

# Markets in financial instruments. Recast

2011/0298(COD) - 20/10/2011 - Legislative proposal

**PURPOSE:** to adopt new rules for more sound, transparent and efficient EU financial markets (recast of the Markets in Financial Instruments Directive (MiFID)).

**PROPOSED ACT:** Directive of the European Parliament and of the Council.

**BACKGROUND:** **the Markets in Financial Instruments Directive (MiFID) (Directive 2004/39/EC)**, in force since November 2007, is a core pillar in EU financial market integration. It establishes a regulatory framework for the provision of investment services in financial instruments (such as brokerage, advice, dealing, portfolio management, underwriting etc.) by banks and investment firms and for the operation of regulated markets by market operators. It also establishes the powers and duties of national competent authorities in relation to these activities.

**The result after 3.5 years in force** is more competition between venues in the trading of financial instruments, and more choice for investors in terms of service providers and available financial instruments, progress which has been compounded by technological advances. Overall, transaction costs have decreased and integration has increased.

However, **some problems have surfaced:**

- the benefits from this increased competition have not flowed equally to all market participants and have not always been passed on to the end investors, retail or wholesale;
- the market fragmentation implied by competition has also made the trading environment more complex;
- market and technological developments have outpaced various provisions in MiFID;
- the financial crisis has exposed weaknesses in the regulation of instruments other than shares, traded mostly between professional investors.

In line with the recommendations from the de Larosière group and the conclusions of the ECOFIN Council of June 2009, **the revision of MiFID therefore constitutes an integral part of the reforms aimed at establishing a safer, sounder, more transparent and more responsible financial system.** It is also an **essential vehicle for delivering on the G20 commitment** to tackle less regulated and more opaque parts of the financial system, and improve the organisation, transparency and oversight of various market segments, especially in those instruments traded mostly over the counter (OTC), complementing the [legislative proposal](#) on OTC derivatives, central counterparties and trade repositories.

**The review of MiFID** will contribute to establishing a single rulebook for EU financial markets, help further develop a level playing field for Member States and market participants, improve supervision and enforcement, reduce costs for market participants, and improve conditions of access and enhance the global competitiveness of the EU financial industry.

The proposal amending MiFID is **divided in two:**

- this proposed Directive on markets in financial instruments, repealing Directive 2004/39/EC of the European Parliament and of the Council;
- [the draft Regulation](#) on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories.

**IMPACT ASSESSMENT:** policy options were assessed against different criteria: transparency of market operations for regulators and market participants, investor protection and confidence, level playing field for market venues and trading systems in the EU, and cost-effectiveness. Overall, the review of MiFID is estimated to generate **one-off compliance costs of between EUR 512 and EUR 732 million and ongoing costs of between EUR 312 and EUR 586 million.** This represents one-off and ongoing cost impacts of respectively 0.10% to 0.15% and 0.06% to 0.12% of total operating spending of the EU banking sector. This is far less than the costs imposed at the time of the introduction of MiFID.

**LEGAL BASIS:** Article 53(1) of the Treaty on the Functioning of the European Union (TFEU).

**CONTENT:** the proposed Directive amends specific requirements regarding the provision of investment services, the scope of exemptions from the current Directive, organisational and conduct of business requirements for investment firms, organisational requirements for trading venues, the authorisation and ongoing obligations applicable to providers of data services, powers available to competent authorities, sanctions, and rules applicable to third-country firms operating via a branch.

A central aim of the proposal is to **ensure that all organised trading is conducted on regulated trading venues: regulated markets, multilateral trading facilities (MTFs) and organised trading facilities (OTFs).** Identical pre and post trade transparency requirements will apply to all of these venues. Likewise, the requirements in terms of organisational aspects and market surveillance applicable to all three venues are nearly identical. This will ensure a level playing field where there are functionally similar activities bringing together third-party trading interests. Importantly however, the transparency requirements will be calibrated for different types of instruments, notably equity, bonds, and derivatives, and for different types of trading, notably order book and quote driven systems.

The main elements of the proposed Directive are as follows:

- **Extension of MiFID rules to like products and services:** the proposals extend MiFID requirements, and particularly conduct of business and conflicts of interest rules, to the advised and non-advised sale of structured deposits by credit institutions, specify that MiFID also applies to investment firms and credit institutions selling their own securities when not providing any advice, and require Member States to apply authorisation and conduct of business requirements analogous to MiFID in national legislation applicable to locally-based entities.
- **Revision of exemptions from MiFID:** the proposal therefore limits the exemptions more clearly to activities which are less central to MiFID and primarily proprietary or commercial in nature, or which do not constitute high-frequency trading.
- **Upgrades to the market structure framework:** the proposal creates a new category for organised trading facilities which do not correspond to any of the existing categories, underpinned by strong organisational requirements and identical transparency rules, and upgrade key requirements across all venues to account for the greater competition and cross-border trading generated together by technological advances and MiFID.
- **Improvements to corporate governance:** the proposals seek to ensure members of the management body possess the sufficient knowledge and skills and comprehend the risks associated with the activity of the firm in order to ensure the firm is managed in a sound and prudent way in the interests of investors and market integrity.
- **Enhanced organisational requirements to safeguard the efficient functioning and integrity of markets:** the proposals aim to bring all entities engaged in high-frequency trading into MiFID, require appropriate organisational safeguards from these firms and those offering market access to other high-frequency traders, and require venues to adopt appropriate risk controls to mitigate disorderly trading and ensure the resiliency of their platforms.
- **Enhancement of the investor protection framework:** the proposal strengthens the regulatory framework for the provision of investment advice and portfolio management and the possibility for investment firms to accept incentive by third parties (inducements) as well as it clarifies the

