

Draft

COMMISSION REGULATION

implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive

BACKGROUND NOTE

Table of Contents

1.	Introduction.....	1
2.	General issues.....	3
2.1.	Choice of instrument and the level of harmonisation	3
2.2.	Streamlining of record keeping, transaction and client reporting and post-trade transparency	4
3.	Transaction Reporting and Cooperation among Competent Authorities.....	5
3.1.	Definition of ‘transaction’	5
3.2.	Determination of the most relevant market in terms of liquidity.....	5
3.3.	Exchange of information between competent authorities.....	5
3.4.	Determination of substantial importance	6
4.	Transparency	7
4.1.	Pre-trade transparency.....	7
4.2.	Systematic internalisation	8
4.3.	Liquid shares	9
4.4.	Post-trade transparency	10
4.5.	Publication.....	11
5.	Admission to trading.....	11
6.	Definitions for the purposes of the Directive.....	12
6.1.	Commodity derivatives	12
Annex	Record-keeping and reporting of transactions – data elements	14

BACKGROUND NOTE

Draft Commission Regulation implementing the Markets in Financial Instruments Directive 2004/39/EC ('MiFID')

1. INTRODUCTION

Directive 2004/39/EC on Markets in Financial Instruments ('the MiFID' or 'the level 1 Directive') is the principal piece of legislation recently adopted in the field of securities markets, and will replace Directive 93/22/EEC on investment services in the securities field. This Directive was agreed unanimously by Member States and gathered a strong Parliamentary majority. It came into force on 30 April 2004. The transposition period, during which Member States are bound to adopt national legislation in order to enact the level 1 Directive into national law elapses on 31 January 2007; a deferred application date, 1 November 2007, has been agreed upon to allow firms to put in place practical arrangements to comply with the obligations under the Directive once the transposition period has elapsed.

The MiFID is a Lamfalussy-type Directive: that is, as a 'level 1' directive, it contains framework principles, agreed by the Council and the European Parliament through co-decision, which need to be developed and elaborated by detailed technical implementing measures ('level 2 measures'). The scope of the level 2 measures is defined and circumscribed by the level 1 text. These technical measures are adopted by the Commission through the 'comitology' procedure established by decision 1999/468/EC, after consultation with the European Securities Committee (ESC), which is the competent regulatory committee in the field of securities, and taking into account the views of the European Parliament. The Commission has presented 2 draft measures to implement the level 1 Directive; in both draft measures, the Commission has taken particular care to ensure that the political agreement represented by the level 1 Directive and the limits of the delegated powers are respected.

The draft implementing measures have been drawn up after a very long, open and iterative consultation process embracing and building on the views of all stakeholders concerned (Member States, industry, exchanges, consumers, regulators). They are largely based on technical advice produced by the Committee of European Securities Regulators (CESR), an independent advisory body in the field of securities which assists the Commission in the preparation of technical implementing legislation on the basis of a Commission mandate. Since 2000 – when the preparatory work began for the level 1 Directive – there have been more than 15 formal, public consultations on MIFID and the implementing measures, including consultations undertaken by CESR in the course of producing its advice. As part of this process, consultation on DG Internal Market and Services draft working documents has taken place within the ESC since March 2005; these working documents were sent to the European Parliament and also published on the Commission's website, and comments from stakeholders on those working documents have been taken into account.

Studies carried out by the Commission and by leading economists have unambiguously shown that the integration of European capital markets has significant and positive overall effects on EU economic growth. These implementing measures form an integral part of the European project to promote those economic benefits.

The draft implementing measures have been structured into one Regulation and one Directive. For the majority of the envisaged measures uniform solutions are desirable to avoid ‘gold-plating’ by Member States; to this end, the Commission has adopted a twofold approach:

Wherever legally possible (i.e. where the texts are sufficiently exhaustive to allow direct application in national legal regimes) – and in order to conform to the Stockholm European Council Declaration on the Lamfalussy process (April 2002) – the Commission has presented the draft implementing measures in the form of a Regulation.

Nevertheless, in those cases where the use of a Regulation was not legally or technically feasible, a principles-based though tightly-worded Directive, allowing Member States to only make the necessary adaptations for the rules to fit into their national legal systems, has been proposed.

Concerning the use of a Regulation, the Commission considers that effective integration of capital markets requires, in some areas, a set of stand-alone rules that are directly applicable in all Member States, thus ensuring that MiFID can function uniformly and effectively in all EU financial markets. Detailed and fully harmonised transparency requirements and rules regulating transaction reporting are necessary to ensure equivalent market conditions and the smooth operation of securities markets throughout the European Union.

