THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref.: CESR/04-261b

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

CONSULTATION PAPER

June 2004

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EXECUTIVE SUMMARY

Background

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.

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

Purpose

The purpose of this consultation document from CESR is to seek comments on the draft technical advice that CESR proposes to give to the European Commission on the implementing measures set out in the first set of provisional mandates received by CESR from the EU Commission on 20 January 2004.

Areas Covered

Given the extent of issues covered by this consultative document, it is not possible to briefly summarise the key issues which are addressed. Broadly speaking, this draft advice covers, *inter alia*, organisational requirements for intermediaries, conflicts of interest, conduct of business obligations and order handling rules, pre- and post-trade transparency obligations by regulated markets and MTFs, post-trade transparency for investment firms, admission of financial instruments to trading, transaction reporting and cooperation between the competent authorities.

Call for comments

CESR invites comments on whether it should advise the Commission to include grandfathering and transitional provisions in the level 2 measures under the Directive. If so, what the substantive effect of these provisions should be.

Furthermore, CESR invites comments on the appropriate level of regulatory intervention in addressing the needs of retail and professional clients with particular regard to the draft technical advice under Articles 19, 21 and 22.

Finally, CESR would like to raise the attention of retail investors to a number of questions and issues that are of direct interest to them, including:

a) record keeping of transactions;
b) safeguards and use of clients' assets;
c) conflicts of interest;
d) conduct of business obligations with particular regard to marketing communications, information to clients and reporting to clients;
e) client agreement;
f) best-execution, with particular regard to the factors relevant for clients;
g) content and availability of transparency information;
h) client order handling;
i) pre- and post-trade transparency.

Among others, these items are highlighted by specific questions in this consultation document. However, even where no specific questions have been posed, CESR invites all market participants (practitioners, consumers and end-users) to comment on the draft advice contained in this consultation document.

Consultation Period

Consultation closes on 17 September 2004. Responses to consultation should be sent via CESR's website in the section "Consultations".

A public hearing will be held in Paris, at CESR premises, on 8 and 9 July 2004. An agenda for the hearing is available in the CESR website.

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INTRODUCTION

1. CESR publishes its consultation paper on its draft technical advice to the European Commission regarding the first set of technical implementing measures for the Directive on Markets in Financial Instruments. This document is aimed at receiving responses to its content and to a number of specific questions included in the document itself.

2. It should be stressed that CESR's draft technical advice should not be perceived as legal text, even if it is precise to facilitate its comprehension in the consultation phase. It is the responsibility of the Commission to draft a proposal for implementing measures taking into account the technical advice provided by CESR. CESR, having to address appropriate differentiation between classes of financial instruments (equities/non equities) and sizes of investment firms, makes use at this stage of flexible wording encompassing all situations, such as "where appropriate", "where relevant" and other similar. CESR aims at elaborating further more precise proposals before final adoption of its technical advice; therefore CESR invites comments on the appropriate calibration to be given to different circumstances.

3. CESR has included a number of questions to highlight those areas in which it would be particularly helpful to have views. Comments are, of course, welcome on all aspects of the proposed CESR advice but, if changes are required, any reasoning accompanied by any practical examples of the impact of the proposals will be very useful. CESR also welcomes specific drafting proposals when respondents are seeking changes to the proposed Level 2 advice.

4. Respondents to this consultation paper should post their responses on CESR's Website (www.cesr-eu.org) in the section "Consultations". CESR will publish a feedback statement on the consultation justifying its final choices vis-à-vis the main arguments raised during the consultation.

5. The Directive on Markets in Financial Instruments (Directive 2004/39/EC) 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 (ISD).

   The decision to revise the ISD reflects common agreement that structural changes in EU financial markets requires legislation to be adapted in order to advance integration of the single market in financial services. The Directive will form one of the cornerstones of the EU's securities regulatory regime, and is intended to deliver an effective 'single passport' for investment firms and regulated markets. The new Directive broadens the range of investment services and activities for which authorisation is required under the existing ISD; it clarifies and expands the list of financial instruments that may be traded on regulated markets and between investment firms; it also introduces rules on the provision of investment advice and more detailed rules on conflicts of interest. Standards for regulated markets and multilateral trading facilities are included, as well as new rules on handling client orders.

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

6. On 20 January 2004, the Commission published "The Provisional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets". The Commission asked CESR to deliver its technical advice in form of an "articulated" text by 31 January 2005. The text of the individual mandates is set out in each specific section of CESR's Level 2 advice.

7. In order to accomplish its tasks CESR set up three Expert Groups: Expert Group on Markets, chaired by Mr Jacob Kaptein; 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 is chaired by CESR's Chairman, Mr Arthur Docters van Leeuwen.) The Expert Groups are assisted by a Consultative Working Group formed of 23 market participants by CESR.

8. CESR published a Call for Evidence on 20 January 2004 with a work-plan containing indications of the most relevant steps in the process of approval of its technical advice and a Consultative Concept Paper on 1 March 2004.

9. In conducting its work CESR has taken into account all its existing work and achievements relevant in the area of intermediaries, markets and cooperation (the complete list of these works is given in Annex 3). In particular, a substantial part of the draft advice under the section on Intermediaries is based on the CESR Standards for Investor Protection, following a decision taken by CESR to include these Standards in its technical advice to the Commission unless these are not in line with the text of the Directive anymore.

10. More details on process and CESR's work plan, a summary of responses to the Call for Evidence and the Consultative Concept Paper, as well as a list of papers already published by CESR with relevance to this first set of mandates, are given in the Annexes to the consultation paper.

CESR

DRAFT TECHNICAL ADVICE

SECTION I – DEFINITIONS

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

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

c) CESR proposes using the following definitions of certain terms used in the draft advice to facilitate its comprehension and simplify its structure:

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

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

3. "*relevant person*" in relation to an investment firm, means a manager, employee or tied agent of that investment firm, which for these purposes shall include any individual who falls within one or more of sub-paragraphs (i) to (iv) below:
   (i) an individual who is a director, partner or equivalent of that investment firm or its tied agent;
   (ii) an individual who works for that investment firm or its tied agent (under a contract of employment or otherwise);
   (iiii) an individual whose services are placed at the disposal and under the control of an investment firm or its tied agent under an arrangement between that investment firm or its tied agent and a third party;
   (iv) an individual who is involved in the provision of services to the investment firm or its tied agent under an outsourcing arrangement, where such inclusion is appropriate in view of the nature of the arrangement and the individual's role,

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

4. "*personal transaction*" means a transaction in financial instruments that a relevant person effects himself or causes another person to effect, where that relevant person is acting:
   (i) outside of the scope of his professional activities; and/or
   (ii) for his own account or for the account of any person in a domestic relationship with him or with whom he has close links or whose relationship with him is such that he has a direct or indirect material interest in the transaction.

   The following shall be excluded from the definition of a personal transaction:

   (iii) discretionary transactions, provided:
   - they are effected by a discretionary portfolio manager (other than the relevant investment firm) that is an investment firm or is

regulated by legal or regulatory provisions or a code of ethics governing the provision of such management services; and

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

(iv) transactions in collective investment undertakings provided:

- such undertakings comply with the conditions necessary to enjoy the rights conferred by Council Directive 85/611/EEC of 20 December 1985, on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) or are subject to supervision on a national basis providing for an equivalent level of risk spreading in their assets; and
- the relevant person and any other person for whose account the transactions are effected are not involved in the management of that undertaking; and

(v) transactions in instruments issued by national governments;

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

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

7. "*depository*" means a third party with whom an investment firm holds client assets;

8. "*conflicts policy*" means the policy maintained by an investment firm under Section II of the draft advice under Articles 13(3) and 18;

9. "*information barrier*" means effective procedures to control the flow of relevant information between persons principally engaged in the different activities that are to be separated by the barrier, which must specify:

   (i) any circumstances in which any persons can be taken over the information barrier (which must be documented and agreed by the compliance function); and

   (ii) the relevant persons and/or activities involved;

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

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

12. "*investment research*" means information whose issue by an investment firm constitutes the provision of the ancillary service in section B(5) of Annex I to the Directive;

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

For these purposes, information is issued to the public if it is designed for, directed at and/or addressed to, a number of people. Information is not addressed to the public if it is directed at one specific person or group of persons acting jointly, unless it forms part of an organised marketing campaign.

Advertisements that:
i) only make the public aware of an investment firm's existence; and
ii) do not recommend any particular service or instrument,
shall not be considered as marketing communications for the purposes of this advice;

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

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

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

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

16. "*compound product*" means a financial product, which consists of a combination of financial instruments and/or financial services, e.g. a stock-lease product combining a loan, a cash financial instrument and an option;

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

18. "*means of distance communication*" refers to any means which, without the simultaneous physical presence of the investment firm and the retail client, may be used for the provision of a service between those parties;

19. "*contingent liability transaction*" means:

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

20. if a provision in this advice refers to a communication, notice, agreement or other document '*in writing*' then, unless the contrary intention appears, it means on paper or another durable medium;

21. "*durable medium*" means 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. Durable media include in particular floppy discs, CD-ROMs, DVDs and the hard drive of the client's computer on which the communication is stored, but they do not include Internet websites unless they fulfil the criteria contained in the definition of a durable medium;

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

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

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

25. "*market personnel*" means operators that support liquidity, e.g. specialists, animateurs, committed principals, market makers etc.;

26. "*RM*" or "*MTF*" means either the market operator or operator of an MTF or the Regulated Market or MTF itself;

27. "*firm price*" means that the price represents the actual terms on which markets participants are committed and obliged to trade;

28. "*indicative price*" means a price which is not firm;

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

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

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

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

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

SECTION II - INTERMEDIARIES

Compliance and personal transactions (Art. 13(2))

Extract from Level 1 text

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

Extract from the mandate from the Commission

3. 1. 1. Compliance obligations and treatment of personal transactions (article 13§2) DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on following issues:

(1) the minimum basic elements that the compliance policies and procedures that an investment firm has to set up should contain as well as the principles governing the content of the policies and procedures;

(2) the criteria for identifying the persons that are to be considered as managers and employees;

(3) the conditions with which the content of the rules established by the investment firm governing personal transactions by managers, employees and tied agents should comply;

(4) what is to be considered as a personal transaction for the purposes of the rule.

Draft CESR advice

Explanatory text

Explanatory text relevant to CESR advice on Articles 13 and 18

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

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

However, external lawyers providing legal advice and external accountants providing audit services should not be considered as falling within this definition.

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

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

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

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

The CESR advice on Article 13(2) is intended to deliver clear principles that can be applied by all types of investment firms under the Directive. In this way CESR seeks to build on the comments received in the Call for Evidence on the Level 2 mandates.

The draft advice attempts to ensure appropriate calibration. For example, smaller firms will not be able, nor will they be required, to devote the same amount of resources to compliance infrastructure as a large investment bank. In addition, the outsourcing of compliance functions can be envisaged in appropriate circumstances. At the same time there are fundamental requirements that all investment firms should meet irrespective of their size or scope of operation. CESR has been especially mindful of the need to ensure that responsibility for compliance is accepted at the most senior levels of the business and that the compliance function must have a direct reporting line to senior management, even in cases where that function is outsourced.

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

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

The Directive (in particular Article 53) stops short of requiring Member States to implement particular mechanisms for the resolution of disputes between investment firms and their clients. This advice therefore does not address the mechanisms that Member States should implement for the judicial or extra-judicial resolution of disputes. However, at least where an investment firm deals with retail clients, CESR believes a firm's own complaints handling procedures should recognise the need for the firm to pay compensation or other forms of redress to clients in cases where it is appropriate to do so, without forcing the client to have recourse to the available national dispute resolution mechanisms.

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

The draft advice on personal transactions is designed to recognise that different types of investment firms will wish to impose internal controls on staff trading that are appropriate for the particular conditions under which they operate, while imposing a minimum standard for mechanisms used to control personal transactions. It is also designed to provide a proportionate range of exemptions in

circumstances where transactions affect collective investment undertakings or instruments issued by national governments or they are executed by a discretionary portfolio manager.

Most of the elements required by the mandate and the indicative elements have been covered, although CESR feels that in some cases certain content (for example, criteria for separately identifying employees and managers) is unnecessary for the effective operation of the proposed Level 2 measures.

This draft advice addresses outsourcing arrangements or intended outsourcing arrangements pertaining to investment services and/or activities for the reasons explained in the second paragraph of the explanatory text to the advice under Article 13(5).

Specific questions for consultation

Independence of the compliance function

CESR Standard 9 on Investor Protection provides that the adequate compliance policies and procedures to be established and implemented by investment firms should include an independent compliance function. It may therefore be felt that an independent compliance function is a necessary prerequisite for the authorisation of any investment firm, even if this is achieved by outsourcing the compliance function in smaller investment firms. However, different members of CESR take different approaches to the independence of the compliance function. For example, some require independence in all cases, some place emphasis on external auditing of compliance and others directly regulate the individual within the firm with responsibility for compliance (even where there is no independent compliance function).

The draft advice indicates that a requirement to maintain an "independent" compliance function would include ensuring both that the individuals in the compliance function are not involved in the performance of services or activities they monitor and that the budget and remuneration of the compliance function is linked to its own objectives and not to the financial performance of the business lines of the investment firm.

The independence of the compliance function will be an important factor in promoting its effectiveness. If a firm's compliance officer is also involved in the performance of services or activities, he may be less willing to address and report breaches arising in the performance of those services or activities, regardless of the size or complexity of the investment firm.

However, Articles 4(1)(1) and 9(4) of the Directive make it clear that it is intended to apply to smaller investment firms in addition to larger investment firms and credit institutions. For smaller firms undertaking non-complex business, a requirement for the compliance function to be independent, whether through the use of internal or outsourced staff, may be felt to be disproportionate, particularly where the individual with responsibility for compliance within the investment firm is subject to direct regulation by the competent authority. The burden of such a requirement could put smaller firms at a disadvantage to larger firms and have an adverse effect on competition and innovation in the market place, which may be to the detriment of users of financial services.

If a calibration is to be introduced to the requirement for the compliance function to be independent, some members of CESR believe it should have regard to the complexity of the investment firm's business and other relevant factors, including the nature and scale of its business. It would also require a small firm undertaking complex business to ensure the independence of its compliance function, where this is appropriate and proportionate.

Question 1.1. - *Must the compliance function in every investment firm comply with the requirements for independence set out in paragraph 2(d), 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 independecence be based on the*

nature and scale of the business of the investment firm?

Outsourcing of investment services

CESR Standard 127 on Investor Protection provides that an investment firm may delegate the portfolio management function to another investment firm only if the delegate firm is authorised in its home country to provide management services on an individual basis and is qualified and capable of undertaking the function in question. In addition, it provides that the mandate shall not prevent the effectiveness of supervision over the delegator and that delegation may only take place to a non-EEA investment firm if an appropriate formal arrangement between regulators enables them to exchange material information concerning both cross-border delegations and the delegatee.

The approach in the CESR Standards, which is limited to the delegation of the portfolio management function, places emphasis on the status of the service provider in addition to underlining the continuing responsibility of the outsourcing investment firm. One approach would be to retain the current scope and wording of this CESR Standard. Alternatively, its scope could be extended to cover the outsourcing of some or all of the other investment services and activities falling within section A of Annex I to the Directive.

A third option would be to adopt a less prescriptive approach in relation to the status of the service provider in the case of all investment services and activities (including portfolio management), while placing particular emphasis on the continuing regulatory responsibility of the outsourcing investment firm, including its obligation of due diligence in appointing a service provider and its regulatory obligation to ensure that the competent authority can exercise the rights to cooperation and access under the contract between the service provider and the outsourcing investment firm.

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 be placed on the status and responsibilities of the outsourcing investment firm?*

Draft Level 2 advice

BOX 1

General provision relevant to advice under Article 13

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

   a. responsibilities are placed upon senior management, Competent Authorities may require investment firms to ensure that such responsibilities are also placed upon the supervisory function (if there is one and within the limits of its powers) without derogation from the responsibilities to be placed on senior management.

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

Policies and procedures to ensure compliance

2. An investment firm must:

   (a) establish and maintain a permanent and effective compliance function, which must have documented status and the necessary authority within the investment firm to discharge its function;

   (b) establish and maintain compliance policies and procedures, including the code of

conduct referred to in paragraph 6, that are designed to ensure compliance with the investment firm's obligations under the Directive, identify and assess compliance risk and foster a compliance culture within the investment firm, and that are appropriate and proportionate in view of the nature, scale and complexity of its business;

(c) be able to demonstrate it has effectively implemented such policies and procedures, including the code of conduct referred to in paragraph 6; and

(d) [*where appropriate and proportionate in view of the nature, scale and complexity of its business,*] ensure that the compliance function is independent, which includes ensuring that:

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

(ii) the budget and remuneration of the compliance function is linked to its own objectives and not to the financial performance of the business lines of the investment firm.

[**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 independecence be based on the nature and scale of the business of the investment firm?*]

3. In establishing its internal allocation of functions, an investment firm must ensure that its senior management is responsible for compliance, including:

(a) ensuring that the investment firm's compliance policy and procedures are effectively implemented and compliance with them is monitored;

(b) approving the compliance policy and reviewing it periodically to ensure that it remains appropriate;

(c) ensuring that the compliance function has sufficient resources;

(d) ensuring that the persons responsible for the compliance function have the necessary expertise, experience, and qualifications to enable them to carry out their duties effectively; and

(e) ensuring that compliance personnel are given full access to all relevant information enabling them to perform their duties.

Where the head of the compliance function is not a member of senior management, he must have a direct reporting line to senior management.

An investment firm must notify the competent authority promptly upon any person:

- being appointed as the head of the compliance function; or

- ceasing to be the head of the compliance function.

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

(a) monitors and assesses on an ongoing basis the adequacy and effectiveness of the investment firm's policies and procedures and the investment firm's compliance

with its obligations under the Directive and its the internal code of conduct, and ensures that the appropriate measures are taken in the event of non-compliance;

(b) reports on a frequent basis to senior management on the matters under (a);

(c) reports on at least an annual basis a summary of the results of the monitoring and assessment to the senior management, the internal auditors (if any) and the external auditors (if any) of the investment firm; and

(d) provides advisory assistance and support in relation to compliance matters to the various business areas of the investment firm on problems concerning compliance with the investment firm's obligations under the Directive and the relevant persons' obligations under the code of conduct referred to in paragraph 6.

Complaints handling

5. An investment firm must, in relation to complaints received from clients regarding the provision by the investment firm of investment services, and, where appropriate, ancillary services:

(a) maintain, publicise and operate effective procedures for handling complaints in a reasonable and timely way, including:

(i) informing clients in writing of any out-of-court complaint and redress mechanism and the methods for having access to it; and

(ii) paying compensation or other forms of redress to retail clients where the investment firm decides this is appropriate;

(b) keep records of complaints and the measures taken for their resolution; and

(c) regularly verify whether complaints are effectively processed.

Code of conduct

6. An investment firm must establish a code of conduct for its relevant persons. The code of conduct is a set of principles designed to promote professionalism and integrity. As a minimum it should contain the investment firm's:

(a) standards of integrity and confidentiality;

(b) guidelines on proper compliance within the legal and regulatory framework in which the investment firm operates;

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

(d) procedures for carrying out personal transactions; and

(e) conflicts policy as provided for in the draft advice under Article 13(3).

Personal transactions

7. An investment firm must:

(a) establish and operate mechanisms that take all reasonable steps to prevent its relevant persons who have access to price-sensitive information or who are subject to conflicts of interest (such as traders, analysts, corporate finance personnel, portfolio managers and compliance personnel) entering into a personal transaction in circumstances where that transaction conflicts or is likely to conflict with the

investment firm's duties under the Directive or the relevant person has or is likely to have price sensitive information that is relevant to financial instruments to which that transaction relates;

(b) make a record of any notifications, authorisations and prohibitions given in connection with such mechanisms;

(d) ensure it receives prompt notification of the execution of any personal transaction or is otherwise able to identify it, and makes a record of it; and

(e) take reasonable steps to ensure that where a relevant person is prohibited from entering into a personal transaction, he does not (except in the proper course of his employment):

(i) counsel or procure any other person to enter into such a transaction; or

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

8. Where successive personal transactions by a relevant person are effected in accordance with pre-determined instructions, without any further intervention by the relevant person referred to under sub-paragraph 7(a), the mechanisms established under paragraph 7 are only required to apply to the issue of, and any subsequent amendment to, those instructions, provided that they are not required to apply to their termination without the disposal of any of the financial instruments acquired pursuant to them.

Outsourcing pertaining to investment services and activities

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

(a) paragraphs 4 and 6 to 9 of the advice on Article 13(5) of the Directive shall apply to such arrangements; and

(b) [*where the outsourcing involves the delegation of the portfolio management function to a service provider located in a third country:*] **OR** [*where the outsourcing involves the delegation of the performance of any investment service and/or activity to a service provider located in a third country:*] **OR** [*delete paragraph (b) and rely on paragraphs 9(b) and (g) of the outsourcing advice, which is applicable to all outsourcings:*]

(i) [*that service provider must be authorised in its home country to provide that service and/or activity*; and

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

[**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 (b) be deleted and reliance be placed on the status and responsibilities of the outsourcing investment firm?*]

Obligations related to internal systems, resources and procedures (article 13(4) and (5) second sub-paragraph)

Extract from Level 1 text

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

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

Extract from the mandate from the Commission

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

- Establish the minimum basic criteria that competent authorities should take into account for determining when the investment firm has taken reasonable steps to ensure that:

(1) their administrative procedures are to be considered as sound;

(2) their accounting procedures are to be considered as sound; in respect of this request CESR should take account of or refer to any relevant provision of Community Law;

(3) their internal control mechanisms are to be considered as sound;

(4) their risk assessment procedures are to be considered as effective. For the definition of the various risks, their categorizations, as well as the means for their assessment, CESR should take account of any relevant provision of Community Law as well as relevant or similar work carried out in the field of financial services in other European and International fora.

(5) their control and safeguard arrangements for information processing systems are to be considered as effective.

Draft CESR advice

Explanatory text

The CESR advice on Article 13(4) and 13(5) second sub-paragraph, is intended to provide an extensive set of criteria which the investment firm shall use in order to assess the adequacy of its internal systems, resources and procedures.

The advice for implementing measures defines the minimum requirements which must be met by all investment firms in respect of administration, accounting and systems and controls.

Such requirements cover a number of general principles of adequate organisation in respect of the decision process, staff competency, allocation of responsibilities, written procedures, internal control mechanisms and internal reporting. Specific requirements are set out for the accounting policies and procedures, risk management policy, information processing systems and business continuity.

The advice also determines the content of more sophisticated mechanisms of internal control, such as the implementation of segregation of duties in order to mitigate operational risk or the setting up of independent functions (risk control function, internal audit function and external auditing). All or some of those mechanisms shall be mandatory for investment firms where this is appropriate and proportionate in view of the nature, the scale and complexity of their business.

Where an investment firm does not have an independent risk control function and internal audit function, it shall appoint a staff member or a senior manager in charge of ensuring the consistency and effectiveness of the internal control of the investment firm and of reporting on such matters to senior management and to the external auditor where applicable.

Draft Level 2 advice

BOX 2

General principles

1. When determining whether its systems, resources and procedures are appropriate and proportionate, an investment firm must take into consideration all relevant matters, including:

(a) the nature, scale and complexity of the investment firm's business, including the services provided and the activities performed by it; and

(b) whether such systems, resources and procedures reasonably ensure that investment services and activities can be performed without interruption, and that such services and activities can be quickly resumed if an unplanned severe business interruption occurs.

2. The principles on which the organisation of an investment firm in respect of its administration, accounting, systems and controls must be based include:

a) clear, transparent, formal and documented decision making processes;

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

c) clear allocation of responsibilities;

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

e) internal control mechanisms ensuring compliance with internal decisions and procedures at all levels of the investment firm; such mechanisms include hierarchical controls, cross-checking and dual control; and

f) effective and appropriate internal reporting and communication of information at all levels of the investment firm.

Record keeping procedures

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

Accounting policies and procedures

4. An investment firm must have accounting policies and procedures which enable it to submit financial reports which reflect a complete, true, verifiable and timely view of its financial position in compliance with applicable accounting standards and rules. Such procedures include:

a) documentation of the bookkeeping systems and accounting procedures;

b) regular reconciliation between internal records and confirmations from third parties;

c) procedures designed to ensure that transactions are only entered into the accounting system of the investment firm with appropriate authority;

d) establishment of systems and procedures for internal and external financial reporting; and

e) keeping of proper accounting records and audit trails.

Financial reports which an investment firm submits to the competent authority must be in agreement with the investment firm's underlying accounting records and must provide the required information fully and accurately in accordance with the principles and rules set out by the relevant authorities.

Risk management policy

5. An investment firm must have a risk management policy which covers among other things:

a) the management and the control of all the risks inherent in the investment firm's activities, products, processes and systems, including operational risk;

b) the level of risk tolerance of the investment firm; and

c) the arrangements in place to monitor, manage, mitigate or control the risks referred to in paragraph (a).

Information processing system

6. An investment firm must establish and maintain information processing systems which reasonably ensure the provision of investment services without interruption and guarantee the integrity and confidentiality of information. The measures taken by an investment firm in this regard must include appropriate:

a) information technology resources to retain, store, and access data, which also permit adequate search applications;

b) security measures for its data and information systems; and

c) arrangements, regularly tested and updated, to ensure that it can continue to function and meet its regulatory obligations in the event of an unplanned severe business interruption. To this end, the investment firm should identify critical information systems and related functions (such as IT infrastructure, telecommunications and power supply), including centralized and decentralized systems as well as outsourcing arrangements, in order to take preventive and mitigating measures and to develop back-up plans and procedures to enable those systems and functions to continue to operate or to be recovered and resumed to normal business capacity in the event of a disruption or a disaster.

Internal control

7. The investment firm must regularly verify whether it can rely on an adequate internal control. Unless the investment firm is required to set up an independent risk control function and an independent internal audit function as referred to in paragraph 8(b) and (c), it must appoint a staff member or a member of its senior management to take charge of:

a) ensuring the consistency and effectiveness of the internal control mechanisms of the investment firm, including its risk management; and

b) reporting on such matters on a regular basis to senior management and, at least once a year, to the external auditors where applicable.

Additional requirements

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

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

b) independent risk control function.
The investment firm must ensure that the risk control function identifies, measures, monitors and controls the risks in accordance with the risk management policy as referred to in paragraph 5. The following principles apply:
(1) the risk control function must be separated and independent from the risk taking functions;
(2) the risk control function must regularly report and provide advice on risk management to senior management and, at least once a year, to the external auditors where applicable;
(3) senior management should approve and periodically review the investment firm's risk management policy and risk control function.

c) independent internal audit function;

The investment firm must ensure that the internal audit function examines and evaluates the adequacy and effectiveness of the investment firm's systems and internal control mechanisms, including the compliance and risk management functions, on the basis of an audit plan that it draws up and implements and provides those responsible within the investment firm with information, analyses, assessments and recommendations in this regard, and verifies compliance with the recommendations it issues. The following principles apply:
(1) senior management or, where national law requires so, the supervisory function must regularly verify, taking due account of the internal audit reports, whether the investment firm can rely on an adequate internal control, and, at least once a year, must assess the internal audit function and the audit plan itself;
(2) the internal audit function must report regularly on the adequacy and effectiveness of systems and internal control mechanisms within the investment firm to senior management or, where national law requires so, the supervisory function, and, at least once a year, to the external auditors where applicable;
(3) the internal audit function must be separated and independent from operational activities audited and have appropriate standing within the organization and impartiality in the carrying out of its assignments;
(4) the person(s) in charge of the internal audit function must be professionally competent in terms of knowledge and experience and have access to systematic continuing training and up-to-date knowledge of auditing techniques and investment activities;

d) external auditing of the accounting records and reporting.

Obligation to avoid undue additional operational risk in case of outsourcing (Article 13.5 first sub-paragraph)

Extract from Level 1 text

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

Extract from the mandate from the Commission

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

(1) Determine what is meant by operational functions; establish the criteria for determining which functions are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis.

(2) Establish the conditions to which the firm is subject and the arrangements to put in place, when outsourcing its operational functions.

(3) Specify what is to be considered as outsourcing for the purposes of this rule

Draft CESR advice

Explanatory text

The CESR advice on Article 13(5) delivers principles to be applied by investment firms when outsourcing important operational functions, other than the use of depositories under arrangements falling within Article 13(7) and 13(8). This draft advice has been prepared taking into account the recent consultative document on High Level of Principles on Outsourcing issued by the Committee of European Banking Supervisors (CEBS) on 30 April 2004.

