

Procedure file

Basic information	
COD - Ordinary legislative procedure (ex-codecision procedure) Directive	2002/0269(COD) Procedure completed
Markets in financial instruments Amending Directive 2000/12/EC Amended by 2005/0111(COD) Amended by 2006/0166(COD) Amended by 2006/0305(COD) Amended by 2009/0161(COD)	
Subject 2.50.03 Securities and financial markets, stock exchange, CIUTS, investments 2.50.08 Financial services, financial reporting and auditing	

Key players			
European Parliament	Committee responsible	Rapporteur	Appointed
	ECON Economic and Monetary Affairs		11/09/2001
		PPE-DE VILLIERS Theresa	
	Former committee responsible		
	ECON Economic and Monetary Affairs		11/09/2001
		PPE-DE VILLIERS Theresa	
	Former committee for opinion		
	JURI Legal Affairs and Internal Market		28/01/2003
		PSE MCCARTHY Arlene	
Council of the European Union	Council configuration	Meeting	Date
	General Affairs	2552	08/12/2003
	Economic and Financial Affairs ECOFIN	2530	07/10/2003
	Economic and Financial Affairs ECOFIN	2513	03/06/2003
	Economic and Financial Affairs ECOFIN	2471	03/12/2002
European Commission	Commission DG	Commissioner	
	Financial Stability, Financial Services and Capital Markets Union		

Key events			
19/11/2002	Legislative proposal published	COM(2002)0625	Summary
03/12/2002	Debate in Council	2471	

16/12/2002	Committee referral announced in Parliament, 1st reading		
03/06/2003	Debate in Council	2513	
02/09/2003	Vote in committee, 1st reading		Summary
02/09/2003	Committee report tabled for plenary, 1st reading	A5-0287/2003	
23/09/2003	Debate in Parliament		
25/09/2003	Decision by Parliament, 1st reading	T5-0410/2003	Summary
08/12/2003	Council position published	13421/3/2003	Summary
15/01/2004	Committee referral announced in Parliament, 2nd reading		
24/02/2004	Vote in committee, 2nd reading		Summary
24/02/2004	Committee recommendation tabled for plenary, 2nd reading	A5-0114/2004	
29/03/2004	Debate in Parliament		
30/03/2004	Decision by Parliament, 2nd reading	T5-0212/2004	Summary
07/04/2004	Act approved by Council, 2nd reading		
21/04/2004	Final act signed		
21/04/2004	End of procedure in Parliament		
30/04/2004	Final act published in Official Journal		

Technical information

Procedure reference	2002/0269(COD)
Procedure type	COD - Ordinary legislative procedure (ex-codecision procedure)
Procedure subtype	Legislation
Legislative instrument	Directive
	Amending Directive 2000/12/EC 1997/0357(COD) Amended by 2005/0111(COD) Amended by 2006/0166(COD) Amended by 2006/0305(COD) Amended by 2009/0161(COD)
Legal basis	EC Treaty (after Amsterdam) EC 047-p2
Stage reached in procedure	Procedure completed
Committee dossier	ECON/5/20196

Documentation gateway

Legislative proposal	COM(2002)0625 OJ C 071 25.03.2003, p. 0062-0125 E	19/11/2002	EC	Summary
Document attached to the procedure	BCE(2003)0009 OJ C 144 20.06.2003, p.	12/06/2003	ECB	Summary

		0006-0012			
Economic and Social Committee: opinion, report		CES0741/2003 OJ C 220 16.09.2003, p. 0001-0004	18/06/2003	ESC	
Committee report tabled for plenary, 1st reading/single reading		A5-0287/2003	02/09/2003	EP	
Text adopted by Parliament, 1st reading/single reading		T5-0410/2003 OJ C 077 26.03.2004, p. 0264-0329 E	25/09/2003	EP	Summary
Council statement on its position		15277/2003	27/11/2003	CSL	
Council position		13421/3/2003 OJ C 060 09.03.2004, p. 0001-0056 E	08/12/2003	CSL	Summary
Commission communication on Council's position		COM(2004)0015	12/01/2004	EC	Summary
Committee recommendation tabled for plenary, 2nd reading		A5-0114/2004	24/02/2004	EP	
Text adopted by Parliament, 2nd reading		T5-0212/2004 OJ C 102 29.04.2004, p. 0033-0163 E	30/03/2004	EP	Summary
Commission opinion on Parliament's position at 2nd reading		COM(2004)0365	30/04/2004	EC	Summary
Implementing legislative act		32006L0073 OJ L 241 02.09.2006, p. 0026-0058	10/08/2006	EU	Summary
Implementing legislative act		32006R1287 OJ L 241 02.09.2006, p. 0001-0025	10/08/2006	EU	Summary
Follow-up document		COM(2007)0178	11/04/2007	EC	Summary

