

**International Swaps and Derivatives Association  
International Capital Market Association  
Asociación de Mercados Financieros  
Association of Private Client Investment Managers and Stockbrokers/EASD  
Bankers and Securities Dealers Association of Iceland  
Bond Market Association  
Danish Securities Dealers Association  
Finnish Association of Securities Dealers  
Futures and Options Association  
London Investment Banking Association  
Norwegian Securities Dealers Association  
Swedish Securities Dealers Association**

## **CESR public consultation on its draft work programme for MIFID Level 3 work.**

Thank you for the opportunity to respond to this important consultation paper. It is of great importance to ensure that MIFID enters into force smoothly and thus achieves its objectives to develop the regulatory foundation for a pan European Single Market. We would be delighted to discuss any aspects of our response, or other relevant issues, with you if that would be helpful.

### **GENERAL COMMENTS**

Our overall impression of CESR's proposed MIFID Level 3 work programme is that it seems more extensive and ambitious than necessary. Given the limited resources of CESR, competent authorities and market participants and the limited time to implement MIFID it is vital that the scope of the work is narrowed down. The focus should be on work that will: enable MIFID to be implemented on time; remove and prevent Single Market barriers; and reduce super-equivalence. Second, the resulting items should be spread out as evenly as possible given externally imposed deadlines (at present too little work is proposed this year and too much in 2007).

We also believe that it is most important that, where CESR Level 3 work is necessary for MIFID implementation by November 2007, CESR should undertake it now, and complete it before the end of January 2007. Otherwise, investment firms will not be able to complete their own preparations in time, in view of the necessary changes to their procedures and systems; and there will also be a risk that individual Member States will prescribe different approaches at national level, when a common approach would be both more cost-effective for investment firms and contribute more towards capital market integration.

The Level 3 work includes many items where it is not clear what issue or issues would set out to tackle – in these respects, the plan is not set out in a way that an external audience can easily understand. Without greater clarity about which issues

the Level 3 work would address it is not possible to assess whether any specific Level 3 work is needed and if so with what priority. Any Level 3 work would however need to satisfy the three-part test set out in CESR's report to the Financial Services Committee "2006 Report on Supervisory Convergence in the field of Securities Markets" as 'rigorous criteria' to prioritise its work:

'A) Risk – the issue identified as a possible priority for supervisory convergence has to represent:

(a) a significant market failure; or

(b) a repeated or major regulatory/supervisory failure.

B) EU Dimension – the issue identified is likely to have an EU-wide impact on market participants or end users (whether retail or wholesale), and on the smooth functioning of the single market.

C) Role of CESR - the issue identified as a possible priority for supervisory convergence is something about which CESR can positively do something, for example by providing input and influencing, thus creating change, or by the collective direct action of CESR members.'

In addition any CESR Level 3 work should focus on deterring restrictive divergent implementation by Member States. Subject to any externally imposed work, CESR should be rigorous in prioritising only those pieces of work which meet this test, with a particular focus on:

- i. work that has to be done to enable MIFID provisions to be implemented (Category 2 on top of page 5), taking into account the need for investment firms to be aware by the transposition date of all the requirements they need to comply with to implement MIFID, whether stemming from any CESR Level 3 initiative or specific national requirements, so that they have the full nine months from 1<sup>st</sup> February 2007 until 31<sup>st</sup> October 2007 in which to put them into effect;
- ii. tackling any interpretation or implementation of MIFID that poses a barrier to the effective operation of the single market under MIFID provisions; and
- iii. monitoring and controlling super-equivalent transposition, interpretation, or implementation.

In the press release of 18<sup>th</sup> July that accompanied the Consultation Paper CESR mentioned the formation of a MIFID Consultative Working Group drawing together technical experts from the markets and types of firms affected to provide advice on the technical practicalities of the guidance developed under the work programme. We welcome this initiative and would urge CESR to ensure that the Consultative Working Group is fully representative of markets, regions and those institutions most affected by the work programme - including institutions who conduct a large amount of their securities business cross-border in the EU and who are therefore particularly sensitive to and thus able to advise on, potential inconsistencies in implementation by different Member States which could impede the smooth implementation and application of MIFID.