The definition of the scope of this advice is based on the assumption that the operational functions as referred to in Article 13(5) do not include outsourcing arrangements or delegation in respect of services and activities as referred to in Article 4(1)(2). As such a reading of the Directive would render its advice on Article 13(5) silent on a matter which is prudentially of great importance, CESR deems it appropriate to address such arrangements under its advice on implementing measures in respect of Article 13(2). By doing so, outsourcing arrangements pertaining to operational functions and to investment services and activities will be treated according to the same principles and rules.

The advice determines the scope of application by providing criteria for identifying outsourced operational functions which are critical for the provision of continuous and satisfactory service to clients. Moreover, it lists arrangements clearly not included in the scope of the advice.

Outsourcing arrangements to other entities of the group, to which an investment firm belongs, fall under the scope of the advice. In such case, the principles and rules must be applied taking into account this situation accordingly where the investment firm and the service provider are subject to supervision on a consolidated basis.

Outsourcing arrangements do not affect the investment firm's regulatory obligations, nor its relations with, and obligations towards, its clients under the Directive.

The main objectives of the conditions for outsourcing functions require the investment firms to conduct a due diligence process before contracting out and to follow up the adequacy of performance of the outsourced functions and, finally, to manage the risks involved.

Outsourcing arrangements must be designed in a way that does not affect negatively the sound and prudent management of the investment firm and does not hamper the supervision of the outsourcing investment firm.

Draft Level 2 advice

BOX 3

Scope

1. Outsourcing means all forms of relying on third parties in relation to operational functions through an arrangement which involves an investment firm making use of a process or a service from an outside service provider that could otherwise be undertaken by the investment firm itself.

2. The rules set out in this advice only refer to outsourcing arrangements pertaining to operational functions where a weakness or failure in the performance of the outsourced functions would cast serious doubt upon the investment firm's continuing compliance with the conditions and obligations of its authorisation and/or the investment firm's financial performance, financial position, continuity of operations or reputation.

3. Subject to the materiality test as referred to in paragraph 2, the following outsourcing arrangements are expected to be included in the scope of application: accounting, back office, human resources department, information technology and information system management and maintenance, marketing and research, services related to the internal audit, compliance and risk management functions.

4. The rules in this advice will also apply to intra-group outsourcing where the arrangements meet the conditions set out in paragraph 2 subject to paragraph 5. However, where the investment firm and the service provider are members of a group that is subject to supervision on a consolidated basis, the extent of application of the obligations of the investment firm as referred to in paragraph 9 shall take this situation into account accordingly.

5. Outsourcing arrangements pertaining to the following are excluded from the scope of application of this advice:

a) discrete advisory services (such as the provision of legal advice), procurement of specialised training, billing and security;
b) non-material functions such as catering and cleaning;
c) investment services and activities as referred to in Article 4(1)(2) of the Directive;
d) the purchase of standardised services such as market information services and provision of prices; and
e) the use of depositaries under arrangements falling within Articles 13(7) and (8) of the Directive.

Principles

6. Outsourcing arrangements do not release the investment firm from its regulatory obligations and cannot result in the delegation of senior management's responsibility. Such arrangements cannot alter the relationship and obligations of the investment firm under the terms of the Directive towards its clients. Outsourcing cannot be undertaken in such a way as to render the investment firm a substantially empty box.

7. An investment firm must provide the competent authority with prior notification of its intention to enter into outsourcing arrangements falling within paragraph 2 and make available all relevant information, enabling the competent authority to effectively exercise its supervision in respect of the provisions referred to in this advice.

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

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

a) the outsourcing investment firm must ensure that senior management defines and regularly reviews the investment firm's policy for outsourcing operational functions; this includes internal review and feasibility, the assessment of risks, the impact on business and costs and the criteria for selecting the service providers;
b) the investment firm must ensure that the service provider has the ability and capacity to perform the outsourced functions reliably, professionally and in the best interest of the investment firm's clients. To that end, the investment firm must evaluate the service provider and its services at the start and during the life cycle of the outsourcing arrangement. In performing this evaluation, the matters of which the investment firm should take particular account include where relevant, whether the service provider is regulated, to what extent and by whom, including whether the provision of the outsourced services is subject to specific regulation or supervision, and concentration risk in terms of other firms using the same service provider;
c) the investment firm must retain the required expertise to effectively supervise the outsourced functions and manage the risks associated with the outsourcing; senior management should take appropriate action if cause for concern arises;
d) the parties' respective responsibilities in an outsourcing agreement should be clearly allocated in a written agreement, including a service level agreement; such agreement must also include, if applicable and when appropriate having regard to the function contracted out, the:
    i. choice of law;
    ii. designation of the applicable code of conduct and of the competent compliance function monitoring the said code of conduct;
    iii. obligation to protect confidential information;
    iv. remedies;
    v. obligation for the service provider to disclose material developments;
    vi. contingency procedures;
    vii. where permitted by national law and by the contract, rules for subcontracting;
    viii. termination rights; and
    ix. designation of methods to measure, and procedures to report, the quantitative and qualitative performance by the service provider, in order to enable the investment firm to assess the adequacy of the services provided under the arrangement;
e) the investment firm must have a comprehensive exit strategy, including when appropriate and proportionate taking into account the nature of the function subject to the outsourcing arrangement, partial exit and step-in clauses, and contingency plans;
f) the investment firm should have complete access to its data in an outsourcing arrangement; such access should also be provided to the investment firm's compliance function, and to its internal and external auditors; and
g) the investment firm must ensure that the terms of the contract with the service provider require it to deal in a open and cooperative way with the competent authorities in the discharge of their functions under the Directive and permit access to the relevant data and their business premises and that the competent authority can exercise those rights.

Record keeping obligation (Article 13(6))

Extract from Level 1 text

Article 13.6 An investment firm shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with the requirements under this Directive, and in particular to ascertain that the investment firm has complied with all obligations with respect to clients or potential clients.

Extract from the mandate from the Commission

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

(1) Establish the conditions with which the arrangements that an investment firm has to put in place in respect of its records have to comply in order to be considered as sufficient to enable the authorities to verify the investment firm's compliance with the applicable rules

(2) Specify which records are covered by this obligation

(3) Specify the period of time for keeping the records

In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to data protection.

Draft CESR advice

Explanatory text

The CESR advice on Article 13(6) is intended to deliver several clear principles that can be applied by all types of investment firm under the Directive. In this way CESR seeks to build on the comments received in the Call for Evidence on the Level 2 mandates.

CESR is also aware that other EU legislation, such as 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, must be taken into account. There is no intention to create record-keeping requirements that conflict with existing EU law.

CESR has covered the issues referred to in the mandate but has chosen not to provide an exhaustive list of information for each type of record. A draft list of minimum requirements is given as annex to this draft advice.

CESR understands that the Commission is to provide it with a further set of mandates to advise on Level 2 measures relating to the Directive. The subjects to be covered will include the requirements under Article 19(4) to (6). In anticipation of that further work, the provisions in the Annex to the draft advice that are relevant to those Articles may need to be revisited.

CESR has noted the request in the indicative elements of the mandate to cover the recording of telephone conversations. This is a difficult issue to deal with as the cost to practitioners in the financial markets of installing and operating a recording system should not outweigh the benefits of recording data in this way. However, the obligation in Article 25(2) to keep relevant data relating to

transactions in financial instruments at the disposal of the competent authority for at least five years only applies to the details of the transactions and does not apply to the recording of the conversations in which the orders are given. The advice therefore contains a lesser requirement but is without prejudice to the powers of national authorities to impose requirements that would enable them to discharge their enforcement and investigatory obligations for example by extending the maintenance period where an investigation is undertaken or contemplated.

The requirement for investment firms to retain records for at least five years should apply irrespective of the termination of the relationship with the client involved.

Specific questions for consultation

The first part of CESR Standard 10 on Investor Protection requires an investment firm to be able to demonstrate that it has not acted in breach of the conduct of business rules.

Such a requirement would assist competent authorities in taking enforcement action against an investment firm which fails to demonstrate that it has complied with the conduct of business rules.

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

Some CESR Members feel that the reversal of the burden of proof is the necessary precondition for the principles-based approach which informs the present draft advice, whereas not including such a provision would require a more detailed regulation aimed at identifying the specific guidelines of conduct which investment firms are supposed to maintain towards their clients.

Furthermore, possible inconsistencies might arise from the provision of investment services via different techniques due to the option granted to Member States to reverse the burden of proof according to Article 15 of the Directive 2002/65/EC on distance marketing of financial services.

Other members of CESR believe sufficient safeguards are already provided by the Level 1 text of Article 13(6) and the requirements under paragraph 2 of the draft advice under Article 13(2).

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?*

The Annex to the draft advice contains a list of the records that an investment firm should be required to keep as a minimum. It may be appropriate to include additional minimum requirements in the advice. In particular, such additional records could relate to capital markets business, investment banking business and general financial advice to corporate clients.

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?*

Draft Level 2 advice

BOX 4

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

2. In complying with the obligation in Article 13(6) of the Directive, an investment firm must;

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

(see Annex to this draft advice for a list of records that investment firms should be required to keep as a minimum)

(b) keep records of telephone orders on a voice recording system for a period of at least one year;

(c) keep records in such a way, including the format, organisation and completeness of such records, that they may be readily reproduced on paper, and that the competent authority is able to readily access and search them and reconstitute each stage of the processing of all transactions and instructions by the investment firm; and

(d) keep records in a manner designed to ensure that any corrections or other amendments as well as the contents of the records prior to any such amendments can be easily ascertained and that the records cannot otherwise be manipulated or altered.

3. The record keeping requirements under paragraph 2 shall survive the termination of the investment firm's authorisation.

4. [*An investment firm must be able to demonstrate that it has not acted in breach of its obligations under the Directive and the internal code of conduct.*]

[**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 the conduct of business rules under the Directive?*]

Annex - Minimum list of records to be maintained

The records below contain the following information (for each information specific details are provided as well as the time when the record should be done):

- ***Type of record:*** contents of record (time at which record must be created)
- ***Categorisation of each client*** which includes sufficient information to support categorisation *(when the client relationship begins or upon re-categorisation, to include annual review where necessary)*
- ***Retail client agreements*** which include the records provided for under paragraph 8 of the draft advice under Article 19(7) *(at the time and for the period provided for under paragraph 8 of the draft advice under Article 19(7))*
- ***Client details*** which include the client identification according to applicable legislation and regulatory requirements, including under Articles 19(4) or (5) *(on giving advice or being appointed as a portfolio manager)*
- ***Allocation of aggregated transactions in a series of transactions all executed within one business day*** which includes the time each transaction is made *(on executing an aggregated transaction)*
- ***An aggregated transaction that includes a client order:*** identity of each client; whether transaction is in whole or in part for discretionary managed investment portfolio and any relevant proportions *(on executing an aggregated transaction)*
- ***Aggregation of one or more client orders and an own account order*** which includes the

intended basis of allocation *(before the transaction is executed)*

- ***Allocation of an aggregated transaction that includes the execution of a client order*** which includes the date and time of allocation; relevant designated investment; identity of each customer client and the amount allocated to each client *(date on which the order is allocated)*

- ***Re-allocation*** which includes the basis and reason for any re-allocation *(at the time of the re-allocation)*

- ***Orders received or arising*** which include the records provided for under paragraphs 17(a) and 18 of the draft advice under Article 22 *(at the time provided for in paragraph 17(a) of the draft advice under Article 22)*

- ***Orders carried out (other than those falling under the following paragraph) and transactions effected for own account*** which include the records provided for under paragraphs 17(b)(i) and 19 of the draft advice under Article 22 *(at the time provided for in paragraph 17(b)(i) of the draft advice under Article 22)*

- ***Transmission of orders received by the investment firm*** which includes the records provided for under paragraphs 17(b)(ii) and 20 of the draft advice under Article 22 *(at the time provided for in paragraph 17(b)(ii) of the draft advice under Article 22)*

- ***Periodic statements to clients*** which include the copy of any periodic statement issued to clients by the firm in respect of services provided *(on date on which it is provided)*

- ***Temporary holding by an investment firm of a client's financial instruments*** which includes client details and any action taken by the investment firm (note also the requirements under paragraph 11 of the draft advice under Articles 13(7) and (8)) *(For duration of holding)*

- ***Client financial instruments held or received by or on behalf of a client or which the investment firm has arranged for another to hold or receive*** which include full details (note also the requirements under paragraph 11 of the draft advice under Articles 13(7) and (8) of the Directive) *(on receipt)*

- ***Financial instruments held for clients used for stock lending activities*** which include the identity of financial instruments held for clients that are available to be lent, and those which have been lent (note also the requirements under paragraph 9 of the draft advice under Articles 13(7) and (8), where applicable) *(on receipt)*

- ***Client funds*** which include sufficient records to show and explain investment firm's transactions and commitments (note also the requirements under paragraph 11 of the draft advice under Articles 13(7) and (8)) *(As soon as monies received and paid out)*

- ***Marketing communications*** which include each marketing communication in writing addressed by the investment firm to clients or potential clients *(at the time the investment firm first issues the marketing communication)*

- ***Investment research*** which includes each item of investment research issued by the investment firm in writing *(at the time the investment firm first issues the item of investment research)*

- ***Compliance policies and procedures*** which include the policies and procedures maintained

under paragraph 2(b) of the advice on Article 13(2) *(on the policies and procedures being established or amended (in respect of each version the period in paragraph 2(a) of the draft advice on Article 13(6) shall commence is the date on which the relevant version is amended).*

- ***Compliance reports*** which include compliance reports to senior management *(at time of the relevant report)*
- ***Internal audit reports*** which include internal audit reports to senior management *(at the time of the relevant report)*
- ***Complaints records*** which include complaints received *(on receipt of complaint)*
- ***Complaints handling*** which include how complaints are dealt with (*as complaints are dealt with)*

[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.*]

Safeguarding of clients' assets (Article 13 (7) and (8))

Extract from Level 1 text

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

Extract from the mandate from the Commission

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

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

Draft CESR advice

Explanatory text

Organisational requirements have to be put in place by investment firms to safeguard clients' ownership rights, especially in the event of investment firms' insolvency or actions brought against them by their creditors or by creditors of one or more of their clients. Because of the present lack of harmonisation of national insolvency or property laws within the European Union, there cannot be uniformity as to the manner in which effectiveness of the organisational requirements on the insolvency of an investment firm is achieved. Furthermore, the implementing measures must take account of the possibility for the purchase through EU investment firms of securities which are subject to the laws and regulations of third countries. As a consequence, the implementing measures would be better described as requiring particular outcomes to be achieved rather than specifying particular arrangements in all circumstances. CESR is aware of the fact that this draft technical advice might be affected by the adoption of CESR-ESBC Standards on Securities Clearing and Settlement Systems and by any future action by the Commission following its Communication on clearing and settlement.

The definition of a "depository" is intended to include a clearing or settlement system with which client assets are held.

Credit institutions receiving funds from, or on behalf of, a client in the course of providing investment services to the client, shall not be subject to this draft advice where the receipt and holding of those funds also constitute the holding of a deposit. However, if a credit institution

chooses to place the client's funds with a third party on behalf of a client, when providing one or more investment services, this advice shall apply.

The records to be kept by the investment firm shall allow proper identification of ownership rights and correspondence to the actual assets held by the investment firm on behalf of its clients. A client's assets shall be properly identified with respect to the investment firm's proprietary assets and assets held by the investment firm on behalf of other clients.

The investment firm's responsibilities with respect to the client's assets it holds shall be clearly stated in writing in the agreement to be entered into by the investment firm with each client under paragraph 12 below. When an investment firm sub-deposits its clients' assets with a depository, it shall, as a minimum, be responsible for any damage suffered by the clients as a consequence of not having exercised due skill, care and diligence in the selection and periodic review of the depository.

Appropriate control and external review shall be regularly carried out to verify effective operation of records and procedures to secure clients' ownership rights.

The mere use of arrangements for the pooling of clients' financial instruments maintained in accordance with national law should not trigger paragraph 5 of this advice.

The following provisions are without prejudice to the ability of the competent authority to determine whether an investment firm is permitted to receive, handle or hold clients' assets.

Specific questions for consultation

Regulated and unregulated depositories

In certain cases, it may be necessary or desirable for financial instruments to be held by a depository located in a third jurisdiction, even though no regulated depositories are located in that jurisdiction (for example, a local depository may be required to process tax reclaims).

However, where regulated depositories do operate in the relevant jurisdiction, their regulated status is supposed to provide additional assurances as to their fitness to act as depositories, entail a level of ongoing supervision and should in principle result in the availability of additional investor protection. There are therefore potentially strong reasons for choosing a regulated depository over an unregulated depository to hold client financial instruments in another jurisdiction.

However, CESR invites comments as to whether there are jurisdictions having both regulated and unregulated depositories in which (bearing in mind the obligations of due diligence that would be placed on investment firms under paragraph 8(a) of this advice) there would be overriding considerations why they should use an unregulated depository instead of a regulated depository.

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?*

Record keeping where equivalent assets held with multiple depositories

There are differing views among CESR Members as to the level of record keeping that should be required where an investment firm holds equivalent financial assets on behalf of clients with different depositories. By way of example, this would be relevant if an investment firm holds 1000 shares in XYZ PLC for client A and 1000 shares in the same company for client B and sub-deposits 1000 of those shares with depository X and 1000 of those shares with depository Y.

Some members believe it is necessary for the investment firm's records to indicate not only that 1000 shares are held for each of client A and client B, but also to record the depository with which each client's shares are held. For example:

- client A – 1000 shares in XYZ PLC: 250 with depository X and 750 with depository Y; and
- client B – 1000 shares in XYZ PLC: 750 with depository X and 250 with depository Y.

In the event of the insolvency of depository X and the loss of the financial instruments deposited with it, such records would allow the clear allocation of loss between client A (250) and client B (750). If no such records were maintained, another method of allocating loss would need to be found in accordance with national provisions pertaining to insolvency procedures (for example, a proportionate loss of 500 shares assigned to each of client A and client B where it is not possible to allocate otherwise the respective losses).

Other Members of CESR believe the minimum requirements set out in the Level 2 measures need only require that the investment firm: (a) maintains records of: (i) the amount of each type of asset held for each client; and (ii) the amount of each type of asset held with each depository; and (b) ensures the aggregate figures correspond with each other in accordance with paragraphs 11(c) and 13(b). Particularly, where the pooling of clients' assets is allowed, the proportionate allocation of loss between the clients may not be an unreasonable approach, as they may have had no control over and knowledge of where their assets were held.

Question 5.2.: *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 firm 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 investment firm's contract with the client: terms relating to liability for depositaries

Paragraph 12(a) of the draft advice envisages that the contract between the investment firm and the client should set out the responsibility that the investment firm accepts for the acts, omissions or insolvency of any depositories. CESR Members agree that the draft advice should set out a minimum level of responsibility to be accepted by the investment firm for its own failure to use all due skill, care and diligence in relation to the depository and more generally for depositories in the same group.

However, some Members of CESR believe the relevant advice should focus on the effect of the provisions of the contract without specifying the particular words on liability to be included in the contract, bearing in mind the lack of harmonisation of national systems of contract law. Such an approach would provide a minimum degree of protection, while allowing investment firms to agree with their clients to accept a higher degree of liability for their depositories.

Other Members of CESR believe it is preferable to specify the provisions to be included in the client agreement, in order to ensure an appropriate degree of protection for clients. Such an approach would also require the investment firm to accept full liability for any losses the client suffers where the investment firm is directly or indirectly linked to the depository. Where the investment firm is not so linked to the depository, it would be required to accept liability for any losses unless it shows that it has exercised all due skill, care and diligence in the selection and periodic review of the depository.

Question 5.3.: *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, care 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?

Draft Level 2 advice

BOX 5

Interpretation and scope

For the purpose of this advice:

1. The following provisions are without prejudice to the possibility for the client himself to deposit his assets with a third party and authorise the investment firm to operate on his behalf the account held with such third party (by virtue of a portfolio management agreement, general agency agreement or other right) to the extent that this is necessary for the performance of the services that the investment firm provides to him.

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

Arrangements designed to protect client assets

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

4. An investment firm must make specific arrangements in respect of the clients' assets it holds. Such arrangements:

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

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

   (c) must include appropriate measures designed to prevent:
      i. the unauthorised use of a client's assets for the account of (or by) other clients; and
      ii. the misappropriation of clients' assets.

   The above requirements do not prevent the investment firm or a depository, taking or enforcing a lawful security interest or lien, or exercising a lawful right of set off over clients' assets in accordance with applicable law and regulation.

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

   a) that client has given his express consent in writing;

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

c) the document in which that client's consent is requested by the investment firm gives clear information to him on:
   i. the obligations and responsibilities of the investment firm and/or of the other clients for whose account the investment firm has been allowed to use the client's financial instruments, with respect to the use of the client's financial instruments (including the terms for the restitution of the financial instruments); and
   ii. the risks involved.

6. Without prejudice to the provisions in the previous paragraph, an investment firm may dispose of clients' assets that it holds only for the account of the relevant client and in so far as this is necessary for the performance of its services for the client or is in accordance with the client's instructions.

Sub deposit of client assets

7. An investment firm which is not a credit institution must promptly sub-deposit client funds into one or more accounts opened with a central bank, a credit institution authorised in accordance with Directive 2000/12/EC of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions or a bank authorised in a third country. Such accounts may be either individual or omnibus accounts provided that they are identified separately from any accounts used to hold funds belonging to the investment firm. Where the investment firm resolves not to deposit client funds with a central bank, the choice of the bank should comply with the conditions set out in the following paragraph other than letter (a)(i) (on the basis that references in that paragraph to "financial instruments" must be read as references to "funds").

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

   a) exercises all due skill, care and diligence in the selection, appointment and periodic review of the depository, including an annual review of the continuing appropriateness of its selection of the depository in light of an appropriate risk assessment. In selecting the appropriate depository, the investment firm must take account of all relevant factors including, to the extent they are applicable or relevant:
      i. in the case of financial instruments, whether the depository is regulated, to what extent and by whom, including whether the holding and the safekeeping of clients' financial instruments is subject to specific regulation and supervision.

         [*In jurisdictions where this is the case, the investment firm must have recourse to a regulated institution unless overriding considerations to the contrary are shown to exist;*] **OR**
         [*In jurisdictions where this is the case, the investment firm must have recourse to such regulated institutions;*]

[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?]*

      ii. the investment firm's experience of the depository's performance of its services to the investment firm;
      iii. the arrangements which are or will be made by the depository for the holding and safekeeping of client financial instruments;

iv. the expertise and market reputation of the depository; and
v. in the case of clients' assets held by an institution located in a third country, any legal requirement or appropriate market practice about the use of particular depositories;

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

c) ensures that it and the depository agree:
i. what services are to be provided by that depository and the level of responsibility accepted by that depository; and
ii. the arrangements for the termination of the depository's appointment.

Pooling of financial instruments held by an investment firm for more than one client

9. If an investment firm, where permitted by national law, has pooled the financial instruments that it holds for more than one client, the investment firm may not enter into arrangements for the lending of any of the pooled financial instruments unless:

a) all of the clients whose financial instruments are held in that pool have consented to those financial instruments being used in such arrangements; or

b) the investment firm has appropriate systems and controls in place to ensure that only financial instruments belonging to clients who have given their consent are used in those arrangements.

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

[**Question 5.2.:** *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?]*

Appropriate record keeping/clarity of ownership identification

10. An investment firm that receives funds from a client must be able to identify whether they are client funds or a payment for services.

11. The records of an investment firm that holds clients' assets must:

a) enable a client's assets held by the investment firm to be promptly identified and distinguished from the proprietary assets of the investment firm and from the assets which the investment firm holds on behalf of other clients. For this purpose, as a minimum requirement, the investment firm must record a separate position in each relevant currency and financial instrument for each client;

[**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 client assets are held, or is it sufficient that the investment firm 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 the aggregate figures correspond with each other in accordance with paragraphs 11(c) and 13(b)?*]

b) be backed-up regularly; and

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

Clarity of responsibilities

12. Without prejudice to the advice under Article 19(7), an investment firm that holds client assets must enter into an agreement in writing with the client that clearly sets out the rights and obligations of the investment firm with respect to the holding of clients' assets. This contract must include:

    a) if the client's assets may be held by a depository on behalf of the investment firm, that this is the case and the responsibility the investment firm accepts to the client for the acts, omissions or insolvency of the depository. [*The contract may not purport to exclude or limit the investment firm's responsibility for losses directly arising from the investment firm's failure to exercise all due skill, care and diligence in the selection and periodic review of the depository as provided for above. The investment firm must also accept the same responsibility for a depository that is a member of its group as it accepts for itself.*] **OR** [*Where the contract purports to exclude or limit the investment firm's responsibility in this respect, it must state that the investment firm will 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 will 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 as provided for above.*] Where the rights and obligations of the investment firm are determined solely by a particular law or regulation, a reference to the relevant provision shall be sufficient;

[**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, care 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?]

    b) if any of the client's assets may, in accordance with national law, be pooled with the assets of other clients of the investment firm (whether by the use of an omnibus account with a depository, the registration of financial instruments in the same name or otherwise), that this is the case and a description of the risks arising as a result of such pooling;

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

    d) a description of the way in which client assets held by the investment firm are

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

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

Appropriate controls

13. An investment firm that holds clients' assets must:

a) have internal control procedures to ensure that its arrangements to safeguard the ownership rights of its clients are operating effectively;

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

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

External review of records and procedures

14. An investment firm that holds clients' assets must have the records provided for in paragraphs 9 and 11 audited by an external auditor on at least an annual basis.

15. External auditors must report on at least an annual basis to the competent authorities on an individual firm's ability to comply, and its actual compliance, with the rules provided for in this advice.

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

Extract from Level 1 text

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

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

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

Extract from the mandate from the Commission

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

(1) the appropriate criteria for determining the types of conflict of interest whose existence may damage the interests of the clients or potential clients of the investment firm

(2) the steps that investment firms might reasonably be expected to take to identify, prevent, manage and/or disclose conflicts of interest when providing various investment and ancillary services and combinations thereof.

Draft CESR advice

Explanatory text

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

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

A balance needs to be struck between measures that fall under Articles 13(3) and 18, and those that are best dealt with under other Articles. In particular, many conduct of business provisions address the prevention and management of conflicts of interest in various ways. For example, rules addressing best execution, client order handling, front running, soft commission, allocations, payment for order flow and other types of inducements, can all be seen as relating to conflicts of interest as well as to the requirement to act in the best interests of the client. To the extent that these issues need to be addressed at Level 2, some of them could more readily fall under measures under Articles 19, 21 or 22 as appropriate, rather than Articles 13(3) and 18.

Nothing in this Level 2 advice is intended to derogate from any specific obligation (of a conduct of business nature or otherwise) that an investment firm may be under by reason of any other provision of the Directive or under any other relevant directive.

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

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

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

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

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

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

The acceptance and provision of inducements by investment firms is a particular area of concern in relation to conflicts of interest. This area is under consideration by a number of regulators and market participants. As this is an area of developing practices, it is desirable for the Level 2 measures to provide competent authorities with flexibility to update current provisions to reflect those changing practices. The draft advice therefore suggests that as a minimum, the offer or receipt of inducements may only be permitted by competent authorities if those inducements can reasonably assist the investment firm in the provision of services to its clients and do not conflict with its duty to act in the best interests of the client. In view of the impact that changes to accepted practices in this area may have on existing market structures, the draft advice focuses on this minimum standard, rather than calling for full harmonisation of the list of acceptable or unacceptable practices at this stage.

Another area that has been given specific attention is the provision of investment research, which has been the subject of a great deal of work by IOSCO, the Forum Group, and individual regulators. The material on investment research conflict management takes a high-level approach to the issue, based on disclosure by investment firms of their arrangements for managing conflicts of interest and a number of minimum organisational standards to be adhered to.

The draft advice includes particular provisions that are complementary to the provisions under Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation (market

abuse) ("MAD") and other general provisions under the Directive on conflicts of interest. This is because it is felt that specific and sometimes more detailed provisions are necessary for the proper prevention and management of either conflicts of interest arising from the provision of investment research, or particular conflicts that might be the result of unavoidable interactions of this ancillary service with other services and activities.

Specific questions for consultation

Measures to ensure independence

As stated above, the emphasis of this Level 2 advice is on general obligations to identify and manage conflicts of interest that are capable of application to investment firms of different characteristics, avoiding standards that could not be of universal application.

The draft advice contemplates that a firm's conflicts policy must include details of its organisational and administrative arrangements for preventing and managing conflicts of interest that may or do give rise to a material conflict of interest.

Paragraph 7 provides that, to the fullest extent practicable, these arrangements must include the segregation by information barriers of the persons engaged in the activities listed in paragraph 2, unless the investment firm is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients. In addition to this requirement, paragraph 8 of the draft advice lists certain other measures for providing an appropriate degree of independence in respect of persons engaged in various business activities.

