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Internal Market and Services DG

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Securities markets

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Working document ESC/8/2005

Explanatory note: Main differences between working document ESC/7/2005 and the CESR level 2 advice

1. Scope of the working document

Working document ESC/7/2005 intends to prepare future discussions on draft level 2 implementing legislation with respect to four issues:

- The information on transactions that has to be included in the reports that Investment Firms have to send to their competent authorities (article 25).
- Requirements relating to the methods by which reports of transactions executed by investment firms must be made to competent authorities (article 25).
- The determination of the competent authorities between which the exchange of information in respect of transaction reports must take place, as well as the arrangements for transferring that information (article 25).
- The procedures for exchange of other information between competent authorities pursuant to a request for information (article 58).

2. Differences of the Commission working document with CESR's advice

The Commission working document is largely based on the advice that the Commission received from CESR on 31 January 2005. There is only one change in terms of policy (see below under 2. 1.); the rest of the changes are technical modifications (see below under 2. 2. and Annexe to this document) or drafting changes in order to transform the advice into a legislative format.

2. 1. Major policy changes: Article 56.2 MiFID

The Commission services consider that that the advice received on this Article does not represent a sufficient basis for adopting a Level 2 measure.

Article 56.2 of the MiFID establishes that in the cases when the operation of a Regulated Market in a Host Member State (that is, a Member State other than the Home Member State in which it is authorised) has become of "substantial importance" for the functioning of the securities markets and the protection of the investors in that Host Member State, the competent authorities of both the Home and the Host Member States

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of the Regulated Market have to establish proportionate cooperation arrangements in order to facilitate the monitoring of the activities of the Regulated Market in the Host Member State.

Article 56 of MiFID provides that the Commission may adopt implementing measures in respect of article 56.2; therefore the Commission issued a mandate to CESR in January 2004 asking for guidance in respect of what could be considered to be of "...substantial importance...". The advice that CESR produced on this complex issue consists in a set of generic principles that would be very difficult to apply in practice.

Accordingly, the Commission services consider that, at this stage, no level 2 measure should be proposed in this area; multiple Regulated Market structures will not suffer from the lack of level 2 legislation since cooperation arrangements have been established between the competent authorities well before the MiFID. If consolidation intensifies and there is a proven and clear economic and legal justification for some regulatory intervention, Level 2 measures could be adopted on this subject in the future.

2. 2. Major technical changes

2. 2. 1. Options for organising the exchange of information between competent authorities

Two options, A and Option B, are included in the working document, representing two different ways of dealing with the question of how to organise the exchange of information between Competent Authorities of information on transactions in financial instruments executed by investment firms. The MiFID requires that

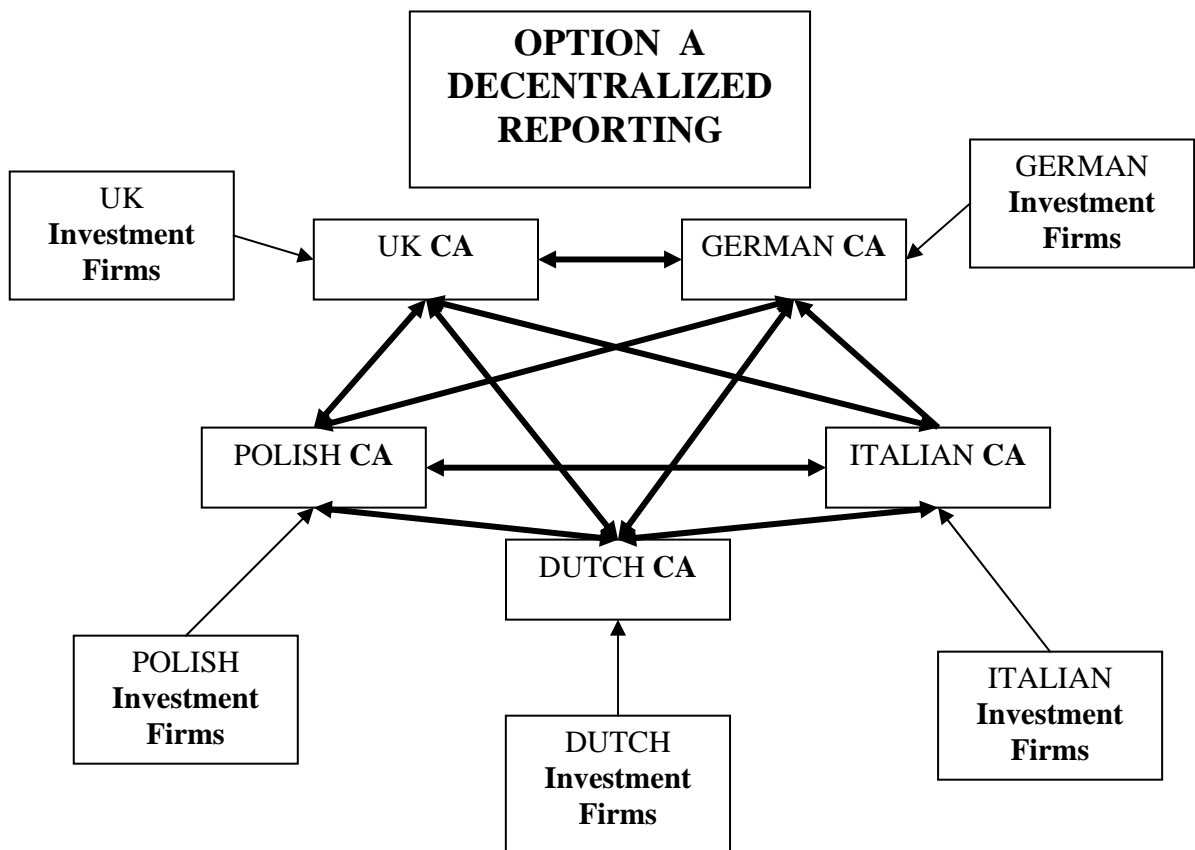
(1) transactions reports must be sent to the competent authority of the investment firm which executed the transaction and

(2) that competent authority must transmit the information contained in a transaction report to the competent authority of the most relevant market in terms of liquidity for the financial instrument in question.