## CLASSIFICATION OF INDIVIDUAL WORK ITEMS

The workstreams and categories set out in the "Background" section on pages 1 to 4 do not correspond to the workstreams and categories in the "Work programme" on pages 5 to 9. As an example, issues listed under stream/category 1 on page 1, such as calculations on liquid shares and transaction reporting, are listed in Workstream III and as category 2 or 3 on page 9. CESR should use a consistent classification system.

For the purposes of this response, we refer to the workstreams and categories in the Work programme section.

Category 1. Since only some of the relevant MIFID provisions require the Commission to consult CESR before reporting, it is not accurate to describe those which do not as 'non-discretionary work'. As CESR states in the "Background" section, 'CESR will only work on "Level 3 by cascade" issues if there is an express and specific request from the Commission'. Such work of course relates to Lamfalussy Levels 1 and 2, and is not strictly speaking Level 3 work.

Category 2. To the extent that what CESR proposes is necessary for the entry into force of the Directive, Category 2 work is not 'discretionary', since CESR or CESR Members must do it if MIFID is to be introduced smoothly. It is important to stress that investment firms need to know all prerequisites and requirements that might have an impact, in particular on IT systems, as early as possible and no later than 1st February 2007. Not only will MIFID implementation require a great deal of systems developments and amendments, but the issue of how competent authorities may choose to arrange their exchange of information (for example as regards transaction reports) might also have an impact to the extent that any consequential changes to information standards and formats would be passed on to the investment firms which have the reporting obligations. Any CESR Level 3 work on harmonising standards needs to take account of the constraints of the timetable and the need to avoid subjecting firms to two different sets of extensive system changes in close succession, one to implement the Directive, and a second to harmonise standards.

To take the transaction reporting example, - an important priority for investment firms - CESR's Q4 2007 timetable would not enable firms to build any harmonised standards that CESR might agree into their MIFID implementation plans. Any work by CESR on a Q4 2007 timescale, if it were to avoid mandating successive major system changes for firms across the EEA, would need to take account of the fact that by then EEA regulators would already have developed their own bespoke mechanisms, to conform with which firms would already have completed extensive system builds or system changes. Firms would need to know by 1<sup>st</sup> February 2007 whether they would continue to use existing proprietary standards to report transactions, in which case any system for exchange of information between competent authorities would have to make use of conversion engines that translated information reported under various standards, or whether they would need to adjust to new information standards imposed by competent authorities.

Category 3. Without more detail on what CESR proposes, it is difficult in many instances to assess the priority or timing proposed. CESR should give priority to removing any barriers to the alignment of regulatory practices that may emerge as a result of Member States' transposition of MIFID or competent authorities' application of it. It will be particularly important to avoid introducing restrictive or prescriptive interpretations that have been rejected by the EEA authorities, and not to seek to impose changes to what is expected of firms, whether through any CESR standards or otherwise, especially during the implementation period between February and November 2007. CESR's work at Level 3 should instead focus on aligning the supervisory approaches of regulators themselves. CESR should take into account the role that market participants have to play, both as interlocutors in consultation on any

specific proposals that CESR may consider necessary, and in the development of industry guidelines.

#### COMMENTS ON DETAILED WORK PROGRAMME (PAGES 5-9)

We observe that the workload is quite unevenly distributed over the rest of this year and the years to come. Only two work items are scheduled for the rest of this year whereas 16 items are scheduled for 2007. The schedule does not always reflect the priorities outlined by the categories explained in the background section.

CESR should ensure that the priority of its work items corresponds to their relative urgency. It would be unacceptable for CESR to schedule priorities of its Level 3 work in a way that would not enable investment firms to implement requirements in a cost-effective and well organised way.

#### I – Work in Connection with upcoming Commission’s reports

**Capital requirements for commodity firms/appropriateness of Article 2(1)(k) exemption.** The timing looks sensible in relation to the Commission’s April 2008 deadline.