Some CESR Members feel that the additional measures in paragraph 8 should, to the fullest extent possible, be included in the conflicts policy unless the investment firm is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients. Such an approach would help to promote independence between business activities while including flexibility.

However, other CESR Members believe that particular methods of achieving independence may not always be the best or the most appropriate solution for the prevention and management of conflicts of interest. There may be situations in which it is necessary or more appropriate for firms to implement a combination of other measures which will prevent conflicts in a more effective fashion, depending on the firm's structure and activities. Also, a number of conduct of business rules can be seen as assisting in the management of specific conflicts of interest, reducing the need for prescriptive conflicts management requirements. An alternative to creating a presumption in favour of measures to ensure independence would be to rely on the general obligation in Article 13(3) and to treat the measures listed in paragraph 8 as examples of the arrangements firms may use to comply with that general obligation.

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

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?

Information barriers in relation to investment analysts

Under Principle 2.2 of the September 2003 IOSCO Statement of Principles for addressing sell-side securities analyst conflicts of interest ("IOSCO Principles"), the IOSCO Technical Committee stated that it believed one of the core measures aimed at preventing analysts' research and recommendations from being prejudiced by the business relationships of the firms that employ them is "establishing robust information barriers between analysts and a firm's other divisions in order to limit the potential for conflicts of interest and prevent other individuals in the firm from attempting to influence analysts' research".

Therefore, it may be felt that, in order to ensure consistency with the IOSCO Statement, the level 2 measures should require the establishment of information barriers between investment analysts and any other divisions of the investment firm.

However, an alternative approach may be to focus on the need for information barriers between investment analysts and the firm's corporate finance division, as the area which presents the most significant particular potential for conflicts of interest in relation to the issue of investment research.

Question 6.3.:

(a) Is it appropriate for an investment firm that publishes or issues investment research to maintain information barriers between analysts and its other divisions?

(b) If so, which divisions should be separated by information barriers in order to prevent analysts' research from being prejudiced?

Organisational requirements for firms that issue or publish investment research

Paragraph 16 of the draft advice contains a number of requirements to be imposed on an investment firm that publishes or distributes investment research. These are based on recommendations contained in the IOSCO principles. The draft advice however provides for a derogation from the requirements in paragraph 16(f)(i) to (v) provided certain conditions are met by the investment firm and sets out two alternatives for these conditions.

The first option takes an approach of limiting the scope for derogations from the requirements set out in paragraph 16(f) of the draft advice by setting up strict conditions for any exemption and additionally requiring clear disclosure where some or all of these requirements are not complied with. Therefore, it requires a combination of: (i) the investment firm taking assiduous efforts to comply with the standards laid down in paragraph 16(f); (ii) the nature and scale of the investment firm's business preventing it from implementing those standards and the conflicts potential being of a minor nature; (iii) disclosure of the fact that the investment research was not prepared in accordance with all of the conflicts of interest standards and disclosure of the alternative measures taken to address the relevant conflicts; and (iv) the investment firm being able to comprehensively demonstrate why it was not able to comply with the standards laid down in paragraph 16(f) and which alternative measures it has taken.

The second option also provides for a derogation from the requirements set out in paragraph 17(f). It focuses on the concern that research should not be presented to clients as objective investment research when all of the measures designed to promote that objectivity have not been taken. It therefore only sets out requirements for clear disclosures coupled with a requirement that none of the circumstances relating to the distribution or presentation of the investment research would lead a reasonable person to whom it was directed to rely on it as objective investment research.

Question 6.4.: *Should the derogation from the requirements in paragraph 16(f)(i) to (v) be available if:*

(a) the investment firm complies with the requirements in paragraphs 17, 18 and 19 of the first option set out below; or

(b) the investment firm complies with the requirements in paragraph 17 of the second option set out below?

Draft Level 2 advice

BOX 6

I - IDENTIFICATION OF CONFLICTS

1. The conflicts of interest that must be identified pursuant to Article 18(1) of the Directive and to which this advice applies are actual conflicts of interest and circumstances involving a risk of a conflict arising, where such actual or potential conflict of interest may cause damage to a client's interests. Without limiting the generality of Article 18(1) of the Directive, an investment firm must ensure that its conflicts policy includes all reasonable steps to identify at least conflicts of interest arising in the following situations and that these steps are effectively implemented:

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

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

   (c) the investment firm or an interested person has a financial or other incentive to favour its own or such other person's interests above those of one or more of the firm's clients, in particular, where the firm or an interested person:

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

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

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

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

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

   This provision is without prejudice to the general obligation for the identification of conflicts of interest arising from or within any business area or other combination of business areas, according to the criteria in paragraph 1 above.

3. The investment firm must maintain updated records of the categories of interested persons, areas of business, types of financial instruments and transactions that have been identified as potential sources of conflicts of interest according to the criteria in paragraphs 1 and 2 above.

II - CONFLICTS POLICY

4. Having regard to the criteria in paragraphs 1 and 2, an investment firm must establish, maintain and enforce a written policy that sets out details of its organisational and administrative arrangements for identifying, preventing and managing conflicts of interest in order to prevent damage to the interests of its clients. To this end, references in this advice to "conflicts of interest" in the context of the prevention or management of conflicts should be understood as applying to the circumstances that may or do give rise to a material conflict of interest, in the sense of presenting a material possibility of damage to the interests of one or more clients.

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

   (a) its organisational structure and business model;

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

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

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

6. The arrangements set out in the conflicts policy must, to the fullest extent practicable, include effective methods of providing an appropriate degree of independence in respect of persons engaged in different business activities involving a conflict of interest that presents a material possibility of damage to the interests of one or more clients and/or may affect the due and proper performance of those respective business activities.

7. The effective organisational and administrative arrangements to be maintained and operated under Article 13(3) of the Directive should, to the fullest extent practicable, include the separation of at least the persons engaged in activities listed in paragraph 2 by information barriers, unless the investment firm is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients.

8. [*The arrangements set out in the conflicts policy must, to the fullest extent possible, include the following methods, unless the investment firm is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients*] **OR** [*Without prejudice to paragraph 7, the following are 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:*]

   (a) establishing information barriers between activities other than those listed in paragraph 2;

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

different senior executives;

(c) making the remuneration of relevant persons principally engaged in one activity independent of the remuneration of, or revenues earned by, relevant persons principally engaged in the other activity;

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

(e) limiting involvement in extraneous activities, for example, by preventing relevant persons principally engaged in one activity from having joint involvement in the activities of relevant persons principally engaged in another activity, where such involvement may lead to poor conflicts management;-and

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

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

[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?]

III - INDUCEMENTS

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

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

11. Where inducements are permitted in accordance with paragraph 9 above the investment firm must inform the client in writing:

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

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

IV - DISCLOSURE

12. An investment firm should disclose to its clients in general terms its conflicts policy in writing. Where possible, such disclosure should take place at the same time as the investment firm is required to provide information before the commencement of the provision of services under Article 19(3) of the Directive; otherwise it must be made prior to the client entering into any relevant transaction.

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

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

(a) provide that disclosure in writing; and

(b) obtain the client's consent before undertaking business with the investment firm.

V - INVESTMENT RESEARCH – CONTENTS OF CONFLICTS POLICY

15. Where an investment firm issues investment research, its conflicts policy must specify the types of investment research issued by it.

16. Where the investment firm publishes or distributes investment research, its conflicts policy shall include the following minimum requirements in relation to the preparation of that research:

(a) analysts must not trade securities or related derivatives ahead of publishing research on the issuer of those securities;

(b) analysts must not trade in securities or related derivatives of an issuer they review in a manner contrary to their existing recommendations, except in special circumstances subject to pre-approval by compliance or legal personnel;

(c) analysts must not accept any inducements from issuers, or others with a material interest in the subject matter of investment research, other than minor gifts or hospitality below a value specified in the conflicts policy;

(d) the investment firm must not promise issuers favourable research coverage, specific ratings, or specific target prices in return for a future or continued business relationship, service or investment;

(e) issuers, or others (other than the investment firm's relevant persons) with a material interest in the subject matter of investment research, may only be permitted to review draft research for the purpose of verifying the accuracy of factual statements made in that research. This draft research must not include the recommendation or the target price; and

(f) Subject to paragraph 17,

(i) [*information barriers must be established between analysts and the firm's other divisions*] **OR** [*information barriers must be established between analysts and the corporate finance division (if any)*];

[**Question 6.3.:**

(a) Is it appropriate for an investment firm that publishes or issues investment research to

maintain information barriers between analysts and its other divisions?

(b) If so, which divisions should be separated by information barriers in order to prevent analysts' research from being prejudiced?]

(ii) analysts must not be supervised by a natural person who has responsibilities or interests that might reasonably be considered to conflict with the interests of the clients to whom the investment research is published or distributed;

(iii) the remuneration of analysts must not be determined by a person who is prohibited from supervising them under sub-paragraph (ii), nor should it create any incentive which is inconsistent with the analyst's objectivity, or could reasonably be considered to be so;

(iv) analysts must not become involved in activities other than the preparation of investment research (such as participating in investment banking activities such as corporate business and underwriting, attending pitches and participation in issuer marketing or "road shows"), where such involvement is inconsistent with the analyst's objectivity, or could reasonably be considered to be so; and

(v) the investment firm's relevant persons with a material interest in the subject matter of investment research, may only be permitted to review draft research for the purpose of verifying the accuracy of factual statements made in that research. This draft research must not include the recommendation or the target price.

[**First option**

17. Having made assiduous efforts to comply with the standards laid down in paragraph 16(f), the investment firm may, without prejudice to the other obligations imposed in this advice and the Directive, issue research that was not prepared in accordance with paragraph 16(f) provided that:

(a) the nature and scale of its business prevents the investment firm from the implementation of those standards, and

(b) the conflicts of interest potential within the particular business of the investment firm is of a minor nature (e.g. the investment firm does not provide investment banking).

18. Given the circumstances mentioned in paragraph 17, the investment firm must disclose that the investment research was not prepared in accordance with all of the conflict of interest standards for the preparation of investment research laid down in the level 2 measures and that the investment firm has taken alternative measures in order to address conflicts of interests related to the preparation of research.

19. Upon request of the competent authority, the investment firm must comprehensively demonstrate why it was not able to comply with the standards laid down in paragraph 16(f) and which alternative measures it has taken.]

OR

[**Second option**

17. Without prejudice to the other obligations imposed on it under the Directive, including under Articles 13(2) and (3), 18 and 19(2) and (3), an investment firm may issue investment research that is not prepared in accordance with paragraph 16(f) provided that:

(a) a warning is included with due prominence in the investment research making it clear that the information should not be relied upon as objective investment research

because it was not prepared in accordance with all of the conflicts management standards for the preparation of objective investment research laid down in the level 2 measures and also referring to the information specified in sub-paragraph (b) below;

(b) separately from the above warning, the investment research contains a substantive description of each of the requirements in paragraph 16(f) that was not complied with in its preparation; and

(c) none of the circumstances relating to the distribution or presentation of the investment research would lead a reasonable person to whom it was directed to rely on it as objective investment research.]

[**Question 6.4.:** *Should the derogation from the requirements in paragraph 16(f)(i) to (v) be available if:*

(a) the investment firm complies with the requirements in paragraphs 17, 18 and 19 of the first option set out below; or

(b) the investment firm complies with the requirements in paragraph 17 of the second option?]

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

Extract from Level 1 text

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

Extract from the mandate from the Commission

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

(1) Specify the criteria for assessing the fairness, clearness and not misleading character of marketing communications and of any other promotional/publicity communication addressed to clients or potential clients.

(2) Specify what is to be considered as a marketing communication in the context of this provision.

In respect of this request CESR should take account of any relevant provision of Community Law and in particular those referring to publicity and marketing communications.

Draft CESR advice

Explanatory text

This advice is intended to specify the criteria for assessing the fairness, clearness and not misleading character of information, including marketing communications and of any other promotion/ publicity communication addressed to clients or potential clients for the purposes of Article 19(2). It is also intended to specify what is to be considered as a marketing communication in the context of this provision.

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

The definition of a marketing communication is not however intended to apply to communications that are directed at one specific person or group of persons acting jointly, unless those communications form part of an organised marketing campaign. (Examples of persons acting jointly include a husband and wife or the guardians of a minor investing jointly.) The reference to organised marketing campaign would prevent an investment firm from circumventing the requirements relating to marketing communications by slightly personalising each communication sent out in a marketing campaign.

Most of the detailed principles set out in the draft advice are only applicable to information provided to retail clients. As recognised in the CESR Professional Regime, it is sufficient in the case of professional clients to rely on the general principle in Article 19(2) that information must be fair, clear and not misleading. This reflects the fact that some information that would be fair, clear and not misleading when provided to a professional client may not meet that standard for a retail client. Retail clients will generally have information needs different from professional clients, and the compliance costs entailed by a more detailed approach are therefore justified. However, the absence of detailed principles for professional clients should not be interpreted as providing exemptions from the general principle in Article 19(2).

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

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

This draft advice is without prejudice to the provisions concerning advertisements relating to an offer to the public of securities or to an admission to trading on a regulated market under Directive 2003/71/EC on the prospectus to be published when securities are offered to the public or admitted to trading.

Member States may impose additional requirements in relation to the subject matter of this advice.

Draft Level 2 advice

BOX 7

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

General obligations

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

3) When an investment firm directs or addresses any information (including a marketing communication) to its retail clients or potential retail clients it must ensure:

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

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

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

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

4) An investment firm must take all reasonable steps to ensure that the information provided by it in a retail marketing communication is consistent with the information it provides to its retail clients in the course of the provision of the investment services.

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

   a) the identity of the investment firm;

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

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

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

7) The competent authority may:

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

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

Content of specific and direct offer retail marketing communications

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

   a) a balanced description of the main characteristics of the financial instrument and/or service to which it relates, including the nature of the financial commitment and the risks involved in the financial instrument and/or investment service and whether or not the financial instruments involved are:

      i) illiquid; and/or

      ii) traded on a regulated market or an MTF, unless such a reference would be inappropriate in view of the nature of the financial instruments or the arrangements made for the client to liquidate his investment;

   b) the existence or absence of any right of withdrawal and, where a right of withdrawal exists, its duration and the conditions for exercising it, including information on any amount that the retail client may be required to pay to exercise (or as a result of exercising) that right; and

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

9) Paragraph 8 does not apply to advertisements that only contain one or more of the following:

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

   b) the name of a financial instrument;

   c) a contact point;

   d) a logo;

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

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

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

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

10) In addition to the information required under paragraph 8, any direct offer retail marketing communication must also contain any additional information required under Article 19(3) in relation to the investment services and/or financial instruments to which it relates.

Specific obligations

11) Information on financial instruments and investment services provided by an investment firm to a retail client or potential retail client must not state or imply that the performance of investment services or of the financial instruments is guaranteed unless there is a legally enforceable arrangement to meet in full the retail client's claim under the guarantee.

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

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

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

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

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

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

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

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

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

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

c) contains information on forecasted future returns:

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

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

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

a) be clearly expressed;

b) state the assumptions on which it is based;

c) be relevant; and

d) not mislead the client.

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

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

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

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

Information to clients (Article 19(3))

Extract from Level 1 text

Article 19(3) - Appropriate information shall be provided in a comprehensible form to clients or potential clients about:
– the investment firm and its services,
– financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies,
– execution venues, and
– costs and associated charges so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format.

Extract from mandate from the Commission

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

(1) Specify the content of the appropriate minimum information that the investment firm should supply to its clients and potential clients in respect of its services and of the firm itself. The content of the minimum information should depend on each type of service.

(2) Specify the content of the appropriate minimum information, including the different warnings, that the investment firm should supply its clients in respect of financial instruments and/or investment strategies.

(3) Specify the content of the appropriate minimum information that the investment firm should supply to its clients concerning the different execution venues. This request should be combined with the requests formulated in the context of Article 19.

(4) Specify the content of the appropriate minimum information that the investment firm should supply to its clients in respect of the costs and associated charges that the client's or potential will have to pay for the provision of the different investment services.

(5) Specify which information should be provided at the outset of the relationship and which should be updated on a continuous basis; determine the form in which the information is to be made available as well as the arrangements for making it available.

Draft CESR advice

Explanatory text

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

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

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

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

While it will often be important for an investment firm to inform a retail client whether a financial instrument is traded on a regulated marketed or an MTF, there may be cases in which such a reference would be inappropriate. (For example, where a collective investment undertaking of the open-ended type provides adequate arrangements for the client to redeem his investment.)

The provisions set out in this advice are intended to apply without prejudice to the requirements 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).

Member States may impose additional requirements in relation to the subject matter of this advice.

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

Draft Level 2 advice

BOX 8

Timing and form of information provision

1) Subject to paragraphs 4 and 5, a retail client or potential retail client must be provided in writing with the information required under Article 19(3) in good time, before:
   a) the commencement of the provision of services to a new client; and
   b) the commencement of the provision of:
      i) new services in relation to new or existing types of financial instruments; and/or
      ii) existing services in relation to new types of financial instruments,

      to an existing retail client, where (in either case) the investment firm has not already complied with the applicable requirements for the provision of information in relation to such services and/or financial instruments.
2) For the purposes of paragraph 1, the meaning of "in good time" should be determined taking into consideration:
   a) the urgency of the situation;
   b) the time necessary for the retail client or potential retail client to absorb and react to the information provided; and

c) the terms of business agreed with the retail client.

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

4) In the case of voice telephone communications with a retail client or potential retail client:

a) the identity of the investment firm and the commercial purpose of the call initiated by the investment firm shall be made explicitly clear at the beginning of any conversation with the retail client or potential retail client; and

b) subject to the explicit consent of the retail client or potential retail client only the following information needs to be given:

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

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

iii) the total price to be paid by the retail client to the investment firm for the financial instruments and/or investment services, including all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service or, where an exact price cannot be indicated, the basis for the calculation of the price enabling the retail client to verify it;

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

v) the existence or absence of any right of withdrawal and, where a right of withdrawal exists, its duration and the conditions for exercising it, including information on any amount that the retail client may be required to pay to exercise (or as a result of exercising) that right.

The investment firm shall inform the retail client or potential retail client that other information is available on request and of what nature this information is. In any case, the investment firm shall provide the full information in writing immediately after starting to provide the service to the retail client.

5) Without prejudice to paragraph 4, the investment firm may provide the information required under Article 19(3) immediately after starting to provide a service to the retail client, if that service has been provided at the retail client's request using a means of distance communication which does not enable the provision of that information in writing in conformity with paragraph 1.

6) The information about the investment firm to be provided to a retail client or potential retail client under Article 19(3) includes the following:

Information about the investment firm

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

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

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

d) the fact that the investment firm is authorised and/or registered and the name of the

competent authority that has authorised and/or registered it;

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

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

Information about methods of redress

g) the existence of guarantee funds or compensation arrangements, not covered by Directive 94/19/EC of 30 May 1994 on deposit guarantee schemes or Directive 97/9/EC of 3 March 1997 on investor-compensation schemes;

h) whether or not there is an out-of-court complaint and redress mechanism for the retail client that receives the investment services and, if so, the methods for having access to it;

i) an outline of the firm's conflicts policy;

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

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

Information about services, financial instruments and costs and charges

7) The information about:

- the investment firm's services;
- financial instruments; and
- costs and associated charges,

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

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

i) the nature of the financial commitment;

ii) whether or not the instruments involved are:

(1) illiquid; and/or

(2) traded on a regulated market or an MTF, unless such a reference would be inappropriate in view of the nature of the financial instruments or the arrangements made for the retail client to liquidate his investment; and

iii) the risks involved;

b) if the retail client envisages undertaking transactions in warrants or derivatives, the information provided must include an explanation of their characteristics (especially the leverage effect and the liquidity and volatility of the market);

c) the total price (including the relevant currency) to be paid by the retail client to the investment firm for the financial instruments and/or investment services, including:

i) all fees, commissions charges and expenses; and
ii) all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service or, where an exact price cannot be indicated, the basis for the calculation of the price enabling the retail client to verify it;

d) the arrangements for payment and for performance;

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

f) the existence or absence of any right of withdrawal and, where a right of withdrawal exists, its duration and the conditions for exercising it, including information on any amount that the retail client may be required to pay to exercise (or as a result of exercising) that right; and

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

8) The information to be disclosed to a retail client or potential retail client on commissions, charges and fees must include:

a) the basis or amount of the charges for transactions, financial instruments and/or investment services, detailing, where appropriate:

i) the percentage or rate applicable;
ii) the frequency with which the percentage or rate is applied;
iii) any maximum or fixed minimum fees; and
iv) where the commission or fee must be paid in foreign currency, the currency involved; and

b) if various investment firms are to be involved in a transaction or investment service, an estimate of the other fees that will be payable.

9) The information provided to a retail client or potential retail client under paragraph 7(a) in relation to a compound product must contain all the relevant and material characteristics of the composite instruments including, for example, the different services involved, the duration of the product, whether the instrument involves credit and the interest due.

10) Where an investment firm has provided information to a retail client or potential retail client that states or implies that the performance of investment services or of the financial instruments is guaranteed, the information provided to that retail client or potential retail client under paragraph 7 in relation to those investment services or financial instruments must include sufficient detail about the guarantor and the guarantee to enable the retail client or potential retail client to make a fair assessment of the guarantee.

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

12) Without prejudice to the second indent of Article 19(3), an investment firm must provide a retail client or potential retail client with appropriate guidance on, and warnings of, relevant risks when providing investment services in relation to:

a) transactions in illiquid financial instruments;
b) leveraged transactions;
c) financial instruments subject to high volatility in normal market conditions;
d) securities repurchase agreements or securities lending agreements;
e) transactions which involve credit, margin payments or the deposit of collateral; and/or
f) transactions involving foreign exchange risk.

13) Where relevant to the financial instruments in relation to which an investment firm is providing investment services, it must also inform a retail client or potential retail client of risks associated with:

   a) clearing house protections (e.g. that although the performance of a transaction is sometimes 'guaranteed' by the exchange or clearing house this guarantee will not necessarily protect the retail client in the event of default by the investment firm or another counterparty);
   b) suspension of trading or listing (e.g. that under certain trading conditions it may be impossible to liquidate a position); and/or
   c) insolvency (e.g. that in the event of default of an investment firm involved with the retail client's transaction, positions may be liquidated automatically and actual assets lodged as collateral may be irrecoverable).

14) Risk warnings provided to a retail client or potential retail client about warrants or derivatives must at least make clear that the instrument can be subject to sudden and sharp falls in value. Where the retail client may not only lose his entire investment but may also be required to pay more later, he must also be warned about this fact and the possible obligation to provide extra funding.

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

Client agreement (Article 19(7))

Extract from Level 1 text

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

Extract from the mandate from the Commission

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

Draft CESR advice

Explanatory text

Since records in general are addressed in the advice under Article 13(7), including client records (both generally and the specific elements mentioned in Article 25(2)) and the period of time that all such records must be kept, it appears necessary to deal only with the records relating to the client agreement in the advice under Article 19(7).

The advice on Article 19(7) deals with the minimum content of the retail client agreement, including the basic agreement, agreements for trading in derivatives and agreements for portfolio management. CESR intends to consult subsequently on the professional client agreement.

The advice follows closely the CESR investor protection standards published in April 2002. A few additions and amendments are proposed in order to take into account the E-Commerce Directive and the Distance Marketing Directive.

Square brackets have been placed around those parts of the text that merely provide examples and explanation.

It will be necessary to distinguish between information that is included in the client agreement under Article 19(7) and therefore binding on the parties, and information that is provided to clients and potential clients under Articles 19(2) and (3) that has a different status. Such non-contractual or pre-contractual information must be "fair, clear and not misleading" as well as consistent with the information provided subsequently in contractual form, but it may not have the same binding effect. These two types of information may of course overlap to some extent, in particular where the contract incorporates certain items of information provided under Article 19(3).

Draft Level 2 advice

BOX 9

Basic retail client agreement

1) In good time prior to providing any investment service or, where appropriate, ancillary service to a retail client, an investment firm must :
   a) provide to the client the terms of the agreement in writing, setting out the rights and obligations of the parties and any other contractual terms, a description of the services to be provided and all other items of information necessary for the proper understanding and performance of the contract, and
   b) obtain the client's consent to the terms of the agreement as evidenced by signature or an equivalent alternate mechanism.

2) By derogation from paragraph 1, the investment firm may provide the terms of the basic retail client agreement in writing and/or obtain the consent of the retail client in accordance with paragraph 1 immediately after starting to provide a relevant service (other than portfolio management or trading in warrants or derivatives) to the client if that service has been provided at the client's request using a means of communication which does not enable the provision of the agreement in writing and/or the evidence of consent of the client in accordance with paragraph 1.

3) The retail client agreement must be clear and easily understandable by the client.

4) The retail client agreement must contain the following items as a minimum:
   a) the identity of each of the parties (including any trade registration number or equivalent of the investment firm);
   b) the geographical address and telephone number or other appropriate contact details of the investment firm;
   c) the identity and geographical address of any relevant representative of the firm established in the client's Member State of residence;
   d) the address and/or other contact details that are to be used by the investment firm to contact the client;
   e) the names of any persons authorised to represent the client for the purposes of the agreement, in particular the names of the natural persons authorised to represent a client who is a legal entity;
   f) a description of any withdrawal right or cooling-off period;
   g) the firm's general terms of business for investment services and, where appropriate, ancillary services [including any particular terms concerning e.g. margin requirements or potential obligations where securities may be purchased on credit];
   h) a general description of the relevant investment services and, where appropriate, ancillary services to be provided by the firm and the types of financial instruments to which such services relate;
   i) the types of orders and instructions that the client may place with the firm, and the media for sending them [(e.g. by telephone, e-mail or post)];
   j) the information to be given by the firm to the client regarding the performance of services including the type, frequency and rapidity of the information to be sent [e.g. regarding order execution or portfolio evaluation];
   k) the forms of communication to be used between the investment firm and the client for sending and receiving orders, instructions and information generally and any alternative media to be used when normal media are unavailable;
   l) full details of the firm's fees and prices for the relevant investment services and, where appropriate, ancillary services, including information on how they are to be calculated, the frequency with which they are to be charged and the manner of payment;
   m) the fact that the firm is authorised and the name of the competent authority that has authorised it;
   n) the law applicable to the contract and the competent national jurisdiction, as ascertained to the best of the knowledge of the firm or as agreed between the parties;
   o) where such a procedure exists, a description of the mechanism for settling disputes between the parties such as an out-of-court complaint and redress procedure;
   p) the duration of the agreement and the procedures for amending, renewing, terminating or withdrawing from it;

q) the actions that the firm shall or may take to dispose of or appropriate any assets of the client in the event the client does not honour his obligations [(e.g. payment of money due to the firm)], including the timeframe for doing so and the information to be given to the client in such circumstances;
r) the languages in which the client can communicate with the firm.

5) Rather than containing all the above items itself, the retail client agreement may refer to other documents containing certain of them, e.g. the general terms of business of the investment firm, the types of investment and, where appropriate, ancillary services offered, the types of orders to be sent by the client, information to be sent by the firm and the fee schedule, provided that all the contractual documents so referred to are provided to the client in good time in accordance with paragraphs 1 or 2 as appropriate.

6) Without prejudice to the provisions on the safeguarding of client assets [i.e. the advice given under Articles 13(7) and (8)], where a custody service is provided to a retail client, either directly by the investment firm party to the contract with the client or indirectly by another investment firm or other entity, the contract must contain an adequate indication of the rights and obligations of the parties, including the provisions relating to the exercise of corporate actions (such as takeover bids and other tender offers, capital reorganisations and conversion or subscription rights) and the exercise of voting rights relating to the securities held.

7) The retail client agreement must state that any material modification of the contract by the investment firm to the detriment of the client,[e.g. regarding fees,] requires the prior notification of the client, and the contract must provide a sufficient opportunity for the client to terminate the agreement at no additional cost (other than the payment of fees and expenses due under the existing client agreement).

8) A copy of the retail client agreement signed by the client, any related contractual documents and any amendments to such agreement or related documents, must be kept by the investment firm for the duration of the client relationship and for at least five years after the end of the relationship; a copy must be provided to the client immediately after signing, and at any time subsequently on request.

