

# **European Securities Markets Expert Group - ESME**

## **FINANCIAL INSTRUMENTS**

### **IMPACT OF DEFINITIONS ON THE PERIMETER OF FSAP DIRECTIVES**

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### IMPACT OF DEFINITIONS ON THE PERIMETER OF FSAP DIRECTIVES

This paper examines the concepts of transferable securities and financial instruments as found in the directives of the Financial Services Action Plan (FSAP). These concepts have evolved over time and are found under various definitions in the directives under review. The paper examines the various definitions, the differences and their interplay after 1<sup>st</sup> November 2007 when MIFID became effective in all Member States.

#### **1. THE NOTION OF TRANSFERABLE SECURITIES IS FIRST FOUND IN THE ISD OF 1993**

The concept of financial instruments is relatively recent. MIFID of 21 April 2004, which came into force on October 31, 2007 contains a large definition of financial instruments. The earlier FSAP directives contain varying definitions of transferable securities and/or financial instruments.

A definition of transferable securities is first found in the Investment Services Directive of 10 May 1993 (ISD) (art. 1 .4),

The ISD does not contain any definition of financial instruments.

The ISD has been repealed by Article 69 of MIFID. MIFID provisions apply from the date of entry into force of the directive and constitute the new legal framework for financial services activities and markets in financial instruments.

The application of the MIFID definition of financial instruments has consequences, because the earlier definitions are different from the MIFID definition and the MIFID definition is wider than the earlier definitions. Therefore, the new definition has a potential impact on the perimeter of some of the earlier directives which make reference to the ISD. The impact of MIFID is to extend *ipso facto* the scope of those earlier directives.

First, this paper examines whether the European legislators should take further action on the perimeter of the directives thus impacted.

Second, this paper will review the challenges for a harmonisation of the legal concepts of transferable securities and financial instruments.

## 2. THE DIRECTIVES UNDER REVIEW

Eight directives and one Commission Regulation include, directly or indirectly, the notion of financial instruments and/or securities. The directives under review are listed here-under chronologically by their abbreviation<sup>1</sup>:

1. The UCITS Directive of 20 December 1985 as amended: this directive includes a notion of « *Transferable Securities* » which is *ad hoc*.
2. The Directive on admission of securities to official listing of 28 May 2001 which includes a notion of « *Securities* » with no definition.
3. The collateral Directive of 6 June 2002 which includes a concept of financial instruments which is *ad hoc* and limited to securities.
4. The Market Abuse Directive of 28 January 2003 which includes an *ad hoc* notion of financial instruments which makes reference to the concept of securities as defined in the ISD of 10 May 1993.
5. The Prospectus Directive of 4 November 2003 which refers to the concept of « *Securities* » as defined in the ISD of 10 May 1993.
6. MIFID of 21 April 2004 which repeals the ISD provisions (10 May 1993) and provides a catch-all definition of financial instruments under a listing in annex I-C of the directive.
7. MIFID : Commission regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC (level 2)
8. The Transparency Directive of 15 December 2004: in its Article 2.1 refers to the definition of “securities” in MIFID. It also contains a reference to the terms “financial instruments” in its Article 13.1.
9. The level 2 Transparency directive of 8 March 2007 contains in its Article 11 an interpretation of the obligation in the Transparency Directive by reference to part of the Annex I-C of MIFID.

## 3. PRELIMINARY FINDINGS

### 3.1 THE CONCEPTS ARE VARIED

The FSAP directives contain concepts of financial instruments and transferable securities which are different in each of the directives under review. The concepts have evolved and have been developed over time towards greater sophistication and detail. In the earlier directives, the concepts are mentioned with practically no definition or a short definition.

Out of the eight directives listed above, five of them contain definitions which are different one from the other. Only MIFID and the Transparency Directive use the same concepts, only because the Transparency Directive was adopted later than MIFID and its definition of “securities” expressly refers to the definition of “transferable securities” as it appears in Article 4.1.18 of MIFID.

MAD and the Prospectus Directive refer to the definition of transferable securities in the ISD and also contain their own definitions of “securities”.

The situation is not so simple because the wordings given in each directive for “financial instruments” and “transferable securities” refer to definitions which are different in each of the directives under review.

We will examine whether these differences interact.

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<sup>1</sup> The official references of the eight directives and the Commission Regulation appear as a footnote at the end the present memorandum. The official texts of the definitions appear in the Annex.

