

October 2004

Implementing Measures under the Directive on Markets in Financial Instruments

Regulations vs Directives

The Directive on Markets in Financial Instruments (MFID) envisages that the Commission will adopt a large number of implementing measures. The Commission will have to consider whether to propose those implementing measures to the European Securities Committee in the form of regulations or directives. The purpose of this note is to set out indicative factors that the Commission should take into account when considering this issue, with a view to contributing to the Commission's analysis.

In general, there is a tendency to favour the use of regulations over directives for the following main reasons, indicated in the Lamfalussy report:

- Regulations ensure a higher degree of uniformity because they are directly applicable and their interpretation is directly a matter of Community law. Directives leave more latitude for Member States to implement Community Law; they often lead to uneven transposition and more readily result in different interpretations. However, in the absence of court decisions, Member States may, in practice, still apply different interpretations of regulations or apply those regulations in different ways (particularly, where the regulation only sets high level standards). Also, regulations may not, in any event, always fully harmonise national rules, leaving Member States free to adopt more stringent requirements. In addition, MFID mitigates some of the potential adverse consequences of differing national approaches by providing for mutual recognition of home country standards, at least as regards cross-border business.
- Regulations can speed up the implementation process because they are directly applicable in the Member States. Member States do not have to pass laws transposing the requirements of regulations. However, in many cases Member States will still have to adopt provisions specifying the measures or sanctions to be applied in the case of non-compliance (in accordance with article 51 MFID). Also, Member States will often still have to adapt other provisions of national law to take account of the requirements of the regulation (e.g. where there are overlapping or interrelated provisions of national law), so that a regulation should still allow Member States time to adapt their legal framework to the new legal situation. In addition, a regulation may sometimes only define (or specify more detail for) one aspect of a MFID provision which Member States are still otherwise required to implement through national legislation.

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In some cases, it will be possible, in advance, to determine whether or not a regulation is, in fact, an appropriate implementing tool by reference to the nature of the MFID provision in question. In other cases, it will also be necessary to consider the proposed content of the implementing measure in question; the nature of the proposed content will be influential as to whether or not a regulation is an appropriate implementing tool.

Implementation by regulation is indicated in the following cases:

- (i) The implementing measure will create a self-contained code setting out requirements directly applicable to investment firms (or other market participants). All that is to be required of Member States is to adopt national measures which provide for relevant measures or sanctions to be applied in cases of contravention.
- (ii) The implementing measure will fully harmonise national rules in a particular area (including the requirements for civil liability), rather than merely setting minimum standards, so that Member States will be prevented from adding super-equivalent requirements (or setting their own standards as to whether or not there should be civil liability for breach of the rules).
- (iii) The implementing measure will provide a self-executing exception to a national rule adopted to implement a relevant provision of MFID.
- (iv) The implementing measure will prescribe a quantitative or other standard (or a definition) which can be referred to in national legislation implementing the relevant provision of MFID.
- (v) Adoption of the implementing measure as a regulation will ensure that the relevant provision of MFID takes effect at the same time in all Member States.

Implementation by directive is indicated in the following cases:

- (a) The implementing measure will only define (or specify more detail for) one aspect of a MFID provision which Member States are still otherwise required to implement through national legislation. Many of the provisions under which the Commission adopts implementing measures only contemplate that the implementing measures will specify particular aspects of an overall provision that Member States are required to implement as a whole. Where this is the case, it is also unlikely that use of a regulation will ensure that the relevant provision of MFID takes effect at the same time in all Member States or speed up the implementation process.
- (b) Member States will be free to impose super-equivalent requirements on top of those set out in the implementing measure. In some cases, this is clear from MFID text itself or could be indicated by the text of the implementing measure.

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- (c) The implementing measure will set general standards or principles which inevitably require detailed application in Member States, will allow Member States to modulate or adjust their implementation to take account of particular circumstances or will only provide a non-exhaustive list of examples of how a particular provision operates (or factors bearing on that operation), which Member States are to be free to particularise or add to in the course of their implementation.
- (d) It will be important that the rules implementing the relevant MFID provision integrate, in a coherent way, with other provisions of national law.
- (e) Member States wish to be able set their own appropriate rules regulating the civil liability of market participants that contravene the binding rules implementing the relevant MFID provisions.
- (f) There are particular concerns about the time allowed for national implementation. Unless there are transitional provisions, the potential civil liability consequences of non-compliance with a regulation creates an inflexible deadline for implementation, even in the absence of a national measures specifying penalties for contraventions. Forcing implementation to take place according to the deadline in MFID may be counterproductive if, in fact, national regulators or firms are not likely to be ready for implementation on time.

