



EUROPEAN COMMISSION

Internal Market DG

FINANCIAL MARKETS

Summary Record of the 29th Meeting of the European Securities Committee / Members

21 March 2005 (ESC/14/2005)

The meeting was chaired by David Wright, Director in Financial Markets, and Nathalie de Basaldua-Lemarchand, Head of the Unit “Securities”.

1. Adoption of agenda

The draft agenda was adopted – there was no request by delegations for additional issues to be discussed under A.O.B.

2. MiFID (Markets in Financial Instruments Directive)

2.1. Timetable for the adoption of level 2 legislation

The Chairman explained that preparatory work within the ESC preceding the formal comitology phase will be split in several parts; the Commission services are planning to present 4 informal documents for discussion:

- The first working document focuses on reporting of transactions, exchange of information between competent authorities and the determination of the most relevant market in terms of liquidity. A first discussion on this document took place in the ESC meeting of 21.3.05 (see below under 2.2.); a second discussion is planned on 21-22 April.
- The second working document will cover organisational requirements and conflicts of interest. The first discussion will take place on 26-27 May and a second one on 21-22 June.
- The third working document will cover conduct of business rules, best execution and client order handling rules, definitions of financial instruments and eligible counterparties. A first discussion is planned on 21-22 June and a second one on 13-14 July.
- The fourth working document will be dealing with the transparency regime and admission to trading. A discussion on this document is envisaged on 13-14 July; given the tight time schedule a written exchange of views could be envisaged for this document.

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The Chairman explained that the final number of the formal legal proposals will be decided with Commissioner McCreevy after having finalised informal discussions within the ESC. As for the nature of the texts, the Chairman recalled the Commission's preference for Regulations wherever possible - depending on the legal exhaustiveness of the texts the Commission services will prepare on the basis of the CESR advice. Cooperation with the ESC delegations and CESR and EP involvement as early as possible are also essential; the working documents will also be put on the Commission's website in order to have full transparency.

Concerning the timing for the adoption of the MiFID level 2 proposals the formal comitology phase is planned to start in September; the vote on the entire "package" could be expected most probably in December and the adoption by the Commission by beginning of next year. This planning might evolve as discussions evolve; however, given that the Commissioner has agreed to extend the transposition and implementation deadlines for the MiFID (6+ 6 months), it is not desirable to consume the extension period for internal organisational and procedural reasons.

Delegations generally agreed with the timetable proposed by the Commission. One delegation suggested to call for a meeting in autumn at Members level in order to possibly solve difficult political questions which may arise; the Chairman agreed to explore this possibility. Another delegation expressed the view to have a second discussion on the fourth working document – where difficult political issues (e.g. pre-trade transparency) will be covered. The Commission services agreed and they will try to plan a discussion on this document in early September.

Delegations supported the Commission's idea to have extensive collaboration with the EP at the earliest convenience; to this end the Chairman suggested that information seminars but also informal discussions with key MEPs be organised. One delegation suggested that a common template be used by ESC delegations when suggesting amendments to the working documents; the Chairman promised that DG MARKT will provide delegations with such a template.

The CESR Secretary General draw the delegations' attention on the second set of mandates and, more specifically on the request concerning Article 40 (admission to trading): additional consultations might be needed on this part, CESR would then be able to deliver this part only by the second half of May.

2.2. Discussions on a working document on a first draft of implementing legislation

The Chairman introduced the MiFID level 2 informal working document: He explained that it largely respects CESR's technical proposals subject to certain technical adaptations in order to transform it into a legal text and ensure coherence with the level 1 Directive. Moreover, bearing in mind the frontline of the Barroso Commission on better regulation and in order to meet the strong demand expressed from the industry for simplification, some simplified proposals concerning the procedure for challenging the most relevant market in terms of liquidity as well as some improvements with respect to standardisation of reporting information have been included in the document.