### 3.2. THE REFERENCE DEFINITION OF FINANCIAL INSTRUMENTS IS NOW FOUND IN MIFID

With the entry into force of MIFID, a definition of financial instruments much wider than earlier definitions is now provided by MIFID, with the aim to include all instruments and contracts of a financial nature (e.g. securities, money market instruments, units of collective investment undertakings, financial futures contracts, certain commodity derivatives and other derivatives contracts having the characteristics of other financial derivatives). There are only a few financial instruments – broadly speaking - which are not covered by MIFID, such as insurance related bonds, because these instruments are covered by insurance legislation and are *stricto sensu* not financial instruments.

“Transferable securities”

It is of interest to compare the definition of “transferable securities” as it appears in the ISD and in MIFID. One could say that the definition found in MIFID (Art; 4.1-18) is very much inspired by the definition of transferable securities in the ISD (Art. 1-4). The two definitions offer a drafting parallelism. The MIFID definition of transferable securities is more detailed than the definition of the ISD. In the indent (b) of the MIFID definition depository receipts are included, which was not the case in the ISD definition.

In the indent (c) of the MIFID definition – starting with “any other securities” the list of financial assets to which reference may be made to determine a cash settlement is enlarged from the ISD definition to include “currencies, interest rates or yields, commodities or other indices or measures”.

One may rightly point out that the new MiFID definition is more inclusive than the ISD definition (in particular in relation to the residual category of art. 4.1.-18, indent (c)) of the MiFID. It is, however, doubtful whether in practice this may lead to any difference in scope and interpretation given the broad wording of the relevant recital 9 of the ISD<sup>2</sup> and the broad interpretation permitted by the absence of inclusive language for cash settled instruments in art. 1.4., 3<sup>rd</sup> indent of the ISD.

Given the evolution of the concepts, it is noteworthy that the concept of “transferable securities” has become a sub-category of financial instruments and appears as one element of the definition of financial instruments given in Annex 1 Section C (1) of MIFID.

The major novelty of MIFID is to include some derivative instruments not previously included in the definition of financial instruments, namely commodities and exotic derivative instruments now found in MIFID Annex 1 (10). These instruments were not part of the definition of the ISD.

### 3.3. THE SPECIAL SITUATION OF MAD AND PROSPECTUS DIRECTIVE WHICH REFER TO REPEALED PROVISIONS OF THE ISD

The concepts of “securities” in two directives, namely the Market Abuse Directive and the Prospectus Directive, refer to a definition in the ISD which is repealed by MIFID.

The *prima facie* consequence of the entry into force of MIFID is the repeal of the ISD definitions by article 69 of MIFID. The application of MIFID results in the substitution of the definition of financial instruments in MIFID to the earlier definition in the ISD. The two definitions are not identical, however. The definition of “securities” in MIFID is worded differently from the definition of “securities” in the ISD.

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<sup>2</sup> Recital 9 of the ISD states as follows: “(...) Whereas transferable securities means those classes of securities which are normally dealt in on the capital market, such as government securities, shares in companies, negotiable securities giving the right to acquire shares by subscription or exchange, depository receipts, bonds issued as part of a series, index warrants and securities giving the right to acquire such bonds by subscription; (...)”

The absence of an exact coincidence between the legal concepts of “securities” in MIFID and in the ISD could have an impact on the Market Abuse Directive and the Prospectus Directive. The possible mismatch concerning these two directives has been reviewed in detail by the ESME working group.

The group discussed whether the scope of MAD would be enlarged as a result of the application of the definition of securities found in MIFID. Instruments such as financial warrants were discussed, and it was concluded that these instruments were part of the definition of securities in the ISD, to which MAD refers, as they are now part of the MIFID definition.

The obvious enlargement of the scope of MAD is to be found in the residual category of financial instruments as defined in art. 1.3., last indent of the MAD which refers to “(...) any other instrument admitted to trading on a regulated market (...)”. This is because the scope of financial instruments which are potentially tradable on a regulated market in the meaning of MiFID has been considerably enlarged if compared to the instruments which were tradable on a regulated market as defined in art. 1.4. of the MAD (see the new categories (5) to (10) of Section C, Annex I of the MiFID). However, one must observe that the MAD itself has introduced an enlarged definition of financial instruments by way of including commodity derivatives in the definition of financial instruments, thus bringing these instruments under the scope of the MAD provided they are admitted to trading on a regulated market. The former reference to a regulated market “as defined under the ISD” in the MAD may have given rise to some confusion as a regulated market under the ISD could only refer to a market trading in instruments as defined under the ISD.

