

The Brief

September 2006

The Derivatives Group

French implementation of the MIFID

New Definition of Financial Instruments

The French government has circulated on the Paris Market last week for comments by markets participants and industry professional associations, the first draft of an ordinance (the "**Draft**", which is appended hereto) aiming at implementing part of the Directive no.2004/39/EC relating to markets in financial instruments ("**MIFID**").

As you are aware, the MIFID, which will, as of **November 1st, 2007**, replace the EU Directive no. 93/22/EC on investment services ("**ISD**"), contains a number of provisions aiming at widening the scope of EU financial regulation. Among other things, this will go through a new definition across the EU of "financial instruments", a concept placed in 1993 at the heart of the ISD, as one of the key criteria by which its provisions and related regulation were to apply. It is such definition that the Draft aims at implementing.

Current EU definition of financial instruments in the ISD reads as follows:

1. (a) Transferable securities.
(b) Units in collective investment undertakings.
2. Money-market instruments.
3. Financial-futures contracts, including equivalent cash-settled instruments.
4. Forward interest-rate agreements (FRAs).
5. Interest-rate, currency and equity swaps.
6. Options to acquire or dispose of any instruments¹ falling within this section of the Annex, including equivalent cash-settled instruments. This category includes in particular options on currency and on interest rates.

.../...

¹ Derivatives - underlined by us.



Gide Loyrette Nouel

Algiers
Tel. +213 (0)21 23 94 94
gln.algiers@glde.com

Beijing
Tel. +86 10 65 97 45 11
gln.beijing@glde.com

Belgrade
Tel.+381 (0)11 30 24 900
gln.belgrade@glde.com

Brussels
Tel. +32 2 231 11 40
gln.brussels@glde.com

Bucharest
Tel. +40 21 223 03 10
gln.bucharest@glde.com

Budapest
Tel. +36 1 411 74 00
gln.budapest@glde.com

Casablanca
Tel. +212 (0)22 27 46 28
gln.casablanca@glde.com

Hanoi
Tel. +84 4 825 19 58
gln.hanoi@glde.com

Hong Kong
Tel. +852 2536 9110
gln.hongkong@glde.com

Istanbul
Tel. +90 212 325 35 81
gln.istanbul@glde.com

Kyiv
Tel. +38 044 206 0980
gln.kyiv@glde.com

London
Tel. +44 (0)20 7826 9700
gln.london@glde.com

Moscow
Tel. +7 495 258 31 00
gln.moscow@glde.com

New York
Tel. +1 212 403 6700
gln.newyork@glde.com

Paris
Tel. +33 (0)1 40 75 60 00
Info@glde.com

Prague
Tel. +420 222 871 111
gln.prague@glde.com

Riyadh
Tel. +966 1 476 60 39
gln.riyadh@glde.com

Shanghai
Tel. +86 21 53 06 88 99
gln.shanghai@glde.com

Tunis
Tel. +216 71 891 993
gln.tunis@glde.com

Warsaw
Tel. +48 (0)22 344 00 00
gln.warsaw@glde.com

However, the implementation of ISD in France by law no. 96-622 of July 2nd, 1996 had been the occasion of a substantial reform of the financial derivatives markets regulation and the legislator, beyond a strict implementation, retained a broader definition of derivatives by defining "forward financial instruments", a component of the financial instruments family, as (as subsequently modified):-

1. Financial forward contracts on all bills, notes, securities, indexes or currencies, including equivalent instruments giving rise to a cash settlement;
2. Forward contracts on interest rates;
3. Swap contracts;
4. Financial forward contracts on commodities or greenhouse gas allowances, provided that they are either further to negotiation, cleared through a financial instruments clearing house or are the subject of periodic margin calls, or provided that they may be cash settled;
5. Purchase or sale option contracts on financial instruments; and
6. All other forward markets instruments.

Two main differences with the ISD definition are worth noting:-

- commodity derivatives, which are excluded from the ISD definition, but were caught by the investment services regulation in France, and
- the absence of any reference to a limited number of underlying in the French definition, the derivatives category being opened by the reference to "*all other forward market instruments*".

The **new EU definition** on financial instruments in the MIFID covers:-

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

.../...

² Same.

Given the currently broad and non restrictive definition of financial instruments in French law, the question was opened to change it or not during the implementation of the MIFID.

To avoid any discrepancy however, and in anticipation that this will not profoundly affect the market as it stands, the French government has chosen to implement a **mere translation** of the MIFID definition.