However, the form of the implementing measure does not necessarily depend on:

- whether or not it is intended fully to harmonise national rules in the area covered (as opposed to setting minimum standards): both regulations and directives can provide for full harmonisation of national rules or set minimum standards and the use of a regulation does not in itself necessarily suggest full harmonisation. There is a particular issue, in any event, because the text of MFID does not explicitly indicate whether or not its provisions, or the implementing measures taken under them, will or will not fully harmonise national rules in the areas covered by the directive and, in many cases, it will be unclear whether or not the effect of a particular implementing measure, in fact, fully harmonises national rules in this sense.
- the degree of detail to be contained in the measure: directives can look like regulations in their degree of prescription and regulations can look like directives when they set high level rules (particularly if those high level rules only provide minimum harmonisation). However, where an implementing regulation is to create a self-contained code, the implementing measure may need to include additional detail which in an implementing directive could be left to national discretion.
- whether there are to be transitional provisions: both directives and regulations can incorporate transitional provisions (or similar measures, such as provisions contemplating progressive implementation of additional, more detailed requirements after a lapse of time).

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The following table examines the various mandates against the list of factors set out above. However, it does not seek to weight, or give priority to, any factor or factors and the number of factors identified is not necessarily indicative that a particular result should obtain. In many cases, the factors listed indicate that the implementing measure might have different results depending on its contents and intended effect and reflect the uncertainty as to whether particular implementing measures are capable of fully harmonising national rules. The aim is to encourage discussion and debate about the right approach to take in particular cases.

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| Article | Subject | May/ Shall | Mandate | Factors indicating regulation | Factors indicating directive | Comments |
|---------|--|------------|-----------------|-------------------------------|------------------------------|---|
| 4.1.2 | Derivatives definition | Shall | 2 nd | (iv) | (a), (b) | The main function of the definition is to fix minimum scope of national authorisation requirements (however, it has a subsidiary role in fixing scope of article 2(1)(i) and (k)) |
| 4.1.4 | Investment advice | May | 2 nd | (iv) | (a), (b) | The main function of the definition is to fix minimum scope of national authorisation requirements (however, it has a subsidiary role in fixing scope of article 2(1)(j) and 3 and the boundary between article 19(4) and article 19(5)/(6)). |
| 4.1.7 | Definition of systematic internaliser | May | 2 nd | (ii), (iv) | (a), (b), (f) | Sets scope of article 27. However, the Commission is only permitted to define aspects of the article 27 regime and unclear whether Member States could impose more stringent requirements on their domestic firms. |
| 13.2 | Compliance policies (general compliance, personal account dealing) | Shall | 1 st | (i), (ii), (vi) | (b), (c), (d) | |
| 13.3 | Conflicts of interest | Shall | 1 st | (i), (ii), (vi) | (b), (c), (e) | Principles based approach may be more suited to a directive. |
| 13.4 | Business continuity | Shall | 1 st | (i), (ii), (vi) | (b), (c), (d) | Bank regulators may impose overlapping prudential requirements. |
| 13.5/1 | Operational risk/ outsourcing | Shall | 1 st | (i), (ii), (vi) | (b), (c), (d) | Bank regulators may impose overlapping prudential requirements. |

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| 13.5/2 | Internal controls/ processes | Shall | 1 st | (i) | (b), (c) | |
| 13.6 | Record keeping | Shall | 1 st | (iv) | (b), (c) | Cannot create a self contained code since relates to provisions some of which not implemented by regulation. |
| 13.7 | Client assets | Shall | 1 st | | (b), (c), (d), (f) | Link to national insolvency law likely to be important. |
| 13.8 | Client money | Shall | 1 st | | (b), (c), (d), (f) | See article 13.7. |
| 18.3 | Conflicts - steps to identify, etc and criteria | Shall | 1 st | (i), (ii), (iv), (v) | (b), (c), (e), (f) | Appears that implementing measures could spell out the whole content of article 18. |
| 19.1 | COB: general principles | Shall | 2 nd | (i), (ii), (v) | (b), (c), (e), (f) | |
| 19.2 | COB: marketing communications | Shall | 1 st | (i), (ii), (v) | (b), (c), (e), (f) | |
| 19.3 | COB: info for clients | Shall | 1 st | (i), (ii), (v) | (b), (c), (e), (f) | |
| 19.4 | COB: suitable advice | Shall | 2 nd | (i), (ii), (v) | (b), (c), (e), (f) | |
| 19.5 | COB: appropriateness | Shall | 2 nd | (i), (ii), (v) | (b), (c), (e), (f) | |
| 19.6 | COB: execution only | Shall | 2 nd | (i), (ii), (v) | (c), (e), (f) | Member States must permit firms to provide services in this way, so the implementing measures will fully harmonise the exception. |
| 19.7 | COB: client agreement | Shall | 1 st | (i), (ii), (v) | (b), (c), (e), (f) | |