Concerning the Prospectus Directive, in general we have not found that the scope of the directive is actually enlarged by the application of MIFID.

### **3.4. MISMATCHINGS ?**

Mismatch in the wording of the FSAP directives has been found, concerning both the notion of transferable securities and the notion of financial instruments.

We have seen here-above the question raised by the repeal of the ISD definition of transferable securities.

Another mismatch could appear concerning this same notion of « transferable securities » (and « money market instruments »). The wording is different in MIFID and in the Prospectus Directive and, additionally, in the Transparency Directive. Regarding the Prospectus Directive, however, the definitions of transferable securities and money market instruments generally correspond with the MIFID typology and the wordings in Art. 4 (18) and (19) MIFID. In its present wording the Prospectus Directive refers to transferable securities and money market instruments with a maturity from 12 months. Two differences should be taken into consideration by the Commission when preparing its assessment according to Art. 31 of the Prospectus Directive.

First of all, the Prospectus Directive shall not apply to “units issued by collective investment undertakings other than the closed-end type” (Art. 1 (2) (a) PD) and therefore applies to closed-end type units (e.g. Art. 18 and Annex XV PD Regulation, respectively). In MIFID “Units in collective investment undertakings” are considered as a type of financial instruments independent of “transferable securities” and “money market instruments”. The divergence could be solved by taking one of the following measures:

- either deleting the respective rules from the Prospectus Directive and including them into the regulation of collective investment undertakings or

- including a specific exemption into the Prospectus Directive (“applying to transferable securities, money market instruments from 12 months and closed-end collective investment undertakings”).

Furthermore, the definitions of “equity securities” in MIFID and Prospectus Directive differ in detail. While MIFID refers to “shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares” (Art. 4 (18)(a)), the Prospectus Directive only covers shares in companies and equity warrants and similar instruments enabling a capital increase by the company, but not shares in partnerships or other entities as well as depositary receipts on shares. Due to the different scope of both directives, as mentioned below, such difference appears to be necessary.

Concerning the notion of financial instruments mismatching could also arise. This concept is found in MIFID and in MAD. However, the definition of financial instruments in MAD is different from the definition given in MIFID: the definition of financial instruments in MIFID is wider and more detailed than the definition in MAD. The two definitions do not match. The most obvious difference comes from the wording in MIFID Annex 1 (10) which includes exotic derivatives instruments (climatic variables, freight rates, emission allowances, inflations rates, etc.) when these are traded, cleared and settled or subject to regular margin calls. These instruments were not subject to MAD. Whether they would come under the catch-all sentence in the last setting of the definition of financial instruments in Article 1 of MAD remains an open question<sup>3</sup>. This certainly is a concern for derivatives business where some derivatives contracts traded on an exchange are in practice very close to OTC instruments and physical spot contracts.

It is therefore not clear whether MAD reporting requirements will apply to instruments covered by MIFID Annex 1 (10). We express the view that the scope of MAD ought to be left unchanged, until the review of commodity and exotic derivatives business initiated by the Commission is finalised.

#### **4. THE PURPOSES AND SCOPES OF THE FSAP DIRECTIVES UNDER REVIEW ARE VARIED AND DIFFERENT FROM ONE ANOTHER**

The FSAP directives under review have varied scopes and purposes. Each of the directives has its own purpose and scope which is different from those of the other directives.

The wordings given in each directive for “transferable securities” and for “financial instruments” refer to definitions which are different in each directive under review, because they correspond to different purposes and scopes of these directives. From a pure literal reading the same concepts have different meanings and such meanings vary depending on the directives that they are applied to.

⇒ It seems logical to accept that the directives should each have a different scope insofar as their objectives are different from one another. No two directives have the same purpose. Hence the scope of each directive should be different. For instance the purpose of :

- ❑ The Prospectus Directive is information of investors on the primary and secondary markets.
- ❑ The Market Abuse Directive is market integrity.
- ❑ MIFID is activities of market intermediaries and the distribution of financial instruments.

In applying the MIFID definitions to earlier directives, it is important to have due regard to the purpose and scope of these earlier directives.