**Appropriateness of rules concerning the appointment of tied agents.** The timing looks sensible in relation to the Commission’s April 2008 deadline.

**Appropriateness of the exemption of Article 2(1)(i) of Level 1.** The timing looks sensible in relation to the Commission’s April 2008 deadline.

**Availability, comparability, and consolidation of information on quality of execution of various venues.** The timing looks sensible in relation to the November 2007 implementation date and the Commission’s November 2008 deadline. It is particularly important for the industry to participate in the preparatory work.

**Reexamine provisions relating to criteria for determining which instruments are to be treated as having the characteristics of other derivative financial instruments.** There seems to be a misalignment between the Q3 2009 timing and the Article 40.2 of Level 2 Regulation deadline for the Commission’s report by October 2007.

**Review of the provision on recording of telephone conversations or electronic communications.** The timing looks sensible in relation to the Commission’s December 2009 deadline.

**Review of the application of Article 4 of the implementing Directive.** The timing looks sensible in the light of the Commission’s December 2009 deadline. However, CESR should be alert to any problems that arise in the application of Article 4 in the interim, in particular in the period between now and the transposition date, proactively investigating and addressing those which come to light.

**State of the removal of the obstacles which may prevent the consolidation at the European level of the information that trading venues are required to publish.**

The timing looks sensible in relation to the November 2007 implementation date, despite its closeness to the Commission's April 2008 deadline.

**Possible extension of the pre- and post-trade transparency obligations to transactions in classes of financial instruments other than shares.** We recognise that the timetable is constrained by the Commission's October 2007 deadline and that the outcome of the Commission's current call for evidence on this issue is expected to be a mandate to CESR which will provide the focus for CESR's work. Independent research by CEPR and CEPS on EU bond markets as well as the UK FSA's Feedback Statement 06/4 on DP05/5 ("Trading Transparency in the UK Secondary Bond Market) point strongly towards a conclusion that there is no market failure in non-equity markets justifying the introduction of mandatory price transparency and that there is therefore no need to extend the existing MIFID transparency obligations to these markets via regulation. These findings are also consistent with CESR's own findings following its February 2006 "Wholesale Day". We fully concur with the concluding remarks in CESR's report on the Wholesale Day that "wholesale markets seem to be functioning properly" and that CESR's role should be limited to continued monitoring.

**Application of Article 27 of Level 1 Directive.** Given the November 2007 implementation date and the Commission's October 2008 deadline, Q3 2008 might be a more appropriate timing for any work by CESR on this issue.

**Appropriateness of the definition of transaction, the tables included in Annex II of the Regulation and the criteria for determination of liquid shares contained in Article 22 of the draft Level 2 Regulation.** The timing looks sensible in relation to the Commission's October 2009 deadline.

**Reexamine Table 4 of Annex II of the Regulation.** Article 40.3 of the Level 2 Regulation requires the Commission to report not later than October 2009 on the re-examination of Table 4 of Annex II. Given the importance to market participants of trade reporting thresholds and delays, we welcome CESR's proposal to schedule work on this issue within a year of the implementation of MIFID. CESR and the Commission should also be alert from the outset (November 2007) to the possibility that the re-examination might need to be brought forward. CESR's timetable should therefore allow for the possibility of an earlier review if necessary.

## II – Work in connection with other Level 3 Committees (3L3)

**Outsourcing.** The timing is sensible as a means of assisting consistent implementation of outsourcing requirements under CRD and MIFID. This issue has particular priority because of the 1<sup>st</sup> January implementation date for CRD.

**Internal governance.** The timing is sensible as a means of assisting consistent implementation of interactions between CRD and MIFID. This issue has particular priority because of the 1<sup>st</sup> January implementation date for CRD.

**Substitute products – aspects around commercialisation and distribution.** It is not clear what Level 3 work CESR envisages in this area. Without further clarification it is not possible to determine whether the issue requires specific Level 3 work, and if so

with what priority, although any Level 3 work should focus on deterring restrictive diverging implementation regulation by Member States.