Additional information

European Commission

[EUR-Lex](#)

Final act

[Directive 2004/39](#)

[OJ L 145 30.04.2004, p. 0001-0044](#) Summary

Final legislative act with provisions for delegated acts

Delegated acts

[2017/2782\(DEA\)](#)

Examination of delegated act

Markets in financial instruments

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 activities 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.?

Markets in financial instruments

The ECB broadly welcomes and supports the proposed directive, which aims at improving the level of regulatory harmonisation and to extend it to new investment services and financial instruments. The proposed directive deals with new issues arising from the increased competition among stock exchanges and new order-execution platforms, laying down rules to ensure that different execution venues are subject to the same set of rules and are therefore able to compete with one another while guaranteeing investor protection, market transparency and efficiency. In order to attain the abovementioned goals, the proposed directive lays down a comprehensive set of rules concerning all the trading venues, namely regulated markets, multilateral trading facilities (MTFs) and intermediaries that execute client orders internally. However, the ECB finds that the proposed directive could further clarify a number of issues, as explained below: - the application of the legislative methodology recommended by the Committee of Wise Men on the Regulation of European Securities Markets; - the exemptions from the scope of the proposed directive; - the rules concerning intermediaries; - the new regulatory framework on trade execution; - the rules concerning clearing and settlement systems; - exchange of information and reporting requirements.?

Markets in financial instruments

The committee adopted the report by Theresa VILLIERS (EPP-ED, UK) broadly approving the Commission proposal under the 1st reading of the codecision procedure, subject to a number of amendments, as follows: - to ensure that the new rules do not increase the cost of share dealing, the committee said that, as regards "conduct of business" obligations, suitability tests should apply only to deals where advice is provided. "Execution only" services (i.e. executing transactions without providing advice), which are very popular among many investors, should not be burdened by extra requirements that would lead to higher charges. At the same time, it should be made clear to the investor that no advice is being given; - the committee also wanted a more flexible approach to the "best execution" principle. While supporting the idea that firms should actively look for the best deal for clients, it said that this point should be clarified because an absolute duty to find the lowest price or the cheapest transaction venue cannot work in practice. It therefore amended the relevant article so that firms will simply have to guarantee they have taken steps to obtain the best result "reasonably achievable"; - while supporting enhanced transparency, the committee took account of concerns that the new rules could have a negative impact on liquidity and could discriminate against investment firms. It therefore clarified the transparency rules, for example by limiting the obligation to make public the bid and offer prices for transactions of a certain size to firms which practise "systematic internalisation" in shares (for instance, firms that regularly and continuously execute orders on their own account or regularly match with other client orders). It also introduced the concept of a "standard size" which will trigger the obligation to make prices public, though the amount will be fixed later by regulators. As regards the obligation for investment firms to disclose the terms of "limit orders" (orders to buy or sell a share only below or above a stated price) when these are not executed immediately, the committee adopted a compromise amendment saying that these orders will be forwarded to a regulated market unless the client objects. ?

Markets in financial instruments

The European Parliament adopted a resolution drafted by Theresa VILLIERS (EPP-ED, UK) and made several amendments to the Commission's proposals. (Please see the document dated 02/09/03.) To expand on certain definitions, Parliament stated that systematic internalisation means the execution, on a systematic, regular and continuous basis, of: - orders up to a standard market size undertaken by any type of client or counterparty, - transactions in shares admitted to or included in trading on a regulated market, - transactions on own account or by means of matching with other client orders, - transactions within a system, a component of which is primarily aimed at facilitating