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<sup>3</sup> As an example, Finnish contracts on stock loans are admitted to trading on OMX Derivatives Markets, but stock loans are not to be considered as financial instruments under the definition in MiFID.

If the same concepts were to be applied with the same meanings to each directive, this would result in an alteration of the purpose and scope of some directives. This is true for MAD, the Prospectus Directive and the Transparency Directive.

As a further example in this regard it is noteworthy that the Prospectus Directive and the directive on admission of securities to official listing do not have similar scopes, in spite of the fact that their purposes complement each other.

This is true also for the admission to listing Directive and the UCITS Directive, the scope of which includes selected financial instruments.

## **5. DOES THE REPEAL PROVISION OF MIFID REALLY ALTER THE PERIMETER OF THE FSAP DIRECTIVES ?**

The repeal provision found in Article 69 of MIFID automatically and in effect means that all references previously made to the ISD are deemed to be made to MIFID. Article 69 has an impact in terms of the directives that were adopted earlier than MIFID. The effect of Article 69 is to substitute to the definitions of securities and transferable securities in the earlier directives the definition of financial instruments provided in MIFID. The application of MIFID will not imply, however, that the new instruments included in the MIFID definition- i.e. commodities and exotic derivative instruments - will automatically come under the scope of other directives. This is because the new instruments in the MIFID definition are outside of the definitions of transferable securities found in the earlier directives. This is not true, however, concerning MAD because MAD contains a definition of financial instrument which is different from the MIFID definition. The result of the application of MIFID is that the definition of financial instrument in MAD has been enlarged indirectly through the broadening of the definition of MIFID which now includes all financial commodity derivatives and derivative contracts having the characteristics of other derivative financial instruments provided they are traded on a regulated market. Article 69 has replaced the earlier definition of transferable securities, only for that part, and it leaves these directives with their reference to securities and transferable securities, without entering into the new field of financial instruments which includes exotic derivatives that are now part of MIFID (Annex I section C (7) and (10).

## **6. CHALLENGES FOR A HARMONISATION OF TWO LEGAL CONCEPTS**

Once the impact of the application of the MIFID definitions has been assessed, two further questions arise:

1. First question: Can the two concepts of financial instruments and transferable securities be merged or combined into one single definition? Is it desirable to do so? Under what conditions?
2. Second question: In the event that a single definition is retained, can this definition apply to each directive of the FSAP? With variations ? Or under certain exemptions ?

If the definitions of financial instruments and transferable securities were to be harmonised, the hypothesis is that such harmonisation would take place on the basis of the MIFID definition of financial instruments. The aim of such a harmonisation would be to do away with mismatching. A number of challenges would lie ahead, notably:

- ❑ The scope of the European passport would be enlarged and the rules applicable to the distribution of financial instruments would apply to a larger product range.
- ❑ Prudential rules especially accounting rules of financial instruments (particularly forward financial instruments) would apply to a wider range of financial instruments.

- ❑ The scope of close-out netting in case of default of a counterparty would have to be adjusted in certain jurisdictions, as a result of the application of a definition of financial instruments and transferable securities which would be enlarged from the present situation.

The MIFID definition of financial instruments in Annex 1 (10) includes transferable securities in its first indent. This in itself contains a built-in flexibility which allows to refer to transferable securities alone or to additional financial instruments.

Prior to assessing the impact of an attempt at harmonising definitions it is important to keep in mind the scope and purpose of each Directive.

- ⇒ To harmonise the definitions of the FSAP directives taking the wider MIFID definition of financial instruments as a base would lead to an alteration of the material scope of several directives (five directives). In the case of the Prospectus Directive, which is one of the five directives affected by a change in definitions, the material scope of the directive would be widened by application of the MIFID definitions: i.e. the information requirements would apply to the financial instruments included in MIFID which were not part of the ISD definition. For example a question might arise as to whether it would be feasible that commodities and exotic instruments would be subject to a prospectus requirement under the Prospectus Directive. Conceptually this would be very difficult, as these instruments are tailor-made to order. This would not be in the area of better regulation to require that a prospectus be prepared for commodity derivative instruments not sold to the public.

Therefore in answer to question 2, any kind of harmonisation should take care of the special purposes of the FSAP directives and provide for particular amendments so that the perimeter of each directive will remain constant and identical to the intent of the legislator at the time it was passed.

## **7. POSITION OF THE ESME GROUP**

The view of the ESME group is that the present situation under which each directive has its own definition of transferable securities and financial instruments is to-day necessary and warranted by the different purposes and scopes of each FSAP directive.