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| 19.8 | COB: client reports | Shall | 1 st | (i), (ii), (v) | (b), (c), (e), (f) | |
| 21.6(a) | Best execution: criteria for execution | Shall | 1 st | | (a), (b), (c), (e), (f) | Implementing measures limited to criteria for judging relative importance of factors. |
| 21.6(b) | Best execution: factors | Shall | 1 st | | (a), (b), (c), (e), (f) | Implementing measures limited to setting factors that may be taken into account. |
| 21.6(c) | Best execution: information to clients | Shall | 1 st | (ii), (iv) | (a), (b), (c), (f) | |
| 22.3(a) | Order handling: prompt/fair execution | Shall | 1 st | (i), (ii), (iv), (v) | (b), (c), (e), (f) | Appears that implementing measures could spell out the whole content of article 22.1. |
| 22.3(b) | Order handling: method of publication of limit orders | Shall | 2 nd | (ii), (iv) | (a) | |
| 24.5(a) | Counterparty regime: opt-down procedure | May | 2 nd | (ii), (iv) | (a) | Classification process will need to be integrated with process under Annex 2 |
| 24.5(b) | Counterparty regime: procedure for obtaining express consent | May | 2 nd | (ii), (iv) | (a) | Classification process will need to be integrated with process under Annex 2 |
| 24.5(c) | Counterparty regime: criteria for corporates | May | 2 nd | (ii), (iv) | (a), (b) | A uniform EU rule would help overcome issues arising from requirement to observe host state criteria (under article 24.3). However, seems that Member States could have less burdensome criteria for recognising corporates as counterparties. |

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| Article | Subject | May/ Shall | Mandate | Factors indicating regulation | Factors indicating directive | Comments |
|----------|---|------------|-----------------|-------------------------------|------------------------------|---|
| 25.7 | Transaction reports: methods and arrangements | May | 1 st | (i), (ii), (iv), (v), (v) | (b), (c), (e), (f) | Appears that implementing measures could spell out the whole content of article 25.3 to 23.5 as it applies to investment firms. |
| 25.7 | Transaction reports: form and content | May | 1 st | (i), (ii), (iv), (v), (v) | (b), (c), (e), (f) | Appears that implementing measures could spell out the whole content of article 25.3 to 23.5 as it applies to investment firms. |
| 25.7 | Transaction reports: relevant market criteria | May | 1 st | (ii), (iv) | (a) | |
| 27.7 (a) | Definition of liquid market | Shall | 2 nd | (ii), (iv) | (a) | Commission is only permitted to define aspects of the article 27 regime. |
| 27.7 (a) | Determinations related to standard market size | Shall | 2 nd | (ii), (iv) | (a) | |
| 27.7 (a) | Handling of multiple quotes | Shall | 2 nd | (ii), (iv) | (a), (c) | Implementing measures specify general criteria only. |
| 27.7 (b) | Method of publication of quotes | Shall | 2 nd | (ii), (iv) | (a) | |
| 27.7 (c) | Exemptions from firm quote rule | Shall | 2 nd | (iii), (iv) | (a), (b), (c) | Implementing measures specify general criteria only. |
| 27.7 (d) | Withdrawal of quotes in exceptional circumstances | Shall | 2 nd | (iii), (iv) | (a), (b), (c) | Implementing measures specify general criteria only. |
| 27.7 (e) | Retail size | Shall | 2 nd | (ii), (iv) | (a) | |

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| 27.7 (f) | Orders exceeding norm | Shall | - | (ii), (iv) | (a) | |
| 27.7 (g) | Public range for prices | Shall | - | (ii), (iv) | (a) | |
| 28.3(a) | Trade reporting: means | Shall | 1 st | (ii), (iv) | (a), (b), (c), (f) | Appears that Member States must impose primary obligation under article 28. |
| 28.3 (b) | Trade reporting: exceptional cases | Shall | 1 st | (iv) | (a), (b), (c), (f) | |
| 29.3 (a)/ 44.3 (a) | MTF/RM pre-trade: bids/offers published | Shall | 1 st | (iv) | (a), (b), (f) | Appears that Member States must impose primary obligation under article 29/44. |
| 29.3 (b)/ 44.3 (b) | MTF/RM pre-trade: exceptions for large trades | Shall | 1 st | (iv) | (a), (b), (f) | |
| 29.3 (c)/ 44.3 (c) | MTF/RM pre-trade: waiver for market models | Shall | 1 st | (iv) | (a), (b), (f) | |
| 30.3(a)/ 45.3 (a) | MTF/RM trade reporting: scope and content of information | Shall | 1 st | (iv) | (a), (b), (f) | Appears that Member States must impose primary obligation under article 30/45. |
| 30.3 (b)/ 45.3 (b) | MTF/RM trade reporting: conditions for deferred publication | Shall | 1 st | (iv) | (a), (b), (f) | |
| 40.6 (a) | Admission to trading: admission criteria | Shall | 1 st | | (a), (b), (c) | Implementing measure only specifies characteristics to be taken into account. |

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|----------|--|---------------|-----------------|----------------------------------|---------------------------------|----------|
| 40.6 (b) | Admission to trading: verification of issuer compliance | Shall | 1 st | (ii), (iv) | (a), (b), (c) | |
| 40.6 (c) | Admission to trading: facilitating access to information | Shall | 1 st | (iv) | (a), (b), (c) | |
| 44 | See article 29 above. | | | | | |
| 45 | See article 30 above. | | | | | |
| 56.5 | Co-operation: when market important | May | 1 st | (iv) | (a), (c) | |
| 58.4 | Exchange of information: procedures | May | 1 st | (i) | (b), (c) | |