the activities set out in the first and third points above; - transactions outside the rules or systems of a regulated market or MTF. Where executions in several securities are part of one transaction (such as portfolio transaction), the size of the total transaction will determine whether the transaction was of standard market size. Parliament also wanted investment firms exempted from the scope of Directive 93/6/EEC to have sufficient financial capacity, which entails: - minimum initial capital of EUR 50 000; - professional indemnity insurance covering the whole territory of the Community or some other comparable guarantee against liability arising from professional negligence, representing at least EUR 1 000 000 applying to each claim and in aggregate EUR 1 500 000 per year for all claims; or - a combination of the above points, in a form resulting in protection equivalent to one of them. On the question of conflict of interest, it must be left to investment firms, subject to regulatory oversight, to determine the appropriate mix of prevention, management and disclosure. The Commission must take into account the frequency of conflicts of interest (whether they occur regularly or in limited, individual cases) in different types of investment firms. Finally, Member States must require that investment firms implement effective procedures for monitoring execution quality. In assessing these procedures, account must be taken of the extent to which the procedures enable the firm to identify and correct recurrent inefficiencies in its execution practices. Member States must also ensure that investment firms inform their clients of any significant change to their execution policy, whereupon clients have the right to terminate any contractual arrangement.?

Markets in financial instruments

The common position was adopted by qualified majority, Ireland, Luxembourg, Finland, Sweden and the United Kingdom voting against. The common position is broadly in line with the Commission's proposal as well as the European Parliament's opinion. The main elements of this common position are as follows: - on the issue of "internalisation" by banks and investment firms of client orders to buy and sell equities outside regulated markets, the Council has now agreed that it must be allowed in all Member States, whereas some countries do not currently allow it. However, the compromise text attaches conditions to prevent market distortion and ensure investors, particularly retail investors, are not sold short or overcharged through a lack of market transparency; - for deals up to a certain value - the Council has agreed on a threshold value somewhat higher than the Parliament's opinion - investment firms would need to reveal to the markets details of client orders and, if the firms are trading on their own account, some indication of the terms on which they themselves stand ready to buy or sell a specified share. For larger deals where it can be assumed professional investors are involved, these requirements would not apply, allowing prices to be fixed by a process of negotiation, which could continue ("price improvement") even after an initial quote. Firms would not be obliged to offer each quote to all their clients, professional and retail they would be able to decide on whom to give access to each specific quote, provided they do not discriminate between investors in the same category; - as far as ensuring retail investors are not sold inappropriate products, the Council's text clarifies and adds some nuances to the Commission's proposal and to the Parliament's opinion. It provides for a full suitability test to be applied when a firm is providing investment advice, no suitability test for execution-only business instigated by the customer and a "light" suitability test for circumstances in between. The Commission can support this solution. The Council's political agreement also reflects a compromise on when "home country" regulation should apply, in other words in which respects investment firms' activities should be regulated by the authorities in the Member State where they are principally based, and where there should be "host country" regulation" in the Member States where they operate.?

Markets in financial instruments

The Commission considers that the common position is faithful to the objectives and the spirit of the Commission proposal. It meets the main concerns of the European Parliament and follows some of the key elements of the Parliament's amendments. The Commission believes that it achieves a good balance. The common position takes account of an important number of amendments proposed by the European Parliament and accepted by the Commission. Some of them have been directly incorporated, whereas the majority of the European Parliament's amendments included in the common position have been reformulated or included in other parts of the text for reasons of internal coherence (some parts of the text have been restructured) or for reasons linked to legislative drafting rules. The changes introduced define and clarify more precisely the system proposed by the Commission. Some of them have been inspired by the relevant European Parliament's amendments adopted at the first reading which were accepted by the Commission. The Commission therefore recommends this Common Position to the European Parliament.?

Markets in financial instruments

The committee adopted the report by Theresa VILLIERS (EPP-ED, UK) amending the Council's common position under the 2nd reading of the codecision procedure. It reinstated a number of amendments adopted by Parliament at first reading which were not taken up by the Council, dealing mainly with pre-trade transparency, the definition of internalisation and execution-only services. On pre-trade transparency (Article 27), the committee laid down a requirement to quote in a "standard market size". The amendments also allowed for "price improvement" (whereby firms that internalise orders can offer their clients a better price than the publicly quoted price) for orders from professional clients under certain conditions. To reach a compromise with Council, the committee was more restrictive about allowing price improvement for orders from retail clients, which MEPs believed in general should be executed at the quoted price. They said that a better price for retail clients should only apply in "distinctive" circumstances. The amendments also limited the discretion of the Commission regarding the definition of the "standard size" which triggers the requirement to make public firm bid and offer quotes. The Commission would therefore have to take into account prevailing local market conditions, the effect on liquidity and price formation among other factors. As for execution-only services, where no advice is given, the amendment simplified the text. It was less restrictive than the common position, making it easier for intermediaries not to have to comply with the suitability test (Article 19). Other amendments dealt with commodities and derivatives, introducing criteria to define when they can be considered a financial instrument for which the single passport applies. ?