Furthermore, the Chairman pointed out two issues where the Commission services felt the necessity to take a political direction different from that adopted by CESR:

- The first one refers to article 56 par. 2, i.e. the determination of when the operations of a Regulated Market in a host country could be considered of substantial importance. The Commission services have decided that for the time being it would be preferable not to have any Level 2 rule on this issue; nevertheless, if, at a later stage, it is felt that level 2 legislation is needed, the Commission could re-examine the issue and propose level 2 implementing legislation on this issue.

- The second issue is related to the question on how the exchange of information could improve the effectiveness of the market supervision and monitoring. Two options have been presented by the Commission in this respect:

- Option A consists in the bilateral exchange of information between competent authorities, and would result in multiplying the flow of information between t authorities whilst limiting the information to which each would have access.
- Option B tends to simplify those exchanges and to make the access to information more easily accessible through the establishment of a common database to which all competent authorities would transmit information and to which all authorities would have access.

The Chairman expressed the preference of the Commission services for a solution close to Option B; this option seems to be supported also by the industry (e.g. the results of the consultation on the “Himalaya” report).

Concerning the form of the future legislation to be adopted on the basis of this working document, the majority of delegations – even those who have a general preference for Directives - supported the use of a Regulation in the present case; nevertheless some delegations added that their final views will depend on the formal text which will be proposed by the Commission.

On the choice between option A and B, a large number of delegations and the ECB expressed themselves in favour of Option B: the main reasons put forward are that this option is simpler, offers easy access to information to various competent authorities and provides for a harmonised format. Nevertheless, many delegations – including those in favour of this option - required further clarification on a number of legal issues (compatibility of a central database with the level 1 Directive, data protection and protection of confidential information, issues linked to private international law and competent jurisdiction, further questions of civil law etc), on the cost, funding and timing involved as well as on the implementation and follow-up of this common database. Some delegations pointed out that they will formulate their final position after having examined the comments made by CESR in this respect.

Concerning data protection the Commission services responded that either option would include any exchange of personal data. Furthermore the MiFID provides sufficient legal basis for option B. Nevertheless, though most delegations agreed that this was a technical question, it was generally agreed that this issue was to be solved at political level. The Chairman agreed with this conclusion; the Commission needs to think broadly taking into consideration cost, complexity and time.

One delegation considered that a thorough check is needed whether it is justified to include the proposals made in this document in a level 2 text or whether they should form part of level 3 measures; they expressed the view that for instance Articles 2, 3, 4, 7 and 8 should be better dealt with at level 3. Some recitals will need to be included – in

due time – in the legal text to explain the necessity of the proposals, ensure that there is sufficient flexibility and that no unjustified burden is created for the firms and regulators. Another delegation also supported the deletion of Articles 7 and 8 and the inclusion of their content at level 3.

The CESR Secretary General insisted on the necessity to have the opportunity to explain the advice drafted by CESR before the Commission draw up its working documents. Furthermore, he draw delegations attention to the fact that whenever the use of level 3 is proposed, sufficient justification should be provided for this preference; additionally, in those cases where Member States consider that level 3 should be agreed, a mandate should be granted to CESR. Concerning the choice between option A and option B the CESR Secretary explained that CESR did not consider option B in its advice because developing this option would go beyond the available timetable, i.e. before the entry into force of the directive. A number of questions would also need to be answered (confidentiality of data, data protection and funding) as well as to conduct some feasibility studies. The Chairman stressed the need to come back to this question in the next meeting. The Chairman agreed that cooperation between the Commission and CESR needs to be ensured at any time to ensure the best possible results and avoid misunderstandings. With respect to level 3 he draw the delegations attention to the fact the political and institutional balance needs to be respected taking into consideration that level 3 does not have any legally binding force.

On article 56 par.2, the majority of the delegations were supportive of the Commission's position, i.e. not to propose level 2 implementing measures. However, one delegation pointed to the fact that in the short term, market developments could justify adoption of Level 2 measures; to this end the CESR proposals should be examined thoroughly. CESR criticized the Commission approach in this respect: some level 2 implementing legislation or at least some guidelines are needed to remedy the unbalance that might exist between the home-host relationship.