Retail client agreement involving trading in warrants or derivatives

9) In good time prior to providing the services of reception/transmission and/or execution of orders involving warrants or derivatives to a retail client, an investment firm must enter into a signed agreement in writing with the client within in the meaning of paragraph 1 containing (or incorporating by reference) all the relevant provisions of the basic retail client agreement as well as the following additional provisions:
a) the types of instruments and transactions envisaged. The contract must mention in particular whether the relevant instruments are admitted to trading on a regulated market or not and whether the client intends to undertake transactions giving rise to contingent liabilities. It must refer to the documentation provided by the firm to the client on the envisaged instruments and transactions for information purposes;
b) the obligations of the investment firm with respect to the envisaged transactions, in particular its reporting and notice obligations to the client. The contract must provide for the immediate confirmation of derivatives transactions and the immediate notice to the client of his payment obligations as they arise, as well as the procedures to be used for such confirmation and notice;
c) the obligations of the client with respect to the envisaged transactions, in particular his financial commitments toward the firm and the time allowed for honouring such commitments. The contract must provide adequate information on any margin requirements or similar obligations, regardless of the source of such requirements [(e.g. an exchange or clearing house or the firm itself)], and must indicate how margin will be calculated and charged, the assets [(cash, securities or other)] accepted as margin, the frequency of margin calls and timetable for delivery or payment of margin by the client. The contract must require immediate notification to the client of any change in margin requirements;

d) an appropriate warning calling to the client's attention the risks involved. The warning must reflect the transactions envisaged, in particular where potential losses may exceed the amounts invested, as well as the experience, knowledge and financial situation/capacity of the client or type of client involved, and must be given due prominence in the contract.

Retail client agreement for portfolio management

10) In good time prior to providing the service of portfolio management to a retail client, an investment firm must enter into a signed agreement in writing with the client, within the meaning of paragraph 1, containing (or incorporating by reference) all the provisions of the basic client agreement except the items referred to in paragraph 4(i), as well as the following additional provisions:
    a) the management objectives, including the level of risk agreed upon, and any specific constraints on discretionary management [resulting from the client's personal circumstances…or his request to exclude certain types of investments…];
    b) the types of financial instruments that may be included within the portfolio and types of transactions that may be carried out in such instruments, including any limits. If the investment firm is mandated to invest in financial instruments not admitted to trading on a regulated market, derivatives, illiquid or highly volatile instruments, or to undertake short sales, purchases with borrowed funds, securities repurchase or lending agreements, or any transactions involving margin payments, deposit of collateral or foreign exchange risk, the contract must state so explicitly and provide adequate information on the scope of the firm's discretionary authority regarding these instruments and transactions;
    c) for information purposes with respect to the client, an appropriate benchmark, based on financial indicators produced by third parties, in common use and consistent with the management objectives, against which performance will be compared. Where it is not feasible to establish a benchmark in view of specific client objectives, this must be stated clearly in the contract and an alternative measure of performance must be indicated;
    d) the basis on which the financial instruments are to be valued at the date of valuation. The contract must state whether the instruments are to be valued with respect to a market price (opening or closing price, bid/ask or offer or mid-market price or other, including the methodology for dealing with currency conversions), or where relevant by reference to indicators such as yield curves or other pricing models and the methodology to be used to value equity instruments that are not admitted to trading on a regulated market or MTF;
    e) all appropriate details regarding any delegation of the management of all or part of the assets in the client's portfolio, where this is envisaged. The contract must state that the delegator retains full responsibility for the protection of the client's interests, and that the client will be informed prior to any material change regarding the delegation of portfolio management.

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

12) If the retail client agreement referred to in paragraph 10 provides for a variable management fee based on the performance of the portfolio, the method of calculation must be clearly defined in the client agreement.

13) The retail client agreement referred to in paragraph 10 must allow the client to terminate the agreement with immediate effect, subject only to the completion of all transactions already commenced and the time necessary to liquidate the portfolio where this is required by the client. The agreement must require that the investment firm provide at least two weeks' notice (or such longer period as agreed by the parties) before terminating the agreement, provided however that where the portfolio cannot be liquidated (where so required by the client) within this timeframe, the agreement may be extended for the necessary additional period, and provided that where the client so agrees after being informed of the firm's intention to terminate, the agreement may be terminated in the timeframe agreed between the parties. In

both cases contemplated by the two previous sentences, the termination must take place on terms that are fair and reasonable for both parties.

Reporting to clients (Article 19(8))

Extract from Level 1 text

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

Extract from the mandate from the Commission

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

Draft CESR advice

Explanatory text

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

Article 19(8) refers to a report being received by the client. However, there may be circumstances where a client may wish to appoint another person to receive reports on his behalf (e.g. the client's accountant or legal adviser). It is not clear that such an arrangement would be catered for in the absence of a statement within the Level 2 materials that permitted the client to appoint another person as recipient. It is likely that a similar clarification will be required by other sections of the Level 2 materials.

CESR Standard 56 has the potential to require double reporting by some investment firms. For example, an investment firm that operates both a portfolio management service and custody service for a client would have to issue two reports that contain substantially the same information to that client. The draft advice proposes the removal of this double reporting requirement where there is information common to both activities by allowing the reporting on one activity to also be taken to satisfy the reporting obligation for the other activity.

However, the ability of an investment firm to include information required in different statements in the same document is without prejudice to its obligation to ensure that all information addressed to clients is fair, clear and not misleading.

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

The draft advice proposes that specific obligations should be imposed on investment firms that operate client accounts that include open positions in contingent liability transactions. The definition of contingent liability transactions focuses on transactions that expose the client to obligations that

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

Specific question for consultation

Certain Member States impose requirements for investment firms to provide reports on investment advice provided to clients, in particular in the case of retail clients or in relation to particular financial instruments. In some cases the advice given to and acted upon by the client will be self-evident to the client and confirmed by a contract note or other confirmation. However, the CESR standards do not include specific reporting requirements in relation to the provision of 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?*

Draft Level 2 advice

BOX 10

Contract notes and confirmations

1) An investment firm must ensure that a client is provided promptly with the essential information concerning the carrying out of his order.

2) No later than the first business day following the execution of an order for a retail client, or receipt of confirmation of execution of such an order by a third party, an investment firm must send to the retail client in writing, a contract note or confirmation notice which includes the following information:

   a) the name of the investment firm;

   b) the name of the retail client's account;

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

   d) the date of execution;

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

   f) the regulated market or MTF on which the transaction was carried out or the fact that it was carried out outside of a regulated market or MTF;

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

   h) the unit price applied and the total consideration;

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

   j) the commissions and expenses charged; and

k) the time limit and procedure for the settlement of the transaction, e.g. details (name and number) of the bank account and financial instruments account (unless such arrangements have been notified to the client in advance).

3) If an order from a retail client is not executed within one business day of its receipt, an investment firm must send a written confirmation of the order to the retail client. The order confirmation notice must include client order details, date and time of reception and, where applicable, date and time of transmission. If an investment firm has only been able to execute part of an order from a retail client, the contract note or confirmation for the executed part of the order may also function as the confirmation of the unexecuted part of the order.

4) For the purposes of this advice, an investment firm may despatch a confirmation, statement or any other information to an agent, nominated by the client in writing, provided that agent is not: the investment firm; its tied agent; or a member of its group.

5) An investment firm does not need to provide a contract note or confirmation under paragraphs 1 (and where applicable 2), if it duplicates a contract note or confirmation containing the essential details of the transaction (other than those that are firm specific) that is to be promptly despatched by somebody else.

6) An investment firm does not need to send a contract note or confirmation in relation to orders carried out under an arrangement for the client to make a series of payments for the purchase of units or shares in an undertaking for collective investment (including one off payments made in addition to those in the series) provided details of those transactions are provided to the client at least every 6 months.

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

Statements of clients' assets

8) An investment firm that holds clients' assets for a client must send to its client at least once a year or as often as agreed with that client a statement of all clients' assets held by the investment firm for that retail client. The statement must also:

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

   b) identify any clients' assets which have been lent; and

   c) show any movement of clients' assets based on either trade date or settlement date clearly and consistently.

9) An investment firm may include the information required by paragraph 8 in any periodic statement provided by the investment firm to the client, or by other separate documents, as long as all sets of information:

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

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

10) Paragraph 8 shall not apply to funds held by a credit institution as a deposit on its books.

Contingent liability transactions

11) An investment firm that operates client accounts, which include open positions in contingent liability transactions, must provide regular statements of such positions.

12) If the statement in paragraph 11 is sent to a retail client, it must be sent monthly and include:

a) information about any open option contracts, such as market price, date of exercise, exercise price and any incidental costs connected with the exercise;

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

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

Notification obligations

13) If an investment firm does not accept an order for a retail client, or decides not to carry one out, it must notify the client immediately.

14) If an investment firm is unable to carry out an order for a retail client, it must notify the client as soon as possible.

Periodic information for portfolio management clients

15) An investment firm must send to a client for whom its provides portfolio management services periodic statements in writing to enable him to assess the performance of the service.

16) If the statement in paragraph 15 is sent to a retail client it must include:

a) a statement of the contents and valuation of the portfolio, including details of each financial instrument held, its market value and the performance of the portfolio and the cash balance, at the beginning and at the end of the reporting period;

b) a management report on the strategy implemented (to be provided at least yearly);

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

d) information on any remuneration received from a third party and details of its calculation basis; and

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

17) If the basis for valuing any of the assets in a client's portfolio has changed (whether from the basis agreed in the portfolio management agreement or subsequently) the statement required in paragraph 16 must include appropriate details of the change including its impact on profits and/or losses.

18) Periodic statements must disclose all relevant information on any remuneration received by the investment firm, or the manager, from a third party that is attributable to services performed for the retail client by the manager of the portfolio.

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

details of each transaction must be provided in the periodic statement.

20) Where a retail client makes the choice referred to in paragraph 19, a periodic statement must be provided at least every three months. Where the information on each transaction is provided to a retail client after each transaction, it is only necessary to provide a periodic statement every six months.

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

22) An investment firm need not provide a periodic statement under paragraphs 11 (and where applicable 12) or 15 (and where applicable 16), if it would duplicate a statement that is to be provided by somebody else.

Best execution (Article 21)

Extract from Level 1 text

Article 21: Obligation to execute orders on terms most favourable to the client

1. Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction.

2. Member States shall require investment firms to establish and implement effective arrangements for complying with paragraph 1. In particular Member States shall require investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best possible result in accordance with paragraph 1.

3. The order execution policy shall include, in respect of each class of instruments, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders.

Member States shall require that investment firms provide appropriate information to their clients on their order execution policy. Member States shall require that investment firms obtain the prior consent of their clients to the execution policy.

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the investment firm shall, in particular, inform its clients about this possibility. Member States shall require that investment firms obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF. Investment firms may obtain this consent either in the form of a general agreement or in respect of individual transactions.

4. Member States shall require investment firms to monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements. Member States shall require investment firms to notify clients of any material changes to their order execution arrangements or execution policy.

5. Member States shall require investment firms to be able to demonstrate to their clients, at their request, that they have executed their orders in accordance with the firm's execution policy.

Explanatory text in relation to Articles 21 and 22

Articles 21 and 22 apply to investment firms that execute orders on behalf of clients. Article 19(1) sets out the general principle that investment firms must act honestly, fairly and professionally in accordance with the best interests of their clients. CESR believes that the requirements concerning best execution and the prompt, fair and expeditious execution of client orders in Articles 21 and 22(1) are more specific requirements under this general principle. In accordance with this principle, investment firms that receive and transmit orders or decide to deal as portfolio manager should also comply with the requirements of Articles 21 and 22, irrespective of whether these requirements are imposed on investment firms under those Articles or under Article 19(1).

As a result, this advice uses the term "order" to cover not only an order received by the investment firm for execution, but also an order received for transmission or a decision by the investment firm to deal when acting as a portfolio manager (whether by executing the transaction itself or instructing another to do so). In the case of portfolio management services, the fact that the client to whom investment management services are provided authorises the firm to implement investment decisions, means that the resulting orders will be considered "orders on behalf of clients" for purposes of this advice.

In formulating advice on the mandates, CESR is especially concerned to ensure that the requirements it devises work well across all of these activities. Therefore, CESR asks that respondents relate their comments to specific services that investment firms may perform. For example, if an investment firm takes different approaches to complying with Article 21 or 22 for different services (*e.g.* portfolio management, reception and transmission or orders or broking), CESR asks that respondents explain how those approaches will differ.

Preliminary Comments on all Mandates under Article 21

Article 21 institutes new requirements on best execution that supersede the provisions in the CESR Standards. Since we have not had the benefit of CESR consultation on these mandates, we expect that this advice will require significant attention, discussion and debate. Accordingly, this section, presented more in the form of a "concept paper" is intended to be the basis for a discussion with the market participants. The text presents preliminary ideas on which CESR has not yet taken definitive views and the consultation will facilitate further discussion amongst CESR members.

In obliging investment firms to obtain the best possible result for their clients, we expect that Article 21 will contribute to enhancing competition among trading venues where these offer trading in the same instruments. It will, therefore, have an interaction with the other provisions of the Directive concerning market transparency.

It is also important to observe at the outset of this discussion that the scope of the best execution obligation is very wide. Article 21 applies to investment firms that execute orders on behalf of clients. In addition, Article 19(1) sets out the principle that investment firms must act honestly, fairly, and professionally in accordance with the best interests of their clients. In accordance with this principle, investment firms that receive and transmit orders or decide to deal as portfolio manager also should comply with the requirements of Article 21, irrespective of whether these requirements are imposed on investment firms under Article 21 or under Article 19(1).

In formulating advice on the mandates, we are especially concerned to ensure that the requirements we devise work well across all of these activities. Therefore, we ask that respondents relate their comments to specific services that investment firms may perform. For example, if an investment firm takes different approaches to complying with Article 21 for different services (*e.g.*, portfolio management, reception and transmission or orders or broking), we ask that respondents explain how those approaches will differ.

In addition, Article 21 encompasses every instrument that is subject to this Directive including transferable securities (equity and fixed income), money-market instruments and financial and commodity derivatives. The markets for these instruments can vary significantly. Therefore, where appropriate, we ask that respondents relate their comments to specific instruments. In particular, we invite comments from firms that intend to use different approaches to implementation of Article 21 for different instruments, explaining what those different approaches are and why they are appropriate.

Extract from the mandate from the Commission

3. 4. Best execution obligation (Art. 21)

Article 21 obliges investment firms to obtain, when executing orders, the best possible result for their clients, following always the specific clients' instructions. To this end, they will establish an order execution policy; they will inform about it to the clients and obtain their prior consent. Investment firms are also obliged to monitor the effectiveness of their order execution policy and correct any deficiencies. CESR should bear in mind that there is a need for a comprehensible set of criteria to be put in place to allow firms to determine whether they are complying with their obligations as well as to allow clients to understand execution policies.

3.4.1 Criteria for determining the relative importance of the different factors to be taken into account for best execution (21.1)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the criteria that the investment firm should take into account when executing clients' orders for determining the relative importance of the factors such as price, costs, speed, likelihood of execution and settlement, size and nature of the order and any other relevant consideration. Those criteria should take into account the retail or professional nature of the client.

Explanatory Text

Article 21(1) establishes the high-level principle that investment firms must take all reasonable steps to achieve the best possible result when executing client orders. However, Article 21 recognises that the best possible result may be different depending on the nature of the investment services the firm is providing and the types of clients and orders the firm handles. Therefore, Article 21 also includes a list of factors that investment firms must consider in determining what the best possible result is.

Article 21(1) requires an investment firm to take all reasonable steps to obtain the best possible result when executing a client order, taking into account price, costs, speed, likelihood of execution and settlement, size, nature, and any other relevant consideration. It is helpful to consider what is meant by each factor.

- ***Price.*** Price is the first consideration in executing client orders. However, the best price in a given market at a given moment may not represent the best possible result for many reasons, some of which are suggested by the remaining factors in 21(1).
- ***Costs.*** Most obviously, the best price may not be the best result for a client if it comes along with high costs, such as high settlement and custody fees. Conversely, venues may offer services related to execution that firms view as justifying higher costs. For example, a venue that is especially good at managing trading in a fast moving market or trading in size may merit a higher cost because this could provide, overall, the best possible result.
- ***Size.*** The "best price" in a market usually represents an opportunity to trade at a particular size, which may be less than the size that the client wishes to trade. In this situation, if part of the order is executed at the indicated size, the price for subsequent executions may become less favourable (*i.e.* the market may "move.") Therefore, a firm may not necessarily achieve the best possible result for a client if it executes at the best price available for only part of the order.
- ***Speed.*** The client or the firm may anticipate that prices will be moving quickly. In that situation, it can be more important to get a trade completed than to use time seeking better prices.
- ***Likelihood of Execution.*** The best price may be illusory if the venue in question is unlikely to complete the order.
- ***Likelihood of Settlement.*** Best price can also be illusory if the venue offering that price cannot settle according to the customer's instructions or, indeed, if it has a poor record for failed trades.
- ***Nature.*** Any order constraint can modify the "best possible result" analysis.

In determining whether it is taking all reasonable steps to obtain the best possible result for its clients, an investment firm must consider any specific instruction from the client together with each

of the foregoing factors and any other consideration relevant to the execution of the order. It follows then, that investment firms also must determine how important each factor is in determining whether a result is the best possible.

Mandate 3.4.1 acknowledges this logic and asks for advice on identifying the criteria that firms should consider in determining how important each factor is. The mandate also asks that those criteria take account of the retail or professional nature of the client.

It is important to emphasise that Mandate 3.4.1 does not invite CESR to determine the relative importance of the factors. That job is left to investment firms. Rather, CESR is asked to provide criteria that firms may use to assess the relative importance of the factors.

We expect that the relative importance of the factors in Article 21(1) will depend on the characteristics of the orders and clients that the firm handles and the venues where those orders can be traded.

- Client Characteristics. We expect that this category will include judgements about the firm's clients, including whether they are retail or professional and the nature of the execution service they require. For example, in determining whether a result is the best possible, an investment firm must take account of its clients' trading objectives, which may include demands for ease, speed, low cost, trading advice or confidentiality, and any other client characteristics that are relevant to determining how orders should be executed;
- Order Characteristics. We expect that this category will include judgements about orders including size, the type of instrument being traded, settlement (time, certificates) and any other order characteristics relevant to determining how orders should be executed; and
- Venue Characteristics. We expect that this category will include judgements about the venues to which a firm may direct its orders for execution including whether a venue is offering the best price, the amount of any commissions, access fees and any other charges it may impose that are passed through to the client, its ability to manage complex orders, its ability to deliver quick execution, whether it is creditworthy, whether it has reliable settlement facilities, and any other venue characteristics relevant to determining how orders should be executed.

Questions for consultation

Q1: Are the criteria described above relevant in determining the relative importance of the factors in Article 21(1)? How do you think the advice should determine the relative importance of the factors included under Article 21(1)?

Q2: Are there other criteria that firms might wish to consider in determining the relative importance of the factors? Do you think that the explanatory text clearly explains the meaning of all the different factors in respect of the different financial instruments?

Q3: How might appropriate criteria for determining the relative importance of the factors in Article 21(1) differ depending on the services, clients, instruments and markets in question? Please provide specific examples.

Q.4: Please provide specific examples of how firms apply the factors in Article 21(1) to determine the best possible result for their clients.

3.4.2. Trading venues to be included in the order execution policy (21.2).
3.4.4. Obligation to monitor and update the order execution policy (21.3)

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

- the criteria for determining the venues that enable investment firms to obtain on a consistent basis the best possible result for executing the client orders; and

- factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate.

Explanatory Text

Article 21 does not require an investment firm to include all trading venues in its execution policy. Rather, Article 21(3) requires that an investment firm shall at least include in its execution policy those possible trading venues that enable it to obtain on a consistent basis the best possible result for the execution of client orders.

Mandate 3.4.2 requires us to describe the criteria that an investment firm should consider in evaluating the capabilities of different trading venues. These factors must assist the firm in determining whether a venue enables the firm to obtain the best possible result for the execution of its client orders in accordance with Article 21(1)-(3). The firm must also determine whether each venue provides the best possible result on a consistent basis.

Mandate 3.4.4 requires us to describe the factors that an investment firm should consider when monitoring, reviewing and, where necessary, changing its order execution arrangements, including the venues in its order execution policy. Thus, Mandate 3.4.4 may be divided into three parts: monitoring requirements, factors to be considered when monitoring and reviewing arrangements and venues and circumstances in which changes may be appropriate.

The criteria an investment firm should consider in evaluating venues for inclusion in its order execution policy will overlap significantly with the criteria the firm must consider when monitoring and reviewing those same venues. Therefore, these mandates will be discussed together.

1. **Review requirements**

In evaluating a venue for inclusion in its order execution policy, an investment firm must assess the venue's overall ability to provide the best possible result for the firm's client orders. To the extent that an investment firm limits the types of orders and/or the types of clients it handles, these aspects of its business model can affect the factors it considers in evaluating venues.
An investment firm should be able to demonstrate that it has included in its execution policy trading venues that enable it to obtain on a consistent basis the best possible result for the execution of its client orders. This is true when the firm selects venues initially and when it evaluates them from time to time. Once an investment firm has used a venue for sufficient time so that a performance review is reasonable, the firm will be obliged to consider how well that venue has executed the firm's client orders.

We expect that investment firms will consider the factors in Article 21(1) when assessing execution venues. Of course, the factors will apply differently in the context of venue selection than they do in the context of order execution. For the purposes of Article 21(3), we expect an investment firm to take account of these factors in identifying execution venues that enable it to obtain the best possible result on a consistent basis. Here the factors are used to demonstrate the best possible result in terms

of consistency, implying a period of time and not a particular trade. Firms will need to implement arrangements that enable them to make these judgements.

In addition, an investment firm might consider the following factors, among others, in evaluating the capability of trading venues to provide the best possible result on a consistent basis:

1. Price
2. Liquidity.
3. Fees, commissions and explicit costs.
4. Average size of orders.
5. Types of market participants.
6. Settlement capabilities.
7. Trading capabilities.

We do not expect that the factors mentioned above will provide an exhaustive list. Firms should consider all factors that are relevant to making an assessment as to whether a particular venue achieves the best possible result for client orders on a consistent basis. Furthermore, decisions should be based on a consideration of a totality of relevant factors. For example, the fact that a venue is very liquid does not necessarily indicate that it offers the best possible result.

For new entrant venues that have no historical information to present, the investment firm will need to make judgements using the same factors but taking into account only forward-looking information about the firm's capabilities.

In evaluating a trading venue's capabilities, investment firms should analyse all these factors in the light of the characteristics of their business model taking specifically into account the type of clients they serve and the types of orders they accept. However, the business model of the investment firm must not be used to justify the exclusion of a venue that will enable the firm to achieve the best possible result on a consistent basis.

Questions for consultation

It will be helpful in formulating our Level 2 advice on these issues to have the following information from firms:

Q.1: *What investment services does your firm provide?*

Q.2: *How many venues does your firm access now? Does your firm expect to access more venues after the Directive becomes effective?*

Q.3: *What factors does your firm consider in selecting and reviewing venues?*

Q.4: *Please provide specific examples of costs you consider in evaluating venues.*

Q.5: *How do costs affect your decisions about venue selection?*

Q.6: *Do you take account of implicit costs such as market impact? Is the question of implicit costs only relevant to firms that act as portfolio managers?*

Q.7: *What specific events have led your firm to re-evaluate venues in the past? Please provide examples of how your firm has changed the venues that it accesses as the firm, its clients, or markets have changed.*

In addition, we invite comments on the following issues:

Q.8: *Have we identified the key criteria?*

Q.9: *What data is available to carry out these reviews? If no data is available, are market solutions likely to provide it?*

2. Monitoring requirements

Article 21(4) requires that investment firms monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any

deficiencies. In particular, firms must assess, on a regular basis, whether the execution venues included in the order execution policy provide the best possible result for the client or whether they need to make changes to their execution arrangements.

The monitoring requirement in Article 21(4) is intended to inform the investment firm's assessment of whether the venues in the execution policy are providing the best possible result for the execution of client orders. It is also intended to aid the investment firm in an ongoing review of its overall execution arrangements.

In developing its monitoring process, an investment firm must make judgements based on the nature of its business including what comparative data it will use, what standards it will use to judge its execution results, what process it will employ to identify results that appear to fall below those standards and how it will investigate, explain and, where appropriate, change its execution policy and/or its execution arrangements to address sub-standard results. To this end, firms also must use their judgement to determine monitoring frequency and coverage.

In addition to the more quantitative monitoring described above, an investment firm should also monitor each venue in its execution policy for any changes that might affect the venue's ability to provide best execution on a consistent basis. More specifically, a firm should monitor its venues for material changes in liquidity, average size of orders, type of market participants, trading and settlement capabilities, fees, explicit costs or any other factor relevant to the ability of a trading venue to provide the best possible result.

The monitoring requirement assists firms in two ways. First, comparing actual executions with other comparable transactions at the venues within their existing execution arrangements enables firms to assess the quality of the execution they achieve; and secondly, comparing actual execution (and, if available, other transactions at those venues) with comparable transactions at venues not included in the execution policy facilitates the review of execution arrangements and the execution policy.

Questions for consultation

It will be helpful in formulating our Level 2 advice on these issues to have the following information:

Q.1: *What kinds of monitoring arrangements do firms use now?*

Q.2: *How frequently do firms monitor execution quality?*

Q.3: *What data is available to aid firms in their monitoring obligations? What does the data cost?*

Q.4: *In what respects does the frequency with which firms monitor execution quality depend on the types of instruments, clients, markets and investment services in question? Please provide specific examples.*

Q.5: *What, if any, market data do firms consult in order to monitor execution quality?*

Q.6: *What additional data do firms expect to use after the Directive's transparency requirements become effective?*

3. Timing of venue assessments

Article 21(4) requires that an investment firm regularly assess its execution policy.

Venue Changes. We expect that an investment firm will review its execution policy whenever a material change in liquidity, average size of orders, type of market participants, trading and settlement capabilities, fees, explicit costs or any other feature of a venue in its execution policy diminishes the firm's ability to obtain the best possible result for its client orders on a consistent basis. At a minimum, we expect that firms will review the venues in their execution policy at least annually.

Changes in the business model of the investment firm. Similarly, we expect that an investment firm will review its execution arrangements, including its execution policy whenever there is a material change in the types of clients or orders the firm accepts or any other material change in the firm's business model (paying special attention to the type of clients it trades for).

Questions for consultation

It will be helpful in formulating our Level 2 advice on these issues to have the following information:

Q.1: *How frequently do firms review the venues to which they direct orders on behalf of clients?*

Q.2: *Do firms re-evaluate their trading venues:*

- *whenever there is a material change at any of the trading venues ?*
- *whenever there is a material change at the firm that affects its execution arrangements?*
- *whenever the firm's monitoring indicates that it is not obtaining the best possible result for clients on a consistent basis?*

Q.3: *What difficulties would firms face in reviewing their execution arrangements in response to each of the foregoing events?*

Q.4: *Do venues make firms aware of material changes in their business?*

Q.5: *Please provide examples of instances in which firms have changed the venues that they use.*

4. **Circumstances in which changes are required**

Article 21(4) requires firms to assess on a regular basis whether the execution venues in the order execution policy provide for the best possible result for the client or whether they need to make changes to their execution arrangements. In addition, Article 21(4) requires firms to correct any deficiencies in their order execution arrangements and order execution policy that are revealed by monitoring.

Mandate 3.4.4 asks for technical advice on the circumstances under which changes to such arrangements may be appropriate.

We expect that an investment firm will change its execution arrangements whenever its monitoring or venue assessment indicates that a firm is not obtaining the best possible result for the execution of its client orders. In considering what changes may be required, we expect an investment firm to consider whether its order execution arrangements are adequate and whether its order execution policy includes those venues that would enable the firm on a consistent basis to obtain the best possible result for the execution of its client orders.

3.4.3 Information to the clients on the execution policy of the firm (21.2)

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30 December on the information to be provided to the client or potential client.

Explanatory Text

Article 21(3) requires firms to provide "appropriate information" to clients on their order execution policy. Mandate 3.4.3, which is titled "Information to the clients on the execution policy of the firm," requests advice on implementing measures concerning the information to be provided to the client or potential client. These provisions are intended to inform clients and potential clients about execution, and to help them compare the execution services on offer from different firms and make more informed decisions about the type of service appropriate to their needs. They are also intended to foster competition between firms on a 'quality of service' basis.

Currently, we are considering four main items of disclosure in response to this mandate: (1) trading venues (2) procedures for the selection and periodic review of trading venues (3) conflicts of interest and (4) information on the firm's procedures for obtaining client consent and for communicating material changes.