To adopt the MIFID definition of financial instruments as the reference definition and to apply this definition to all other FSAP directives does not seem to have unforeseen consequences concerning the scope of the directives, with the exception of MAD in as much as it is questionable whether MAD should apply to traded exotic derivatives instruments. The MIFID definition of financial instruments is wider than the earlier definitions of transferable securities.

The MIFID definition should be interpreted in a manner that transferable securities form an independent category of financial instruments which is different from the other categories of financial instruments. It should be made clear that each financial instrument can only belong to one category of financial instruments in the MIFID list in order to avoid any discrepancies among different Directives.

The application of MIFID should leave each directive with its particular scope. Regarding the Prospectus Directive the only exception refers to the closed-end units issued by collective investment undertakings.

We express the view that to harmonise the definitions of financial instruments into a single definition in the FSAP directives is not desirable, as such harmonisation would result in an alteration of the perimeter of some of the directives.

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**Official references to Directives under review :**

1. *UCITS* : Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (85/611/EEC), OJ L375 of 31.12.1985, p. 3.
2. *Investment Services Directive (ISD)* : Council Directive 93/22/EEC of 10<sup>th</sup> May 1993 on investment services in the securities field, OJ L141, 11/06/1993 p.27-46
3. *Admission to listing Directive* : Directive 2001/34/EC of the European Parliament and of the Council of 28 May 2001 on the admission of securities to official stock exchange listing and on information to be published on those securities, OJ L184 of 6.7.2001 p.1.
4. *Collateral Directive* : Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements, OJ L168 of 27.6.2002 p. 43.
5. *Market Abuse Directive (MAD)* : Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ L96 of 12.4.2003 p. 16.
6. *Prospectus Directive* : Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, OJ L345/ of 31.12.2003 p. 64.
7. *MIFID* : Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, OJ L 145, 30.4.2004, p. 1.
8. *Transparency Directive* : Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, OJ L 390 of 31.12.2004, p. 38.
9. *MIFID*: Commission regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive.
10. *Transparency* : Commission directive 2007/14/EC of 8 March 2007 ( level 2)

## **ANNEX**

### **DEFINITIONS**

By chronological order

#### **1. UCITS DIRECTIVE OF 20 DECEMBER 1985 AS AMENDED**

▪ **Article 1 – 8)**

For the purposes of this Directive, 'transferable securities' shall mean :

- shares in companies and other securities equivalent to shares in companies ('shares'),
- bonds and other forms of securitised debt ('debt securities'),
- any other negotiable securities which carry the right to acquire any such transferable securities by subscription or exchange, excluding the techniques and instruments referred to in Article 21.

#### **2. ISD – 10<sup>th</sup> May 1993**

##### **Definition of transferable securities**

▪ **Article 1 – 4)**

**Transferable securities** shall mean :

- shares in companies and other securities equivalent to shares in companies,
- bonds and other forms of securitized debt which are negotiable on the capital market and
- any other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement excluding instruments of payment.

#### **3. ADMISSION OF SECURITIES TO OFFICIAL LISTING OF 28 MAY 2001**

This directive refers to the concept of securities. However, it contains no definition of transferable securities or financial instruments.

#### **4. COLLATERAL DIRECTIVE OF 6 JUNE 2002**

▪ **Article 2- Definitions**

1. For the purpose of this Directive :

- (e) 'financial instruments' means shares in companies and other securities equivalent to shares in companies and bonds and other forms of debt instruments if these are negotiable on the capital market, and any other securities which are normally dealt in and which give the right to acquire any such shares, bonds or other securities by subscription, purchase or exchange or which give rise to a cash settlement (excluding instruments of payment), including units in collective investment undertakings, money market instruments and claims relating to or rights in or in respect of any of the foregoing.

## **5. MARKET ABUSE Directive (MAD) January 28<sup>th</sup> 2003**

### ▪ **Article 1**

3) "Financial instrument" shall mean:

- Transferable securities as defined in Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field(9),
- Units in collective investment undertakings,
- Money-market instruments,
- Financial futures contracts, including equivalent cash-settled instruments,
- Forward interest-rate agreements,
- Interest-rate, currency and equity swaps,
- Options to acquire or dispose of any instrument falling into these categories, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates,
- Derivatives on commodities,
- Any other instrument admitted to trading on a regulated market in a Member State or for which a request for admission to trading on such a market has been made.