Furthermore a number of further technical comments/suggestions for improvement were delivered:

- the degree of harmonisation with respect to the content of the transaction report is unclear; in this respect, the Commission services responded that the formulation of Art. 1 and 6 is mistaken; those provisions will be modified in order to make clear that the content of the report provided for in art. 6 is exhaustive and that the only possibility for the competent authority to request more information is the one included in Art. 6 par. 3
- Some delegations asked for a clearer definition, in article 2, of the concepts of “trade” and “all the competent authorities”.
- Concerns were raised why the definition of “transaction” in Article 2 needs cover also systematic internalisers; the Commission services pointed out that this is essential to make the link with Article 27 of the level 1 Directive.
- Some delegations questioned the differentiated treatment provided for bonds compared to shares in Article 3.
- Some delegations asked for clarification on the scope of Article 3 par. 2 (i.e. which instruments are meant to be covered under a).

- Clarification was also sought in Article 3 par. 1 b) the Commission should explain why reference to the country of origin was replaced by the Member State of the registered office of the issuer.
- Concerns were expressed by delegations and CESR about the waiver in article 6. The Commission considered that the drafting can be improved in order to ensure coherence with the CESR advice.
- Delegations were split on whether the client identification code should be included in the reporting items in the annex.
- It should be clarified why according to Article 5 par. 3 reporting systems need to be approved; in the context of this same paragraph one delegation pointed out that the CESR advice provided for an exception which is not included in the Commission's working document.
- In general, additional explanation needs to be provided by the Commission on the modifications introduced in their text compared to the CESR advice (for instance with respect to Article 58); clarification on some aspects should be introduced, at a later stage, in the formal proposal though the recitals.

The Chairman invited delegations to send written comments on this working document by 4/4/05.

3. LEVEL 4 OF THE LAMFALUSSY PROCESS

3.1. Transposition by Member States

The Chairman drew the delegations attention to the poor results with respect to the transposition of the MAD directives:

- Only seven Member States have notified the transposition of all four directives (Austria, Czech Republic, Denmark, Germany, Lithuania, Slovakia and Slovenia).
- One Member State (Poland) has notified the transposition of the level 1 directive and one out of three level 2 directives.
- Two other Member States (Spain and Latvia) have notified the transposition of the level 1 directive.
- Only 2 transposition tables have been made available from those MS having notified complete or partial transposition.

The Chairman asked the delegations to update the Commission by the 4th April on their progress in the transposition process and to report on the realistic timeframe needed for final completion. The Chairman also announced that the Commission is planning to establish a "securities scoreboard", following the example of the "Single Market Scoreboard", to measure the Member States performance with respect to the transposition of all securities directives in force. The "securities scoreboard" would include a ranking of the Member States following completeness of transposition.

3.2. Compliance with EU directives

This agenda item referred back to discussions on the same issue in the last ESC meeting. The Commission has circulated tables setting out the functions and minimum powers of competent authorities under four Securities Directives (Prospectus, MAD, Transparency, MiFID) produced under the Lamfalussy process. The purpose of these tables is to assist Member States when transposing the directives to ensure that the competent authorities designated for the purposes of each directive have the regulatory tools and the full range of powers which they are required to have under those Directives.

Preliminary responses were given at the ESC meeting of 22.3.05. The Commission invited delegations to deliver further comments. CESR welcomed the tables; they consider they offer a good opportunity to monitor equivalence of powers – and also meet their concerns in the context of the ‘Himalaya’ report. The Commission further commented that delegations are free to provide further information on powers granted to competent authorities going beyond the powers established in the EU securities Directives; however what is important in the context of this exercise is to know whether Member States are properly equipped to enforce these directives in the future.

4. PROSPECTUS: DISCUSSION ON COMPLEMENTARY LEVEL 2 LEGISLATION

Following discussions in the previous ESC meeting, the Commission services reminded the meeting of the issue in question, namely the range of historical financial information which should be included in a prospectus in a case where the issuer of the securities has a “complex financial history”. Regulation EC n° 809/2004 does not deal adequately with such cases since it does not require the inclusion in a prospectus of financial information relating to entities other than the issuer. An amendment to the Regulation would be necessary to enable competent authorities to require that such information be included in a prospectus.