Markets in financial instruments

The European Parliament adopted the resolution drafted by Theresa VILLIERS (EPP-ED, UK) in line with a compromise worked out between the rapporteur and the Council. Under the terms of the compromise, the Council will change the threshold of block-sized quotes, above which

firms do not have to disclose publicly the price of trades before a transaction takes place. This means more transactions will be excluded from the obligation to publish pre-trade prices. The threshold for the quoting obligation will now be the "standard market size" instead of "large in scale compared to normal market size". The calculation for the standard market size will be based on an arithmetical average of orders executed in the market. The standard market size for any class of share must not be significantly disproportionate to any share included in that class. Concerning price improvement, the common position remains basically unchanged. Accordingly, significant restrictions remain on the price improvement clauses, which allow quoted spreads to be wider than the best bid on offer, so as to protect against the additional risk of public quotes. Firms will not be able to improve on their public quote when dealing with retail clients. Price improvement will be possible for professional clients, under stricter conditions than Parliament had proposed. The directive will allow, as Parliament had requested, execution only services to continue, though under more complex conditions than those proposed by Parliament. The definition of firms that must comply with the directive remains largely unchanged. A new recital states that it is not the intention of the directive to require the application of pre-trade transparency rules to transactions carried out on an OTC basis, the characteristics of which include that they are ad-hoc and irregular and are carried out with wholesale counter parties and are part of a business relationship which is itself characterised by dealings above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser.?

Markets in financial instruments

PURPOSE : to strengthen the capacity of the EU legislative framework to create a single market for investment services and regulated markets. **LEGISLATIVE ACT :** Directive 2004/39/EC of the European Parliament and of the Council on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC. **CONTENT :** This Directive is a key element in the implementation of the Financial Services Action Plan. The main objectives of this Directive are: - the protection of investors and market integrity by establishing harmonised requirements governing the activities of authorised intermediaries; and - the promotion of fair, transparent, efficient and integrated financial markets: this 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 investment firms. The directive establishes common regulatory requirements relating to investment firms wherever they are authorised in the Community and governing the functioning of regulated markets and other trading systems. The Directive will increase harmonisation of national rules and give investment firms an effective "single passport", which will allow them to operate throughout the European Union on the basis of authorisation in their home Member State. It will also ensure that investors enjoy a high level of protection when making use of investment firms, wherever they are located in the European Union. It seeks to establish, for the first time, a comprehensive regulatory framework governing the organised execution of investor transactions by exchanges, other multilateral trading systems and investment firms. The proposed directive will replace the previous investment services Directive, Directive 93/22/EEC, which laid down a regulatory framework which no longer provides an adequate response to pressing regulatory issues caused by evolving market structures and business and supervisory practices. The Directive introduces definitions of regulated market and MTF. These are closely aligned with each other to reflect the fact that they represent the same organised trading functionality. The definitions exclude bilateral systems where an investment firm enters into every trade on own account and not as a riskless counterparty interposed between the buyer and seller. The Directive covers undertakings the regular occupation or business of which is to provide investment services and/or perform investment activities on a professional basis. Its scope does not cover any person with a different professional activity. The Directive gives definitions of persons excluded from its scope. It should be noted that central banks and other bodies performing similar functions as well as public bodies charged with the management of the public debt are excluded. Member States' competent authorities must not grant authorisation where factors such as the content of programmes of operations, the geographical distribution or the activities actually carried on indicate clearly that an investment firm has opted for the legal system of one Member State for the purpose of evading the stricter standards in force in another Member State within the territory of which it intends to carry on or does carry on the greater part of its activities. Finally, the Directive imposes an effective "best execution" obligation to ensure that investment firms execute client orders on terms that are most favourable to the client. **ENTRY INTO FORCE :** 30/04/04. **DATE OF TRANSPOSITION :** 30/04/06.?

Markets in financial instruments

The European Parliament, at its second reading, adopted 29 amendments, based on a compromise package agreed at the meeting of the Coreper on 18 March 2004 by all Member States and the Commission. The Commission can accept all the amendments and amends its proposal accordingly.?

Markets in financial instruments

ACT: Commission Regulation 1287/2006/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading and defined terms for the purposes of that Directive.

