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CESR Work Programme on MiFID level 3 Work

PUBLIC CONSULTATION

Background

The Markets in Financial Instruments Directive (2004/39/EC) "MiFID", a key directive of the Financial Services Action Plan (FSAP) set up to achieve a harmonized legal framework for wholesale and retail financial markets within the European Economic Area, was passed on April 2004.

While the draft implementing measures are to be finally approved in September this year, CESR is starting to prepare ground for convergent implementation and application of the new regime by ensuring a common approach to the operation of the Directive takes place throughout the EU amongst supervisors. To this extent, CESR has identified the following streams of MiFID Level 3 work:

1. The first category of Level 3 work consists of **technical issues of operational importance** needed to achieve consistent implementation of the Level 1 and Level 2 texts. The material that would fall under this category should be targeted at making the legislative texts workable and includes areas where clarification is needed before the entry into force of the Level 1 Directive and Level 2 implementing measures. Work in these areas is prioritized and should start as soon as possible, if it has not already started.

Issues that would fall under this category include, among others, the following:

- (i) Calculations relating to market transparency (definition of liquid shares and definition of "block sizes").
 - (ii) Transaction reporting arrangements (art. 25 of MiFID).
 - (iii) Aspects related to the functioning of the passport of investment firms and regulated markets (where relevant), including home/host relationships in the phases of authorization, free provision of services/activities, establishment of branches, crisis management; it also covers transitional provisions around the passport, and issues regarding the provision of cross border business by tied agents.
 - (iv) Publication and consolidation of market transparency information.
2. The second category of Level 3 work is the so called **Level 3 "by cascade"** and covers work that CESR is mandated to conduct under Level 2 measures and/or input to the Commission in the preparation of reports and/or reviews requested by Level 1 and Level 2. The content of such work is subject to the finalization of the Level 2 measures. It includes, for instance, the reviews under Article 65 of the MiFID, for which the Commission expressed the intention to seek CESR advice. In the work plan below the work arising from this category is marked with category 1. This is because it is not-discretionary work. It does not mean that this work is going to be tackled before the technical issues of operational importance of paragraph 1 above. CESR will only work on these issues if there is an express and specific request from the Commission and provided that



the areas of work are considered by CESR members to satisfy the criteria contained in the report of the Priorities Task Force. Timing of this work will therefore depend on the different deadlines set by the Commission.

The work arising from the Level 1 and 2 reviews should start sufficiently in advance to meet the deadlines established in the texts and/or in the mandates received by the Commission. Some of the reviews included in article 65 of MiFID are the following:

- (i) Possible extension of the pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares. The Commission's report is due by October 2007. The Commission published a call for evidence on 12 June 2006.
- (ii) Appropriateness of the exemption under article 2(1)(k) of MiFID for undertakings whose main business is dealing on own account in commodity derivatives. The Commission's report is due by April 2008.
- (iii) Content and form of proportionate requirements for the authorisation and supervision of such undertakings as investment firms. The Commission's report is due by April 2008.
- (iv) Appropriateness of rules concerning the appointment of tied agents in performing investment services and/or activities, in particular with respect to the supervision on them. The Commission's report is due by April 2008.
- (v) Appropriateness of the exemption of article 2(1)(i) of MiFID. The Commission's report is due by April 2008.
- (vi) State of the removal of the obstacles which may prevent the consolidation at the European level of the information that trading venues are required to publish. The Commission's report is due by April 2008.
- (vii) Application of article 27 of MiFID (systematic internalizers). The Commission's report is due by October 2008.