In cases where the transaction report is sent to the competent authority of the host State of a branch of the investment firm, that authority must also transmit the information in the report to the competent authority of that firm's home Member State.

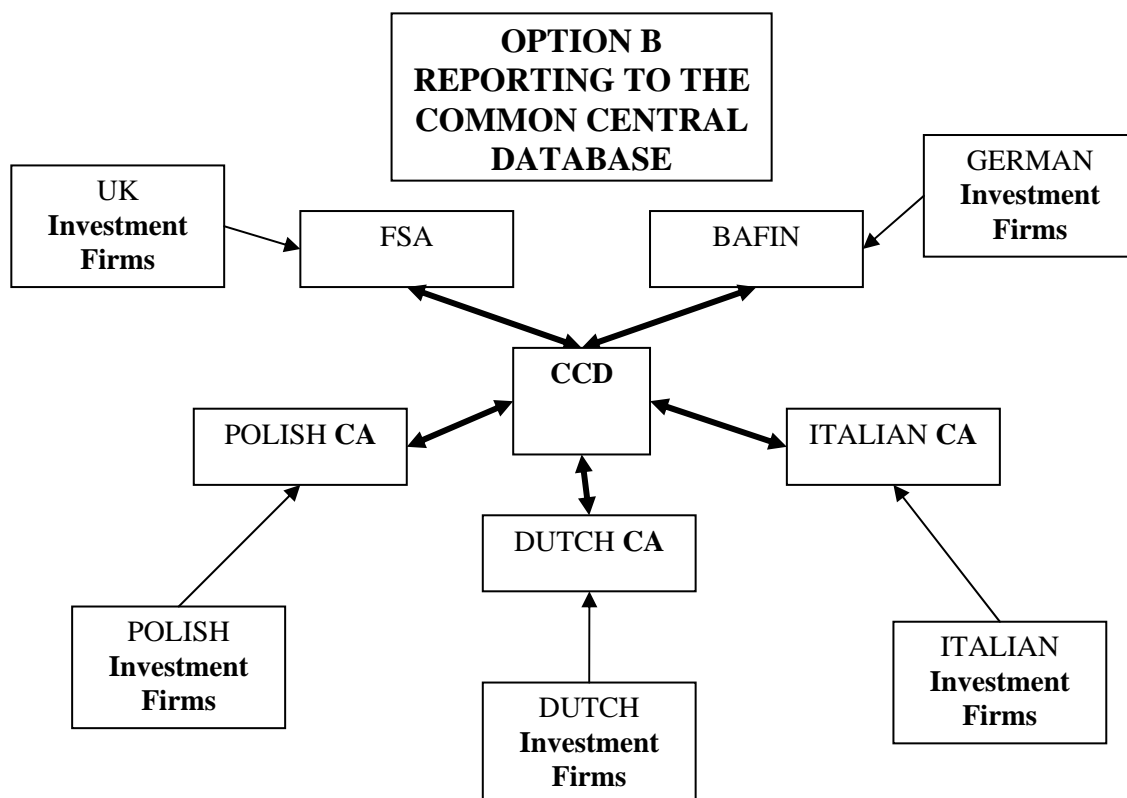
Under Option A each competent authority would send the information (contents of a transaction report) directly to any other authority required by the MiFID. **Under Option B**, all competent authorities would send information contained in transaction reports to a "Common Central Database", to which they would all have unrestricted access; this would be more efficient e.g. for detecting market abuse. Both options would require additional investments to be made. **CESR is assessing the costs.**

The practical effect of each option is illustrated by the following diagrams:



Simplified schema showing the transaction reporting flows under Option A.

For example, Dutch investment firms will send reports on all transactions they executed to the Dutch competent authority. The Dutch Competent authority will then have to filter out the transactions in those instruments for which it is not the competent authority of the most relevant market in terms of liquidity and then send the information on these transactions to the relevant competent authorities. So, for example, information on transactions executed on the Amsterdam exchange by Dutch investment firms in some Italian securities will be then sent to the Italian competent authority, information on transactions executed on the Amsterdam exchange by Dutch investment firms in some German securities will be then sent to the German competent authority, etc. Similarly, all other competent authorities will have to send the information on transactions in instruments for which they are not the authorities of the most relevant in terms liquidity directly to the authorities who are.



Simplified schema showing the transaction reporting flows under Option B

The first step is the same as in Option A. Dutch investment firms will send reports on all transactions they executed to the Dutch competent authority. Similarly, all other investment firms will send their transaction reports to their respective competent authorities. The competent authority will then simply take all the transaction reporting information and send it along to the central database after reviewing it. The database will thus concentrate information on all executed transactions. All other authorities will have access to the database and therefore the authorities of the most relevant market in terms of liquidity for a given instrument will obtain the information they should under the MiFID requirements.