1. **Trading venues.** We are considering requiring that an investment firm discloses to clients and potential clients the number and name of trading venues in its execution policy and whether the firm has direct or indirect access to those venues.
2. **Procedures for the selection of trading venues and their periodic review.** We are considering requiring that an investment firm discloses to clients and potential clients information about the policies it follows in selecting, monitoring and reviewing trading venues and any material changes made to those policies. This could include information about factors used to select venues.
3. **Conflicts of Interest.** We are considering requiring that an investment firm discloses to clients and potential clients any arrangements with venues that involve incentives to select venues for reasons other than execution quality.
4. **Information on the firm's procedures for obtaining client consent and for communicating material changes.** We are considering requiring that an investment firm discloses to clients and potential clients information about its procedures for:
    - Obtaining agreement of its clients to its execution policy;
    - Obtaining the express consent of its clients in order to execute their orders outside a regulated market or an MTF;
    - Notifying clients of any material change to the firm's execution arrangements or execution policy.
5. **Timing.** We are considering requiring that an investment firm provides the foregoing information to clients and potential clients according to the same requirements that have been proposed in the Level 2 measures under Article 19(3), that being, generally, in good time before the commencement of services.

Questions for consultation

We invite comment on the following issues regarding information to clients and potential clients:

Q.1: *At present, how many venues do firms access directly? Indirectly?*

Q.2: *Should an investment firm be required to provide clients and potential clients with information on the percentage of a firm's orders that have been directed to each venue?*

Q.3: *For example, should an investment firm be required to disclose to clients and potential clients what percentage of its client orders were executed in the trading venues to which the firm directed most of its client orders (to cover, at least 75% of the transactions executed)?*

Q.4: *How frequently should investment firms make this information available to clients? On a quarterly basis, for example?*

Q.5: *Should firms be required to update the information to reflect recent usage? How frequently?*

Q.6: *Are there any other categories of information that a client or potential client needs to be adequately informed about the execution services provided by firms?*

Q.7: *Should the information provided by portfolio managers and firms that receive and transmit*

orders be different from that provided by brokers? What are the key differences?

Q.8: *Have all of the key conflicts of interest been identified?*

Q.9: *When should firms be required to provide required disclosure to clients and potential clients?*

Q.10: *Is there any reason to impose different timing requirements for disclosure under Article 21 than are required in the Level 2 measures under Article 19(3)?*

Client order handling (Article 22(1))

Extract from Level 1 text

Article 22(1) - Member States shall require that investment firms authorised to execute orders on behalf of clients implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the investment firm.

These procedures or arrangements shall allow for the execution of otherwise comparable client orders in accordance with the time of their reception by the investment firm.

Extract from mandate from the Commission

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 30 December 2004 on:

(1) the conditions with which the order handling procedures and arrangements that investment firms have to set up shall comply in order to obtain prompt, fair and expeditious execution of client orders.

(2) the situations in which or types of transaction for which investment firms may reasonably deviate from prompt execution so as obtain more favourable terms for clients.

To respond to these requests CESR should take into account the retail or professional nature of the client.

Draft CESR advice

Explanatory text

This advice is intended to deliver principles relating to the manner in which investment firms should achieve the prompt, fair and expeditious execution of client orders in accordance with Article 22(1).

Under Article 22(1), Member States are to require that investment firms authorised to execute orders on behalf of clients implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the investment firm.

When the investment firm is executing orders on behalf of clients, receiving and transmitting orders or deciding to place orders in its capacity as a portfolio manager, the procedures and arrangements to be implemented should provide for the prompt, fair and expeditious carrying out of those orders or decisions to deal relative to any other client orders for execution or transmission or decisions to deal or trading interests of the investment firm.

Without prejudice to Article 22(2), where orders are qualified with a condition, as is the case with a limit order, the condition must be met (e.g. the price becomes available) before the requirements for prompt and sequential execution can apply.

In order to ensure that clients are treated fairly it is also important that conflicts of interest are properly managed. The order execution rules are of relevance in managing conflicts of interest that

arise in relation to the investment firm's orders or other activities such as the practices of front running or dealing ahead.

Investment firms should be required to make adequate records of client orders and other transactions undertaken in the course of adhering to the order execution requirements.

Draft level 2 advice

BOX 11

Reception and transmission or orders and portfolio management

For the purpose of this advice:

1. The requirement for investment firms to implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the investment firm, should also apply in relation to:

    a. the reception and transmission of orders in relation to one or more financial instruments by investment firms; and

    b. decisions by investment firms to deal as a portfolio manager.

Details of orders

2. Before carrying out an order for a retail client, an investment firm must ensure the order is clear and precise and includes the following information:

    a. the name or other designation of the client and of any relevant person acting on his behalf;

    b. the financial instrument to be traded;

    c. the number or total value of the financial instruments;

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

    e. any other relevant details and particular instructions from the client for the order to be properly carried out, e.g. limit orders, validity period and venue of execution; and

    f. the account for which the order has to be carried out.

3. If an investment firm may act as principal in relation to a client order, it must inform the client in advance that this may be the case.

Fair dealing

4. An investment firm must take all reasonable steps not to improperly effect a transaction for its own account or the account of any of its relevant persons before those of clients in identical or better conditions than the latter (“front running”).

5. Where an investment firm intends to publish investment research to its clients, it must take all reasonable steps to refrain from improperly effecting transactions on its own account until those clients have had a reasonable opportunity to act upon it ("dealing ahead").

Prompt and sequential execution and transmission of orders

6. An investment firm must carry out orders for clients sequentially.

7. The requirements to carry out orders promptly and sequentially do not apply where the characteristics of the order and/or prevailing market conditions make this impossible or require otherwise in the interest of the client.

Aggregation and allocation of orders

8. An investment firm may only aggregate a client order for carrying out with another order if:

    a. it is likely that the aggregation will not work to the disadvantage of each of the clients concerned; and
    b. it has disclosed to each client concerned that the effect of aggregation may work on occasions to its disadvantage.

9. If an investment firm aggregates orders, it must make a record of the intended basis of allocation of such orders prior to carrying them out.

10. An investment firm must ensure the proper and prompt recording and allocation of executed transactions.

11. Where an investment firm is responsible for overseeing or arranging the settlement of an order it must take all reasonable steps to ensure any client assets received in settlement of that transaction are promptly and correctly delivered to the account of each relevant client.

12. Where orders for own and client accounts have been aggregated, the investment firm must not allocate the related trades in any way that is detrimental to any client. If such an aggregated order is only partially executed, allocation to clients must take priority over allocation to the investment firm.

13. An investment firm must have procedures in place to prevent that reallocation of principal transactions executed along with client transactions on an aggregated basis gives unfair preference to the investment firm or to any of its clients for whom it deals.

14. If client orders have been aggregated and such an aggregated order has been partially executed, the investment firm must allocate the related trade on a proportional basis, unless it has a different allocation policy and the clients involved have been informed accordingly prior to the order being carried out.

Information

15. An investment firm must inform retail clients of relevant risks or impediments for the proper carrying out of the orders. If, due to market conditions, or for any other reason, an order cannot be carried out according to the instructions given by the retail client, an investment firm must ensure that the retail client is duly informed as soon as possible.

16. Where an order has been executed in several tranches for a retail client, the investment firm must inform the retail client about the price of execution of each tranche, unless the retail client requests an average price.

Record keeping

17. An investment firm must:

    a. immediately record the essential elements of all orders that are received or arise,; and
    b. record the essential elements of all:

        i. orders carried out, together with transactions executed for its own account, other than orders falling within sub-paragraph (ii), immediately after their execution; and

ii. orders transmitted that were received by the investment firm, immediately after they are transmitted.

An investment firm must record in an analogous manner the orders it issues and the transactions it carries out for the purpose of remedying errors made in recording, or carrying out orders.

18. To comply with paragraph 17(a) an investment firm that carries out an order should at least record the following details of the order:

    a. name or other designation of the client;

    b. the date and exact time of the receipt of the order or the decision to deal;

    c. the financial instrument;

    d. the number or total value of the financial instruments, including any price limit;

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

    f. any other instruction received, such as venue for execution, or period of validity, of the order.

19. To comply with paragraph 17(b)(i) an investment firm that carries out an order (other than an order falling within paragraph 17(c)) should at least record the following details of the execution of the transaction:

    a. name or other designation of the client;

    b. name of the counterparty if known;

    c. venue of execution if known;

    d. date and exact time of execution;

    e. the relevant person who executed the transaction;

    f. the financial instrument;

    g. the number of or total value of the financial instrument;

    h. price and other significant terms; and

    i. nature of the transaction.

20. To comply with paragraph 17(b)(ii) an investment firm that receives and transmits an order should at least record the following details of the transmission:

    a. name or other designation of the client;

    b. the person to whom the orders was transmitted;

    c. the terms of the order transmitted; and

    d. the date and exact time of transmission.

Questions for consultation

We invite comment on the following issues regarding client order handling:

Q.1: *Do you agree with the definition of prompt, fair and expeditious execution of an order from a client? Do you think that it is exhaustive? If not, can you suggest any elements to complete this concept?*

Q.2: *Do you think that the details of the orders included under paragraph 2 of the draft technical advice should apply also to professional clients?*

Q.3: *Which arrangements should be in place to ensure the sequential execution of clients' orders?*

Q.4: *Do you agree with the reference in paragraph 7 of the draft technical advice to prevailing market conditions that make it impossible to carry out orders promptly and sequentially?*

Q.5: *Do you think that the possibility that the aggregation of client orders could work to the disadvantage of the client is in accordance with the obligation for the investment firm to act in the best interest of its clients?*

Q.6: *Do you think that the advice should include the conditions with which the intended basis of allocation of executed client orders in case of aggregation should comply or should this be left to the decision of each investment firm?*

Q.7: *Do you consider that CESR should allow the aggregation of client and own account orders? Do you think that other elements (i.e. in respect of the arrangements in order to avoid a detrimental allocation of trades to clients) should be included?*

Q.8: *Do you think that paragraphs 15 and 16 of the draft technical advice should only apply to retail clients?*

SECTION III – MARKETS

A. GENERAL INTRODUCTION

This draft advice covers those mandates from the Commission that relate to pre- and post-trade transparency (Articles 28, 29, 30, 44 and 45) and admission to trading of financial instruments on regulated markets (Article 40).

The current mandates do not cover Article 27 which regulates pre-trade transparency outside regulated markets and MTFs. That area will be addressed on the basis of a separate mandate. The content of that work will need to be evaluated together with this paper in order to ensure consistency.

In this draft advice, in line with the Level 1 text, all proposals on transparency are applicable to shares but not to other financial instruments. Regarding proposals on admission to trading the text covers all types of instruments which can be admitted to trading on a regulated market.

B. MARKET TRANSPARENCY

Introduction

Pre-trade transparency aids price formation and lowers search costs for participants in choosing trading venues. The rapid dissemination of information on completed equity market trades is widely recognised as fundamental to the efficient operation of equity markets. It informs on ongoing trading as well as provides data for checking the quality of completed trades. It can also help to integrate separate/fragmented liquidity pools by showing where prices are consistently most competitive.

However, the provision for deferred publication of trades in the Directive is an acknowledgement that there is also a trade-off between transparency and liquidity. In some cases, immediate post-trade transparency may have adverse effects on liquidity, especially through the negative effects that full disclosure could have on the ability and willingness of liquidity providers to put their capital at risk for big orders and to provide liquidity to the market. Therefore it is necessary to facilitate delayed publication for large trades where the intermediary ends up with a risk position.

The Directive aims at facilitating competition between different trade execution venues, while at the same time promoting efficient markets. Regarding post-trade transparency one key provision is the rapid publication of information on executed trades regardless of whether they were executed on a regulated market ("RM"), an MTF or outside them.

Consolidation of transparency information

In order to serve the needs of investors it is not enough that adequate pre- and post-trade information is available from different trading venues. CESR is of the opinion that in order to give a full picture the information needs to be consolidated. CESR believes that is also the aim of the Directive. The Directive does not however mandate any specific consolidation system or structure; CESR believes this is because the adoption of a regulatory framework (both at Level 1 and 2) that eliminates the possible barriers to consolidation will allow market forces (such as regulated markets and data vendors) to establish a "market led" solution. However, CESR notes that in order to be consolidatable the information disclosed by RMs, MTFs and firms need to fulfil certain criteria. Ideally it should follow (one) generally agreed data standard(s). Establishing such standards is supported by CESR but it is not seen primarily as the regulator's role and therefore any Level 2 requirements in this area are likely to be high level.

The consolidation of pre- and post-trade information is very important because information on the volumes and prices of completed trades enables market participants and their customers to assess

the state of the market and to monitor the quality of executions they have obtained compared with other market users.

Accordingly, pre- and post-trade information should be properly consolidated in order to achieve market integrity and to guarantee adequate investor protection through the compliance with best execution requirements and the detection and pursuit of market manipulation practices. CESR Members recognize that there are several ways of consolidating pre and post trade information and consider that CESR might promote the use of standards and/or practices in order to facilitate the consolidation of pre- and post-trade information but the way of consolidating trading information should be left at the discretion of trading venues and market users.

Pre-trade Transparency requirements for Regulated Markets (Article 44) and MTFs (Article 29)

Extract from Level 1 text

*Article 29 [*for MTFs*]:*
1. Member States shall, at least, require that investment firms and market operators operating an MTF make public current bid and offer prices and the depth of trading interests at these prices which are advertised through their systems in respect of shares admitted to trading on a regulated market. Member States shall provide for this information to be made available to the public on reasonable commercial terms and on a continuous basis during normal trading hours.

2. Member States shall provide for the competent authorities to be able to waive the obligation for investment firms or market operators operating an MTF to make public the information referred to in paragraph 1 based on the market model or the type and size of orders in the cases defined in accordance with paragraph 3. In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

*Article 44 [*for regulated markets*]:*

1. Member States shall, at least, require regulated markets to make public current bid and offer prices and the depth of trading interests at those prices which are advertised through their systems for shares admitted to trading. Member States shall require this information to be made available to the public on reasonable commercial terms and on continuous basis during normal trading hours.

Regulated markets may give access, on reasonable commercial terms and on a non-discriminatory basis, to the arrangements they employ for making public the information under the first subparagraph to investment forms which are obliged to publish their quotes in shares pursuant to Article 27.

2. Member States shall provide that the competent authorities are to be able to waive the obligation for regulated markets to make public the information referred to in paragraph 1 based on the market model or the type and size of orders. In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

Extract from the mandate from the Commission

- Specify the range of bid and offers or designated market-maker quotes, and the depth of trading interest at those prices that are to be made public.

- Establish the criteria for determining the type and size of orders for which pre-trade transparency obligations may be waived and define orders that are "large in scale compared with normal market

size"

In respect of size, and in particular when defining orders that are "large in scale compared with normal market size" (block orders), CESR advice should take account of the fact that the objective of the waiver is to exempt from the pre-trade transparency obligation those transactions which size could have a market impact that could affect investors and/or that could affect the provision of liquidity by market makers and/or could affect the quality of price formation process on the market. In this respect, CESR should also take particular account of the differences between order and quote driven markets. The definition of block orders should be analysed with a view to establish harmonized criteria for each type of shares in the EU, to promote legal certainty and to develop as simple a model as possible. At this respect, CESR, in delivering its advice, might wish to analyse the possibility to establish a single measure in terms of number of shares and/or of quantity that could be applicable to most of the trading in shares in the EU.

- Establish the criteria for determining the market models for which pre-trade transparency obligations may be waived.

Draft CESR advice

Draft Level 2 advice

BOX 12

Content of information

1. Where a Regulated Market (RM) or a Multilateral Trading Facility (MTF) operates a price discovery mechanism through an auction electronic trading system, it should display an indicative theoretical equilibrium price during the pre-auction phase, together with the underlying orders (the orders on which the calculation of the indicative theoretical equilibrium price is based).

   The indicative theoretical equilibrium price is the price at which the largest volume of shares can be transacted at a given time.

2. Where an RM or an MTF runs an electronic trading system providing for continuous trading, each bid or offer displayed on the system shall at least include the following elements :

   - Type of quote/order, i.e. bid or offer
   - Security identifier
   - Number of shares the market participant is ready to buy (or sell) and,
   - Price at which the market participant is willing to buy (or sell).

3. Where an RM) or an MTF runs a floor trading system, with market members acting as market personnel in one or more stocks, the bids and offers (quotes) of the market personnel should be displayed electronically on the floor.

Updating and withdrawal of quotes

4. The bids/offers/quotes as referred to in paragraphs 1-3 shall be firm ones. Members and participants are entitled to update and withdraw their bids/offers/quotes, subject to orderly market and market abuse provisions.

5. RMs and MTFs shall have rules governing the conditions and circumstances in which designated market makers may withdraw their quotes. Such rules should ensure that such conditions and circumstances are clearly defined and that they provide only limited exemptions.

6. RMs and MTFs shall also have rules governing the conditions and circumstances in which

designated market makers may update their quotes to ensure that this is not so frequent as to intentionally deprive market participants of trading against the quotes displayed.

Depth of trading interests and access to pre-trade information

7. Where the RM or the MTF operates an electronic order driven system, it shall make available all bids and offers in the order-book, updated on a continuous basis.

8. Where the RM or the MTF operates an electronic quote driven system, it shall make available the quotes of each designated market maker in any given equity.

9. Where the RM or the MTF operates a floor-based trading system with market members acting as market personnel in one or more stocks, the bids and offers (quotes) of the market personnel should be made available electronically.

10. An RM or an MTF should make available the same degree of pre-trade information to all its members, participants, investors or other interested parties.

Timeliness

11. The information referred to above shall be disclosed in real time during trading hours.

Effectiveness

12. Pre-trade information can be made available to the public either directly, through contractual arrangements, or indirectly, through data vendors. The arrangements set up by RMs or MTFs shall ensure that the information is reliable. These arrangements shall be capable of monitoring the correctness of the information and alerting of obvious mistakes and correcting wrong data when necessary.

Exemptions from pre-trade transparency

Based on market model

13. If trading on an RM or MTF is based on a market model where the price of the transaction is not determined within the trading system, but by reference to that of another trading venue, then there is no obligation to display orders and/or quotes.

Based on type of order

14. If trading on an RM or MTF is conducted by means of an 'iceberg'-type order, whereby the proportion of the order which is available for execution is visible, pre-trade transparency obligations will be considered to have been met.

Large trades

15. The obligation to display orders or quotes does not apply when the following conditions are met:

CESR is still considering in detail how to define the block size which would qualify for a waiver from pre-trade transparency or for deferred publication of post-trade transparency.

It is currently evaluating three alternatives which are as follows:

- *"average daily volume method"*

  This method compares the size of order (or trade) with the average daily volume of a share. This would be calibrated such that an order (or trade) of a size exceeding a certain percentage of daily average volume would qualify either for waiver or deferred publication.

- *"method based on the average size of orders"*

  In response to the forthcoming mandates on Article 27 CESR will provide proposals on pre-trade transparency for systematic internalisers. A formula for calculating size thresholds is already set out in the Level 1 text of Article 27 - the arithmetic average value of the orders executed in the market. On the basis of this calculation with respect to standard market size, CESR could extrapolate what is large in scale compared with normal market size.

- *"market impact method"*

  This method measures the impact of different order sizes on the market. For each share a relationship can be established between ticket size and market impact. On the basis of this relationship we can calibrate the minimum impact that warrants waiver or delay.

Whatever the methodology is eventually chosen by CESR, the following conditions should be met:

- *If the method refers to liquidity, turnover or other market activity, it should be calculated on the basis of total trading activity in the EU (not that of any single platform);*
- *Although identifying a unique block size for each individual share might lead to the appropriate size for that share, CESR proposals are likely to be based on the idea of grouping shares into different groups in order to make the method more practical.*

Explanatory text

16. In paragraphs 1-3 the content of the pre-trade transparency for "basic cases" is defined. The proposal aims at providing members/participants and investors with sufficient trading information.

17. While recognising the need for transparency the proposal takes into account different features of different trading methodologies. Paragraph 1 covers trading by auction in electronic systems (covering e.g. opening/closing auctions and periodic auctions). Paragraph 2 covers trading which takes place in an electronic system for continuous trading (order driven or quote driven). Paragraph 3 covers physical floor trading. Although it is not commonly used it has been seen necessary to cover such trading forms in order not to create regulatory loopholes.

18. Moreover the paper deliberately does not discuss the types of orders that have (or do not have) to be entered into the trading systems. The focus is: when a bid or offer is displayed, which elements should it contain. Concerning the price and size information the bid/offer/quote shall be firm which means that it represents the actual terms on which market participants are committed to trade. Trading facilities which publish only indicative prices are not covered by the proposal.

19. In order to allow investors to benefit from enhanced pre-trade transparency, CESR is of the opinion that the same level of information should be available to all members/participants and investors alike. Therefore, CESR is proposing that certain arrangements with privileged information for liquidity providers should no longer be allowed (incentivisation of liquidity provision should be done by other means).

20. While there is broad support for wide pre-trade transparency, it has also been noted that too much pre-trade transparency, especially in illiquid markets and/or shares, may attract manipulative behaviour. It has also been pointed out that at present pre-trade transparency in many markets is not as wide as proposed, which could have cost implications. It was proposed to limit pre-trade transparency to 5 best bids/offers maximum. However, that was not widely supported. CESR is therefore proposing that there should be wide pre-trade transparency.

Questions

Q12.1. *Do consultees agree with the specific proposals as presented or would they prefer to see more general proposals?*

Q12.2. *Is the content of the pre-trade transparency information appropriate?*

Q12.3. *Do consultees agree on the proposal regarding the depth of trading interest and access to pre-trade information?*

Q12.4. *Do consultees agree on the proposed exemptions to pre-trade transparency? Are there other market models which should be exempted?*

Q12.5. *Do consultees support the waiver for "crossing systems" as defined in paragraph 13? Could pre-trade transparency for crossing systems have a negative impact on liquidity or create the potential for abusive behaviour?*

Q12.6. *Do consultees support the same minimum size of trade for the waiver to transparency pre-trade and delayed publication post-trade? Are there circumstances in which the two should be different?*

Q12.7: *Do consultees have a preference for one of the options proposed for defining the block size, are there other methods which should be evaluated?*

CESR

Post-Trade Transparency requirements for Regulated Markets (Article 45) and MTFs (Article 30) and for Investment Firms (Article 28)

Extract from Level 1 text

Article 28:
1. Member States shall, at least, require investment firms which, either on own account or on behalf of clients, conclude transactions in shares admitted to trading on a regulated market outside a regulated market or MTF, to make public the volume and price of those transactions and the time at which they were concluded. This information shall be made public as close to real-time as possible, on a reasonable commercial basis, and in a manner which is easily accessible to other market participants.

2. Member States shall require that the information which is made public in accordance with paragraph 1 and the time limits within which it is published comply with the requirements adopted pursuant to Article 45. Where the measures adopted pursuant to Article 45 provide for deferred reporting for certain categories of transaction in shares, this possibility shall apply mutatis mutandis to those transactions when undertaken outside regulated markets or MTFs.

Article 30:
1. Member States shall, at least, require that investment firms and market operators operating an MTF make public the price, volume and time of the transactions executed under its systems in respect of shares which are admitted to trading on a regulated market. Member States shall require that details of all such transactions be made public, on a reasonable commercial basis, as close to real time as possible. This requirement shall not apply to details of trades executed on an MTF that are made public under the systems of a regulated market.

2. Member States shall provide that the competent authority may authorise investment firms or market operators operating an MTF to provide for deferred publication of the details of transactions based on their type or size. In particular, the competent authorities may authorise the deferred publication in respect of transactions that are large in scale compared with the normal market size for that share or that class of shares. Member States shall require MTFs to obtain the competent authority's prior approval to proposed arrangements for deferred trade-publication, and shall require that these arrangements be clearly disclosed to market participants and the investing public.

Article 45:
1. Member States shall, at least, require regulated markets to make public the price, volume and time of the transactions executed in respect of shares admitted to trading. Member States shall require details of all such transactions to be made public, on a reasonable commercial basis and as close to real time as possible.

Regulated markets may give access, on reasonable commercial terms and on a non-discriminatory basis, to the arrangements they employ for making public the information under the first subparagraph to investment firms which are obliged to publish the details of their transactions in shares pursuant to Article 28.

2. Member States shall provide that the competent authority may authorise regulated markets to provide for deferred publication of the details of transactions based on their type or size. In particular, the competent authorities may authorise the deferred publication in respect of transactions that are large in scale compared with the normal market size for that share or that class of shares. Member States shall require regulated markets to obtain the competent authority's prior approval of proposed arrangements for deferred trade-publication, and shall require that these arrangements be clearly disclosed to market participants and the investing public.

Extract from the mandate from the Commission

- Specify the scope and content of the information to be made public.

- Establish the conditions under which deferred publication of trades may be allowed as well as the criteria to be applied when deciding the transactions for which, due to their size or the type of share involved, deferred publication is allowed,

In respect of large orders, CESR should, where relevant, combine this request with the requests formulated in the context of Article 44.

1) Specify the means by which investment firms may comply with their post-trade transparency obligations including the following possibilities:

i) through the facilities of any regulated market which has admitted the instrument in question to trading or through the facilities of an MTF in which the share in question is traded;

ii) through the offices of a third party;

iii) through proprietary arrangements.

2) Specify the scope (which types of transactions) and the conditions of application of the post-trade transparency obligation to transactions involving the use of shares for collateral, lending or other purposes where the exchange of shares is determined by factors other than the current market valuation of the share.

Draft CESR advice

Draft Level 2 advice

BOX 13

Content of post-trade information

21. The following information shall be made public trade by trade for every trade regardless of whether it was executed on an RM, MTF or outside them:

- Market or other source identification;
- Security identifier;
- Date and time of trade;
- Volume (number of shares);
- Price per share;
- (If applicable) indicator that the trade was eligible for delayed publication;
- (If applicable) indicator that the trade was at a price other than the current market price;
- Any amendments to previously disclosed information.

22. Moreover, in an aggregated manner and at the end of the trading session[or each trading day], the following information shall be provided by RMs, MTFs and systematic internalisers:
    - Opening price;
    - Closing price;
    - Maximum and minimum price during the session;
    - Weighted average price of the session;
    - Total traded volume.

23. The procedures for disclosing the information in paragraph 21 (trade by trade information) shall ensure that every trade is published only once. If the trade is done on an RM or MTF the publishing may happen according to their rules. If not specified by their rules, or for trades which are executed outside an RM or an MTF, the investment firm acting as the seller shall be responsible for disclosing the information. Where the seller is not an EU investment firm (but

the buyer is), the publication obligation is on the buyer.

Arrangements to disclose post trade information

24. Post trade information shall be made public as close to real time as possible taking into account the characteristics of the trading venue where the transaction was executed. This should in any case not happen later than one minute after the transaction took place. The information published shall be available for at least 14 days from its publication.

25. The publication arrangements for trading information shall operate all the time trading takes place. For RMs and MTFs that covers the period when trading is possible according to their systems and rules. For investment firms the mechanism shall be available all the time the firm is (actively) trading.

26. Post-trade information can be made available to the public either directly, through contractual arrangements, or indirectly through data vendors. RMs, MTFs and investment firms shall have in place appropriate arrangements to make the post-trade information available to all interested parties in a way which is easily consolidatable.

27. The arrangements set up by RMs, MTFs and investment firms shall ensure that trading information published is reliable. These arrangements shall be capable of monitoring the correctness of the information and alerting of obvious mistakes and correcting wrong data when necessary.

28. When the transaction does not include the transfer of economic risk (relating to the instrument) between counterparties the obligation to publish the transaction does not apply.

29. When transactions include transfer of shares where the price is based on other factors than current market valuation of the share, the information to be published shall include an indicator showing that the price of the trade is away from the prevailing market value of the share.

Deferred publication of transactions

30. In accordance with paragraph 24 post-trade information shall be published in as close to real time as possible. However, in specific circumstances the publication of post-trade information may be deferred when the following requirements are met:

31. a. The transaction shall include the participation of an investment firm acting as a principal in the transaction in a risk-taking capacity.
b. The firm must have created a risk position through taking a long or short position in the security as a direct result of the facilitation of third party business.
c. The size of the trade must be above the threshold to qualify.

32. Trades eligible for delayed publication shall be published according to the following formula:

CESR will further investigate the definition of a block size along the lines described in paragraph 15.

Explanatory text

33. Taking into account the importance of post-trade information and the purpose of the Directive it is extremely important for that information to be disclosed as soon as it is technically possible (except where delayed publication is justified – see block trades). Therefore CESR has taken a strict view on the timing in order to promote an efficient and competitive market. CESR has also made the choice that all transactions should be covered by the post-trade transparency. It could be argued that trading which takes place only occasionally and does not represent significant proportion of the trading are not necessarily vital for adequate price formation. However

defining which trades (especially regarding post-trade information) could be excluded would make the regime more complicated. The one minute deadline (for occasional off-market trades) is estimated to accommodate the needs of such trading.

34. CESR has noted that there are some common elements between post-trade transparency information and regulatory transaction reporting. On the other hand there are some differences (e.g. as regards timing) which do not make it possible to have identical reports for both purposes. It should also be noted that according to the Directive the objectives of the two are completely different.