This level 2 Regulation will lay down:

- the criteria for determining the most relevant market in terms of liquidity for a financial instrument for the purposes of Articles 25(3) and 27(2) of the MiFID;
- requirements and procedures relating to the exchange of information contained in transaction reports in financial instruments between competent authorities, in accordance with Articles 25, 56 and 58 of the MiFID;
- the information to be included in such reports of transactions provided in accordance with Articles 25(3) and (5) of that Directive, and requirements relating to arrangements for transmitting such reports to the competent authority in accordance with those Articles;
- procedures for the exchange of information relating to calculations relevant to transparency, based on Article 58 of the MiFID;
- technical details relating to pre-trade transparency requirements for regulated markets and for MTFs for the purposes of Articles 29 and 44 of the MiFID;
- criteria for determining whether an investment firm is a systematic internaliser for the purposes of Article 4(1)(7) of the MiFID;
- technical details relating to the obligation for systematic internalisers to make public firm quotes for the purposes of Article 27 of the MiFID;
- technical details relating to post-trade transparency requirements for investment firms, MTFs and regulated markets, for the purposes of Articles 28, 30 and 45 of the MiFID;
- the methods by which an investment firm is deemed to meet obligations under Article 22(2) of the MiFID relating to publication of client limit orders;

- conditions for the admission of financial instruments to trading on a regulated market for the purposes of Article 40 of the MiFID;
- the circumstances in which a contract should be considered to be for commercial purposes for the purposes of Section C(7) of Annex I to the MiFID, and therefore not a financial instrument within that Annex; and
- the circumstances in which a contract should be considered to fall within Section C(10) of Annex I to that Directive, provided that the other criteria set out in that section are satisfied.

2. GENERAL ISSUES

2.1. Choice of instrument and the level of harmonisation

For a large number of the draft measures, comprehensive and uniformly applicable provisions are desirable to avoid both divergences in transposition and ‘gold-plating’ by Member States. Furthermore, the provisions of this Regulation are detailed and technical, and as such are capable of direct application, without the need for national transposition, to all investment firms in all Member States.

The Regulation also has further advantages:

- a Regulation will eliminate any delay in transposition, thereby giving firms certainty at an earlier stage as to what requirements will affect them and maximising the time available for adjustment to the new regime;
- in reducing the possibility of ‘gold-plating’, whereby Member States add super-equivalent measures that go beyond the requirements of a Directive, is expected to significantly reduce the regulatory burden on the aspects covered by this measure to which firms might otherwise be subject;
- a Regulation will ensure greater convergence in interpretation and application of the level 1 Directive in the Member States;
- a highly harmonised set of rules on transaction reporting and transparency will provide firms with a simpler legal framework and a more effective passport;
- in the context of the Lamfalussy process, both the European Council (Stockholm Resolution of 23 March 2001) and the European Parliament (European Parliament Resolution of 5 February 2002) have expressed strong support for the use, whenever possible, of Regulations rather than Directives, *inter alia* to speed up the legislative process.

There are also important arguments related to each of the specific fields regulated in the legal text that favour the use of Regulation rather than a Directive. For transaction reporting, the regime aims to ensure that relevant competent authorities are properly informed about transactions in which they have a supervisory interest. For those purposes it is necessary to ensure that a single data set is collected from all investment firms with a minimum of variation between Member States, so as to minimise the extent to which businesses operating across borders are subject to different reporting obligations, and so as to maximise the

proportion of data held by a competent authority that can be shared with other competent authorities. This is only achievable with the use of Regulation. The use of a Regulation will thus be crucial in ensuring that competent authorities are in a position to carry out their obligations under that Directive as expeditiously and efficiently as possible.

In the field of market transparency, detailed and fully harmonised transparency requirements are appropriate so as to ensure equivalent market conditions and the smooth operation of securities markets throughout the Community, and to facilitate the effective integration of those markets. Those requirements are part of a broader framework of rules designed to promote competition between trading venues for execution services so as to increase investor choice, encourage innovation, lower transaction costs, and increase the efficiency of the price formation process on a pan-Community basis. The uniform application of the transparency requirements through the use of a Regulation is an essential part of this framework, so as to ensure a level playing field between trading venues and also make sure that the rules for the exemptions to the transparency regime are applied in the same manner. Similarly, the requirements concerning the admission of financial instruments to trading on regulated markets need to be adopted in the form of a Regulation in order to ensure a level playing field between regulated markets in different Member States. Finally, when considering the choice of the most appropriate legal instruments for the provisions concerning the commodity and other derivative instruments, the use of a Regulation is most appropriate in order to ensure the correct functioning of the MiFID passport. This is because this area essentially delimits the scope of the MiFID by specifying what contracts are to be considered financial instruments. A variation in the definitions of financial instruments of this kind would seriously hinder the cross-border provision of services in relation to those instruments.

