

Markets in financial instruments. Recast

2011/0298(COD) - 15/04/2014 - Text adopted by Parliament, 1st reading/single reading

The European Parliament adopted by 574 votes to 23 with 34 abstentions, a legislative resolution on the proposal for a directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (recast)

The report had been sent back to committee during the plenary session of 26 October 2012.

Parliament adopted its position at first reading under the ordinary legislative procedure. The amendments adopted in plenary were the result of a compromise between Parliament and Council. They amend the Commission's proposal as follows:

Strengthening the regulatory framework: the text underlines that the financial crisis has exposed the need to strengthen the framework for the regulation of markets in financial instruments, including where trading in such markets takes place over-the-counter (OTC), in order to increase transparency, better protect investors, reinforce confidence, **address unregulated areas**, and ensure that supervisors are granted adequate powers to fulfil their tasks.

Members want to ensure that new **organised trading systems** (which have emerged alongside regulated markets) do not benefit from regulatory loopholes.

Market structure and transparency: Parliament and Council agreed that all trading venues, namely regulated markets, multilateral trading facilities (MTFs), and OTFs, should lay down **transparent and non-discriminatory rules** governing access to the facility. A central counterparty (CCP) is not covered by the term Organised Trading Facility as defined in the Directive.

Governance: to ensure sound and prudent management of the firms, the management body of an investment firm, regulated markets and data reporting services providers should at all times commit sufficient time and possess adequate collective knowledge, skills and experience to be able to **understand the firm's activities including the main risks**. Diversity should be one of the criteria for the composition of management bodies.

Firms have a duty to take effective steps to identify and prevent or **manage conflicts of interest** and mitigate the potential impact of those risks as far as possible.

Algorithmic trading and high-frequency trading: Parliament wanted to **regulate algorithmic trading** where a trading system analyses data or signals from the market at high speed, typically in milliseconds or microseconds, and then sends or updates large numbers of orders within a very short time period in response to that analysis. Both firms and trading venues should ensure **robust measures** are in place to ensure that high-frequency and automated trading does not create a disorderly market and cannot be used for abusive purposes.

Trading venues should ensure their trading systems are resilient and properly tested to deal with increased order flows or market stresses and that **circuit breakers** are in place on trading venues to **temporarily halt trading or constrain it if there are sudden unexpected price movements**.

Members or participants must carry out appropriate testing of algorithms and all order generated by algorithmic trading should be **flagged** in order to permit the competent authorities to react efficiently and effectively against algorithmic trading strategies that behave in an abusive manner or pose risks to the orderly functioning of the market.

The Directive would **ban the provision of direct electronic access to markets** by investment firms for their clients where such access was not subject to proper systems and controls.

In order to ensure that market integrity was maintained in the light of technological developments in financial markets, **ESMA** should regularly seek input from national experts on developments relating to trading technology.

Fee structures of trading venues: these should be transparent, non-discriminatory and fair and should not be structured in such a way as to promote disorderly market conditions. Member States should allow for trading venues to adjust their fees for cancelled orders according to the length of time for which the order was maintained and to calibrate the fees to each financial instrument to which they applied.

Ensuring appropriate investor protection: Member States should ensure that investment firms acted in accordance with **the best interests of their clients** and were able to comply with their obligations under this Directive. They should accordingly understand the features of the financial instruments offered or recommended and establish and review effective policies and arrangements to **identify the category of clients to whom products and services were to be provided**.

Accordingly, investment firms which manufacture financial instruments must: (i) ensure that those products are manufactured to meet the needs of an **identified target market of end clients** within the relevant category of clients, (ii) take reasonable steps to ensure that the financial instruments were distributed to the identified target market and (iii) periodically review the identification of the target market of and the performance of the products they offered.

When advice was provided on an independent basis a **sufficient range of different product providers' products** should be assessed prior to making a personal recommendation.

To further protect consumers, the new rules should ensure that investment firms did not **remunerate or assess the performance** of their own staff in a way that conflicts with the firm's duty to act in the best interests of their clients, for example through remuneration, sales targets or otherwise which provided an incentive for recommending or selling a particular financial instrument when another product may better meet the client's needs.

Staff who advised on or sell investment products to retail clients must possess an appropriate level of **knowledge and competence** in relation to the products offered.

The requirements of the Directive regarding investor protection also applied to **investment products in the form of insurance contracts** which were often sold to clients as an alternative to or substitute for financial instruments regulated under the Directive.

Derivative contract in relation to a commodity: in order to prevent market abuse, competent authorities must be able to **establish limits**, on the basis of a methodology determined by ESMA, on the positions any person can hold in a derivative contract in relation to a commodity at all times, including cornering the market, and to support orderly pricing and settlement conditions including the prevention of market distorting positions.

All venues which offer trading in commodity derivatives should have in place appropriate position management controls, providing the necessary powers at least to monitor and access information about commodity derivative positions, to require the reduction or termination of such positions and to require that liquidity is provided back on the market to mitigate the effects of a large or dominant position.

Firms from third countries: the amended text provided that a Member State may require that a third-country firm intending to provide investment services or perform investment activities to retail clients or to professional clients establish **a branch** in that Member State. The branch should acquire a prior authorisation by the competent authorities of that Member State in accordance with certain conditions.

The third-country firm requesting authorisation should, inter alia, pay due regard to any FATF recommendations in the context of anti-money laundering and countering the financing of terrorism.