients	X	
Article 19(8)	3	Use of anonymous trading systems	X	
Article 19(8)	4	Execution of an order in multiple tranches for a retail client	X	
Article 19(8)	5	Unexecuted open orders received from retail clients	X	
Article 19(8)	6	Provision of information to an agent of the client		X
Article 19(8)	7	Duplication of information: contract notes or confirmation notices		X
Article 19(8)	8	Arrangement for a series of purchases of units or shares in a collective investment undertaking		X
Article 19(8)	9	Failure by another person to supply required information		X
Article 19(8)	10	Statement of client assets		X
Article 19(8)	11	Duplication of information: statements of client assets		X
Article 19(8)	12	Deposits with investment firms that are credit institutions		X
Article 19(8)	13	Contingent liability transactions		X
Article 19(8)	14	Contingent liability transactions: retail clients	X	
Article 19(8)	15	Failure to accept or execute an order received from a retail client	X	
Article 19(8)	16	Periodic information for portfolio management clients		X
Article 19(8)	17	Periodic information for retail portfolio management clients	X	
Article 19(8)	18	Portfolio management: change in basis for valuing assets	X	
Article 19(8)	19	Portfolio management: provision of contact notes or confirmation notices in the periodic statement		X
Article 19(8)	20	Portfolio management: timing of periodic statements for retail clients	X	
Article 19(8)	21	Portfolio management: periodic statements for retail clients: leveraged portfolios	X	
Article 19(8)	22	Duplication of information: periodic statements		X