Some of the reviews included in the draft Level 2 texts are the following:

- (ix) Review on the application of article 4 of the implementing Directive. The Commission's report is due by 31 December 2009;
 - (x) Availability, comparability and consolidation of information concerning the quality of execution of various execution venues. The Commission's report is due by November 2008.
 - (xi) Recording of telephone conversations or electronic communications involving client orders. The Commission's report is due by 31 December 2009.
 - (xii) Re-examine, at least once every two years, the definition of transaction, the tables included in Annex II of the Regulation and the criteria for determination of liquid shares contained in article 21 of the Regulation;
 - (xiii) Re-examine the provisions of articles 38 and 39 of the Regulation relating to criteria for determining which instruments are to be treated as having the characteristics of other derivative financial instruments;
 - (xiv) Re-examine, no later than two years after the date of application of the Regulation, table 4 of annex II of the Regulation.
3. The third stream of work comes from the “**3Level3**” work to be conducted with CEBS and CEIOPS to foster greater cross-sector convergence. A work program for this category of Level 3



work (Re. CESR/06-061) has already been agreed with CEBS and CEIOPS and includes the following issues:

- (i) Outsourcing. Cooperation between CESR and CEBS will continue in order to ensure consistency to the maximum extent permitted by the EU legal framework between the Level 2 provisions and the respective Level 3 guidance stemming from MIFID and the Level 3 guidance developed in relation to the CRD. The aim of this work is to create consistency between standards of CEBS, the Level 2 and 3 work in the MIFID area and the future work on UCITS and Solvency II. To avoid inconsistencies with these developments, CEIOPS is participating in this alignment in view of its work in the framework of the Solvency II project.
 - (ii) Reporting requirements. The Committees will request input from relevant market participants to take stock of potential inconsistencies and/or overlaps, if any, in reporting requirements to competent authorities across sectors. The Committees aim at presenting a first result of this inventory within the second half of 2006. Based on this inventory, future work may be proposed to streamline, where possible if any, these practical operational reporting requirements without changing existing MiFID based reporting requirements that have been worked out and endorsed at CESR level. The CESR MiFID Level 3 group may provide support to this activity.
 - (iii) Internal governance. The work within the context of the CRD and the MIFID on internal governance of banks and investment firms will be discussed. An analytical report will be prepared and shared with the market on any overlaps and areas of possible further work. This will take into account the current thinking on Solvency II. CEBS' guidelines on internal governance within e.g. the supervisory review process and model validation work, and Level 2 measures under MIFID (based on CESR's work on internal governance in the MIFID area), will be discussed in order to assess whether there is a need to do future work in this area. UCITS will also be taken into account. CEIOPS is participating in this alignment of work in view of avoiding inconsistencies relating to its work on Solvency II, as well as any input following from the pension funds side and current insurance directives. An analytical report will need to be produced during q4 of 2006.
 - (iv) Deposit insurance/Deposit guarantee schemes/Insurance guarantee schemes. Any follow up work that CEBS may do in this area will be discussed with CESR, in order to align thinking on funding between deposit insurance and investor protection schemes. CEIOPS is following this issue in view of the directive on guarantee schemes the Commission might issue in 2006.
 - (v) Capital requirements for commodity firms. CEBS has started working on this issue at request from the Commission. CESR is observer to this Group.
 - (vi) Substitute products. CESR, CEIOPS and CEBS, on the basis of their agreed work program, will undertake work on substitute products. The MiFID Level 3 expert group might be asked to contribute to such work on commercialisation and distribution of these products.
4. **Other issues** of a technical and operational nature, aimed at ensuring a convergent implementation of MiFID that may warrant further work by the Expert Group under Level 3. Such issues might include those signalled with category three in the proposed work plan below or others that emerge from the transposition workshops organized by the Commission or the *implementation fora* held by CESR. Such issues are indicative of possible areas of future work and further consideration by CESR is needed to assess whether further Level 3 work is necessary or desirable, taking into account any potential market failure, risks to investor protection and, where appropriate, the views of market participants.
5. CESR will also organize informal **implementation fora** with representatives of competent authorities to exchange views on practical issues arising in the context of national transposition of the Level 1 and Level 2 measures. The Commission will be invited to these sessions, which will be chaired by a member of the CESR Secretariat and are intended to complement the meetings organized by the Commission with Member States. The sessions could also prove to be instrumental in the identification of operational areas where work is needed to achieve a



common understanding and application of the Level 1 & 2 measures. The first of these will be held at CESR premises on July 26, 2006.