2.2. Streamlining of record keeping, transaction and client reporting and post-trade transparency

The implementing Regulation aims to ensure maximum coherence and consistency when imposing obligations in areas that share common characteristics.

This policy is applied, for example, in the areas that relate to data handling for regulatory purposes: reporting to clients; record-keeping of orders and transactions; trade reporting to competent authorities, and post-trade transparency. Here, a major effort at streamlining and content-harmonisation has been made which will lead to a significant reduction of the compliance burden that would otherwise be imposed upon firms.

This effort consists of two basic elements. First, the Regulation establishes a single set of definitions which apply for the common components of all the records or reports concerned. This will ensure that the underlying content of the records or the reports in respect of those elements is the same. Second, the elements that have to be included in the records or reports are limited to those that are strictly necessary for the fulfilment of a given regulatory objective. This streamlining of content is important in order to avoid differences between the different reports or records which are not justified by regulatory needs. It is also a prerequisite for market integration, and fundamental to ensuring the cost efficiency of the obligations, particularly for small and medium-sized investment firms. This work of harmonisation and streamlining is designed to ensure the greatest number of possible shared elements between the different records or reports. The **Annex** to this Background Note present in detail the relationship between the different record-keeping and reporting requirements.

3. TRANSACTION REPORTING AND COOPERATION AMONG COMPETENT AUTHORITIES

The regulation of transaction reporting and the exchange of information between competent authorities under the MiFID (in Article 25, and Articles 56 and 58 respectively) is a central element of its scheme for ensuring that competent authorities are in a position to carry out their obligations under the Directive as expeditiously and efficiently as possible; to this end information should be shared between competent authorities to the greatest degree possible. Thus, transaction reporting also plays an important role in facilitating the efficient functioning of an integrated single market. In order to ensure that transaction reporting delivers the intended effects, the implementing Regulation provides for a single data set collected from all investment firms with a minimum of variation between Member States, minimising divergences in reporting obligations for firms.

3.1. Definition of ‘transaction’

In order to ensure that the transaction reporting requirements are applied consistently across Member States and that the types of transaction reported are not subject to national variation, it is necessary to include a definition of transaction in the implementing Regulation (Article 5). The definition, which is valid for other areas dealt with by the Regulation such as post-trade transparency, includes only the purchase and sale of financial instruments and excludes other types of transactions such as securities financing transactions and other transactions that may include a purchase or sale component in an incidental way.

3.2. Determination of the most relevant market in terms of liquidity

Article 25 of the MiFID provides that information on transactions should be exchanged between competent authorities so that the competent authority of the most relevant market in terms of liquidity for a particular instrument always receives the details of all transactions in that instrument. For this purpose it is necessary to identify the most relevant market in terms of liquidity for each financial instrument.

The approach taken by the implementing Regulation (Article 8) is based on the use of proxies to identify the most relevant market for a financial instrument. Different proxies are chosen for different kinds of instrument, reflecting the nature of those instruments and their trading patterns. For shares, for example, the most liquid market will be the market in which the share was first admitted to trading, while for many bonds it will be the market where the registered office of the issuer is situated. The proxy approach is simple, practical and reasonably accurate. A tie-break mechanism is provided for certain cases where the proxy approach does not result in a single market being identified. The Regulation also provides for a correction mechanism (Article 9) in cases where the result of the proxy approach would identify a plainly incorrect market as the most relevant in terms of liquidity.

3.3. Exchange of information between competent authorities

Large volumes of transaction information must be exchanged between competent authorities to ensure that each competent authority has a complete picture as regards the financial instruments for which it is the competent authority of the most relevant market in terms of liquidity, or ‘relevant competent authority’. Competent authorities must establish the arrangements needed for a prompt sharing of transaction information.

The approach of the implementing Regulation is to set out clear objectives for competent authorities while leaving open the way in which these objectives should be met (Article 13)¹. Accordingly, no particular structure or arrangements necessary for this exchange of information has been prescribed or recommended (Recital 6). It is possible that several different types of arrangements emerge, ranging from very systematic and closely-integrated arrangements between those authorities that have a voluminous data set, to exchange on a daily basis, to simpler arrangements between competent authorities where a very small volume of information is to be exchanged sporadically.