conditions and arrangements under which investors are able to transact freely in the market in certain non-complex instruments with minimal duties or protections afforded on behalf of their investment firm. Furthermore, it reinforces the requirements concerning the handling of funds or instruments belonging to clients by investment firms and their agents and classifies as an investment service the safekeeping of financial instruments on behalf of clients. The proposal helps improving the information to clients in relation to the services provided to them and to the execution of their orders.

- **Heightened protection in the provision of investment services to non-retail clients:** the overarching high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading should apply irrespective of client categorization. Finally, it is proposed that eligible counterparties benefit from better information and documentation for services provided.
- **New requirements for trading venues:** the proposal therefore introduces a requirement for trading venues to publish annual data on execution quality. Second, commodity derivative contracts traded on trading venues frequently attract the broadest participation by users and investors and can often serve as a benchmark price discovery venues feeding into, for example, retail energy and food prices. It is therefore proposed that all trading venues on which commodity derivative contracts are traded adopt appropriate limits or alternative arrangements to ensure the orderly functioning of the market.
- **An improved regime for SME markets:** it is proposed to create a new subcategory of markets known as SME growth markets. An operator of such a market (which are usually operated as MTFs) could elect to apply to have the MTF also registered as an SME growth market if it meets certain conditions.
- **Third country regime:** the proposal creates a harmonised framework for granting access to EU markets for firms and market operators based in third countries in order to overcome the current fragmentation into national third country regimes and to ensure a level playing field for all financial services actors in the EU territory. It introduces a regime based on a preliminary equivalence assessment of third country jurisdictions by the Commission. Third country firms from third countries for which an equivalence decision has been adopted would be able to request to provide services in the Union. Services provided to eligible counterparties would not require the establishment of a branch; third country firms could provide them subject to ESMA registration. They would be supervised in their country. Appropriate cooperation agreement between the supervisors in third countries and national competent authorities and ESMA would be necessary.
- **Increased and more efficient data consolidation:** the proposals improve the quality and consistency of data by requiring that all firms publish their trade reports through Approved Publication Arrangement (APA). The provisions set procedures for competent authority to authorise the APAs and set organisational requirements for the APAs.
- **Heightened powers over derivative-positions for competent authorities:** the regulators would be bestowed with explicit powers to demand information from any person regarding the positions held in the derivative instruments concerned as well as in emission allowances. The supervisory authorities would be able to intervene at any stage during the life of a derivative contract and take action that a position be reduced. This heightened position management would be complemented by the possibility to limit positions in an ex-ante, non-discriminatory fashion. All actions should be notified to [ESMA](#).
- **Effective sanctions:** Member States should provide that appropriate administrative sanctions and measures can be applied to breaches of MiFID. To this end, the Directive will require them to comply with the following minimum rules. The maximum level of administrative pecuniary sanctions laid down in national legislation should exceed the benefits derived from the breach if they can be determined and, in any case, should not be lower than the level provided for by the Directive. Criminal sanctions are not covered by this proposal.
- **Emission allowances:** unlike trading in derivatives, spot secondary markets in EU emission allowances (EUAs) are largely unregulated. A range of fraudulent practices have occurred in spot markets which could undermine trust in the emissions trading scheme (ETS), set up by the EU ETS

Directive. In parallel to measures within the EU ETS Directive to reinforce the system of EUA registries and conditions for opening an account to trade EUAs, the proposal would render the entire EUA market subject to financial market regulation. Both spot and derivative markets would be under a single supervisor. MiFID and the Directive 2003/6/EC on market abuse would apply, thereby comprehensively upgrading the security of the market without interfering with its purpose, which remains emissions reduction. Moreover, this will ensure coherence with the rules already applying to EUA derivatives and lead to greater security as banks and investment firms, entities obliged to monitor trading activity for fraud, abuse or money laundering, would assume a bigger role in vetting prospective spot traders.

**BUDGETARY IMPLICATIONS:** the specific budget implications of the proposal relate to task allocated to ESMA. Total appropriations are estimated at **EUR 1 744 million from 2013 to 2015**.

**DELEGATED ACTS:** the proposal contains provisions empowering the Commission to adopt delegated acts in accordance with Article 290 TFEU.