The main difference in the Draft definition consists in the inclusion of **two additional categories** of financial forward instruments, which underlying would be (i) bills of exchange, and (ii) commodities and emission allowances but in relation to forward financial instruments that do not fulfil any of the criteria already set out by the MIFID. However, such instruments, being out of the scope of the MIFID, would not give rise to the benefit of the European passport procedure (which allows for freedom of establishment and to provide services within EU Member States).

As to the investment services, the Draft implements in a fair and accurate manner the MIFID, enlarging the existing definition. This might result in an increase of the obligations governing the trading in forward financial instruments (for instance, as suggested in the current European Commission's Call for Evidence on pre- and post-trade transparency provisions in relation to transactions in classes of financial instruments other than shares, transparency obligations could in the future concern a class called "credit derivatives", encompassing bond options and futures, CDS, interest rate swaps and various other forms of credit derivatives).

French implementation process

Now EU Regulation no.1287/2006, a MIFID implementing measure, which notably details some characteristics of forward financial instruments, has been published on September 2nd, 2006, the publication of the definitive French texts should occur very soon, since the implementation of the MIFID under national law is scheduled for January 31st, 2007, and its enforcement, for November 1st, 2007.

We are at your disposal to receive any comments you would have in relation to the above.

**Draft Provisions of the French Monetary and Financial Code
relating to Financial Instruments,
as amended for the Implementation of the MIFID**

Unofficial English Translation - For Information Purposes Only

DRAFT NEW ARTICLE L.211-1

- I. Financial instruments include:-
1. Shares and other securities which give, or could give, direct or indirect access to the capital or voting rights, and which are transferable by book-entry or delivery;
 2. Debt instruments, which individually represents a claim against the issuing legal entity [*personne morale*] or securitisation fund [*fonds commun de créances*], and which are transferable by book-entry or delivery, with the exception of bills of exchange [*effets de commerce*] and cash vouchers [*bons de caisse*];
 3. Units or shares of collective investment undertakings;
 4. Forward financial instruments; and
 5. All financial instruments similar to those mentioned in the previous paragraphs, issued under foreign laws.
- II. Forward financial instruments are:-
1. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash; inter alia, they are traded on a regulated market or an MTF, are cleared and settled through recognised clearing houses or are subject to regular margin calls;
 2. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);
 3. Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF;
 4. Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled not otherwise mentioned in C.6 and not being for commercial purposes, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls;
 5. Derivative instruments for the transfer of credit risk;
 6. Financial contracts for differences;

.../...

7. Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event), under the conditions enumerated in articles 38 and 39 of [EC Regulation no. 1287/2006 dated August 10, 2006]; and
 8. Any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in paragraphs (1) to (6) above, which have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are cleared and settled through recognised clearing houses or are subject to regular margin calls, under the conditions set out in articles 38 and 39 of [EC Regulation no. 1287/2006 dated August 10, 2006].
- III. Forward financial instruments also include, however without entailing any right to benefit from the provisions of articles L.532-16 to L.532-27 [freedom of establishment and freedom to provide services provisions]:-
1. Forward financial contracts on bills of exchange [*effets de commerce*]
 2. Options, futures, swaps and any other derivative contracts relating to commodities or emission allowances which do not fulfil the conditions set out in articles 38 and 39 of [EC Regulation no. 1287/2006 dated August 10, 2006].
- IV. Financial instruments, other than forward financial instruments, may be issued only by the State, a legal entity, a unit trust, a property bond fund or a securitisation fund.

*

French Version - For Information Purposes Only**PROJET D'ARTICLE L.211-1 NOUVEAU**