The Committee of European Securities Regulators (CESR) is well placed to coordinate the design or implementation of any arrangements agreed by its members. This has been recognised explicitly in Recital 8 of the implementing Regulation which states that it is open to competent authorities to work through CESR in discharging their duty to coordinate the design and establishment of those arrangements. As explained above, the Regulation leaves open the architecture of the arrangements to be put in place. This means that it is open to competent authorities to create a system or different systems and arrangements that best suit their needs in reflecting the amount of data to be exchanged between each competent authority, the type of local reporting system and a host of other relevant technical factors, provided only that such systems or arrangements discharge the obligations in the MiFID and its implementing measures. Competent authorities are also required to inform the Commission, which should subsequently inform the European Securities Committee, of the design of those arrangements and any subsequent significant changes.

3.4. Determination of substantial importance

The MiFID grants a regulated market authorised in one Member State the right to operate in another Member State without being subject to supervision by the authorities of that other State. Exceptionally, Article 56 of the MiFID allows host Member States to establish proportionate cooperation arrangements with the home competent authority of the regulated market. The MiFID, which enshrines the principle of home country control, carefully limits the scope of this shared supervision to exceptional cases (when the operations of the regulated market are of substantial importance in the host Member State) and avoids duplication of supervision.

Article 15 of the implementing Regulation determines the specific conditions under which the operations of a regulated market in a host Member State should be considered as of substantial importance, with the consequence that proportionate cooperation arrangements need to be established. The Regulation takes into account the current market structure and possible future developments, which exceptionally give rise to the concerns that would trigger the need to establish the cooperation arrangements. This is the reason why the Regulation refers to legal criteria with a clear economic impact², and not pure economic criteria. The latter might have over-extended the facility for shared supervision, and consequently affected the cross-border operations of established exchanges. Recital 9 underlines that the intention is not to subject regulated markets to more than one competent authority where otherwise there would not be.

¹ The speed at which the systems to be created (if any) are integrated is also left open. Nothing prevents the different competent authorities from taking a gradual approach to this issue, for instance, using interim solutions.

² In most of the cases it will apply to markets that continue to operate in the same manner but that have changed their home Member State by way of mergers, acquisitions, etc.

4. TRANSPARENCY

The regime established by the level 1 Directive governing transparency requirements in respect of transactions in shares admitted to trading on a regulated market aims to ensure that investors are fully informed as to the true level of actual and potential transactions in such shares, whether those transactions take place on regulated markets, MTFs, systematic internalisers, or outside those trading venues. Those requirements are part of a broader framework of rules designed to promote competition between trading venues for execution services so as to increase investor choice, encourage innovation, lower transaction costs, and increase the efficiency of the price formation process on a pan-Community basis. A high degree of transparency is an essential part of this framework, so as to ensure a level playing field between trading venues so that the price discovery mechanism in respect of particular shares is not impaired by the fragmentation of liquidity, and investors are not thereby penalised. The implementing Regulation sets out the necessary details of this regulatory scheme, as mentioned in section 2 above.

On the other hand, that Directive recognises that there may be circumstances where exemptions from pre-trade transparency obligations, or deferral of post-trade transparency obligations, may be necessary.

The implementing Regulation also sets out details of those circumstances, bearing in mind the need both to ensure a high level of transparency, and to ensure that liquidity on trading venues and elsewhere is not impaired as an unintended consequence of obligations to disclose transactions and thereby to make public risk positions.

4.1. Pre-trade transparency

The specific pre-trade transparency measures contained in the Regulation avoid imposing a 'one size fits all' transparency regime, for there are myriad different ways of making market interests interact. The level 1 Directive and the implementing Regulation recognise that the existence of a variety of trade matching functionalities benefits all market participants: those that offer the service can choose the type of business they engage in; competition and innovation are encouraged; and investors benefit from a diversified offer that can best fit their needs.

The implementing Regulation (Article 16) singles out the three most common types of trade matching systems (continuous auction order book, quote-driven and periodic auction) and specifies the specific conditions with which they have to comply in order to be considered as pre-trade transparent. A description of these systems, and of the information they are required to make public, is set out in Table 1 of Annex II to the Regulation. In addition, Article 16(5) provides for a residual regime that applies to all other systems (present or future) not covered by those specific models, or which represent a hybrid of one or more types. The objective of the residual regime is to ensure that these systems should also be subject to adequate levels of transparency.