## **6. PROSPECTUS DIRECTIVE OF 4 November 2003**

### ▪ **Article 2 – Definitions**

1. For the purposes of this Directive, the following definitions shall apply :

- (a) 'securities' means transferable securities as defined by Article 1(4) of Directive 93/22/EEC with the exception of money market instruments as defined by Article 1(5) of Directive 93/22/EEC, having a maturity of less than 12 months. For these instruments national legislation may be applicable ;
- (b) 'equity securities' means shares and other transferable securities equivalent to shares in companies, as well as any other type of transferable securities giving the right to acquire any of the aforementioned securities as a consequence of their being converted or the rights conferred by them being exercised, provided that securities of the latter type are issued by the issuer of the underlying shares or by an entity belonging to the group of the said issuer ;
- (c) 'non-equity securities' means all securities that are not equity securities.

## **7. MiFID - 21<sup>st</sup> April 2004**

### **Definition of transferable securities**

#### ▪ **Article 4.1- 18)**

'Transferable securities' means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as :

- (a) shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares ;
- (b) bonds or other forms of securitised debt, including depositary receipts in respect of such securities ;

- (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.

## **Definition of financial instruments**

### ▪ *Annex I*

#### **LIST OF SERVICES AND ACTIVITIES AND FINANCIAL INSTRUMENTS**

##### **Section C Financial Instruments**

- (1) Transferable securities ;
- (2) Money-market instruments ;
- (3) Units in collective investment undertakings ;
- (4) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash ;\*
- (5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event) ;
- (6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF ;
- (7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls ;
- (8) Derivative instruments for the transfer of credit risk ;
- (9) Financial contracts for differences ;
- (10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), as well as any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls.

### ▪ *Article 69*

#### **Repeal of Directive 93/22/EEC**

Directive 93/22/EEC shall be repealed with effect from<sup>\*4</sup>. References to Directive 93/22/EEC shall be construed as references to this Directive. References to terms defined in, or Articles of, Directive 93/22/EEC shall be construed as references to the equivalent term defined in, or Article of, this Directive.

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<sup>4</sup> 24 months after the entry into force of this directive [note by the author : postponed to 30 October 2007]

## **8. Transparency directive 2004/109 of 15 December 2004**

### ▪ **Article 2. 1**

(a) “securities” means transferable securities as defined in Article 4 (1), point 18, of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments [OJ L 145, 30.4.2004, p; 1] with the exception of money-market instruments, as defined in Article 4 (1), point 19, of that Directive having a maturity of less than 12 months, for which national legislation may be applicable.

The Transparency Directive also contains a reference to “financial instruments” in its Article 13.1.

### **Article 13.1**

“The notification requirements laid down in Article 9 shall also apply to a natural person or legal entity who holds, directly or indirectly, financial instruments that result in an entitlement to acquire, on such holder's own initiative alone, under a formal agreement, shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market.”

## **9. MIFID level 2**

Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive

Excerpts

### CHAPTER V

#### **ADMISSION OF FINANCIAL INSTRUMENTS TO TRADING**

##### *Article 35*

(Article 40(1) of Directive 2004/39/EC)

##### **Transferable securities**

1. Transferable securities shall be considered freely negotiable for the purposes of Article 40(1) of Directive 2004/39/EC if they can be traded between the parties to a transaction, and subsequently transferred without restriction, and if all securities within the same class as the security in question are fungible.

L 241/16 EN Official Journal of the European Union 2.9.2006

2. Transferable securities which are subject to a restriction on transfer shall not be considered as freely negotiable unless that restriction is not likely to disturb the market.

3. Transferable securities that are not fully paid may be considered as freely negotiable if arrangements have been made to ensure that the negotiability of such securities is not restricted and that adequate information concerning the fact that the securities are not fully paid, and the implications of that fact for shareholders, is publicly available.

4. When exercising its discretion whether to admit a share to trading, a regulated market shall, in assessing whether the share is capable of being traded in a fair, orderly and efficient manner, take into account the following:

(a) the distribution of those shares to the public;

(b) such historical financial information, information about the issuer, and information providing a business overview as is required to be prepared under Directive 2003/71/EC, or is or will be otherwise publicly available.