35. In order to give reliable information on trading which took place, the post-trade information should cover each transaction only once. If trading takes place on an RM or MTF trades will be published usually automatically by the systems of the market operator (and the system itself makes sure that there is no multiple publication). If in some cases it is not determined by the RM or MTF and in cases where the trade takes place off-RM and off-MTF, CESR proposes that the investment firm acting as seller should be responsible for publication.

36. There are several ways for market participants to organise the publication of post-trade information. Since the information is considered vital for investors, the methods shall ensure that such information is available all the time the trading method in question is functioning. For example, for RMs and MTFs the publication arrangements should operate all the time trading takes place i.e. normal trading hours but also different forms of "after market hours". For investments firms the information should be available all the time the firm in question is trading. When choosing the publication channel the party responsible for publication should take this into account. If for example an investment firm will use the services of an RM to publish its off-market transactions, it should make sure that the service provided by that RM is functioning all the time the firm is trading.

37. The Directive sets out that investment firms are required to make public certain information about concluded transactions in shares admitted to trading on an RM, which took place outside an RM or MTF. It mentions that this information should be made public in a certain way (as close to real time as possible, on a reasonable commercial basis, and in a manner which is easily accessible to other market participants). In the Directive, the comitology provision asks for specification of the means by which firms may comply with their post-trade transparency obligation in this Article, and mentions specifically different possibilities that have been envisaged.

38. CESR believes that it is important that post-trade transparency data is submitted in a way which supports market efficiency and integrity (including assisting with monitoring for best execution). The rapid dissemination of information on completed equity market trades is fundamental to achieving this objective.

39. CESR supports the Directive's intention to provide for a genuine choice of reporting arrangements for investment firms. CESR believes however that only if data published through these different mechanisms can be brought together in a way which facilitates consolidation and comparison between the prices prevailing in different trading venues, can the true benefits of broad-based post-trade transparency requirements be reaped by investors and the market as a whole. CESR is therefore minded to work with the market (involving investment firms, data publishers, exchanges, etc) to consider how the cost of consolidation could be reduced and the production of consolidated data be encouraged.

40. Publication just on the firm's own website or on a third-party website where only one or a few firms' data is published is unlikely to meet the 'easily accessible' test, in so far as investors are unlikely to be able to search through all websites. Thus investment firms shall choose a publication mechanism which publishes the post-trade transparency information in a form which is easily consolidatable.

41. Certain transactions involve transfer of shares without transferring the economic risk relating to those shares or the issuer. In such cases there is no need to publish those transactions in the

interests of price formation. Therefore it is proposed that they are exempted from the post-trade transparency obligation. Such transactions are for example: using shares as collateral or stock lending.

42. For certain types of equity market transactions post-trade transparency to the public may be more or less useful. In certain circumstances such information could even send misleading signals as to trading conditions in the real market. It is therefore proposed that, when publishing certain transactions where the valuation of the share is based on other criteria than the current market valuation of the share, those transactions should be marked (flagged) in order to avoid misleading signals. Such transactions are for example: Exercising a stock option.

43. Based on a fact finding exercise on block trades within the EU it seems that there is currently a great variety regarding both the criteria for applying the delay and the length of the delay. It should also be noted that – at present – the publication of block trades is not necessarily delayed in the markets of all CESR Members.

44. There are several methods currently in use to determine the minimum size of trade eligible to benefit from delayed publication. They attempt either to define the point at which publication of a trade would have an impact on the market price, or to define what is significantly larger than the prevailing traded volumes in the market.

45. CESR has taken the view that intermediaries should be able to benefit from delayed publication only where they put their capital at risk to facilitate the trade of a third party. Trades that are conducted on own account with no third party should not be able to benefit from delayed publication.

46. This is because, if a large block of shares passes from one investor to another investor (whether by an agency cross or some form of riskless principal trade via an intermediary), the transaction is complete and no party to the transaction is at (immediate) risk. There is therefore no reason why the price and volume of shares in the transaction should not be published immediately.

47. On the other hand, where a broker-dealer facilitates a large transaction by taking the position (whether buy or sell) onto its books before entering into offsetting trades to unwind that position, it is self-evident that other market participants might attempt to move the market against the risk-taking intermediary if they were aware (as a result of immediate trade publication) that the intermediary had taken on the position. There is therefore a case for permitting delayed publication of such trades in order to provide the risk-taking intermediary with a reasonable opportunity to unwind its risk. (Each unwinding trade is normally published immediately.)

Questions

Q13.1: *Do consultees support the method of post-trade transparency (trade by trade information), should some other method be chosen (which)?*

Q13.2: *Do consultees support the inclusion of "aggregated information" in paragraph 22 or should it be left for market forces to provide on the basis of the information disclosed under paragraph 21. If it is included what should the content be?*

Q13.3: *Do consultees support the two week period for which the post-trade information should be available?*

Q13.4: *Should some minor trades be excluded from publication (and if so, what should be the determining factor)?*

Q13.5: *Do consultees agree on the method of defining the time limit in paragraph 24 and is the one minute limit capable of meeting the needs of occasional off-market trades?*

Q13.6: *Do consultees support the view that only intermediaries who have created a risk position to*

facilitate the trade of a third party should benefit from deferred publication or should all trades which are above the block size be eligible for deferred publication?

Q13.7: *Should the identifier of a security be harmonised and if so to what extent? What should be the applicable standard (ISIN code, other)?*

Q13.8: *Should more information be available on stock lending? If so, which should be the content? Are there other similar types of activities which should be covered?*

Q13.9: *Should CESR initiate work, in collaboration with the industry and data publishers, to determine how best to ensure that post-trade transparency data be disseminated on a pan-European basis?*

C. ADMISSION OF FINANCIAL INSTRUMENTS TO TRADING (ART. 40)

Introduction

Regarding this issue it should be noted that admission of financial instruments to trading has linkages with several other directives (Prospectus Directive, Transparency Obligations Directive, Market Abuse Directive). CESR is of the opinion that the Directive should not add any additional requirements in the areas covered by these Directives, but should concentrate on issues not regulated by them. It should also be noted that the Consolidated Listing Directive remains in force to some extent – which will allow Member States to maintain an 'Official List' with more stringent requirements applied to constituent securities than for others.

Regarding the second and third part of the mandate it should be noted that they are directly linked to the final content of the draft Transparency Obligations Directive ("TOD"). The exact content of CESR proposal should be checked against the final content of the TOD and its implementing measures.

Extract from Level 1 text

Art. 40:
1. Member States shall require that regulated markets have clear and transparent rules regarding the admission of financial instruments to trading.

Those rules shall ensure that any financial instruments admitted to trading in a regulated market are capable of being traded in a fair, orderly and efficient manner and, in the case of transferable securities, are freely negotiable.

2. In the case of derivatives, the rules shall ensure in particular that the design of the derivative contract allows for its orderly pricing as well as for the existence of effective settlement conditions.

3. In addition to the obligations set out in paragraphs 1 and 2, Member States shall require the regulated market to establish and maintain effective arrangements to verify that issuers of transferable securities that are admitted to trading on the regulated market comply with their obligations under Community law in respect of initial, ongoing or ad hoc disclosure obligations.

Member States shall ensure that the regulated market establishes arrangements which facilitate its members or participants in obtaining access to information which has been made public under Community law.

4. Member States shall ensure that regulated markets have established the necessary arrangements to review regularly the compliance with the admission requirements of the financial instruments which they admit to trading.

5. A transferable security that has been admitted to trading on a regulated market can subsequently be admitted to trading on other regulated markets, even without the consent of the issuer and in

compliance with the relevant provisions of Directive 2003/71/EC of the European Parliament and of the Council of "…"on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC. The issuer shall be informed by the regulated market of the fact that its securities are traded on that regulated market. The issuer shall not be subject to any obligation to provide information required under paragraph 3 directly to any regulated market which has admitted the issuer's securities to trading without its consent.

Extract from the mandate from the Commission

- Specify the characteristics of different classes of instruments to be taken into account by the regulated market when assessing whether an instrument is issued in a manner that allows it to be traded on a fair, orderly and efficient manner, in the case of transferable securities, define the conditions under which financial instruments are freely negotiable

- clarify the arrangements that the regulated market is to implement so as to be considered to have fulfilled its obligation to verify that the issuer of a transferable security complies with its obligations under Community law in respect of initial, ongoing or ad hoc disclosure obligations.

- clarify the arrangements that a regulated market that admits transferable securities to trading has to establish in order to facilitate its members or participants in obtaining access to information which has been made public in the conditions established under Community law.

Draft CESR advice

Draft level 2 advice

BOX 14

Requirements for instrument to be admitted to trading

1. The admission requirements cover transferable securities and derivatives.

2. Minimum conditions for admission to trading on an RM include the following requirements:

   a. An RM shall be responsible for maintaining fair and orderly trading of instruments admitted to trading on its market, taking into account:

      i. (if an equity) the free float;
      ii. the expected trading activity of the instrument and (if a security) expected holders;
      iii. the appropriate trading mechanism for the instrument.

   b. Transferable securities (both equity and non-equity) shall be freely negotiable (i.e. freely transferable) and fungible.

3. For derivatives, minimum conditions for admission to trading on an RM include the following requirements:

   a. The terms of the derivative contract should be unambiguous and allow for a correlation between the price of the derivative and the price of the underlying asset (or the value measure of the underlying factor);
   b. The price (or other value measure) of the underlying can be considered reliable and is publicly available;
   c. There is sufficient information typically needed to value the derivative;
   d. The arrangements for determining the settlement price of the contract should ensure that the price properly reflects the price (or other value) of the underlying asset (or factor) and minimises the potential for manipulation or distortion;
   e. Where the derivative requires the delivery of an underlying asset rather than cash settlement:

i. there shall be adequate settlement and delivery procedures for the underlying asset; ii. there are adequate arrangements to obtain relevant information about the underlying asset (e.g. quality grade).

RM's obligation to verify issuer's compliance with disclosure obligations

Initial disclosure obligations

4. The admission of financial instruments to trading on an RM shall be subject to the verification by the RM that the competent authority of the home Member State of the issuer has approved the prospectus and, if needed, made a notification on the basis of Article 18 of the Prospectus Directive.

   If there is no obligation to prepare a prospectus on the basis of Article 4(2) of the Prospectus Directive, the RM shall satisfy itself that the conditions for an exemption have been met.

5. The rules and/or procedures adopted by the RM shall clearly state the processes it adopts to satisfy itself of issuers' compliance with their initial disclosure obligations together with any contractual arrangements with the issuer or the person applying for the admission of financial instruments to trading without the consent of the issuer.

Ongoing and ad hoc disclosure obligations

6. The rules and/or procedures adopted by the RM shall clearly state the processes it adopts to satisfy itself of issuers' compliance with their ongoing and ad hoc disclosure obligations including any information sharing mechanisms with the competent authority of the home Member State of the issuer as well as any contractual arrangements with the issuer.

RM's obligation to facilitate flow of information

Initial disclosure obligations

7. The RM shall provide links to the prospectuses and annual information documents on its website if they are available electronically. In case a prospectus does not exist in electronic form, the RM shall provide a link to the lists of prospectuses published on the web-site of the relevant competent authority. If an annual information document does not exist in electronic form, the RM shall provide on its website information on where it can be obtained.

Ongoing and ad-hoc disclosure obligations

8. The RM shall provide information on where the regulated information disclosed on the basis of the Transparency and Market Abuse Directives can be obtained and, if possible, links to such a source (e.g. officially appointed mechanism, competent authority or web-site of the issuer). This method does not need to be used if the RM receives the regulated information directly from the issuers and forwards it directly or indirectly to its members and participants.

Explanatory text

9. The Prospectus Directive ("PD") provides for harmonised requirements for the information to be provided to investors in a prospectus, and a passport to allow the use of a single prospectus in different Member States.

10. The PD, TOD and the Market Abuse Directive ("MAD") together establish initial, ongoing and ad-hoc disclosure obligations on issuers of securities as regards making information available to the public on the issuer, the nature of the security they have issued, and their financial health as an undertaking. This is because their primary function is to promote efficient European capital markets and rigorous and appropriate investor protection. It follows that any requirements that

CESR recommends for securities traded on a RM should be focused on supporting optimum trading on that RM – i.e. "ensuring that any financial instruments admitted to trading in a regulated market are capable of being traded in a fair, orderly and efficient manner[1]". Indeed CESR cannot specify at Level 2 provisions for the Directive in the areas covered by the PD/TOD/MAD. If there were additional requirements on issuers whose securities are already issued in accordance with PD and TOD, this would imply that, despite the existence of the PD and the TOD, there are further standards in those areas that issuers have to fulfil before their securities can be admitted to trading on any RM.

11. Given the existence of the PD, MAD and TOD (and the additional requirements of the Consolidated Listing Directive), in the case of equity and non-equity securities, this Level 2 advice should not cover topics already dealt with by those Directives. Instead, it should be directed at supporting optimum trading on the RM.

12. The PD and the TOD apply to transferable securities. For derivatives, there is no Directive specifying the structure and content etc. of – for example – derivative contracts admitted to trading on an RM. However, there is general agreement within CESR that the MiFiD should allow derivatives exchanges to compete for business. Thus any admission to trading criteria should be restricted to principles covering the relationship with the underlying instrument for pricing purposes, terms of delivery (where the contract is for physical delivery) and information about the underlying itself.

13. In order to fulfil its obligation to satisfy itself that the issuer of a transferable security has complied with its initial disclosure obligation the RM can refer to the website of the competent authority of the home Member State of the issuer where all the approved prospectuses or a list of them will have to be included on the basis of the Prospectus Directive. In case the RM is located in another Member State than the issuer, the RM shall also satisfy itself that the competent authority of the home Member State of the issuer has, where necessary, provided the competent authority of the home Member State of the RM with a certificate of approval required in accordance with Article 18 of the Prospectus Directive.

14. In order to satisfy itself that the conditions for the exemption from the obligation to prepare a prospectus have been met, the RM can, among other things, require the issuer or the person applying for admission to trading to provide it with sufficient information on the fact that the conditions for the exemption have been met (e.g. an exemption granted by the competent authority).

15. The Prospectus Directive and its implementing measures do not require the issuer (or the person applying for admission to trading on an RM) to publish the prospectus in an electronic form. However, the home Member State of the issuer can require issuers which publish their prospectus in a newspaper or in a printed form to publish their prospectuses also in an electronic form.

16. In addition, the competent authority of the home Member State must publish on its web-site either all the prospectuses approved or at least the list of prospectuses approved including a hyperlink to the prospectus if it has been published electronically. If a prospectus has not been published electronically, the list has to include information on how such a prospectus has been made available and where it can be obtained.

17. The annual information document referred to in Article 10 of the Prospectus Directive does not have to be published electronically nor does it have to be included in the list published on the website of the competent authority.

18. The TOD requires the issuer or the person who has applied for admission to trading on an RM without the issuer's consent to always disclose regulated information in a manner ensuring fast access to such information on a non-discriminatory basis and to make it available to the officially appointed mechanism chosen by the home Member State of the issuer for the central

[1] Article 40 (1) subparagraph 2 of the Directive.

storage of regulated information. The issuer or person applying for admission to trading also has to use such media as may reasonably be relied upon for the effective dissemination of information to the public throughout the European Union. The methods for disseminating and keeping information available to the public will be, however, determined in the comitology procedure. Thus it is difficult at this stage to provide exact guidance on how the RM should facilitate obtaining access to this information.

Questions

Q14.1: *Do consultees agree on the requirements for admission to trading? Should more (qualitative and/or quantitative) criteria for admission to regulated markets be specified in the level 2 measures? If yes, which?*

Q14.2: *Do consultees agree on the role proposed for RMs in order to ensure that the issuers fulfil their disclosure requirements?*

SECTION IV – COOPERATION AND ENFORCEMENT

Transaction Reporting (Article 25)

General foreword

A. The MiFiD on transaction reporting

Pursuant to Article 25(3) first sub-paragraph, investment firms have to report transactions in financial instruments admitted to trading on a regulated market to the competent authority of the home Member State. Article 25(3) second sub-paragraph provides that competent authorities shall establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for financial instruments also receives that information. Pursuant to Article 32(7), in case of branches, transactions reports have to be made to the competent authority of the host Member State. Finally, Recital 45 states that Member States should be able to apply transaction reporting obligations of the Directive to financial instruments that are not admitted to trading on a regulated market.

B. General objectives of transaction reporting

Promotion of market integrity in Europe is an objective shared both by regulators and market participants as they have a common interest in the proper functioning of the market and a common responsibility in solving problems and maintaining investors' confidence. In addition, CESR is guided in its approach by the need to encourage greater convergence of supervisory rules and practices across Europe for issues of common concern, so that the advantages of an efficient single market can be realised.

In a situation of increasing cross-border activities in financial markets and of competition between different trading venues, the requirement for investment firms to report transactions to competent authorities (and the exchange of that information between competent authorities) is to be considered as a mechanism of utmost importance for the regulators in order for them to be able to fulfil their supervisory duties, in particular those related to market integrity and investor protection.

Transaction reporting is an essential tool in the detection, investigation and enforcement of market abuse, which becomes even more important with the adoption of the Market Abuse Directive.

In addition, transaction reports may also be used for the detection of potential breaches by investment firms of conduct of business rules, or to assess whether trading venues are functioning in an orderly manner.

C. General approach by CESR

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

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

The proposed Level 2 advice for reporting financial transactions will apply to all investment firms (or approved reporting channels), all financial transactions and all financial instruments under the Directive.

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

Extract from Level 1 text

Article 25

1. Without prejudice to the allocation of responsibilities for enforcing the provisions of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse)[1], Member States shall ensure that appropriate measures are in place to enable the competent authority to monitor the activities of investment firms to ensure that they act honestly, fairly and professionally and in a manner which promotes the integrity of the market.

2. Member States shall require investment firms to keep at the disposal of the competent authority, for at least five years, the relevant data relating to all transactions in financial instruments which they have carried out, whether on own account or on behalf of a client. In the case of transactions carried out on behalf of clients, the records shall contain all the information and details of the identity of the client, and the information required under Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering[2].

3. Member States shall require investment firms which execute transactions in any financial instruments admitted to trading on a regulated market to report details of such transactions to the competent authority as quickly as possible, and no later than the close of the following working day. This obligation shall apply whether or not such transactions were carried out on a regulated market.

The competent authorities shall, in accordance with Article 58, establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for those financial instruments also receives this information.

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

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

6. When, in accordance with Article 32(7), reports provided for under this Article are transmitted to the competent authority of the host Member State, it shall transmit this information to the competent authorities of the home Member State of the investment firm, unless they decide that they do not want to receive this information.

7. In order to ensure that measures for the protection of market integrity are modified to take account of technical developments in financial markets, and to ensure the uniform application of

[1] OJ L 96, 12.4.2003, p. 16.

[2] OJ L 166, 28.6.1991, p. 77. Directive as last amended by Directive 2001/97/EC of the European Parliament and of the Council (OJ L 344, 28.12.2001, p. 76).

paragraphs 1 to 5, the Commission may adopt, in accordance with the procedure referred to in Article 64(2), implementing measures which define the methods and arrangements for reporting financial transactions, the form and content of these reports and the criteria for defining a relevant market in accordance with paragraph 3.

Extract from the mandate from the Commission

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

(1) the methods and arrangements for reporting financial transactions.

(2) the criteria for assessing liquidity in order to define a relevant market in terms of liquidity for financial instruments.

(3) the minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities.

Draft CESR advice on the methods and arrangements for reporting financial transactions

Explanatory text

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

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

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

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

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

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

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

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

8. As mentioned before, in carrying out this work CESR has paid special attention to existing arrangements for transaction reporting and has refrained from proposing unnecessary new requirements that would involve radical changes to the existing arrangements and would bring about excessive additional costs for the entities concerned. For this reason, the proposed set of general minimum conditions reflects the requirements that competent authorities have for different reporting channels today. For the same reason, under certain conditions an investment firm could be granted an exemption from the requirement to report in electronic format by the competent authority.

Draft Level 2 Advice

BOX 15

The methods and arrangements for reporting financial transactions

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

   a) electronic form of the transaction reports (An investment firm may be granted an exemption from this requirement by the competent authority under certain conditions.);
   b) timeliness (capacity to provide the competent authority with the transaction reports within the timeframe imposed by the Directive);
   c) sufficient data safety, including confidentiality of the data;
   d) reliability/quality control mechanisms/existence of validation tools and correcting mechanisms in order to modify an erroneous transaction report;
   e) appropriate precautionary measures in case of system failures;
   f) capacity to report the minimum content of transaction reports in the required national standard/format;
   g) capacity to report or fulfil specific national requirements for transaction reporting that the competent authority of that Member State might decide to put in place;
   h) if an investment firm reports through another reporting channel, there needs to be an appropriate service-level agreement between the investment firm and the reporting channel in order to define and ensure the responsibility issues regarding the effectiveness and/or correctness of the transaction reports.

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

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

Questions

Q15.1: *Should competent authorities be able to waive the requirement for investment firms to report transactions in electronic format? Should such an exemption be limited to exceptional cases, and what cases would those be in your view?*

Q15.2: *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?

Q15.3: *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?*

Q15.4: *Do you agree with the set of the general minimum conditions suggested? If you do not agree, what other general conditions would be more appropriate in your view? In particular, taking into consideration the responsibilities of investment firms on the one hand and third parties and other reporting channels, on the other, do you think that CESR should include the requirement of a standard-level agreement between an investment firm and a reporting channel in the list of general minimum conditions, or would this be better addressed at Level 3? What is your view on the border line as to the responsibilities for reporting if done by a third party acting on behalf of an investment firm or by a reporting channel?*

Q15.5: *What other issues, if any, should CESR take into account when responding to the Mandate concerning the "methods and arrangements for reporting financial transactions"?*

Level 3 recommendations

1. Further examination of the responsibility issues regarding transaction reporting from the investment firms/other reporting parties, in order to get a common view among the competent authorities in Member States.

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

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

Draft CESR advice on criteria for assessing liquidity in order to determine the most relevant market in terms of liquidity for financial instruments

Explanatory Text

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

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

2. Article 25(3) subparagraph 2, provides that competent authorities shall establish the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity for financial instruments (admitted to trading on a regulated market) also receives the transaction reports for these instruments executed on trading venues situated in another Member State in accordance with the provisions of Article 58, thereby providing it with a broader picture as to that instrument.

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

4. In CESR's view, the common understanding of liquidity might be best described as the ability of investors to find a counterpart and to execute their orders at the best conditions in terms of price, speed, etc. Therefore, liquidity refers to the ability of investors to trade quickly at prices that are reasonable in light of underlying demand and supply conditions. This definition is in line with the academic literature on the subject.

5. When considering the issue of liquidity more precisely, CESR has taken into account that assessing liquidity of a market and comparing liquidity of different markets for the purpose stated in the Mandate necessarily leads to difficulties as liquidity is neither static, nor can liquidity in different markets with varying market structures and market models be easily calculated and compared.

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

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

7. CESR discussed different specific criteria for measuring liquidity:

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

    All other criteria, in particular all concepts related to spreads, have not been considered suitable since there have been significant problems with regard to the availability of such data. In addition, there have been severe conceptual problems in applying these criteria to different market models.

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

9. In its fact-finding CESR tested whether the proxies provided for a reliable identification of the most relevant market in terms of liquidity. CESR computed liquidity for different instruments using three criteria:

   a) volume in 2003, single counted;
   b) turnover in 2003. In case of non-Euro-members the average yearly exchange rate as published by the European Central Bank was used to convert non-Euro-currency into Euro;
   c) number of transactions in 2003, only one side counted.

10. The results of the fact-finding analysis proved that the tested proxy for shares was extremely useful. In an overwhelming number of cases the proxies indicated that the most relevant market in terms of liquidity, measured by the criteria "volume" and "turnover", was indeed the market that was suggested by the proxy. However, since some CESR Members had problems in reporting data relating to the criterion "number of transactions" CESR could not test that criterion.

11. In a second step, CESR tested whether the criterion "volume" or the criterion "turnover" produces a better assessment of liquidity. The analysis led to identical results. Therefore, it is neither possible nor necessary to prioritise these two criteria.

12. Having a closer look at the size of the most liquid market relative to other markets a remarkable result occurred. The notion that liquidity is being split more or less evenly between markets seems to be a theoretical one. At least, with respect to shares, the data observed by the Group suggest a different view: in 95 % of all the cases, the most liquid market had at least five times the size of the second biggest market (using the criterion "volume" as well as the criterion "turnover"). In 90 % it had even more than eleven times the size of the next biggest market.

13. Therefore, the survey indicates that for shares liquidity currently is concentrated in one market, typically in the market of the primary listing. The existence of multiple different trading platforms/markets did not seem to have significant effects on liquidity. Or to put it another way: the existence of multiple trading platforms has not yet led to fragmentation of liquidity.

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

15. Nevertheless, CESR acknowledges that there might be cases in which the proxy approach does not provide the correct result. Therefore, where the proxy approach proves to be not accurate or no longer valid, CESR recommends applying an alternative approach based on the computation of "volume" and/or "turnover" for a specified period of time, for each individual financial instrument concerned. In addition, CESR recommends setting up revision procedures providing for some flexibility.
    For example, in case of an Initial Public Offering that would take place in more than one Member State, the competent authorities of the Member States concerned should come to a mutual agreement as to which competent authority should be considered to be the competent authority of the most relevant market in terms of liquidity for an initial period of time. After a sufficient period of time the most relevant market in terms of liquidity shall be determined in accordance with the revision procedures described below.

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

most relevant market in terms of liquidity shall be conducted in accordance with the revision procedures described below.

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

18. CESR suggests that only when the competent authority of a Member State, for a specific financial instrument, has doubts on whether the most relevant market in terms of liquidity is/remains valid, or wants to challenge the applicable proxy, the situation has to be reconsidered. Consequently, that authority should contact the other competent authority identified at that time as the competent authority of the most relevant market in terms of liquidity. They will both compute the liquidity in accordance with the alternative approach to proxies. Depending on the result of the computation, which will be determined by the market where "volume" or "turnover" has been the highest for an appropriate period of time, the identification of the most relevant market will change. (As to cases of disagreement between competent authorities concerned concerning the results of the computation see paragraph 25 at the proposed Level 2 advice regarding Article 58).

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

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

21. Considering the criteria and approaches for the determination of the most relevant market in terms of liquidity and being aware of some of their drawbacks, CESR recommends not to publicly identifying those markets. Rather, CESR recommends making public the competent authority that has been designated as the competent authority of the most relevant market in terms of liquidity for a specific financial instrument, in order to avoid interfering in the competition between markets and to avoid un-wanted impact on the industry.

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

23. As soon as the revision procedures result in a change of the identification of the most relevant market in terms of liquidity for a financial instrument, all the other competent authorities must be informed without undue delay of the change (which can also be made public) by the competent authorities of both the relevant market prior to the change and the new relevant market.

Draft Level 2 Advice

BOX 16

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

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

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

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

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

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

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

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

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

7. As an alternative to the proxies for determining the most relevant market in terms of liquidity for a financial instrument as et out above, the measure of liquidity to retain for the assessment should be the computing of the criteria "turnover" and/or "volume" for a financial instrument, so that the most relevant market in terms of liquidity would be the market in which the highest turnover and/or volume in the respective financial instrument occurred over an appropriate time period.

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

    This alternative computation would be used for:

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

8. For the computation of liquidity in order to determine the most relevant market in terms of

liquidity, the competent authorities need to consider trading on all markets, not just regulated markets.

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

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

10. Each competent authority would be expected to make available to all the other competent authorities and to the public the up-dated list of financial instruments for which it is the competent authority of the most relevant market in terms of liquidity without mentioning that market, and update the list as soon as changes occur.

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

12. Within five years from the entry into force of these implementing measures, CESR should consider reviewing the whole process of assessment of the most relevant market in terms of liquidity, and, where necessary, propose changes.

Questions

Q16.1: *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?*

Q16.2: *Do you agree with the suggested proxies? If you do not agree, what other proxies would be more appropriate in your view?*

Q16.3: *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 financial 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.*

Q16.4: *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?*

Q16.5: *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"?*

Level 3 recommendations

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

1. Finalising the revision procedures:

    a) Determine the definitions in the revision procedures for determining the most relevant market in terms of liquidity:
        i. volume (amount of shares traded) over the specified period , single counted;
        ii. turnover (nominal value of shares traded in Euro) over the specified period. In case of non-Euro-members, the average exchange rate over the specified period as published by the European Central Bank shall be used to convert non-Euro-currency into Euro.
    b) Determine the definition of the phrase "appropriate period of time" in the revision procedures for determining the most relevant market in terms of liquidity including whether it shall be agreed only between the two competent authorities concerned or determined at EU level. The time period for the criteria (turnover/volume) should be long enough to illustrate a structural change in terms of liquidity allocation.
    c) Issues to consider for the work on the revision procedures at Level 3: timing for the launching of the revision procedure and its duration; need for drafting standard format documents (e.g. for questioning the assessment of the most relevant market), information policy of the other competent authorities/CESR about the on-going revision procedure or existence of a formal opening/closing of the procedure.