CONTENT: Directive 2004/39/EC establishes the framework for a regulatory regime applying to the Community's financial markets. Amongst others this Regulation governs:

- operating conditions relating to an investment firms service performance;
- ancillary services and investment activities;
- organisational requirements for investment firms performing such services and activities;
- regulated markets;
- reporting requirements in respect of transactions in financial instruments;
- transparency requirements in respect of transactions in shares admitted to trading on a regulated market.

The purpose of this Regulation is to guarantee a harmonised regime in all of the EU Member States in order to promote market integration and the cross-border provision of investment and ancillary services. Indeed, provisions concerning certain aspects of record-keeping, transaction reporting, transparency and commodity derivatives do not interface often with national law. In providing fully harmonised transparency requirements and rules regulating transaction reporting, the Community is able to ensure equivalent market conditions and the smooth operation of securities markets across the EU.

To recall, Directive 2004/39/EC includes provisions ensuring that national competent authorities are properly informed about transactions in which they have a supervisory interest. In order to guarantee that businesses operating across borders are subject to the same reporting requirements, this Regulation establishes a single data set applicable to all investment firms. The measures have been designed in such a way that the competent authorities are in a position to carry out their obligations under the Directive as expeditiously and efficiently as possible.

This is a comprehensive implementing Regulation covering a wide range of related issues. In summary, this Regulation:

- Sets out and defines a number of terms. They are: commodity; issuer; Community issuer; third country issuer; normal trading hours; portfolio trade; relevant competent authority; trading venue; turnover and security financing transaction.
- Establishes provisions on transactions relating to an individual share in a portfolio trade and the weighted volume average price transaction.
- Sets out measures on references to 'trading day' and references to transactions.
- Establishes provision on record-keeping, client orders and transactions.
- Establishes provisions on transaction reporting. More specifically, setting out conditions on determining the most relevant market in terms of liquidity; seeking alternative determination of the most relevant markets in terms of liquidity and establishing a list of financial instruments. It also sets out provisions on reporting channels; the content of a transaction report and the exchange of information on transactions.
- Establishes provisions on market transparency. For example, on pre-trade transparency obligations; waivers based on market model and the type of order or transaction and reference to negotiated transactions. In other matters the Regulation specifies the criteria for determining whether an investment firm is a systematic internaliser as well as measures on the determination of liquid shares and standard market shares.
- Establishes provisions on the admission of financial instruments to trading. This covers issues relating to transferable securities; units in collective investment undertakings and on derivatives.
- Establishes provisions concerning derivative financial instruments including the characteristic of other derivative financial instruments.
- Requires the Commission to re-examine the definition of 'transaction' at least once every two years.
- Requires the Commission to re-examine provisions relating to criteria determining which instruments should be treated as having the characteristics of other derivative financial instruments.

ENTRY INTO FORCE: 22 September 2006. It shall apply from 1 November 2007.

Markets in financial instruments

ACT: Commission Directive 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

CONTENT: Directive 2004/39/EC establishes the framework for a regulatory regime applying to the Community's financial markets. Amongst others this Regulation governs:

- operating conditions relating to an investment firms service performance;
- ancillary services and investment activities;
- organisational requirements for investment firms performing such services and activities;
- regulated markets;
- reporting requirements in respect of transactions in financial instruments;
- transparency requirements in respect of transactions in shares admitted to trading on a regulated market.

This Commission Directive sets out the implementing rules needed to guarantee a uniform application of the provisions set out in Directive 2004/39/EC. They have been designed to ensure a high level of integrity, competence and soundness among investment firms and entities that operate regulated markets of MTFs.

The implementing rules provide for rigorous procedures particularly concerning matters such as compliance, risk management, handling complaints, personal transactions, outsourcing and the identification, management and conflicts of interest.

Uniform procedures allow investment firms to have equal access to Community markets. They also help eliminate obstacles linked to authorisation procedures and to any obstacles preventing cross-border activities. Further, unambiguous implementing rules ensure a high level of investor protection and help clarify the relationship between an investment firm and its clients.

The Directive specifies that in order to keep the rules uniform Member States may not add supplementary binding rules when transposing and applying the rules set out in this Directive other than in exceptional circumstances. The Directive also requires the competent authorities to issue interpretative guidance on the Directive's provisions in order to help clarify some of the Directive's practical applications.