CESR presented the results of a fact finding exercise among its members.: Practices differ from one State to another, but in most Member States the competent authorities require pro forma financial information for complex histories, and some States require restated financial information relating to entities other than the issuer for a specified period. On the basis of the current prospectus Regulation, there is a risk that some regulators won’t be able to continue with their current practice in cases where an issuer has a complex financial history.

The majority of delegations were in favour of an amendment to the Regulation. One delegation expressed its opposition to an amendment: there is not sufficient time to amend the level 2 Regulation before the entry into force of both level 1 and level 2 in July. In this context, there is a significant risk of creating legal uncertainty and distortion of competition between Member States. The Chairman admitted that a modification to the Regulation is not conceivable before July; however, it should be borne in mind that the Lamfalussy process is flexible and allows the rectification of omissions or ambiguities in a relatively expeditious way. The Commission services promised to reflect on this issue and come back with a concrete proposal in one of the next ESC meetings.

5. FINANCIAL ANALYSTS

The Commission announced its future plans on this issue: The Commission reminded delegations that it was originally asked to examine this subject on account of concerns arising from the investment research related events in the US, which were discussed at the Oviedo Informal ECOFIN Council and in this Committee. The Commission recalled

the conclusions of the Forum Group on Financial Analysts - which was created to carry out this task – which focused mainly on two related areas:

(i) Ensuring that investment firms have effective systems in place to prevent or manage conflicts of interest between their investment research and investment banking departments; and

(ii) Complementing such systems, the inclusion of prominent and meaningful disclosure of the main conflicts of interest in research reports.

There is a reasonably good fit between the key issues raised in the Forum Group's report and legislative measures already agreed or in the pipeline:

- The Level 2 measure under the Market Abuse Directive on fair presentation of investment recommendations sets out a fairly comprehensive disclosure regime for investment research.
- CESR's forthcoming Level 2 advice for the MiFID – and the subsequent EU level 2 legislation - will include measures that investment firms should take into consideration when developing arrangements to identify, prevent, manage and/or disclose conflicts of interest.

The Commission believes that, taken as a whole, these measures will address the key concerns raised by the events in US markets; careful monitoring to check their effectiveness is also needed. The Commission envisages to prepare a Communication which will set out clearly those EU legislative measures that will address analysts' potential conflicts of interest and will also recommend that investment banks, issuers and professional and industry bodies representing analysts and issuers review any existing best practice codes and policies to ensure that they sufficiently address ethical issues and relations between analysts and issuers.

Furthermore, the Commission intends to monitor the development of the market for independent research along with the impact of the legislative measures contained in the MiFID and the Market Abuse Directive. Should the market fail to respond to the needs of investors, further measures may be considered.

There were no comments from delegations.

6. MARKET INFRASTRUCTURE

6.1. Clearing and Settlement

An update was provided by the Commission services on the following points:

- **The CESAME group meeting of 7 March 2005** (the next meeting will take place on 10 June 2005)

The main issues were:

a) Data request: the Commission reiterated its intention to collect data to perform an analysis of the concentration of the settlement activity; in this context, a data format will be sent to ECSDA and CEECSDA for initial replies, while further requests to market participants are likely to follow;

b) Impact Assessment: Annex 1, which analyses the existing studies on Clearing and Settlement, was presented and discussed. Annex 1 aims at identifying the lower bound of benefits of integration of the Clearing and Settlement industry in the EU;

c) The responses to the Communication were analysed; they are now ready for publication, and the press release are to be finalised;

d) Definitions: an ad-hoc sub-group on definitions has been established; the sub-group had its first meeting on March 2nd in which it started analysing the issue on the basis of a note prepared by the Commission; the next meeting is expected at the end of April or early May;

e) The developments and the future industry work on the Giovannini barriers were also discussed.