Public consultation and timetable

In releasing this consultation, CESR is inviting all interested parties to submit views as to what CESR should consider in its further work in the area of the MiFID, the different areas of Level 3 work indicated in the work plan and its priorities. The consultation process will contribute in identifying issues to be included in the Level 3 work program which will be defined by CESR, and will help CESR setting priorities on the different issues of the program.

This document has been released on 18 July 2006 for an eight week comment period. CESR is therefore inviting all interested parties to submit their views by **11 September 2006** to Mr Fabrice Demarigny, Secretary General, by posting it on line in the section Consultations on CESR's website (www.cesr.eu).



CESR MiFID Level 3 work programme

This table indicates the expected work to be carried out by CESR at Level 3 and suggests as criteria for categorisation the following:

1. what is requested by the Level 1 Directive or Level 2 measures (*non-discretionary work*);
2. what is necessary for the entry into force of the new measures (*discretionary work*);
3. what is important (*other discretionary work*). To give an indication of sub priorities, according to the need for action and the potential risks of investor damage or market failure involved:
 - 3.1 refers to medium-high priority, (this category includes, in particular, conduct of business rules); and
 - 3.2 refers to medium-low priority (this category includes, in particular, organisational requirements).

Timing, as referred to in the last column, does not correspond necessarily with *categories*, since in some case it is established in the legal texts. For instance, category 1 is non-discretionary work, which has to be completed in relation to specific deadlines of L1 Directive or in Level 2 measures. Categories 2 and 3 are defined and self-imposed by CESR. Issues with a category 2 are considered of operational importance to achieve consistent implementation of Level 1 and Level 2 texts and should be completed before or as near to November 2007. Category 3 issues are to be tackled as soon as is practical and sub-prioritised subject to a perceived need for guidance in the industry or whether there is a specific risk to be addressed.

The timing indications are to be understood to inform about the latest possible date of delivery of the report on the subject. A more precise work plan with indications on the expected commencement, duration and termination of the work will therefore be elaborated taking into account the views of market participants under the current consultation.

Level 3 work and prioritisation issues will be placed in the context of the following criteria adopted by CESR for its future activities: risk of significant market failure or of repeated or major regulatory/supervisory failure; EU dimension; possible role of CESR.

Possible Work	Category	Timing
I- Work in connection with upcoming Commission's Reports		
Capital requirements for commodity firms/ Appropriateness of the exemption under article 2 (1)(k) for undertakings whose main business is dealing on own account in commodity derivatives. Content and form of proportionate requirements for the authorisation and supervision of such undertakings as investment firms. The Commission's report is due by April 2008. (Article 65 of the Level 1 Directive)	1	Q4 2007/ Q1 2008
Appropriateness of rules concerning the appointment of tied agents in performing investment services and/or activities, in particular with respect to the supervision on them. The Commission's report is due by April 2008. (Article 65 of the Level 1 Directive)	1	Q4 2007/ Q1 2008
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Appropriateness of the exemption of article 2 (1)(i) of Level 1. The Commission's report is due by April 2008. (Article 65 of the Level 1 Directive)		Q4 2007/ Q1 2008
Availability, comparability and consolidation of information concerning the quality of execution of various execution venues. The Commission's report is due by November 2008 (Article 44 of the draft level 2 Directive)	1	Q2/Q3 2008
Re-examine the provisions relating to criteria for determining which instruments are to be treated as having the characteristics of other derivative financial instruments. (Articles 38, 39 and 40 of the draft Level 2 Regulation)	1	Q3 2009
Review of the provision on recording of telephone conversations or electronic communications involving client orders. (Article 51 of the draft level 2 Directive)	1	Q2/Q3 2009
Review the application of article 4 of the implementing Directive. The Commission's report is due by December 2009.	1	Q2/Q3 2009
State of the removal of the obstacles which may prevent the consolidation at the European level of the information that trading venues are required to publish. The Commission's report is due by April 2008. (Article 65 of the Level 1 Directive)	1	Q2 2008
Possible extension of the pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares. The Commission's report is due by October 2007. (Article 65 of the Level 1 Directive)	1	Q3 2006 Q1/Q2 2007
Application of article 27 of Level 1 Directive (systematic internalisers). The Commission's report is due by October 2008.	1	Q2 2008
Appropriateness of the definition of transaction, the tables included in Annex II of the Regulation and the criteria for determination of liquid shares contained in article 21 of the draft Level 2 Regulation. (Re-examination under the draft Level 2 regulation)	1	Q3 2009
Re-examine Table 4 of Annex II of the Regulation (Article 40 of the draft Regulation)	1	Q3 2008
II- Work in connection with other Level 3 Committees (3L3)		
<i>Outsourcing (3L3)</i> To ensure consistency to the maximum extent permitted by the EU legal framework (Article 13(5) of the Level 1 Directive and articles 13 to 15 of the draft Level 2 Directive)	2	Q3/Q4 2006