In certain cases where it is considered that no pre-trade transparency is appropriate the Regulation allows for a waiver from the pre-trade transparency obligations (Articles 17 and 18ee). These waivers should be understood as a limitation of the general principle of transparency and should therefore be interpreted narrowly. Waivers are only acceptable in the following cases: a) systems such as crossing systems where the price is determined by a

reference price generated by another system³ (Article 17(1)(a)); b) negotiated transactions (i.e., those negotiated privately by the parties but executed within a regulated market or MTF), but only if certain conditions are fulfilled⁴ (Article 17(1)(b)); c) orders held in order management facilities such as so-called ‘iceberg’ orders (Article 17(2)); and d) orders large in scale compared with normal market size (so-called ‘block trades’) (Article 19 and Table 2 of Annex II). Importantly, competent authorities should not discriminate between trading venues when granting waivers (Recital 10).

In the case of limit orders, the implementing Regulation (Article 30) specifies that a firm meets the requirements of publicity and accessibility set out in Article 22 of the MiFID⁵ if it transmits such orders to a regulated market or MTF that operates an order book trading system. In other cases, the firm must ensure that the limit order is made public and can be easily executed as soon as market conditions allow.

4.2. Systematic internalisation

Article 27 of the level 1 Directive imposes significant obligations on those firms that are deemed to be systematic internalisers, so it is necessary to provide for a uniform application of the definition of a systematic internaliser in all Member States. According to Article 4(1)(7) of the level 1 Directive, systematic internalisers are those firms that execute client orders by dealing on own account (i.e., against their own book) on an organised, systematic and frequent basis. The implementing Regulation establishes a set of objective criteria that should clarify the meaning of ‘organised, systematic and frequent’ for competent authorities and, above all, investment firms themselves, and thus ensure that investment firms understand when their activity qualifies them as a systematic internaliser.

Broadly speaking, the criteria identified by Article 20 of the Regulation are organisational (the firm has personnel or an automated technical system dedicated to this business), commercial (the activity is available to clients on a regular or continuous basis, and has a material⁶ commercial role for the firm) and qualitative (the activity is carried out in accordance with non-discretionary rules and procedures, and therefore has characteristics of a market). By their combined effect, these criteria should cover those firms that carry out the internalisation function in a manner that gives rise to the concerns that underlie the application of the MiFID to internalisers – the need for transparency and investor protection.

Article 20(4) requires the maintenance and publication by each competent authority, of a list of systematic internalisers. The list is considered published when it is submitted to CESR in accordance with Article 33(5). This mechanism will assist market participants and should also make apparent any national deviation in the application of the implementing Regulation.

³ It is considered that the transparency issues presented by traded volumes in these systems with respect to price formation can be adequately dealt with by post trade disclosure of the trades.

⁴ In brief, the negotiated transaction should not simply be a means of avoiding the obligation to quote by systematic internalisers (see Recital 12).

⁵ Provided, of course, that the order book operates a system that guarantees the disclosure of the interests expressed in the limit order.

⁶ Materiality, for the purposes of the implementing Regulation, is a multi-faceted concept that can take into account not only the relative importance of the activity to the firm or to the market but also its absolute importance (Recital 13).

4.3. Liquid shares

The scope of Article 27 of the Level 1 Directive is determined by the range of shares that are considered to have a liquid market ('liquid shares'). As noted above, the concept of transparency has to take into account the realities of the markets in which it is to operate. For the regulated markets, this principle requires a graduated application of transparency requirements by reference to the type of system operated. For systematic internalisers, a similarly graduated approach is achieved by limiting the application of the requirements in terms of a) scope (only liquid shares have to be quoted), and b) size (mandatory quoting obligations apply only to dealings up to standard market size). The proposed approach to defining the scope of the application of Article 27 is intended to strike a careful balance, which gives due recognition both to the general need for transparency and the need to produce a level playing field as intended by the Directive, and also to the fact that internalisers put their own capital at risk when providing this service.

Article 21 of the implementing Regulation determines which shares are liquid in a particular market by using a series of proxies. These proxies are free float (not less than €500 million), average daily number of trades (not less than 500) and daily turnover (not less than €2 million). Member States are given limited discretion to combine the proxies in a manner that best suits the characteristics of their markets⁷. The element of choice for Member States provides them with a degree of flexibility in the number of liquid shares that reflects the different market structures of the Member States, whilst preserving the general balance referred to in the previous paragraph.

However, while the exclusive use of these proxies is certainly adequate for the big markets, it may not be deliver the right results for Member States with smaller markets. The consequence of this would be that such markets would not have any liquid shares at all to which the transparency requirements apply. This might impact adversely on the interests of investors or market efficiency. For this reason, it is appropriate to give Member States the power to specify a minimum number of shares – no greater than 5 – that are considered to have a liquid market for that Member State (Articles 21(2)) and (3)).