5. A transferable security that is officially listed in accordance with Directive 2001/34/EC of the European Parliament and of the Council (1), and the listing of which is not suspended, shall be deemed to be freely negotiable and capable of being traded in a fair, orderly and efficient manner.

6. For the purposes of Article 40(1) of Directive 2004/39/EC, when assessing whether a transferable security referred to in Article 4(1)(18)(c) of that Directive is capable of being traded in a fair, orderly and efficient manner, the regulated market shall take into account, depending on the nature of the security being admitted, whether the following criteria are satisfied:

- (a) the terms of the security are clear and unambiguous and allow for a correlation between the price of the security and the price or other value measure of the underlying;
- (b) the price or other value measure of the underlying is reliable and publicly available;
- (c) there is sufficient information publicly available of a kind needed to value the security;
- (d) the arrangements for determining the settlement price of the security ensure that this price properly reflects the price or other value measure of the underlying;
- (e) where the settlement of the security requires or provides for the possibility of the delivery of an underlying security or asset rather than cash settlement, there are adequate settlement and delivery procedures for that underlying as well as adequate arrangements to obtain relevant information about that underlying.

#### *Article 36*

(Article 40(1) of Directive 2004/39/EC)

#### **Units in collective investment undertakings**

1. A regulated market shall, when admitting to trading units in a collective investment undertaking, whether or not that undertaking is constituted in accordance with Directive 85/611/EEC, satisfy itself that the collective investment undertaking complies or has complied with the registration, notification or other procedures which are a necessary precondition for the marketing of the collective investment undertaking in the jurisdiction of the regulated market.

2. Without prejudice to Directive 85/611/EEC or any other Community legislation or national law relating to collective investment undertakings, Member States may provide that compliance with the requirements referred to in paragraph 1 is not a necessary precondition for the admission of units in a collective investment undertaking to trading on a regulated market.

3. When assessing whether units in an open-ended collective investment undertaking are capable of being traded in a fair, orderly and efficient manner in accordance with Article 40(1) of Directive 2004/39/EC, the regulated market shall take the following aspects into account:

- (a) the distribution of those units to the public;
- (b) whether there are appropriate market-making arrangements, or whether the management company of the scheme provides appropriate alternative arrangements for investors to redeem the units;
- (c) whether the value of the units is made sufficiently transparent to investors by means of the periodic publication of the net asset value.

4. When assessing whether units in a closed-end collective investment undertaking are capable of being traded in a fair, orderly and efficient manner in accordance with Article 40(1) of Directive 2004/39/EC, the regulated market shall take the following aspects into account:

- (a) the distribution of those units to the public; 2.9.2006 EN Official Journal of the European Union L 241/17

(1) OJ L 184, 6.7.2001, p. 1. Directive as last amended by Directive 2005/1/EC.

- (b) whether the value of the units is made sufficiently transparent to investors, either by publication of information on the fund's investment strategy or by the periodic publication of net asset value.

#### *Article 37*

(Article 40(1) and (2) of Directive 2004/39/EC)

#### **Derivatives**

1. When admitting to trading a financial instrument of a kind listed in points of Sections C(4) to (10) of Annex I to Directive 2004/39/EC, regulated markets shall verify that the following conditions are satisfied:

- (a) the terms of the contract establishing the financial instrument must be clear and unambiguous, and enable a correlation between the price of the financial instrument and the price or other value measure of the underlying;
- (b) the price or other value measure of the underlying must be reliable and publicly available;
- (c) sufficient information of a kind needed to value the derivative must be publicly available;

- (d) the arrangements for determining the settlement price of the contract must be such that the price properly reflects the price or other value measure of the underlying;
- (e) where the settlement of the derivative requires or provides for the possibility of the delivery of an underlying security or asset rather than cash settlement, there must be adequate arrangements to enable market participants to obtain relevant information about that underlying as well as adequate settlement and delivery procedures for the underlying.
2. Where the financial instruments concerned are of a kind listed in Sections C (5), (6), (7) or (10) of Annex I to Directive 2004/39/EC, point (b) of paragraph 1 shall not apply if the following conditions are satisfied:
- (a) the contract establishing that instrument must be likely to provide a means of disclosing to the market, or enabling the market to assess, the price or other value measure of the underlying, where the price or value measure is not otherwise publicly available;
- (b) the regulated market must ensure that appropriate supervisory arrangements are in place to monitor trading and settlement in such financial instruments;
- (c) the regulated market must ensure that settlement and delivery, whether physical delivery or by cash settlement, can be effected in accordance with the contract terms and conditions of those financial instruments.