<p><i>Internal governance (3L3)</i> Interactions between the CRD and MiFID (Article 13 of the Level 1 Directive and Chapter II of the draft Level 2 Directive)</p>	2	Q1 2007
<p><i>Substitute products</i> Aspects around commercialisation and distribution.</p>	3.2	After Q2 2008
<p>III- Other Areas of Work</p>		
<p>Aspects related to the functioning of the <i>passport</i> of investment firms and regulated markets (where relevant), including home/host relationships in the phases of authorization, free provision of services/activities, establishment of branches, crisis management; it also covers transitional provisions around the passport, and issues regarding the provision of cross border business by tied agents. (Articles 31 and 32 of the Level 1 Directive)</p>	2	Q1 2007
<p><i>Best execution</i></p> <ol style="list-style-type: none"> 1) Development of convergent views regarding application of the best execution requirements to non-equity markets; 2) Clarification on the disclosure requirements (differentiating between equities and other securities, disclosure of timing – percentage, cost, speed...); 3) Convergent interpretation as to the execution performance; 4) Clarification on the aspect of error correction and order handling (the need to ensure that obligations and detailed requirements of Art. 21 of the Level 1 Directive are applied in a flexible manner so as to accommodate different market structures and financial instruments); 5) Clarification on firms not executing client orders; 6) Allocation of orders, in coordination with the markets group where appropriate. <p>(Article 21 of the Level 1 Directive and articles 44 to 46 of the draft Level 2 Directive)</p>	3.1	<p>Q2 2007 for item 1</p> <p>Q3 2007 for the other ones</p>
<p><i>Record keeping</i> Minimum list of records to be maintained (Article 51 of the draft Level 2 Directive)</p>	3.1	Q1 2007
<p><i>Execution only</i></p> <ol style="list-style-type: none"> 1) List of non-complex instruments 2) Definition of a derivative (which kind of instruments are allowed to be traded under Article 19(6) of the Level 1 Directive and which are excluded from the service – criteria) 	3.1	After Q2 2008
<p><i>Inducements</i> - practices of “softing and bundling” (Article 26 of the draft Level 2 Directive)</p>	3.1	Q3 2007
<p><i>Internal system, resources and procedures</i> - accounting policies and procedures (Article 13 of the Level 1</p>	3.2	After Q3 2008