On the basis of our calculations⁸, the effect of this regime combining proxies with a power of designation for Member States will be that around 500 shares, representing more than 90% of the overall European markets in terms of turnover, will be covered by the transparency rules which apply to liquid shares. For the most important European markets in terms of turnover, this regime should also ensure that more than their current most traded indices⁹ are covered by those rules.

Article 21(6) requires competent authorities to ensure the maintenance and publication of a list of liquid shares for which they are the relevant competent authority. The list is considered as published when it is submitted for publication to the CESR in accordance with Article 33(5).

⁷ For the purposes of the implementing Regulation, a share will be considered to have a liquid market if it has a free float of at least €500 million, and one or (at the election of the Member State) both of the following conditions is fulfilled: average daily number of transactions not less than 500; average daily turnover not less than €2million.

⁸ Based on data published by CESR in January 2005 and our assumptions as to how Member States will exercise the option.

⁹ FTSE 100 in the UK, CAC 40 in France, DAX 40 in Germany, MIB 30 in Italy and IBEX 35 in Spain.

Article 33(5) allows CESR, in turn, to publish lists in a consolidated form of all shares admitted to trading on a regulated market, and all systematic internalisers.

4.4. Post-trade transparency

The implementing Regulation sets out the content of the post-trade information to be made available by firms and trading venues (Article 26). That information includes the identifier of the venue where the trade took place¹⁰. This disclosure, in the case of systematic internalisers, might be considered as potentially damaging if provided in real time¹¹. The Regulation recognises this possibility and allows systematic internalisers to disclose post trade data without disclosing their identity¹² (Article 26(2)). However, in order to take advantage of this option, internalisers will have to provide the markets with a quarterly summary of the volumes they have traded¹³ (Article 26(2)).

Article 28(2) of the implementing Regulation requires the information to be disclosed as close to real time as possible. To this end it fixes a maximum limit of three minutes. The information should only be published close to the three minute limit in exceptional cases when the technology available does not allow for a publication in a shorter period of time (Recital 15). There is a special rule for portfolio transactions, which must be made available as close to real time as possible, having regard to the need to allocate prices to particular shares (Article 28(3)).

To the extent that the MiFID relies on post-trade transparency to maximise the effectiveness of price formation mechanisms in the market, there is only very limited scope for any derogation from the principle that post-trade disclosure of transactions should be as close to real time as possible. The graduated application of pre-trade transparency requirements that is used to promote efficient market functioning is not appropriate for post-trade transparency,¹⁴ and consequently little or no differentiation on the basis of the trading matching system is acceptable.

The implementing Regulation (Article 27 and Table 4 of Annex II) sets out criteria, based on size, for applying the power contained in Articles 28, 30 and 45 of the Directive to defer post-trade publication of certain kinds of transaction. It recognises that firms that provide liquidity to their clients for large trades need to be able to dilute their positions in the market without producing a significant market impact. This is considered a necessary protection in order to facilitate an activity which contributes to the overall liquidity of the market.

¹⁰ For the purposes of the implementing Regulation, trading venues are defined as regulated markets, MTFs and systematic internalisers acting as such.

¹¹ It would imply that the systematic internaliser will be constantly communicating to the market changes in its net positions. For those systematic internalisers that might have important market share this would be potentially damaging and could discourage them from providing liquidity to the market. However, systematic internalisers that wish to disclose themselves as trading venues will be free to do so.

¹² All the other information relating to volume and prices is required to be disclosed, so there is no impact on the overall price formation process.

¹³ This is especially important for best execution purposes as well as for improving transparency and competition.

¹⁴ Differentiation is acceptable when it serves competition and market efficiency which, apart from very limited exceptions, is not the case for differentiation as regards post-trade transparency.

The regime for deferred publication of block trades has a ‘ladder’ of increasing delays according to the liquidity class of the share in question¹⁵. For each liquidity class the permitted delay varies in accordance with the absolute size of the trade and, in some cases, the percentage of the average daily turnover for the share represented by the trade size. The greater the size the longer the delay (up to the end of the second trading day next after the trade).

4.5. Publication

The transparency regime of the MiFID would not achieve its objectives in terms of price formation, investor protection and avoidance of market fragmentation if it were not supported by a tailored publication regime that enables market participants and investors¹⁶ to make the best use of the information that will be disclosed.

To this end Article 21 of the implementing Regulation establishes a set of principles which aim to ensure the reliability and availability of information. It also introduces an obligation on firms to facilitate the consolidation of data. The implementing Regulation recognises that it is not the task of public authorities to consolidate pre- or post-trade information, and that this role should be left to the initiative of the markets themselves. That is consistent with the level 1 Directive: however, it is also clear that the consolidation of information in a fragmented market structure is desirable in view of the general objectives of the level 1 Directive. The implementing Regulation seeks to facilitate the development of market-led solutions which will achieve that consolidation.