2. Determining the procedures for establishing the list of the competent authorities of the most relevant market for each financial instrument, and the procedures for up-dating that list. Questions to consider for the work on procedures for establishing and up-dating the list on Level 3 include whether a list should be published with the competent authorities of all financial instruments, the mechanisms for up-dating that list and a possible centralisation of the list.

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

Draft CESR advice regarding the minimum content and common standard/format of transaction reports

Explanatory text

1. Article 25(4) states that a transaction report should include, in particular, details of the names and numbers of the instruments bought or sold, the quantity, the dates and times of execution and the transaction prices and means of identifying the investment firms concerned. However, this is not sufficient information to facilitate the use of transaction reports for the detection, investigation and enforcement of market abuse and the other regulatory purposes transaction reports are used for.

2. CESR considers that the minimum requirements set out in Article 25(4) should be complemented with information, in particular, concerning the trading capacity of the investment firm concerned, the counterparties that they dealt with or on behalf of, and identifying the trading venue on which the transaction took place. In addition, more detailed information is required to appropriately interpret the content set out in Article 25(4).

3. Consequently, CESR agrees that the technical advice should set out the minimum information at a national level that should be included in a transaction report submitted by or on behalf of an investment firm regardless of the reporting mechanism used to submit the information. However, CESR does not believe it should set out the format of this information - it should be up to the competent authorities to determine how these requirements are met, driven by the existing reporting mechanisms and arrangements. As mentioned before, CESR has paid special attention to existing arrangements for transaction reporting and has refrained from proposing unnecessary new requirements that would involve radical changes to the existing arrangements and would bring about excessive additional costs for the entities concerned, which was also a recurring comment in the response to the Call for Evidence and the Consultative Concept Paper. The minimum content of the reports requested from investment firms/obliged reporting parties should be harmonised at a national level as regards the format, in order to avoid unequal treatment of reporting parties, but national differences in the format are considered to be acceptable.

4. However, at a European level, the format of the minimum content should be harmonised by the competent authorities before exchanging the transaction reports with other competent authorities designated as contact points. Article 25(3) requires competent authorities to exchange information received in transaction reports. CESR believes that not all the information received by competent authorities needs to be exchanged and that the sharing of information between authorities is a matter for the competent authorities and should not require any further involvement of investment firms. Therefore, CESR considers that when delivering its advice it should ensure that arrangements facilitate the exchange of information between regulators and the comparability of reports, that they provide regulators with adequate data to fulfil their responsibilities, and that they are proportionate. Consequently, the format of the minimum content of transaction reports to be exchanged between competent authorities would be harmonised. This is the reason why the list in Annex B to this draft advice contains more information than the list in Annex A to this draft advice.

5. With respect to the content of transaction reports, CESR Members had extensive discussions on whether a "client/customer identification code" should be included in the list of information required in the transaction reporting from investment firms. Indeed, views vary among Members: some Members already receive this type of information – usually in the form of the reporting firms' internal code for a client - and find it necessary for their supervisory activities, or are in favour of receiving this information for a number of reasons (it would reduce the number of transactions that need to be reviewed; it would permit reviews on client's trading profile; it would permit reports on leading clients in products; etc.). Others 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 (limited interest of a code that varies from firm to firm as there is no unique code for a particular client such as the social security number; ability to obtain client IDs from the investment firm when required for investigatory purposes; potential problems as to data protection/confidentiality considerations). Consequently, CESR proposes that investment firms need only report this information if it is required to do so by national law in the Member State of the competent authority to which they are reporting.

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

Draft Level 2 Advice

BOX 17

Minimum content and common standard/format of transaction reports

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

2. Annex B to this draft advice sets out the information that should be exchanged between competent authorities. Convergence on the format of these fields will be achieved at EU level through Level 3 measures.

Questions

Q17.1: *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?*

Q17.2: *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?*

Q17.3: *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?*

Q17.4: *How would you define the field "agent/propriety"?*

Q17.5: *What are the advantages/disadvantages of requiring the field "client identification code" in transaction reports, bearing in mind the objectives of transaction reporting? 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?*

Q17.6: *What other issues, if any, should CESR take into account when responding to the Mandate concerning the "minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities"? Will this approach serve the objectives pursued?*

Level 3 recommendations

CESR considers that, since there are not yet sufficient systems in place for the reporting of all financial instruments admitted to trading on regulated markets and for the exchange of transaction reports between competent authorities and because it is important to have flexible arrangements in place for different markets and changes to market structures, the following work should be conducted at Level 3 rather than at Level 2:

1. Standardisation of the format and content of transaction reports exchanged between competent authorities. For information subject to Article 25 that is exchanged between competent authorities CESR believes that the precise format of the information should be defined at Level 3 in order to provide some flexibility if the techniques or standards used in the market would change. Amongst the issues that will need to be discussed are:
    a) the date and time format;
    b) the definition of own account and agency transactions;
    c) the categories of instrument types;
    d) definition of the codification for the authority key: for example it could be proposed to use a code comprising a country reference and an authority identifier.- country code could be the ISO country code (ISO 3166-1). It must be noted that this ISO country code is currently used by the EU in the Geonomenclature of the EU Statistical Office (Eurostat)- authority identifier could be the initials/short name, used internationally by the competent authority. (Then, the authority would look as follow UK FSA; FR AMF; SP CNMV…);
    e) as to trading venues and exchange between regulators: there could be a need to have a consolidated list of the trading venues (including at least names) the codes refer to, at CESR level or to be exchanged regularly between CESR Members.

Annex A to draft advice – Minimum content of a transaction report by or on behalf of an investment firm

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

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

Annex B to the draft advice – Information received in transaction reports that should be exchanged between competent authorities

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

	• Equity • Bond • Equity derivative • Bond derivative • Commodity derivative • Interest rate derivative • Index derivative
Price	This is the price per security or derivative contract excluding items like commission and accrued interest.
Price Notation	The currency in which the price is expressed or percentage for debt instruments.
Quantity	The number of securities, the nominal value of bonds, or the number of derivative contracts in the transaction.
Quantity Notation	Confirmation of whether the quantity is number of securities, nominal value of bonds or number of derivative contracts.
Trade Value	The value of the transaction, including accrued interest where applicable.
Value Notation	If the trade value is expressed in a different currency to the price then competent authorities will need to include the currency in which the value of the transaction is expressed.
Price Multiplier	The number of pieces of the financial instrument concerned in a trading lot, e.g. the number of derivatives or securities represented by one contract.
Counterparty Name and Code	Where possible competent authorities will need to translate the counterparty code reported by the investment firm and provide other authorities with the name of the counterparty. If the code reported by the investment firm is an internal code which cannot be translated then the code should remain.
Customer/Client Identification	This field contains the identification of the client or customer on whose behalf the reporting firm was acting. This is likely to be the reporting firm's own internal code for its client/customer. Competent authorities would only report this information if it is available in accordance with national law of the competent authority.
Trading Venue	An identification of the stock exchange or trading venue in which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC code or regulatory code for the MTF or OTC/OFF for other transactions.
Transaction Reference Number	A unique identification number for the transaction reported by the investment firm.
Maturity Date	Required for most bond and derivative transactions. It should be the maturity date of the bond or the exercise date/maturity date of the derivative contract.
Derivative Type	Whether the derivative is an option, future or warrant
Put/Call	Whether the option or warrant is a put or call
Strike Price	The strike price of the option or warrant contract.

Obligation to cooperate (Article 56(2))

Extract from Level 1 text

Article 56

1. *Competent authorities of different Member States shall cooperate with each other whenever necessary for the purpose of carrying out their duties under this Directive, making use of their powers whether set out in this Directive or in national law.*

   Competent authorities shall render assistance to competent authorities of the other Member States. In particular, they shall exchange information and cooperate in any investigation or supervisory activities.

   In order to facilitate and accelerate cooperation, and more particularly exchange of information, Member States shall designate one single competent authority as a contact point for the purposes of this Directive. Member States shall communicate to the Commission and to the other Member States the names of the authorities which are designated to receive requests for exchange of information or cooperation pursuant to this paragraph.

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

3. *Member States shall take the necessary administrative and organisational measures to facilitate the assistance provided for in paragraph 1.*

   Competent authorities may use their powers for the purpose of cooperation, even in cases where the conduct under investigation does not constitute an infringement of any regulation in force in that Member State.

4. *Where a competent authority has good reasons to suspect that acts contrary to the provisions of this Directive, carried out by entities not subject to its supervision, are being or have been carried out on the territory of another Member State, it shall notify this in as specific a manner as possible to the competent authority of the other Member State. The latter authority shall take appropriate action. It shall inform the notifying competent authority of the outcome of the action and, to the extent possible, of significant interim developments. This paragraph shall be without prejudice to the competences of the competent authority that has forwarded the information.*

5. *In order to ensure the uniform application of paragraph 2 the Commission may adopt, in accordance with the procedure referred to in Article 64(2), implementing measures to establish the criteria under which the operations of a regulated market in a host Member State could be considered as of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State.*

Extract from the mandate from the Commission

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

The criteria under which the operations of a regulated market in a host member state could be

considered as of substantial importance for the functioning of the securities markets and the protection of investors in the host member state.

Draft CESR advice

Explanatory text

Purpose and rationale

1. The purpose of this technical advice is to provide criteria under which the operations of a regulated market could be considered as of substantial importance for the functioning of the securities markets and the protection of the investors in a host Member State. The mandate does not contain any indicative elements which CESR might wish to have regard to in providing its advice.

2. Article 56(2) is intended to cover situations 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.

3. Under the mandate, CESR is not required to provide advice on the specific form or content of such cooperation arrangements.

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

Situations envisaged by Article 56(2)

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

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

7. Article 56(2) therefore might envisage situations whereby a regulated market is offering access to its trading facilities in another Member State (host Member State). (A hypothetical example is: An investment firm from Member State A trading in securities first admitted on a regulated market in Member State A, are then traded on a regulated market in Member State B.)

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

9. Furthermore, Article 56(2) should not be triggered by the mere fact that a market operator or a regulated market in Member State A acquires a shareholding in a regulated market (or a market operator) in Member State B. However, where a market operator operates regulated markets in different Member States using a common platform/system and/or common procedures, or where such an operator has decided to reorganise or change the nature of the particular market(s), then it may be necessary for a competent authority to invoke Article 56(2). (This scenario may be illustrated by the following, hypothetical example: X operates regulated market in country A and uses platform 1. Y operates regulated market in country B and uses platform 2. Y takes over the X and integrates X' activities into its organisation. X ceases to be a legal entity. Y decides to integrate its platform 2 into platform 1.)

10. It may also be necessary to take into consideration any decision of an acquiring market operator or regulated market that may impact on the admission to trading policies or organisation of the regulated market or markets to be acquired.

Arrangements

11. In the Commission mandate, CESR has not been requested to provide technical advice on the interpretation of "established arrangements". Nevertheless, it appears useful for a better understanding to set out here what the meaning of "established arrangements" might be. Remote access/membership is a necessary condition for the application of Article 56(2). The additional factors may be instructive in determining substantial importance of a regulated market:

    Remote access/membership: the arrangements established by the regulated market include the provision of access to trading by remote members or participants established in that host Member State (cf. Art. 4(21)).

    Additional *factors*: in addition to remote access/membership, arrangements established by the regulated market in the host Member State may include *inter alia* the following:

    a. The admission to trading of securities of issuers that are registered or established in the host Member State;

    b. The admission to trading of securities that were first admitted to trading on a regulated market in the host Member State;

    c. The use and operation in the host Member State of a platform/system and/or procedures that are integrated in or shared with the ones the regulated market uses and operates in the home Member State.

Determining what constitutes "substantial" importance

12. The 'trigger' for the operation of Article 56(2) is whether the operations of a regulated market that has established arrangements in a host Member State are of "substantial importance" for the functioning of that host Member State's securities market and the protection of investors. As previously highlighted, it is essential that the criteria to be used in determining such a broad concept remain as flexible as possible and do not impinge on competent authorities' abilities to adopt pragmatic, risk sensitive and fit-for-purpose approaches to the supervision of such entities. Therefore, CESR does not consider it appropriate to establish an exhaustive list of criteria to be used when determining "substantial importance".

13. CESR conducted an internal fact finding in order to assess whether remote membership or access to a regulated market is a common feature of regulated markets and the extent to which such remote members have an impact on the trading on such regulated markets.

    Figures have been gathered on the traded turnover in foreign instruments (shares and corporate bonds, without distinction on where the issuer is incorporated) admitted to trading on regulated markets in Member States compared to the total turnover on those regulated markets. In value

(Euro) over a year, the share of trading in foreign securities varies from 0,2% to 14,2% depending on the Member State regulated market(s) concerned. Out of the 13 Member States for which information has been made available, there are 3 cases where the value of foreign trading represents more than 10% of total trading value, and, 5 cases where the value of foreign trading represents less than 1%.

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

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

Factors relating to the access and trading on the regulated market

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

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

18. The most obvious factors likely to be of relevance here include:

    a) the number of remote members/direct participants active on the regulated market in question, and their respective trading volumes;

    b) the number of financial instruments also admitted to trading on the regulated market and their respective trading volumes in the host Member State;

    c) the number of financial instruments of issuers located in another Member State admitted to trading on a regulated market and the extent of trading in those instruments by remote members located in the same Member State as the issuer.

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

    a) for remote member/direct participants, their overall trading volumes resulting from their activities on a regulated market in another Member State as compared to the overall trading volume on that market;

    b) for financial instruments also admitted to trading on a regulated market in another Member State, a comparison of the overall trading volumes for the instrument concerned. This issue is interrelated with the determination of the most relevant market in terms of liquidity as far as only regulated markets are concerned.

Qualitative factors

20. In addition to the above quantitative factors, there may be other more general, qualitative factors which are relevant in establishing "substantial importance". This could be as broad as the overall size/nature of the economy of the host Member State, the nature of the market (i.e. the

extent to which retail/wholesale investors are active in a particular market) and whether cross-membership or access agreements exist between the regulated markets in question.

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

Draft Level 2 Advice

BOX 18

Substantial importance - factors to be taken into account

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

    a) whether cross-membership/cross-access agreements between regulated markets of the host and home Member States exist;

    b) the overall trading volumes carried out by remote members established in a host Member State;

    c) the overall trading volume of financial instruments admitted to trading on the host regulated market which have been admitted to trading for the first time on a regulated market in another Member State;

    d) the number of investors from the host Member State holding securities that are traded on the regulated market, including the value of their holdings;

    e) the migration of a substantial part of the listings on a regulated market in the host Member State of securities of issuers established in that host Member State, to a regulated market in another Member State.

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

    a) the overall trading volume on the securities markets of the host Member State, including Regulated Markets and other trading venues;

    b) the need for protection of the investors in the host Member State;

    c) the extent to which securities of issuers located in a Member State admitted to trading on the host regulated market in question are concerned, in particular when included in portfolios of pension funds and other savings vehicles such as UCITS in the Member State of the issuer.

Level 3 recommendations

24. CESR does not consider it appropriate at this stage to provide any detailed guidance on the form or nature of any cooperation arrangements that may be necessary to ensure the smooth functioning of securities markets in the EU.

25. Competent authorities shall ensure that where the provisions of Article 56(2) are invoked, any measures taken by the respective competent authorities are proportionate. The respective competent authorities shall ensure that the market operator/regulated market is consulted prior to such arrangements taking effect.

Questions

Q 18.1: *To what extent to you agree with the additional situations outlined in paragraph 11?*

Q 18.2: *In determining whether a regulated market is of substantial importance, do you consider the factors listed in paragraph 22 and 23 appropriate and are there any other factors which you believe CESR/competent authorities should take into account?*

Q 18.3: *To what extent should the overall size/nature of the economy of the host Member State and other economic factors such as sectoral figures in relation to the issuer's activity, employment figures be taken into account as a factor to include in paragraph 23?*

CESR

Cooperation and Exchange of Information (Article 58)

Extract from the Level 1 text

Article 58

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

   Competent authorities exchanging information with other competent authorities under this Directive may indicate at the time of communication that such information must not be disclosed without their express agreement, in which case such information may be exchanged solely for the purposes for which those authorities gave their agreement.

2. *The competent authority having been designated as the contact point may transmit the information received under paragraph 1 and Articles 55 and 63 to the authorities referred to in Article 49. They shall not transmit it to other bodies or natural or legal persons without the express agreement of the competent authorities which disclosed it and solely for the purposes for which those authorities gave their agreement, except in duly justified circumstances. In this last case, the contact point shall immediately inform the contact point that sent the information.*

3. *Authorities as referred to in Article 49 as well as other bodies or natural and legal persons receiving confidential information under paragraph 1 of this Article or under Articles 55 and 63 may use it only in the course of their duties, in particular:*

   (a) to check that the conditions governing the taking-up of the business of investment firms are met and to facilitate the monitoring, on a non-consolidated or consolidated basis, of the conduct of that business, especially with regard to the capital adequacy requirements imposed by Directive 93/6/EEC, administrative and accounting procedures and internal-control mechanisms;
   (b) to monitor the proper functioning of trading venues;
   (c) to impose sanctions;
   (d) in administrative appeals against decisions by the competent authorities;
   (e) in court proceedings initiated under Article 52; or
   (f) in the extra-judicial mechanism for investors' complaints provided for in Article 53.

4. *The Commission may adopt, in accordance with the procedure referred to in Article 64(2), implementing measures concerning procedures for the exchange of information between competent authorities.*

Extract from the Mandate from the Commission

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

Draft CESR advice

Explanatory Text

1. The purpose of this technical advice is to establish a general framework for cooperation between the competent authorities, in order to facilitate the fulfilling of their duties under the Directive.

2. CESR holds the view that the issue of cooperation among regulators requires striking a balance between greater clarity and legal certainty, on the one hand, and retaining flexibility to cater for different scenarios, on the other hand.

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

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

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

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

7. Article 58 establishes the obligation of competent authorities designated, in accordance with the Directive, as "contact points" to immediately supply one another with the information required for the purposes of carrying out the duties of the competent authorities set out in the provisions adopted pursuant to the Directive.

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

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

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

11. There are certain common characteristics between the exchange of information for the purposes provided for in the Directive and the exchange of information under other Directives, such as the Market Abuse Directive 2003/6/EC or the Prospectus Directive 2003/71/EC which could provide useful guidance for cooperation.

12. In carrying out this work CESR paid special attention to existing frameworks, such as the CESR Memorandum of Understanding ("MoU"), and the practice developed within CESRPOL and the IOSCO multilateral MoU, as well as the experience gained in the field of exchange of information within the European Union and in a broader context by cooperating with third-country competent authorities.

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

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

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

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

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

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

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

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

18. Article 25(3) second subparagraph obliges competent authorities to establish, in accordance with Article 58, the necessary arrangements in order to ensure that the competent authority of the most relevant market in terms of liquidity also receives those transaction reports that concern financial instruments for which it is the competent authority of the most relevant market in terms of liquidity.

19. The wording of the indicative elements in the mandate on Article 58 suggests that, when delivering its advice on the procedures for the exchange of information between competent

authorities designated as contact points, CESR should pay particular attention to the transmission of information on the transactions in financial instruments as to establishing the criteria in order to identify those particular cases where information should be immediately supplied to the competent authority of the most relevant market in terms of liquidity without mediating any request.

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

21. CESR is of the view that, although there could be merit in keeping the Level 2 advice flexible as to when and how often transaction reports should be transmitted to the competent authority of the most relevant market in terms of liquidity, it should be pointed out that, for practical and cost-benefit reasons, it would be desirable to find only one "universal" flexible solution, which has the validity for every competent authority and every financial instrument, so that the transmission of information according to Article 25(3) should in particular be simple and workable. There could neither be the flexibility for each authority to say when or how often the transaction reports should be transmitted, nor flexibility for each financial instrument, since that would make the exchange of transaction reports too complicated and probably too expensive.

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

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

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

25. In situations where a competent authority does not receive the expected communication from another competent authority, a mechanism for finding solutions in such instances may be envisaged by CESR at Level 3. Such a mediation mechanism for cases of disagreement between competent authorities would be part of a more general approach, i.e. not only covering this Directive, of CESR at Level 3. This could be based on the mechanism foreseen in Article 16(2) and (4) of the Market Abuse Directive.

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

<u>Draft Level 2 advice</u>

BOX 19

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

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

Obligatory/automatic exchange of information

29. Obligatory/automatic exchange of information relates to information which is transmitted to the competent authority of another Member State, in accordance with the Directive, without prior specific request. It includes, among others:

    i. the transmission of information on the transactions in financial instruments to the competent authority(ies) designated in accordance with Article 25(7) of the Directive;

    ii. the notification of the withdrawal of the license or the change of status of the license to the competent authority of the Member State where the investment firm provides services and;

    iii. the notification of "de-listing" or suspension from trading of financial instruments to the competent authorities of the Member State where the financial instruments have been admitted to trading.

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

Special procedure for the transmission of information on transactions reporting

30. When a competent authority receiving a transaction report is not the competent authority of the most relevant market in terms of liquidity, the transaction reports should be supplied to the competent authority of the most relevant market in terms of liquidity without mediating any request, immediately after having transformed the transaction reports into the harmonised format of transaction reports to be exchanged between competent authorities.

31. When a branch reports to the competent authority in the host Member State, the competent authority of the host Member State should transmit the transaction reports to the competent authority of the home Member State without mediating any request, immediately after having transformed the transaction reports received into the harmonised format of transaction reports exchanged between competent authorities, unless the competent authority of the home Member State decides that it does not want to receive these reports.

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

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

Requests for cooperation and exchange of information

33. Paragraph 34 to 41 are applicable to the transmission of information in case of consultation

among competent authorities provided for in the Directive and to exchange of information "upon request" under the provisions of Article 56(1) and Article 58(1) "whenever necessary for the purpose of carrying out their duties under this Directive".

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

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

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

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

Execution of requests for cooperation and exchange of information

38. Requests should be acknowledged without undue delay.

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

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

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

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

Questions:

Q19.1: *Do you agree with the general conditions with which all the competent authorities designated as contact points would have to comply? If you do not agree, what other general conditions would be more appropriate?*

Q19.2: *Do you agree with the proposal for when and how often transaction reports should be exchanged? If you do not agree, what other alternatives would be more appropriate in your view?*

Q19.3: *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"?*

Q19.4: *Is the split between level 2 and level 3 appropriate?*

Level 3 recommendations

43. CESR might undertake further work at Level 3 in the field of the convergence of the procedures for the exchange of the different categories of information previously identified.

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

45. CESR will consider developing a special format for requests for information if necessary with respect to those already in use within CESR and within IOSCO.

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

47. The processing of requests by the requested authority in accordance with the Directive should be aimed at producing responses that provide the requesting authority with the necessary cooperation or information as quickly as possible. This may necessitate further formal or informal contact with the requesting authority to clarify which information is most relevant to the subject matter of the request.

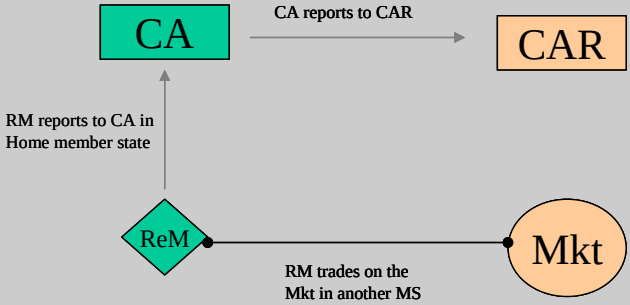
48. The requested authority should notify the requesting authority as soon as a delay in the execution of the request becomes apparent. Where appropriate, the requested authority should provide regular feedback as to progress. Such notification should contain an estimate of how long the execution of the request will take. Where the taking of statements is concerned, a turnaround time of three months is generally appropriate.

49. To ensure constant improvement of cooperation, authorities should provide feedback to each other where appropriate as to the usefulness of cooperation or information received, the outcome of the case in relation to which the cooperation or information was sought and any problems encountered in providing such cooperation or information.

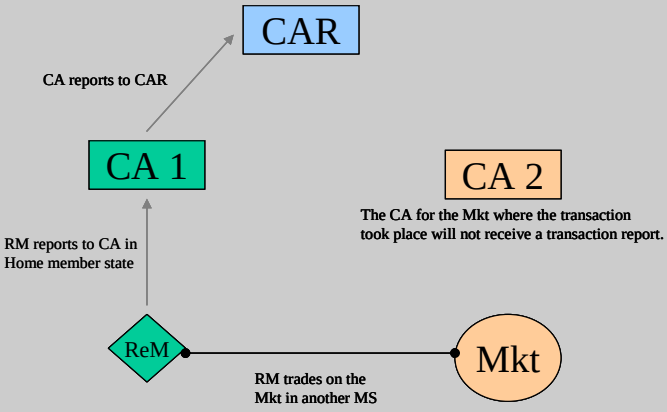
50. CESR considers that the Level 3 work could include determining the maximum time period, in particular as concerns the techniques, as to the supply of transaction reports to the competent authority of the most relevant market in terms of liquidity "immediately after having transformed the transaction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

51. Work on the procedures for transaction reporting of remote members:
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 would then forward the transaction report to the competent authority of the Member State where the transaction took place, provided that it is the competent authority of the most relevant market in terms of liquidity.

Explanations to the illustrations
ReM = Remote Member
Mkt = Regulated Market, MTF etc
CA = Competent Authority
CAR= Competent Authority of the most relevant market in terms of liquidity
MS = Member State

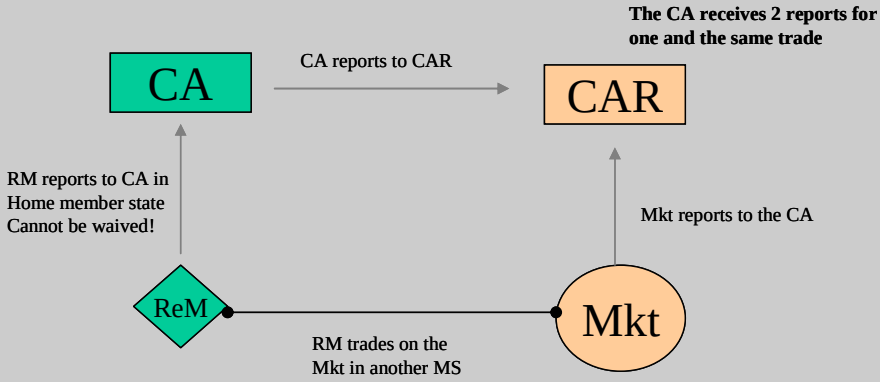


As a result, the competent authority of the Member State where the transaction took place might not receive a transaction report for this transaction if the most relevant market in terms of liquidity is in another Member State. That competent authority may request transaction data pursuant to Article 58. CESR might consider whether a competent authority should be able to request this information (in accordance with the cooperation arrangements of the Directive) on a *regular* basis from other competent authorities where that instrument is listed even if it is not the competent authority of the most liquid market.



According to the Directive, if a remote member reports directly (itself or via another reporting channel, such as a regulated market) to the competent authority in a Member State where the transaction took place (if the transaction took place in a Member State other than the home Member State), its obligation to report to the home Member State would not be waived.

Consequently, a remote member that reports directly to the competent authority in the Member State where the transaction took place (if the transaction took place in a Member State other than the home Member State), would have to make two reports, one to the competent authority of the home Member State and one to the competent authority in the Member State where the transaction took place. This would impose the problem of double reporting, if the competent authority in the Member State where the transaction took place is also the competent authority of the most relevant market in terms of liquidity.



CESR believes that it is important that remote members can be given the choice to report directly to the competent authority in the Member State where the transaction took place, even if this means that the remote member would also have to report to the competent authority of the home Member State.

Therefore, Level 3 could include work on how to provide for a good and workable solution on this issue.