Directive)		
<p><i>List of financial instruments</i></p> <p>1) Clarifications on aspects of commodity derivatives (practical test)</p> <p>2) Clarification on aspects of contracts for differences (see relevant suggestion contained in the responses) (Section C of Annex I of the Level 1 Directive)</p>	3.2	After Q2 2008
<p><i>Marketing communications (See also the Distance Marketing Directive and the E-commerce Directive and CESR Standards on cold calling)</i></p> <p>- Direct offer</p> <p>- Telephone conversations</p> <p>- Cold calling</p> <p>(Article 19(2) of the Level 1 Directive)</p>	3.1	After Q2 2008
<p><i>Appropriateness</i></p> <p>To be referred to the MIFID Fora</p> <p>Criteria for assessing the appropriateness through investment parameters.</p> <p>(Article 19(5) of the Level 1 Directive)</p>	3.1	After Q2 2008
<p><i>Compliance</i></p> <p>Clarification of functional issues:</p> <p>1) Clarification on reporting of serious breaches to Board (already CESR standard)</p> <p>2) Person responsible for the compliance oversight</p> <p>3) Code of conduct</p> <p>(Article 13 of the Level 1 Directive and article 6 of the draft Level 2 Directive)</p>	3.2	After Q2 2008
<p><i>Information to clients</i></p> <p>(Article 19.3 of the Level 1 Directive and articles 27 to 34 of the draft Level 2 Directive)</p>	3.1	After Q2 2008
<p><i>Reporting obligations</i></p> <p>Changes in the basis for valuing assets in connection with potential market fragmentation</p> <p>(Article 19(8) of the Level 1 Directive and articles 40 to 43 of the draft Level 2 Directive)</p>	3.1	After Q4 2008
<p><i>Contingent liability transactions for retail clients</i></p> <p>(Article 31 of the draft Level 2 Directive)</p>	3.1	After Q4 2008
<p><i>Conflicts of interest</i></p> <ul style="list-style-type: none"> • Conflicts of interest policy <p>(Article 22 of the draft Level 2 Directive)</p>	3.2	After Q2 2008
<p><i>Investment research</i></p> <p>Clarification of some relevant aspects (personal recommendations)</p> <p>(Articles 24 and 25 of the draft Level 2 Directive)</p>	3.2	After Q3 2008

<p><i>Publication and consolidation of market transparency information</i></p> <ul style="list-style-type: none"> - Publication of transparency information (accuracy of the information, avoiding double publication, requirements for proprietary arrangements etc.) - Consolidating the transparency information (Articles 27, 28, 29, 30, 44, and 45 of the Level 1 Directive) 	2	Q1 2007 (CP October 2006)
<p>Common procedures and formats for the calculation and publication of data (liquid shares, block sizes and the list of systematic internalizers) (Articles 27, 28, 30 and 45 of the Level 1 Directive)</p>	2	Q1 2007
<p><i>Required calculations and estimates concerning liquid shares and delayed publication</i></p> <ul style="list-style-type: none"> - Free float: identification of holdings held by a collective investment undertaking or a pension fund and cooperation between competent authorities to share the information; - Average daily turnover - Estimates in relation to "new listings" - Block trade thresholds <p>(Articles 27, 28, 30 and 45 of the Level 1 Directive)</p>	2	Q2 2007
<p>Reporting of serious breaches to competent authorities ("significant breaches" referred to in Articles 26.2 and 43.2 of the Level 1 Directive)</p>	3.2	After Q3 2008
<p>Clarification of the nature of repo and stock lending (Annex 1 of the Level 1 Directive)</p>	3.2	After Q3 2008
<p><i>Transaction reporting</i></p> <ol style="list-style-type: none"> 1) Alignment of the way of granting exemptions from an electronic format in the different Member States in order to develop a common views on when exceptions could be considered to be acceptable 2) Proposal for a standard service Level agreement between an investment firm and the reporting channel 3) Measures for approving reporting channels and measures to ensure that competent authority in Member State follow the same "approach" when approving and monitoring different reporting channels 4) Guidances as to the harmonization of the standards and formats of transaction reports at EU level 5) Work to avoid duplication of reporting rules 6) Calculation of the turnover of a financial instrument (Article 9.2 of the draft Level 2 Regulation) 	2/3	Q3 2007 Q4 2007 Q2 2007 (for item 3) Q4 2007 Q4 2007 Q4 2007
<p>Instruments reference data (Article 11 of the draft Regulation)</p>	3	Q2 2007