### III – Other areas of work

**Aspects related to the functioning of the passport.** It is important to reach agreement on issues relating to the functioning of the passport as soon as possible, to enable firms to plan ahead with full knowledge about passporting rights and associated regulatory obligations, and to plan in advance how competent authorities will manage the practical consequences of mismatches between ISD and MIFID requirements that may occur as a result of any late implementation in certain Member States. CESR should therefore start work on this aspect now, and not wait for Q1 2007. It is important for CESR to be aware of the considerable practical problems that would arise as a result of interpreting Article 32.7 of Level 1 Directive to apply home country rules to branches' cross-border business. As Recital 32 of Level 1 Directive points out, the branch country competent authority is best placed to regulate all of the services that the branch provides, regardless of the location of the client.

**Best execution.** The timing of item 1 for development of convergent views regarding application of best execution requirements to non-equity markets looks sensible as a means of assisting coordinated implementation where this is necessary. The issue of a clarification of firms not executing client orders (item 5) may be more urgent than the suggested timing. However, it is not apparent in many instances (items 2, 3, 4, 6) what CESR plans to propose. Without further clarification it is not possible to determine whether the issue requires specific Level 3 work, except to deter restrictive implementation.

**Record keeping.** If the work that CESR envisages is reducing discrepancies in the minimum list of records under Article 51.3 of Level 2 Directive, it would be most usefully done before the minimum lists are fixed as part of Member States' 31<sup>st</sup> January transposition. It will be important not to disrupt firms' implementation of the new record-keeping requirements during the February to November 2007 implementation period.

#### **Work items where it is unclear what CESR envisages**

It is not clear what Level 3 work CESR envisages in the following areas. Without further clarification it is not possible to determine whether the work item requires specific Level 3 work, and if so with what priority, although any Level 3 work should focus on deterring restrictive diverging implementation by Member States

**Execution only;**

**Inducements;**

**Internal system, resources and procedures;**

**List of financial instruments;**

**Marketing Communications;**

**Appropriateness;**

**Compliance;**

**Information to clients;**

**Reporting obligations;**

**Contingent liability transactions for retail clients;**

**Conflicts of interest;  
Investment research;  
Clarification of the nature of repo and stock lending.**

**Publication and consolidation of market transparency information.** CESR should take into account our comments in response to earlier phases of its work on these topics, in particular the need to focus on the removal of barriers to consolidation of information (cf the separate piece of work on this in section I, which is scheduled for Q2 2008), the need not to distract attention from the primary need to implement MIFID's market transparency requirements during the January to November 2007 implementation period (which coincides with CESR's proposed timing), and the need avoid impeding the market's ability to devise appropriate and cost-effective solutions.

**Common procedures and formats for calculation and publication of data.** The timing looks sensible as a means of assisting consistent implementation. It is essential that data on block sizes and liquid shares are available well in advance of the October 2007 implementation date.

**Required calculations and estimates concerning liquid shares and delayed publication.** It is essential that these data are available well in advance of the October 2007 implementation date.

**Reporting of serious breaches.** We presume that CESR envisages a consistent definition of serious breaches for the purpose of exchange of information about market abuse. Medium-low priority and post-Q3 2008 timing appear appropriate.

**Transaction reporting.** We do not think that items 1 and 2 are issues which require Level 3 work (or indeed that item 2 is a matter for regulation at all). Items 3, 4, and 5 are very important matters for the smooth operation of transaction reporting and the ability of international groups to design reporting systems that they can use across the EU. CESR should work on them in full consultation with the market participants. As described in our comments on Category 2 above, the suggested timing Q2 to Q4 2007 of these items does not accord with the need for firms to be able to design systems without interruption and with full knowledge of technical requirements between February and October 2007, and to avoid the necessity for extensive successive system changes.

**Instrument reference data.** CESR should take into account that the Article 11 of Level 2 Regulation lists are required to be in place by the beginning of June 2007.

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