Questions

Q1: *New systems and databases for the exchange of transactions reports will probably have to be put in place by the competent authorities designated as contact points in order to be able to meet with the requirements of the Directive Do you think that the implementing measures should allow for the possibility of competent authorities to have more time available for setting up such systems, and why? How long should such a period be?*

Q2: *What could be the advantages/disadvantages of a common database, as explained in paragraph 44 above, in particular taking into account cost-benefit considerations? Could a common database be useful for other information to be exchanged between competent authorities? Should a common database be created at Level 2 or at Level 3?*

Q3: *CESR considers undertaking more detailed work on the issue of a mediation mechanism in case of disagreements between competent authorities. Such a mechanism would not only cover the situations envisaged by Article 16(2) and (4) of the Market Abuse Directive, but might be a more general approach by CESR at Level 3. Do you have any views whether such a mechanism would be appropriate for areas of the Directive (e.g. concerning the identification of the most liquid market or exchange of information)? Are there other areas of the Directive where such a mechanism should apply?*

Annex C to this draft advice: List of provisions whose implementation will require cooperation or exchange of Information between competent authorities
(indicative and non-exhaustive)

FIMD Art.	Kind of behaviour required	Matters /Conditions/ Situations
6.2 (and 56.1 or 58.1)	Exchange of information	to IF initial scope of authorisation - for examination of the change in status
6.2 (and 56.1 or 58.1)	Transmission of information (without prior request)	an IF seeking authorisation to extent its business to additional services or activities shall submit a request for extension
7 (and 56.1 or 58.1)	Exchange of information	procedures for granting and refusing requests of authorisation
8 (and 56.1 or 58.1)	Transmission of information (without prior request)	circumstances for a withdrawal of authorisation of an IF
9.1 (56.1 or 58.1	Exchange of information	when person is not a resident in MS where IF is seeking authorisation
9.2 (and 56.1 or 58.1)	Exchange of information	when, at the time the authorisation is sought, a change in management has been notified to the CA which has to grant authorisation, in case the new management is non resident in that MS
9.2 (and 56.1 or 58.1)	Exchange of information	Change in management after initial authorisation if the newly appointed staff is a resident of another MS
9.2 (and 56.1 or 58.1)	Transmission of information (without prior request)	Accepted change in management (after initial authorisation) in case of FPS or branch
10.1 subpara.1 (and 56.1 or 58.1)	Exchange of information prior to authorisation	if shareholders or members with qualifying holdings in an IF are residents of other MS
10.3 (and 56.1 or 58.1)	Exchange of information in case of change of status	person proposes to acquire qualifying holding of IF is resident of other MS
10.4 (and 60)	Consultation prior to authorisation	(1) if acquirer of a qualifying holding referred to in 10.3 is a) IF, CI, IU or UCITS authorised in other MS, or b) parent undertaking thereto, or c) person controlling IF, CI, IU, UCITS authorised in other MS and if (2) the undertaking would become acquirer's subsidiary or come under his control

10.6	Transmission of information (without prior request)	When shareholding problems or when failure to provide prior information in relation to acquisition or increase of holding, or, acquisition without consent of authorities, in case of FPS or branch
13.3 (and 56.1 or 58.1)	Exchange of information	assessment of conflict of interests organisational and administrative requirements
13.5 (and 56.1 or 58.1)	Exchange of information prior to authorisation	if IF is relying on third party for the performance of operational functions/outsourcing and third party is resident of other MS
13.6 (and 56.1 or 58.1)	Exchange of information	if information about services and transactions is relevant in own investigation
16.2 (and 56.1 or 58.1)	Exchange of information	if an IF has notified the CA of any material changes to the conditions for the initial authorisation Remark : doubt about Exchange of information under this provision. In case of FPS or branch, the matters to notify are covered by art. 31-4 (for information related to art. 31-2 and by art.32-9 (for information related to Art. 32-2)
18.1 (and 56.1 or 58.1)	Exchange of information	MS requires IF to take all reasonable steps to identify conflicts of interest with managers, employees and tied agents, when located/resident abroad or when it concern the branch of an IF
19 (and 56.1 or 58.1)	Exchange of information	ongoing supervision of conduct of business obligations (branch excepted) or investigation
20 (and 56.1 or 58.1)	Exchange of information	IF is allowed to rely on information transmitted by other IF if it provides services through the medium of an IF (in another MS)
21 (and 56.1 or 58.1)	Exchange of information	best execution obligations when client not located in home MS (except for branch)
22 (and 56.1 or 58.1)	Exchange of information	client order handling rules
23 (and 56.1 or 58.1)	Exchange of information	obligations of an IF when appointing tied agents
24.2 subpara. 1 ~~2~~ and 24. 3 (and 56.1 or 58.1)	Exchange of information	transactions executed with eligible counterparties (located in another MS)
24.2 subpara.2 and 24.3 subpara.2 (and 56.1 or 58.1)	Exchange of information	Request from eligible counterparty to be treated as "normal client" or express confirmation from prospective counterparty that it agrees to be treated as eligible counterparty, when located in another MS

25.3 subpara.2 (and 58)	Transmission of information (without prior request)	CAs shall establish necessary arrangements in order to ensure that the CA of the most relevant market in terms of liquidity for those financial instruments also receives the transaction reports ("minimum content")
25.6	Exchange of information	if host MS of branch receives transaction reports and home MS did not "opt out" of receiving those reports
31.2 subpara.1(with 31.3)	Notification	if IF wants to provide FPS in another MS for first time or in case of changes in range of service or activities
31.2 subpara.2	Exchange of information	if IF wants to provide FPS in another MS for first time and intends to use tied agents in the host MS
31.4 (with 31.2)	Notification	in case of changes of any of the information received under 32.2
31.6 subpara.1	Notification	if MTF intents to provide arrangements in other MS
31.6 subpara.2	Exchange of information	~~if~~ When MTF intents to provide cross-border arrangements
32.3 (with 32.2)	Notification	if a) an IF intends to establish a branch in another MS and b) the CA of the home MS has no reason to doubt the adequacy of the administrative structure or the financial situation of an IF
32.4	Notification	For the first time, or in the event of a change, in the particulars of the accredited compensation scheme of which the IF is a member
32.7	No exchange of information provided for	CA of host MS shall assume responsibility for ongoing supervision in regard to Art. 19, 21, 22, 25, 27 and 28
32.8	Notification prior to on-site inspection	if CA of home MS of the IF intends to carry out on-site inspections in a branch of the IF in another MS
32.9	Notification	in the event of a change in any information communicated in accordance with 32.2
35.2 (and 56.1 or 58.1)	Exchange of information (for authorisation ; in case of changes)	if MTF decides to use a central counterparty, a clearing house and/or a settlement system from another MS
37.1 (and 56.1 or 58.1)	Exchange of information('prior to authorisation and for changes)	if the persons who will effectively direct the business and the operations of the RM are residents of another MS
37. 2 (and 56.1, 58.1)	Exchange of information prior to authorisation	if the persons who effectively direct the business and the operations of a RM are residents of another MS and/or they effectively direct the business and the operations of an already authorised RM , in particular in another MS
38.1 (and 56.1 or 58.1)	Exchange of information prior to authorisation	if the persons exercising significant influence over the management are residents of another MS

38.2 lit.b) and 38. 3 (and 56.1 or 58.1)	Exchange of information	if a transfer of ownership of the RM results in the change of identity of persons exercising significant influence over the operation of the RM-When these persons are residents of another MS
39. lit.a (and 56.1 or 58.1)	Exchange of information	in relation with the assessment of potential conflicts of interest with owners or market operators when the latter are residents/located in another MS
41.1 subpara.2	Notification	if operator of RM has suspended or removed a financial instrument from trading and has communicated the relevant information to the CA
41.2	Notification	if CA demands the suspension or removal of a financial instrument from trading
42.3	Exchange of information	if person wishes to participate in a RM it has to be fit and proper, sufficient level of trading ability, adequate organisational arrangements and sufficient resources
42.6 subpara.2	Notification	if RM has communicated to the CA of the home MS the intention to provide arrangements for remote membership in another MS
42.6 subpara.3	Exchange of information	When a RM provides arrangements for remote members or participants from another MS
46.2 (and 58.1)	Exchange of information (for authorisation ; in case of changes)	if RM enters into arrangements with the central counterparty or clearing and settlement system of another MS
47	notification	MS draw up a list of RM for which it is the home MS; changes of the list
48.1	notification	designation of competent authorities which are to carry out each duty under the FIMD
48.2	notification	arrangements entered into with regard to delegation of task
56.1 and 56.3	Cooperation	general provision to cooperate, whenever it is necessary under the FIMD; especially exchange of information for purpose of supervision and investigations
56.2	Cooperation	if operations of RM has established arrangements in host MS which are of substantial importance for the functioning of securities markets and investor protection in host MS
56.4	Unsolicited information transmission	if MS has reasons to believe that violations of the FIMD are carried out by entity that is not under its supervision in the territory of another MS
56.4	Notification (of feed back)	if MS was informed of suspicion that violations of the FIMD are carried out by entity its territory that is not under supervision of the informing CA
57, 1st sentence	Cooperation	generally in cases of supervisory activities for an on-the-spot verification or investigations or information exchange
57, 2nd sentence	Exchange of information	when IF is remote member of a RM and CA of RM chose to address the IF directly
58.1	Exchange of information	general clause about the way and details of an exchange of information required for the purposes of carrying out the duties of CA under the FIMD
59	Notification	Refusal to cooperate

60.1	Exchange of information (Consultation prior to authorisation)	conditions : a) if IF is a subsidiary of IF/CI in other MS or b) a subsidiary of the parent undertaking of IF/CI in another MS or c) when IF is controlled by the same persons which control IF/CI in another MS
60.2	Exchange of information (consultation prior to authorisation of CA of MS responsible for supervision of CI or UI)	conditions: a) if IF is a subsidiary of CI/IU in other MS or b) a subsidiary of a parent undertaking of a CI/IU in the Community or c) when CI/IU is controlled by same persons which control CI/IU in the Community
60.3 (with 9 and 10.4)	Exchange of information (consultation)	when assessing suitability of shareholders or members and reputation and experience of persons directing the business of another entity of the same group (fit and proper test)
62.1 subpara.1	Notification	if the CA in host MS has reasons to believe that an IF operating cross boarder (FPS) or has established a branch in the host MS is in breach of obligations under FIMD
62.1 subpara.2	Notification	if CA of host MS intends to take appropriate measures against violation
62.2 subpara.2	Notification	if measures are taken to stop violation of national law by branch in host MS
62.2 subpara.3	Notification	if branch of IF in host MS is violating the laws of the host MS despite measures under 62.2 subpara.2
62.3 subpara.1	Notification	if the CA of the host MS of a RM or MTF has reasons to believe that the RM or the MTF is in breach of the obligations under the FIMD
62.3 subpara.2	Notification	if, despite the measures taken by the CA of the home MS, the RM or MTF persists in violation the interests of the investors an the markets of the host MS

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

CESR

ANNEX 1

PROCESS AND WORK PLAN

1. On 20 January 2004, the European Commission published its first set of provisional mandates requesting CESR's technical advice on possible implementing measures for the MiFiD by 31 January 2005 (Ref. CESR/04-021). A second set of mandates from the Commission is expected in the course of June 2005.

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

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

   - The beginning of work on certain aspects of technical advice by CESR shall not, in any way, prejudice the outcome of the discussions between the European Parliament and Council. The request for technical advice does not touch or prejudice Level 1 issues at any stage, or any point.

   - CESR should start work on the basis of the texts of the Directive of the European Parliament and of the Council on markets in financial instruments being discussed in the Council and the European Parliament. The Commission representative attending meetings of CESR or its expert groups will regularly inform CESR of any developments in respect of the text of the Directive.

   - CESR should provide 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. Given the time constraints and the variety and complexity of issues covered by this proposal for a Directive, the Commission, in order to provide guidance to CESR to define the limits of the scope of the mandate, is putting forward in an annex to the provisional mandate a list of indicative elements in respect of each request for advice 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 realises that the mandates to CESR must be very clear and precise for the items that have to be covered by CESR's future advice. This indicative guidance is not exhaustive; it could be completed by further questions or replaced by completely different ones by CESR, and it is not binding.

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

   - CESR should address to the Commission any questions they might have concerning the clarification on the text of the Directive or other parts of Community legislation, which they should consider of relevance to the preparation of its technical advice.

   - The Commission itself will not issue a formal mandate to CESR until the final adoption of the Directive on Financial Instruments Markets in Council and Parliament.

- The technical advice given by CESR to the Commission will not take the form of a legal text. However, CESR should follow a structured approach, i.e. provide the Commission with an "articulated" text in a language which is easily understandable and respects current legal terminology used in the field of financial securities law.

- CESR should provide advice which takes account of the different opinions expressed by the market participants (practitioners, consumers and end-users) during the various consultations. CESR will provide a feed-back statement on the consultation justifying its choices vis-à-vis the main arguments raised during the consultation. CESR should also inform, if necessary, the Commission. Particular attention should be paid of the level of detail to be included in Level 2 legislation.

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

   - **Expert Group on Intermediaries**: The Expert Group is chaired by Mr Callum McCarthy (Chairman of the UK's Financial Regulator, the Financial Services Authority [FSA]); rapporteur of the group is Mr Carlo Comporti. This Expert Group will cover the provisional mandates related to: organisational requirements; conflicts of interest; conduct of business obligations when providing investment services to clients; best execution; client order handling rules, with particular regard to prompt, fair and expeditious execution of client orders.

   - **Expert Group on Markets:** This Expert Group is chaired by Mr Jacob Kaptein (Commissioner at the Dutch Securities Regulator, the Autoriteit Financiële Markten [AFM]); rapporteur of the group is Mr Jari Virta. This Expert Group will cover the provisional mandates relating to: the admission of financial instruments to trading; pre-trade transparency requirements for multilateral trading facilities (MTFs) and regulated markets; post-trade transparency requirements for MTFs and regulated markets; post-trade disclosure by investment firms.

   - **Expert Group on Cooperation and Enforcement**: This Expert Group is chaired by Mr Michel Prada (President of the French Securities Regulator, the Autorité des Marchés Financiers [AMF]); rapporteur of the group is Mr Alexander Karpf. This will cover the provisional mandates related to: transaction reporting, co-operation between competent authorities and exchange of information.

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

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

   The following 23 external experts are members of the Consultative Working Group:

   Dr Heiko Beck, General Counsel DekaBank Deutsche Girozentrale
   Dr Michele Calzolari, Chairman of Assosim and CEO of BIPIELLE SIM
   Mr Jean-François Conil-Lacoste, CEO of Powernext SA
   Mr Henri de Crouy-Chanel, Administrateur Délegué of Aurea Finance Company
   Mr Peter De Proft, Member of the Executive Committee of the Bank Nagelmackers

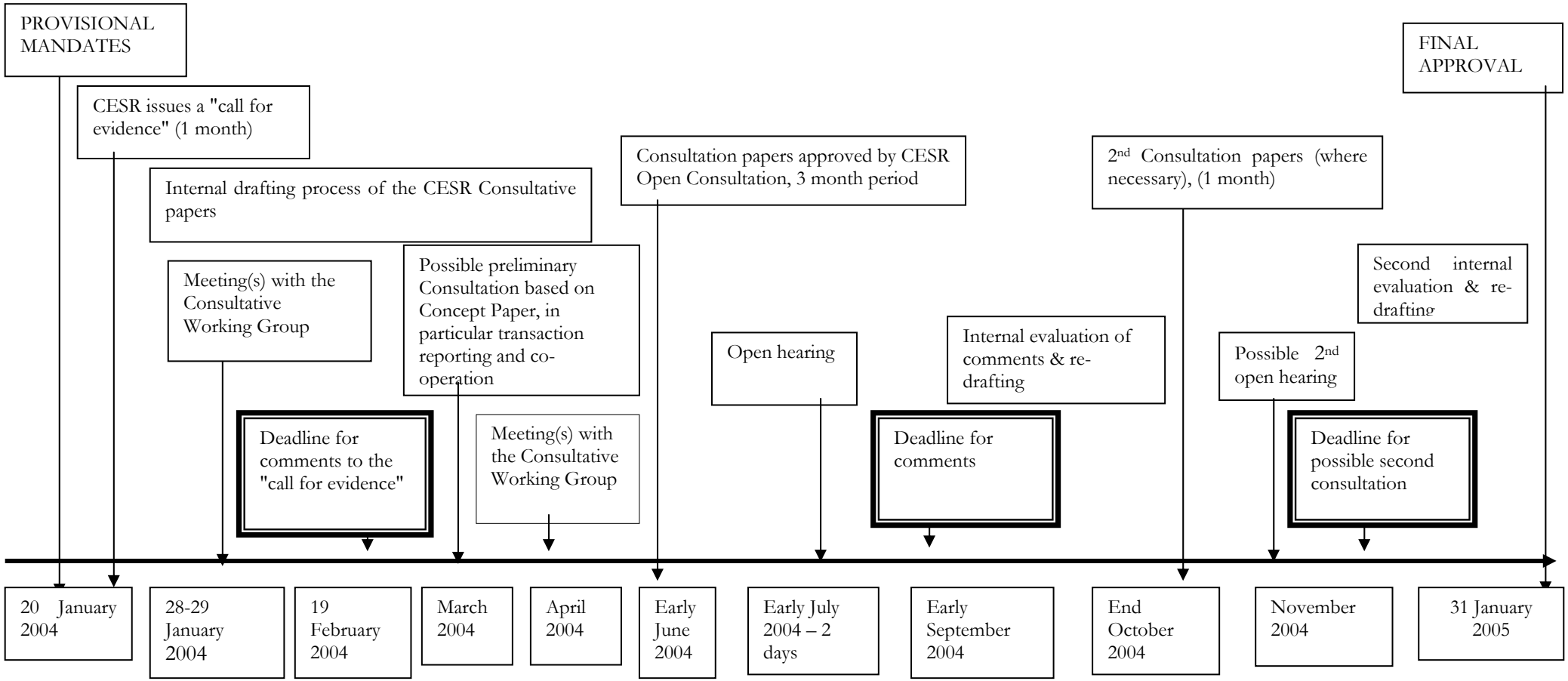
Mr Mark Harding, Group General Counsel of Barclays Bank Plc
Mr Brian Healy, Director of Trading of the Irish Stock Exchange
Mr Henrik Hjortshøj-Nielsen, Senior vice president Nykredit
Mrs Marianne Kager, Chief Economist of Bank Austria
Mr Socrates Lazaridis, Vice-President of the Athens Stock Exchange
Mr Jacques Levy-Morelle, Secretary General of Solvay SA
Ms Louise McBride, Research Journalist Consumers Association of Ireland
Mr Gyorgy Mohai, Advisor to the Budapest Stock Exchange
Mr Peter Norman, Executive President of Sjunde AP-fonden
Mr Anthony Orsatelli, CEO of CDC Ixis
Mr Joao Martins Pereira, Compliance officer and Adviser to the Board of Directors of Banco Espírito Santo
Mr Frede Aas Rognlien, Chief Legal Counsel in the Association of Norwegian Stock broking Companies
Mr Roger Sanders (OBE), Joint Chairman of FSA-SBPP Deputy Chairman of the Association of Independent Financial Advisers
Dr Jochen Seitz, Senior expert for European Regulatory Affairs from Deutsche Börse Group
Mr Erik Thedéen, Deputy Director General – The Swedish National Debt Office
Mr Juan Carlos Ureta, Chairman and CEO of Renta 4
Mr Renzo Vanetti, CEO of SIA S.p.A
Mr Jan-Willem Vink, General Counsel ING Group

5. CESR has undertaken to consult widely all interested parties according to the principles set out in the Final Report of the Committee of Wise Men and as set out in CESR's "Public Statement on Consultation Practices" (Ref. CESR/01-007c). The first step in CESR's consultation process began with the launch of a Call for Evidence from all interested parties on 20 January 2004 (Ref. CESR/04-021). Views from all interested parties on any or particular parts of the mandates were invited by 19 February 2004. CESR received more than 40 responses from a wide range of market participants, which are available on CESR's website. These responses were taken into consideration by the three Expert Groups in the development of the consultation paper. (A summary of the main issues emerging in the responses to the Call for Evidence can be found in Annex 2.)

6. CESR also decided that the Expert Group on Cooperation and Enforcement should collect comments from market participants with respect to the issues covered by this Expert Group, because, unlike the other two Expert Groups which were able to build upon previous CESR work, it had to start work basically from scratch on the issues dealt with. CESR published a Concept Paper on 1 March 2004 for a six-week consultation period presenting CESR's initial orientations and a number of open questions (Ref. CESR/04-073b). CESR also requested comments from all interested parties, what issues should be dealt with at Level 2 or Level 3, and what the costs and regulatory impact of changes to the transaction reporting requirements would be. CESR received some 25 responses in the consultation process (published on CESR's website), which were generally of high quality and were duly taken into account by CESR in drafting the present consultation paper. (A summary of the responses can be found in Annex 2.)

7. The work plan for handling the first set of mandates, which has been accomplished up to now, can be found below. After publication of the consultation paper, the next important step in the consultation process is going to be an open hearing to be held at CESR on 8 and 9 July 2004, to which all interested parties are invited.

Indicative CESR Work Plan for the first set of provisional mandates under the ISD2
(Extract from CESR's cover note to mandates Ref. CESR/04-021)



ANNEX 2

SUMMARY OF RESPONSES TO THE CALL FOR EVIDENCE AND THE CONSULTATIVE CONCEPT PAPER

1. Call for Evidence

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 on the MiFiD. The deadline for responses was 19 February 2004, and more than 40 responses were received. The following is a short summary of the principal recurring issues which emerged in the responses to the Call for Evidence. A full list of those who responded and the respective submission can be found on CESR's website under "Consultations".

General comments

Respondents asked that more time should be given to CESR to give its technical advice to the Commission, thus providing time for additional consultations with market participants, and that all ISD Expert Groups should publish concept papers in addition to the consultation papers envisaged.
It was suggested that CESR should conduct an initial survey of existing relevant legislations across Europe and an impact analysis of its proposed measures, also taking account of cost-benefit considerations, in order to be able to justify regulatory changes that would be proposed by CESR.
Some concern was expressed as to the use of regulations as Level 2 implementing measures, giving preference to directives. Others would prefer regulations in order to bring about harmonisation in Member States.
Quite a few comments raised the issue of the level of detail in Level 2 measures (criticising the detail already contained in the Commission's mandates), and urged CESR to find the right balance, not preventing the development of new products/services/market models. Others favoured detailed and specific provisions conducive to real harmonisation at EU level. It was also argued that CESR could consider – in specific areas – to propose that no Level 2 advice was needed.
Some consultees requested CESR to consider very carefully the area of commodity derivatives and offered to have close contact with CESR in this area, because theses markets would face new obligations. It was also proposed having a special advisory group in this area.

Intermediaries

Respondents asked that CESR should pay more attention to the peculiarities of some services and products, namely portfolio management and commodity derivatives.
As regards the content of CESR's advice, views were divided: some respondents favoured a principles-based approach; others favoured detailed and specific provisions conducive to real harmonisation at EU level. Respondents nonetheless expressed a strong desire to avoid over regulation. A principles-based approach was favoured in the area of conflicts of interest.
Furthermore, as regards the mandates concerning the conduct of business rules, overall support was expressed for the foundation of CESR's advice the existing CESR Standards. Representatives of the portfolio management industry urged CESR to devote particular attention to the need to ensure coherence between the rules applicable under the ISD2 and the UCITS Directive.
A number of specific suggestions were presented in the areas of conduct of business rules, and in particular of information to clients and best execution obligations.
Finally, some respondents asked for the introduction of a grandfathering provision for the application of current rules to existing clients.

Markets

The Content of pre-trade transparency was mentioned by several respondents. Some favoured publishing the whole order book information while others argued that transparency should be more limited. Some respondents pointed out that although not expressly mentioned in the mandate transparency obligations in the directive cover shares only.

Regarding the treatment of block trades some preferred one single factor for whole EU while others were in favour of leaving flexibility for national regulators and/or markets.

Regarding the method of making transparency information public it was pointed out that, especially concerning investment firms, there should be a real choice of publishing mechanism. At the same time it was noted that in order to satisfy the needs of market participants the arrangements for disclosing the information need to be such that they can ensure the quality of information.

On admission to trading consultees expressed concerns about the possible duplication of the requirements in other directives (Market Abuse, Prospectus and Transparency Obligations). CESR should, in the context of the Directive not propose anything on the areas which are covered by those directives. It was also pointed out the need to take into account the characteristics of different instruments.

Regarding the role of Regulated markets to monitor issuers´ compliance with their disclosure requirements, the issue was primarily seen as a responsibility of competent authorities.

Additionally, many respondents pointed out that CESR should resist the possibility mentioned in the mandate to draft Level 2 criteria establishing different segments for different securities.

Cooperation and enforcement

A few respondents suggested that it would have to be ensured that, where functioning systems were already in place, no parallel systems were set up, but instead to examine whether tried and tested systems could be retained at national level. It was a recurring issue that there should under no circumstances be an obligation for firms to report in an EU-wide standard IT format.
Some respondents were of the view that CESR should not mandate a standard such as ISIN in this field and instead to look at the considerable amount of work that has been undertaken by the industry to find a more suitable, common standard that would be useful for transaction reporting, pre- and post-trade transparency requirements and record keeping requirements, and hence facilitate consolidated reporting solutions.
On the issue to which authority reporting should be made by investment firms and other reporting parties, some respondents asked for further clarification from CESR, as it would not be obvious in certain situations (e.g. reporting of off-exchange transactions on securities listed and mostly traded in a specific country carried out by an investment firm, being remote member of a regulated market in that country).
In a number of responses the view was expressed that making optimal use of transaction reporting is foremost the duty of the competent authorities, so it was regarded as their obligation to arrange for efficient and effective reception, forwarding, concentration, sharing and screening of data among competent authorities.

Since this issue is mainly of interest to competent authorities themselves the submissions did not provide too much input here.

One issue appeared to be the question of confidentiality and data protection when competent authorities exchange information among themselves.

2. Consultative Concept Paper

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. The full list of respondents and their responses can be found on CESR's website under "Consultations". In the following, a short summary of the main, recurring issues is provided.

General

In addition to the comments already made to the Call for Evidence (see above), generally, consultees welcomed the idea of a concept paper as this provided an opportunity to provide input at an early stage of discussion within CESR, and asked for the use of concept papers for the other ISD Expert Groups. It was suggested to consider advising the Commission to provide for transition periods for particular areas that involve major changes to entities covered.

Transaction Reporting

In some submissions it was explained that it would be very costly to implement new IT-systems or changing existing ones, and that the different existing reporting systems in Europe were in different stages of maturity, so that CESR should adopt an extremely cautious approach as to concrete specifications of the reporting obligations.
As to commodity derivatives and OTC bond markets, a few respondents suggested that CESR needed to consider these markets carefully, and should consider the possibility of transitional periods.
Respondents commenting on the proposed regulatory objectives of transaction reporting were of the view that those were too far-reaching and should be restricted to the purpose of protection of market integrity.

Regarding the methods and arrangements for transaction reporting, respondents agreed that the set of minimum conditions for reporting systems should provide a level playing-field for all transaction reporting solutions, irrespective of made by an investment firm itself or by other reporting parties.

On the possible criteria for determining the most relevant market in terms of liquidity, respondents expressed their support for a flexible approach which would be adaptable to different market structures and easy to implement. CESR was asked to be cautious in its approach to the possible publication of the determination of the most liquid market as this could interfere with competition between markets.

Comments regarding the minimum content of transaction reports mainly were in favour of the approach proposed by CESR which would not make a difference between the reporting parties. Some responses suggested that the harmonised list of the minimum content should still allow maximum flexibility in the technical implementation of these requirements, i.e. an obligation on reporting parties to prepare the reports in a harmonised EU-wide standard IT format would involve unjustifiable additional costs.

It was also pointed out that the MiFiD could lead to serious consequences in terms of costs as to the transaction reporting requirements for remote members of regulated markets, since it would not foresee an opt-out clause as provided for in Article 20(2) of the ISD. CESR was asked to come up with a workable solution in this respect.

Cooperation and Exchange of Information

Regarding the technical advice requested for Article 56(2), some respondents were concerned that the granting of (excessive) additional powers to host Member States could undermine the principle of mutual recognition.
It was also suggested that the notion of operations of a regulated market in a host Member State could cover access for remote members or listing of certain securities in the host Member State, but not technical cooperation between regulated markets, such as selling and maintaining trading systems. Some suggested additional criteria, such as promotional activities of a regulated market in another Member State or the extent to which a regulated market provides the trading platform and other essential services for a regulated market in another Member State.
As regards the criteria for assessing “substantial importance” in terms of trading volume of securities of issuers listed in a host Member State the figures proposed varied considerably.

In some submissions regarding exchange of information between competent authorities, it was suggested that implementing measures should ensure effective and immediate, if necessary,

exchange of information. The issue of a European central solution was raised, because decentralized regulation and consequently the amount of information to be exchanged could lead to an overly complicated network.

ANNEX 3

LIST OF RELEVANT WORK ALREADY CONDUCTED BY CESR IN THIS AREA

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

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

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

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

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

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

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

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

- **CESR Multilateral Memorandum of Understanding (FESCO-99-126)**