Some delegates expressed their concerns with respect to an impact analysis, to be conducted internally by the Commission services; they fear that the element of cost might not be sufficiently assessed. The Commission services explained that the analysis will be done internally; 6 Directorates General will be involved. This steering group will, at a first stage, analyse the economic benefits of eliminating the Giovannini barriers, i.e. the added value of the integration of the systems. Depending on the results, the political benefits will be scrutinised, i.e. which is the best option in order to achieve the identified benefits. The economic part should be completed by summer, the political part by the end of the year.

- **The ongoing preparatory work to set up the Fiscal Compliance Experts' Group:** This Group will identify fiscal procedures relevant to EU Clearing and Settlement and pinpoint the most problematic disparities. It will comprise about 15 experts drawn across the EU from industry, accountancy and legal firms. The first meeting is expected to be held mid-April.
- **The follow up to the Legal Certainty Group Meeting of 31 January 2005:** In the process of analysing the current legal regimes and identifying where the key problems arise, a detailed questionnaire has been agreed, intended to flesh out all relevant problems both domestic and cross-border. The early results of the questionnaire will be considered on 21 April, as well as what advice the Group might want to give to the Commission for its position at the forthcoming intergovernmental committee of experts at UNIDROIT in Rome on May 9th.

6.2. The Hague Securities Convention

As ECB's deadline to send their Opinion is 31st March, and it appears that this has been met. An in-depth discussion is planned for a future ESC meeting. In the meantime, the ECB delegate delivered two main messages:

a) the ECB supports the essential objectives of the Convention.

b) The ECB expressed some doubts about whether the transposition of the Convention will increase legal certainty, and how the Convention will interact with other legislative instruments. This is why the ECB – together with other Member States – is more in favour of a deeper analysis.

No discussion took place on this point.

6.3. Legal Certainty Group – UNIDROIT – Convention on harmonised substantive rules regarding securities held with an intermediary

The Commission services repeated the objectives of UNIDROIT: UNIDROIT draft Convention aims to establish harmonised substantive rules regarding securities held with an intermediary. Member States should co-ordinate internally.

The Commission considers that there is a overlap between UNIDROIT and the Settlement Finality directive; at this stage a solution needs to be found at EU level. To the extent that the draft Convention relates to subject matters for which the European Union has already exercised its internal competence, the Union is competent for the conclusion and negotiation of the Convention. The European Commission ought to appear at the first session on May 9th in Rome not as an observer, but rather as a party mandated to negotiate. The Commission services reiterated the need to find a common position; the coordinating role is in the hands of the EU (LUX) Presidency.

6.4. The Settlement Finality Directive

As discussed at the last meeting, the Commission will deliver a comprehensive report on the implementation and application of the Settlement Finality Directive in the EU 25, accompanied by proposals for amendments to the Directive where appropriate. The Commission's intention is to have this report ready by the end of 2005.

The Commission services stressed the fact that the sooner the Member States will send their comments, the sooner it will be possible to have amendments designated to increase protection against systemic risks. The deadline for the questionnaire was 21st March. Eight delegations replied immediately that they would send their replies in two weeks' time at latest. Delegations who did not respond were asked to inform the Commission on the state of play by next week.

7. US-EU FINANCIAL RELATIONSHIP

The Chairman gave some information about some issues currently at the heart of the EU-US dialogue, given his upcoming meeting on 22nd March with Treasury, Congress, CFTC SEC and Industry.

- The meetings will focus on the convergence of International Accounting Standards (IAS) with US General Agreed Accounting Principles (US-GAAP). There are some signs that the US start to think on establishing a roadmap and a timeframe for convergence/equivalence. They also seem to press for an enforcement mechanism in Europe. These discussions are also crucial for the determination of equivalence in the context of the prospectus and the transparency directives. The Governance of the IASB will also be on the agenda.

- The meeting will also seek clarification on whether the SEC is ready to move forward on the delisting and deregistration procedures. Earlier signals tended to show that the US takes this issue seriously, but there has been no clarity since the beginning of the year.