5. ADMISSION TO TRADING

In relation to the admission to trading of financial instruments, in particular, the implementing Regulation adopts a principles-based approach. Principles-based regulation entails a responsibility on regulated entities to consider whether they are complying with their high level obligations, and to design and adopt compliance measures that are best suited to their particular nature and circumstances.

Articles 35 to 37 of the implementing Regulation specify the conditions that financial instruments must meet before being admitted to trading on regulated markets in accordance with Article 40(1) of the Directive¹⁷. The conditions established in the Directive are of a general nature and focus on the requirement that a financial instrument, in order to be admitted to trading on a regulated market, must be freely negotiable and capable of being traded in a fair, orderly and efficient manner. It is important to note that these requirements do not overlap with requirements relating to securities traded on regulated markets which are imposed by the Prospectus¹⁸ or Transparency¹⁹ Directives, and neither do they interfere with

¹⁵ The implementing Regulation establishes 4 classes of shares in terms of average daily turnover: 1) those with an average daily turnover (‘ADT’) of less than €100,000; € 2) ADT between €100,000 and €1M; 3) ADT between €1M and €50M; and 4) ADT more than €50M.

¹⁶ This is also relevant in the context of best execution and the analysis of the conditions offered by the different trading venues.

¹⁷ Essentially, an instrument in order to be admitted to trading has to be capable of being traded in a fair and orderly manner and be freely negotiable.

¹⁸ Directive 2003/71/EC

¹⁹ Directive 2004/109/EC

the provisions of the Consolidated Admissions Requirements Directive²⁰, which regulates the official listing of securities. An officially listed transferable security shall be deemed to be freely negotiable and capable of being traded in a fair, orderly and efficient manner (Article 35(5)).

The implementing Regulation continues the high-level principles-based approach to the regulation of regulated markets which is adopted in the Directive. When establishing the admission rules for the concrete types of financial instruments, the implementing Regulation relies on the assessment that will be made by the regulated market, an assessment which to a large extent should be made on the basis of commercial discretion, while of course respecting the obligations set out in the level 1 Directive and its implementing Regulation.

In particular, the implementing Regulation establishes general provisions with respect to all transferable securities (Article 35(1) to (3)), together with specific provisions for the following kinds of financial instruments: a) shares (Article 35(4)); b) derivative securities (Article 35(6)); c) units in UCITS (Article 36); and d) derivatives (Article 37). It does not deal with bonds and money market instruments. They remain subject to the general conditions set out in the Directive.

6. DEFINITIONS FOR THE PURPOSES OF THE DIRECTIVE

6.1. Commodity derivatives

In line with Recital 4 of the level 1 Directive, those physically settled commodity derivatives not traded on regulated markets or MTFs should only be included in the list of financial instruments if they are constituted and traded in a manner that gives rise to regulatory issues comparable to those raised in connection with traditional financial instruments. Only those types of derivatives that raise specific concerns with respect to market stability or to investor protection should therefore be subject to the implementing Regulation.

According to Section C(7) of Annex I of the level 1 Directive, contracts that can be physically settled, are not for commercial purposes, and have the characteristics of other derivative financial instruments should be treated as financial instruments for the purposes of the Directive. To determine whether contracts have the characteristics of other derivative instruments, one should have regard, among other things, to whether they are cleared and settled through recognised clearing houses or are subject to regular margin calls. There is a clear suggestion in Recital 4 of the level 1 Directive as well as the last part of Section C(7) that the existence of commercial purposes are to be inferred from the way particular contracts are constituted and traded, that is, by looking at objective determinative factors rather than subjective motivations of the contracting parties.

In other words, when determining whether a contract for a physically-settled derivative meets the two criteria (not being for commercial purposes and having the characteristics of other financial instruments), regard should be had to the institutional context in which the terms of the contract are to be performed. This can be ascertained by looking at whether such contracts are traded in a manner similar to that of other more organised venues such as regulated markets and MTFs – the ‘market test’.

²⁰ Directive 2001/34/EC. Regulated markets are free to maintain official listing segments at their discretion, as long as they comply with the obligations established in the Consolidated Admissions Requirement Directive .