- I. Les instruments financiers comprennent :
1. Les actions et autres titres donnant ou pouvant donner accès, directement ou indirectement, au capital ou aux droits de vote, transmissibles par inscription en compte ou tradition ;
 2. Les titres de créance qui représentent chacun un droit de créance sur la personne morale ou le fonds commun de créances qui les émet, transmissibles par inscription en compte ou tradition, à l'exclusion des effets de commerce et des bons de caisse ;
 3. Les parts ou actions d'organismes de placements collectifs ;
 4. Les instruments financiers à terme ;
 5. Et tous instruments financiers équivalents à ceux mentionnés aux précédents alinéas, émis sur le fondement de droits étrangers.
- II. Les instruments financiers à terme sont :
1. Les contrats d'option, contrats à terme fermes, contrats d'échange, accords de taux futurs et tous autres contrats à terme relatifs à des valeurs mobilières, des devises, des taux d'intérêt ou des rendements ou autres instruments à terme, indices financiers ou mesures financières qui peuvent être réglés par une livraison physique ou en espèces ;
 2. Les contrats d'option, contrats à terme fermes, contrats d'échange, accords de taux futurs et tous autres contrats à terme relatifs à des marchandises qui doivent être réglés en espèces ou peuvent être réglés en espèces à la demande d'une des parties (autrement qu'en cas de défaillance ou d'autre incident amenant la résiliation) ;
 3. Les contrats d'option, contrats à terme fermes, contrats d'échange et tous autres contrats à terme relatif à des marchandises qui peuvent être réglés par livraison physique, à condition qu'ils soient négociés sur un marché réglementé ou un système multilatéral de négociation ;
 4. Les contrats d'options, contrats à terme fermes, contrats d'échange et tous autres contrats à terme relatifs à des marchandises qui peuvent être réglés par livraison physique, non mentionnés par ailleurs au 3, et non destinés à des fins commerciales, qui présentent les caractéristiques d'autres instruments financiers à terme en tenant compte de ce que, notamment, ils sont compensés et réglés par l'intermédiaire d'organismes de compensation reconnus ou font l'objet d'appels de marge réguliers, dans les conditions prévues à l'article 38 du [CE 1287/2006 du 10 août 2006] ;
 5. Les instruments financiers à terme servant au transfert du risque de crédit ;
 6. Les contrats financiers pour différences ;
 7. Les contrats d'options, contrats à terme fermes, contrats d'échanges, accords de taux futurs et tous autres contrats à terme relatifs à des variables climatiques, à des tarifs de fret, à des autorisations d'émissions ou à des taux d'inflation ou d'autres statistiques économiques officielles qui doivent être réglés en espèces ou peuvent être réglés en espèces à la demande d'une des parties (autrement qu'en cas de défaillance ou d'autre incident amenant la résiliation), dans les conditions prévues aux articles 38 et 39 du [CE 1287/2006 du 10 août 2006] ;

.../...

8. Tout autre contrat à terme concernant des actifs, des droits, des obligations, des indices et des mesures non mentionné par ailleurs aux 1 à 6 ci-dessus, qui présente les caractéristiques d'autres instruments financiers à terme en tenant compte de ce que, notamment, il est négocié sur un marché réglementé ou un MTF, est compensé et réglé par l'intermédiaire d'une chambre de compensation reconnue ou fait l'objet d'appels de marge réguliers, dans les conditions prévues aux articles 38 et 39 du [CE 1287/2006 du 10 août 2006].

III. Sont également des instruments financiers à terme, sans toutefois ouvrir droit aux dispositions des articles L.532-16 à L. 532-27 :

1. Les contrats à terme ferme sur effets de commerce ;
2. Les contrats d'options, contrats à terme fermes, contrats d'échanges et tous autres contrats à terme sur marchandises ou autorisations d'émission ne remplissant pas les conditions prévues aux articles 38 et 39 du règlement [CE 1287/2006 du 10 août 2006].

IV. Les instruments financiers, autres que les instruments financiers à terme, ne peuvent être émis que par l'Etat, une personne morale, un fonds commun de placement ou un fonds commun de créances.

*

The present memorandum is a summary of certain legal reforms introduced or to be introduced in France. It is circulated for information purposes only and should not be used as the basis for any business or investment decision without specific legal assistance.

*

You can also consult this brief on our website, in the News/Publications section.

The Brief – The Derivatives Group (the "Newsletter") is a free, periodical electronic publication edited by the law firm Gide Loyrette Nouel (the "Law Firm"), and published for Gide Loyrette Nouel's clients and business associates. The Newsletter is strictly limited to personal use by its addressees and is intended to provide non-exhaustive, general legal information. The Newsletter is not intended to be and should not be construed as providing legal advice. The addressee is solely liable for any use of the information contained herein and the Law Firm shall not be held responsible for any damages, direct, indirect or otherwise, arising from the use of the information by the addressee.

In accordance with the French Data Protection Act, you may request access to, rectification of, or deletion of your personal data processed by our Communication Department (privacy@gide.com).

Gide Loyrette Nouel

Association d'Avocats
à la Cour de Paris

26, cours Albert 1^{er}
75008 Paris - France
Tel. +33 (0)1 40 75 60 00
Fax +33 (0)1 43 59 37 79
E-mail: info@gide.com
www.gide.com

Contacts

Alban Callemer du Ferrage
E-mail: acf@gide.com

Philippe Goutay
E-mail: goutay@gide.com

Karole-Anne Sauvet
E-mail: sauvet@gide.com



Gide Loyrette Nouel