- One key issue for the discussion with the Treasury will be the future of the EU/US dialogue on financial services and how this dialogue can be made more efficient. The role of regulators – i.e. CESR – is very important in this respect. Some ways should be also explored on how to ensure more input from the industry

- The usual list of subjects concerning the US-EU financial relationship will also be tackled, namely the insurance collateral, the conglomerates Directive, Basel II implementation etc.

Commissioner Mc Creevy will go to New York and Washington to discuss these issues further on 20th April.

The Chairman also stressed the importance of similar dialogues to be launched with China and Japan; in this respect, he mentioned the successful visit of a 25-member Chinese delegation in February this year and the opening up of Japan to the idea of a global financial framework.

Following a question by CESR, the Chairman promised to provide additional details as well as the program of a conference which is planned later this year in New York organised by DG EcFin focussing the European Financial Integration Process as well as on the Euro.

8. FIRST IMPRESSIONS ON THE “HIMALAYA REPORT” / DISCUSSIONS ON SUPERVISORY CONVERGENCE

The CESR Secretary General provided an overview of the comments received to this report. CESR received more than 35 responses to their questionnaire. Following main conclusions have been drawn at this stage:

- The discussion on the supervisory process was welcomed by all respondents.
- The main line of reasoning of CESR was accepted: supervisory structures need to follow market forces, and not the contrary. It is therefore wiser to follow and adaptive strategy; it would be premature to create a single regulator at this stage. Instead, it is better to wait for more market integration.
- Almost all respondents agreed on the need to have a certain degree of convergence of supervisory powers in the EU.
- The pragmatic way forward followed by CESR by proposing cooperative tools of level III (for instance the exchange of staff, work of the review panel, peer pressure, common data bases) was generally appreciated.
- More clarification is sought with respect to the mediation mechanism, for instance its links with the industry; there is also a need for a solid legal basis.
- Accountability links with other EU institutions need also to be clarified. CESR aims at establishing better accountability links: to this end, CESR is going to present in the next FSC meeting its annual activity report as well as a report on supervisory convergence
- Concerning ideas developed by CESR requiring legal/ institutional changes, the idea that the delegation of powers between authorities - as it is the case in the prospectus directive - could be extended to other directives was welcomed by respondents under the condition that this should be looked at on a case by case basis; as regards the capacity of adopting decisions with an EU-wide scope views are broadly positive but with strong request to further analysis. Most agreed the focus should concentrate on practicalities; again the creation of such a legal capacity should concentrate on some specific issues, e.g. credit rating agencies, markets, IFRS.

The CESR secretary promised to circulate the summary of responses to the consultation to ESC delegations.

The Commission expressed its preliminary views on this paper: The Commission has welcomed this paper recalling that discussions also were being pushed in the FSC subgroup. The Commission's official response will form part of the Green Paper on the Financial Services Policy 2005-2010. In the meantime, the Commission will circulate to delegations its contribution to the FSC which proposes a systematic 4-step approach which consists in (1) defining the objectives, (2) assessing the current framework, (3) development of existing tools, (4) development of new tools. Sequencing is needed at all steps. Existing tools under the Lamfalussy Level 3 framework – through the supervisory networks established under CESR and its banking and insurance counterparts CEBS and CEIOPS – should be exploited to the maximum extent possible and any gaps identified. New supervisory tools or structures should only be developed if there is compelling evidence that the current framework cannot meet the requirements of EU rules or deliver financial integration.

No discussion took place on this point.

9. MARKET DEVELOPMENTS IN THE MEMBER STATES

No discussion took place on this point.

10. A.O.B. – WORK PROGRAM FOR THE SECOND QUARTER OF 2005

The CESR Secretary General drew the Commission's attention to the fact that two points should be put on the ESC agenda soon: first, the progress report on the transparency directive – discussed on 17th March in the CESR Chairmen meeting; second, the final advice on transparency, which will probably be presented in Autumn. The Commission services responded that it is their intention to include these issues in the ESC program after the summer break. They also asked the delegations to send any additional suggestions.