More specifically, the Directive:

- Sets and defines a number of terms. They are: distribution channels; durable medium; relevant person; financial analyst; group; outsourcing; person with who a relevant person has a family relationship; securities financing transaction; senior management.
- Sets out conditions for providing information.
- Sets out additional requirements on investment firms in certain cases.
- Establishes organisational requirements as established by Article 13 (2) ? (8) of Directive 2004/34/EC. This includes general requirements, compliance matters, risk management, internal audits; senior management responsibility, handling complaints, the meaning of a personal transaction and personal transactions. In other measures the Directive specifies provisions on outsourcing such as setting out the conditions for outsourcing critical or important operational function/investment services or activities. Amongst others, it also deals with service providers located in third countries and safeguarding/depositing client?s financial instruments and funds.
- Establishes operating conditions for investment firms and refers to inducements, forwarding non-misleading information, information about the investment firm and its services for retail clients and potential clients.

ENTRY INTO FORCE: 22 September 2006.

TRANSPPOSITION: 31 January 2007. It shall apply from 1 November 2007.

Markets in financial instruments

The Commission is required by Article 65(6) of Directive 2004/39/EC on markets in financial instruments ('MiFID') to report to the European Parliament and Council on the continued appropriateness of the requirements for professional indemnity insurance ('PII') that are currently imposed on intermediaries under Community law. This is the purpose of this report.

Professional indemnity insurance is a liability insurance designed to cover, either entirely or in part, sums to be paid by professionals, either as damages or resulting from approved negotiated settlements, to third parties as compensation for losses arising from acts, errors or omissions committed by the professional during the conduct of its business activities. Community law requires some investment and all insurance intermediaries to obtain such insurance as a precondition to be able to provide services. The relevant requirements are derived from two Directives:

- Directive 2002/92/EC on insurance intermediation ('IMD');
- Directive 2006/49/EC on the capital adequacy of investment firms and credit institutions (re-cast) ('the re-cast CAD').

In March 2006, the Commission addressed a questionnaire to the Member States and their respective competent authorities asking for information concerning the application of professional indemnity insurance under the IMD and the re-cast CAD. 19 responses to the questionnaire were received. The responses have been compiled and published as part of the Draft Report on 14 August 2006. As we understand it, the incomplete number of responses is due to the fact that, at the time, the transposition of the IMD had only been completed recently in many Member States and that the transposition deadline for most of the provisions of the re-cast CAD had not yet expired. For the same reasons, it is clear from the available responses that Member States generally have little experience and available data on which to base an adequate assessment of the impact of the regime introduced by these directives on firms and protection it offers to consumers. Furthermore, it is hard to predict what the impact will be on MiFID intermediaries that also carry on insurance intermediation business under the IMD. It seems that adequate data which would allow for a proper evaluation will not be available until early 2008.

The Commission invited interested parties to comment on the Draft Report by 31 October 2006. The recommended format was for respondents to submit general remarks followed by answers to specific questions. Comments were received from 7 organisations. One was pan-European and represented the joint response from insurance intermediary associations from 14 EU Member States. Of the others, 4 were based in the UK, one in Germany and one in Austria. The respondent organisations represented various sectors of the insurance industry (brokers, agents, insurers, underwriters), one represented independent financial advisers and one was a regulator.

Some respondents argued for stricter PII requirements while others favoured a more flexible approach adapted to the size and risk profile of individual firms.

Two respondents said that firms should be permitted to supplement or wholly replace PII protection with capital requirements to ensure that the lack of affordable PII would not lead to the failure of intermediaries.

One respondent representing insurance agents described the PII requirements as a significant and unnecessary burden which had prompted insurers to shift the cost of PII onto their agents.

Two respondents urged the Commission to undertake a further review of the situation once the Directives are in full operation in all Member States to enable a more complete assessment.

To conclude, the analysis of the information provided by Member States as well as stakeholders in response to the two rounds of consultation suggests that, on the limited evidence that is currently available, the policy reasons that motivated the PII requirements imposed under community law remain valid, and there is insufficient evidence to indicate that those requirements are no longer appropriate.

However, it is also clear that it is too early to make a comprehensive assessment of how those requirements impact on the service providers and consumers. The regime under the IMD has only been in place in Member States for a short time, and States have no experience at all of the application of the new PII requirements for investment firms under the re-cast CAD. A proper evaluation of the continued appropriateness of those requirements cannot be made without more practical experience and data, and that will not be available until the requirements under the re-cast CAD have been implemented and applied in Member States for at least one year. Then, it may be appropriate to further investigate whether PII and capital requirements are adequate substitutes. Accordingly, the Commission will continue to monitor the situation if evidence of market failure emerges.