## CHAPTER VI

### **DERIVATIVE FINANCIAL INSTRUMENTS**

#### *Article 38*

(Article 4(1)(2) of Directive 2004/39/EC)

#### **Characteristics of other derivative financial instruments**

1. For the purposes of Section C(7) of Annex I to Directive 2004/39/EC, a contract which is not a spot contract within the meaning of paragraph 2 of this Article and which is not covered by paragraph 4 shall be considered as having the characteristics of other derivative financial instruments and not being for commercial purposes if it satisfies the following conditions:

(a) it meets one of the following sets of criteria:

(i) it is traded on a third country trading facility that performs a similar function to a regulated market or an MTF;

(ii) it is expressly stated to be traded on, or is subject to the rules of, a regulated market, an MTF or such a third country trading facility;

(iii) it is expressly stated to be equivalent to a contract traded on a regulated market, MTF or such a third country trading facility;

(b) it is cleared by a clearing house or other entity carrying out the same functions as a central counterparty, or there are arrangements for the payment or provision of margin in relation to the contract;

(c) it is standardised so that, in particular, the price, the lot, the delivery date or other terms are determined principally by reference to regularly published prices, standard lots or standard delivery dates.

2. A spot contract for the purposes of paragraph 1 means a contract for the sale of a commodity, asset or right, under the terms of which delivery is scheduled to be made within the longer of the following periods:

(a) two trading days; L 241/18 EN Official Journal of the European Union 2.9.2006

(b) the period generally accepted in the market for that commodity, asset or right as the standard delivery period.

However, a contract is not a spot contract if, irrespective of its explicit terms, there is an understanding between the parties to the contract that delivery of the underlying is to be postponed and not to be performed within the period mentioned in the first subparagraph.

3. For the purposes of Section C(10) of Annex I to Directive 2004/39/EC, a derivative contract relating to an underlying referred to in that Section or in Article 39 shall be considered to have the characteristics of other derivative financial instruments if one of the following conditions is satisfied:

(a) that contract is settled in cash or may be settled in cash at the option of one or more of the parties, otherwise than by reason of a default or other termination event;

(b) that contract is traded on a regulated market or an MTF;

(c) the conditions laid down in paragraph 1 are satisfied in relation to that contract.

4. A contract shall be considered to be for commercial purposes for the purposes of Section C(7) of Annex I to Directive 2004/39/EC, and as not having the characteristics of other derivative financial instruments for the purposes of Sections C(7) and (10) of that Annex, if it is entered into with or by an operator or administrator of an energy transmission grid, energy balancing mechanism or pipeline network, and it is necessary to keep in balance the supplies and uses of energy at a given time.

*Article 39*

(Article 4(1)(2) of Directive 2004/39/EC)

**Derivatives within Section C(10) of Annex I to Directive 2004/39/EC**

In addition to derivative contracts of a kind referred to in Section C(10) of Annex I to Directive 2004/39/EC, a derivative contract relating to any of the following shall fall within that Section if it meets the criteria set out in that Section and in Article 38(3):

- (a) telecommunications bandwidth;
- (b) commodity storage capacity;
- (c) transmission or transportation capacity relating to commodities, whether cable, pipeline or other means;
- (d) an allowance, credit, permit, right or similar asset which is directly linked to the supply, distribution or consumption of energy derived from renewable resources;
- (e) a geological, environmental or other physical variable;
- (f) any other asset or right of a fungible nature, other than a right to receive a service, that is capable of being transferred;
- (g) an index or measure related to the price or value of, or volume of transactions in any asset, right, service or obligation.

**10. Commission directive 2007/14/EC of 8 March 2007**  
**(Transparency )**

*Article 11*

**Types of financial instruments that result in an entitlement to acquire, on the holder's own initiative alone, shares to which voting rights are attached**

(Article 13(1) of Directive 2004/109/EC)<sup>1</sup>. For the purposes of Article 13(1) of Directive 2004/109/EC, transferable securities; and options, futures, swaps, forward rate agreements and any other derivative contracts, as referred to in Section C of Annex I of Directive 2004/39/EC, shall be considered to be financial instruments, provided that they result in an entitlement to acquire, on the holder's own initiative alone, under a formal agreement, shares to which voting rights are attached, already issued, of an issuer whose shares are admitted to trading on a regulated market.