The implementing Regulation therefore defines the conditions under which the market test is fulfilled (Article 38(1)). It consists of four sub-tests which operate cumulatively so that, if all are met by a contract, it should be treated as a financial instrument under Section C(7). First, the contract should not be a spot contract, as it is not intended that the Directive should regulate trading in the underlying commodity. Article 38(2) of the Regulation defines ‘spot contract’. This definition is necessary to determine the scope of the Regulation, and to ensure that the Directive only applies to non-spot contracts.²¹ Secondly, the contract should be analogous to the contracts traded on regulated markets or MTFs. Thirdly, there should be arrangements either for clearing or for the provision of margins for the contracts in question. Finally, important elements of the contract should be standardised. Similar criteria apply to contracts under Section C(10), or so-called ‘exotic derivatives’.

Additionally, Recital 18 clarifies that whatever the result of the market test may be in determining what contracts are considered to be financial instruments, commercial producers or consumers are not the focus of regulation under the Directive²².

In respect of electricity markets, Article 38(4) of the implementing Regulation takes into account the peculiarities of energy trading with their ‘grid’ systems run by system operators or administrators. For this purpose it recognises that contracts concluded that are necessary for keeping in balance the supply and use of energy in a given time with or by an operator of an energy transmission grid, energy balancing mechanism or pipeline network are not to be considered as financial instruments. All other trading organised under that umbrella will be subject to the Directive if that is the effect of the market test.

Finally, it should be stated that a derivative contract relating to emissions allowances that is settled by amendment of the parties’ positions on the applicable register of emissions allowances should be capable of falling within Section C(10) of Annex I to Directive 2004/39/EC if it meets the relevant conditions set out in this Regulation.

²¹ The definition is based on a thorough analysis of the different market and consists in setting the spot time-limit by reference to the general market conditions but establishing a minimum threshold of two days.

²² The exemptions referred to in this Recital, although not exclusive for commodity business, needed to be clarified in this context because of the particular nature of these markets.

Annex

Record-keeping and reporting of transactions – data elements

A ‘Y’ indicates that the data element for reporting of transactions to competent authorities is contained in the relevant report or record.

Data element for reporting of transactions to competent authorities (Article 12) ²³	Record-keeping of orders received or decisions to deal taken (Article 6)	Record-keeping of orders executed or transmitted for execution (Article 7)	Post-trade transparency (Article 26)	Reporting of transactions to clients (Article 40 Implementing Directive)
	Name or other designation of the client	Name or other designation of the client		Name or other designation of the client
1. Reporting Firm Identification				Y
2. Trading Day		Y	Y	Y
3. Trading Time		Y	Y	Y
4. Buy/Sell Indicator		Y		Y
6. Instrument Identification	Y	Y	Y	Y
16. Unit Price	Y	Y	Y	Y
18. Quantity	Y	Y	Y	Y
19. Quantity Notation	Y	Y	Y	Y
20. Counterparty Identification		Y		
21. Venue Identification		Y	Y	Y
	Nature of the order	The terms of the order transmitted		
	Date and exact time of the receipt of the order or the decision to deal	Date and exact time of transmission of order		

²³ (not including any details required to be included in Transaction Reports by Member States under Articles 12(3) and (4))

Data element for reporting of transactions to competent authorities (Article 12) ²³	Record-keeping of orders received or decisions to deal taken (Article 6)	Record-keeping of orders executed or transmitted for execution (Article 7)	Post-trade transparency (Article 26)	Reporting of transactions to clients (Article 40 Implementing Directive)
		The total consideration		The total consideration
	Name or other designation of any relevant person acting on behalf of the client			
	Any other details, conditions and particular instructions from the client that specify how the order must be carried out			
		The name or other designation of the person to whom the order was transmitted		
		Natural person if any who executed the transaction or is responsible for execution		
			Indication that the exchange of shares is determined by factors other than the current market valuation of the share, where applicable	
			Indication that the trade was a negotiated trade, where applicable	
				Commissions and expenses charged
				Client's responsibilities in relation to settlement
				Indication that

Data element for reporting of transactions to competent authorities (Article 12) ²³	Record-keeping of orders received or decisions to deal taken (Article 6)	Record-keeping of orders executed or transmitted for execution (Article 7)	Post-trade transparency (Article 26)	Reporting of transactions to clients (Article 40 Implementing Directive)
				counterparty was the investment firm or member of the firm's group unless the order was executed through a trading system
5. Trading Capacity				
7. Instrument Security Code Type				
8. Underlying Instrument Identification				
9. Underlying Instrument Identification Code type				
10. Instrument Type				
11. Maturity Date				
12. Derivative Type				
13. Put/Call				
14. Strike Price				
15. Price Multiplier				
17. Price notation				
22. Transaction Reference Number				
23. Cancellation Flag				