

Markets in financial instruments

2002/0269(COD) - 19/11/2002 - Legislative proposal

PURPOSE : proposal for a new Directive on investment services and regulated markets. **CONTENT** : the current Investment Services Directive (ISD), adopted in 1993, sought to establish the conditions in which authorised firms and banks could provide specified services in other member States on the basis of home country authorisation and supervision. Services eligible for a passport under the present ISD include brokerage, dealing, individual portfolio management, transmission of investor orders and underwriting /placing activities. The existing ISD no longer provides an effective framework for undertaking investment business on a cross-border basis in the EU. The principal shortcomings of the existing ISD include the following: - it does not provide sufficient harmonisation to allow effective mutual recognition of investment firm licences; - it contains outdated investor protection disciplines; - ISD does not span the full range of investor-oriented services; - ISD does not address the regulatory and competitive issues that arise when exchanges start competing with each other and with new order-execution platforms; - ISD provides for an optional approach to the regulation of market structure creating a formidable stumbling block to the emergence of an integrated and competitive trading infrastructure; - ISD provisions relating to designation of and cooperation between competent authorities are under developed; - ISD provisions are inflexible and out of date, unable to respond to pressing regulatory issues caused by evolving market structure and business and supervisory practices. This proposal serves two over-arching regulatory objectives: - the protection of investors and market integrity by establishing harmonised requirements, governing the activities of authorised intermediaries; - the promotion of fair, transparent, efficient and integrated financial markets. This goal will be furthered by the development of ground rules governing the negotiation and execution of transactions in financial instruments on organised trading systems and marketplaces, and by investments firms. The new directive is discussed under the following headings: i) measures to promote an efficient, transparent and efficient financial trading infrastructure. It should be noted that the proposal envisages the introduction of a new core service relating to the operation of an MTF ("Multilateral Trading Facility"). The revision of the ISD seeks to create a regulatory framework in which obligations are tailored to the specific risk-profile of different market participants, and which takes account of competitive and regulatory interactions between different trading formats so as to maintain overall market efficiency. Transparency obligations are emphasised. ii) clauses governing the provision of investment services, with a view to protecting investors and fostering market integrity. The proposal envisages a far-reaching modernisation and reinforcement of the obligations that investment firms must comply with when providing services to clients or acting in the marketplace, as well as rights to which investment firms are entitled by virtue of ISD authorisation. The relevant provisions encompass: - conditions for initial authorisation, including organisational requirements. This includes modification of the Capital Adequacy Directive; - general operating conditions including conflict of interest identification and management; - obligations of investment firms when providing services to clients, including conduct of business rules, best execution obligations and client order handling rules. There is provision for the adoption of common conduct of business rules through comitology. The proposal also establishes a separate provision governing the best execution obligations of brokers/broker-dealers. - requirements to uphold market efficiency, including transparency obligations; - provisions governing the rights of investment firms. iii) proposed extensions to the scope of the Directive. It is proposed to expand the scope to integrate some investor-facing actives or dealing activities that are financial in character, are widely offered to investors, clients, or financial market participants, and/or which give rise to investor or market-facing risks which could usefully be addressed through the application of core ISD disciplines. The most notable changes (apart from the inclusion of MTF operation) relate to the inclusion of investment advice, financial analysis, and commodity derivatives. iv) other issues such as clearing and settlement and supervisory cooperation. There are also provisions on comitology. The proposal confines its treatment of clearing and settlement to clarification of the rights of the investment firm and regulated market populations in terms of access to/choice of clearing and settlement facilities located in other Member States. These rights are to absolute: demonstrable prudential concerns on the part of the supervisor, or

commercial interests of clearing and settlement providers may prevail over the access demands of investment firms or market operators.