

Markets in financial instruments. Recast

2011/0298(COD) - 26/10/2012 - Text adopted by Parliament, partial vote at 1st reading/single reading

The European Parliament adopted by 495 votes to 15, with 19 abstentions, **amendments** to 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 matter was referred back to the committee responsible for reconsideration and the vote was postponed until a subsequent plenary session.

The main amendments adopted by Parliament are the following:

Strengthening the regulatory framework: the text underlines that the evolution of financial markets 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, in order to increase transparency, better protect investors, reinforce confidence and **address unregulated areas**. Members want to ensure that new organised trading systems (which have emerged alongside regulated markets) do not benefit from **regulatory loopholes**.

All trading venues, namely regulated markets, multilateral trading facilities (MTFs), and organised trading facilities (OTFs), should lay down **transparent rules**. In this context, trading venues should be able to allow users to specify the type of order flow that their orders interact with prior to their orders entering the system provided this is done in an open and transparent manner and does not involve discrimination by the platform operator.

Investments under insurance contracts: investments are often sold to clients in the form of insurance contracts as an alternative to or substitute for financial instruments regulated under this Directive. To **deliver consistent protection for retail clients**, it is important that investments under insurance contracts are subject to the **same conduct of business standards**, in particular those relating to managing conflicts of interest, restrictions on inducements, and rules on ensuring the suitability of advice or appropriateness of non-advised sales.

The **investor protection and conflicts of interest requirements** in this Directive should therefore be applied equally to those investments packaged under insurance contracts and coordination should be ensured between this Directive and other relevant law including Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation.

Corporate governance: to prevent conflicts of interest an executive member of the management body of investment firms should not also be an executive member of the management body of a trading venue but could be a non-executive member of such a management body, for example in order to provide user participation in decision-making.

Where practiced, employee representation in the management body should also be seen as a positive way of enhancing diversity, by adding a key perspective and genuine knowledge of the internal workings of the institution. Furthermore mechanisms are needed to ensure that members of management bodies can be held accountable in case of severe mismanagement.

Algorithmic trading and high-frequency trading: Parliament strongly supports **the Commission proposals** on regulatory scrutiny of 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.

All orders should be subject to **appropriate risk controls at source**. In addition, it is proposed to **end the practice of sponsored and naked access to avoid the risk that firms with insufficient controls** in place create disorderly market conditions and to ensure that market participants can be identified and held accountable for any disorderly conditions for which they are responsible. It is also necessary to be able to clearly identify order flows coming from high-frequency trading.

ESMA should also continue to monitor developments in technology and in methods used to access trading venues and should continue to prepare guidelines to ensure that the requirements of this Directive can continue to be effectively applied in the light of new practices.

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. Trading venue fee structures should incentivise a lower ratio of system messages to executed trades with higher fees applying to practices such as the cancellation of high volumes or proportions of orders which could create such disorderly conditions.

Ensuring appropriate investor protection: Member States should ensure that:

- investment products or structured deposits for sale to professional or retail clients designed by investment firms **should meet the needs and characteristics of an identified target market** within the relevant category of clients;
- the investment firm should take reasonable steps to ensure that the investment product is marketed and distributed to clients within the target group.

Producers should also **periodically review the performance of their products**, to assess whether the products have performed in accordance with their design and to establish whether their target market for the product remains correct.

Investment firms providing investment advice should:

- clarify the basis of the advice they provide, in particular the range of products they consider in providing personal recommendations to clients, the **cost of the advice** or, where the cost of fees and inducements cannot be ascertained prior to the provision of the advice, the manner in which the cost will be calculated;
- indicate whether the investment advice is provided **in conjunction with the acceptance or receipt of third-party inducements** and whether the investment firms provide the clients with the periodic assessment of the suitability of the financial instruments recommended to them.

When providing discretionary portfolio management, the investment firm should, prior to the agreement, inform the client about the expected scale of inducements, and periodic reports should disclose all inducements paid or received.

Consumer protection: the objective is to ensure investment firms do 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.

Remuneration of staff selling or advising on investments should therefore not be solely dependent on sales targets or the profit to the firm from a specific financial instrument as this would create incentives to deliver information which is not fair, clear and not misleading and to make recommendations which are not in the best interests of clients.

Given the complexity of investment products and the continuous innovation in their design, it is also important to ensure that staff who advise on or sell investment products to retail clients possess **an appropriate level of knowledge and competence in relation to the products offered**.

Third countries: Members stress the need to introduce a **common regulatory framework** at European Union level for third-country firms, including both investment firms and market operators.

In order to provide a basis for third-country firms to benefit from a passport enabling them to provide investment services and carry out investment activities throughout the EU, this regime should, among other things, **ensure that an effective equivalence assessment is carried out by the Commission in relation to the regulatory and supervisory framework of third countries**, prioritising the assessment of the EU's largest trading partners and areas within the scope of the G-20 programme.

Derivative contract in relation to a commodity: Parliament recommends that explicit powers should be granted to trading venues and to competent authorities **to limit the ability of any person or class of persons to enter into or hold a derivative contract in relation to a commodity**, based on technical standards determined by ESMA, and to otherwise manage positions in such a way as to promote integrity of the market for the derivative and the underlying commodity without unduly constraining liquidity. Such limits should not apply to positions which objectively reduce risks directly relating to commercial activities in relation to the commodity.

Development of a Union framework governing securities: with this aim, the Commission should put forward a proposal for a regulation on securities law further specifying the definition of safekeeping and administration of financial instruments and should also, in conjunction with ESMA, the European Supervisory Authority (European Banking Authority) and the European Systemic Risk Board promote work on standardisation of identifiers and messaging so as **to enable near-real time transaction analysis and the identification of complex product structures**, such as those containing derivatives or repos.