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*****II**

RECOMMENDATION FOR SECOND READING

on the Council common position for adopting a European Parliament and Council directive 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

(13421/3/2003 – C5-0015/2004 – 2002/0269(COD))

Committee on Economic and Monetary Affairs

Rapporteur: Theresa Villiers

Symbols for procedures

- * Consultation procedure
majority of the votes cast
- **I Cooperation procedure (first reading)
majority of the votes cast
- **II Cooperation procedure (second reading)
*majority of the votes cast, to approve the common position
majority of Parliament's component Members, to reject or amend
the common position*
- *** Assent procedure
*majority of Parliament's component Members except in cases
covered by Articles 105, 107, 161 and 300 of the EC Treaty and
Article 7 of the EU Treaty*
- ***I Codecision procedure (first reading)
majority of the votes cast
- ***II Codecision procedure (second reading)
*majority of the votes cast, to approve the common position
majority of Parliament's component Members, to reject or amend
the common position*
- ***III Codecision procedure (third reading)
majority of the votes cast, to approve the joint text

(The type of procedure depends on the legal basis proposed by the Commission)

Amendments to a legislative text

In amendments by Parliament, amended text is highlighted in ***bold italics***. Highlighting in *normal italics* is an indication for the relevant departments showing parts of the legislative text for which a correction is proposed, to assist preparation of the final text (for instance, obvious errors or omissions in a given language version). These suggested corrections are subject to the agreement of the departments concerned.

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PROCEDURAL PAGE

At its sitting of 25 September 2003 Parliament adopted its position at first reading on the proposal for a European Parliament and Council directive on Investment services and regulated market (amendment of Directives 85/611/EEC, 93/6/EEC and 2000/12/EC) (COM(2002) 625 – 2002/0269(COD)).

At the sitting of 15 January 2004 the President of Parliament announced that the common position had been received and referred to the Committee on Economic and Monetary Affairs (13421/3/2003 – C5-0015/2004).

The committee had appointed Theresa Villiers rapporteur at its meeting of 11 September 2001.

It considered the common position and the draft recommendation for second reading at its meetings of 2 December 2003, 19 January, 20 January, 27 January, 16 February, 17 February, 23 February and 24 February 2004.

At the last meeting it adopted the draft legislative resolution by 26 votes to 8, with 4 abstentions.

The following were present for the vote: John Purvis (acting chairman), José Manuel García-Margallo y Marfil and Philippe A.R. Herzog (vice-chairmen), Theresa Villiers (rapporteur), Generoso Andria, Pervenche Berès, Roberto Felice Bigliardo, Hans Blokland, Jean-Louis Bourlanges (for Ioannis Marinos), Philip Bushill-Matthews, Klaus-Heiner Lehne (for Brice Hortefeux pursuant to Rule 153(2)), Hans Udo Bullmann, Martin Callanan, Nirj Deva (for Othmar Karas pursuant to Rule 153(2)), Benedetto Della Vedova, Manuel António dos Santos (for a member to be nominated), Andrew Nicholas Duff (for Carles-Alfred Gasòliba i Böhm pursuant to Rule 153(2)), Harald Ettl (for Christa Randzio-Plath), Jonathan Evans, Göran Färm (for Helena Torres Marques), Ingo Friedrich, Robert Goebbels, Lisbeth Grönfeldt Bergman, Mary Honeyball, Christopher Huhne, Lord Inglewood, Ian Twinn (for Piia-Noora Kauppi pursuant to Rule 153(2)), Giorgos Katiforis, Christoph Werner Konrad, Alain Lipietz, Astrid Lulling, Jules Maaten (for Karin Riis-Jørgensen pursuant to Rule 153(2)), Neil Parish, Malcolm Harbour, Jacqueline Foster (for Mónica Ridruejo pursuant to Rule 153(2)), Fernando Pérez Royo, Alexander Radwan, Giacomo Santini (for Renato Brunetta pursuant to Rule 153(2)), Olle Schmidt, Peter William Skinner, Charles Tannock (for Hans-Peter Mayer), Gary Titley (for David W. Martin pursuant to Rule 153(2)), Bruno Trentin, Ieke van den Burg (for Bernhard Rapkay).

The recommendation for second reading was tabled on 25 February 2004.

DRAFT EUROPEAN PARLIAMENT LEGISLATIVE RESOLUTION

on the Council common position for adopting a European Parliament and Council directive on the proposal for a European Parliament and Council directive 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
(13421/3/2003 – C5-0015/2004 – 2002/0269(COD))

(Codecision procedure: second reading)

The European Parliament,

- having regard to the Council common position (13421/3/2003 – C5-0015/2004),
 - having regard to its position at first reading¹ on the Commission proposal to Parliament and the Council (COM(2002) 625)²,
 - having regard to Article 251(2) of the EC Treaty,
 - having regard to Rule 80 of its Rules of Procedure,
 - having regard to the recommendation for second reading of the Committee on Economic and Monetary Affairs (A5-0114/2004),
1. Amends the common position as follows;
 2. Instructs its President to forward its position to the Council and Commission.

Council common position

Amendments by Parliament

Amendment 1
Recital 4

(4) It is appropriate to include in the list of financial instruments commodity derivatives which are constituted and traded in such a way as to give rise to regulatory issues comparable to traditional financial instruments *such as futures, options, swaps, and any other derivative contract relating to commodities that can be settled in cash or that is physically settled provided that it is traded on a regulated markets or a Multilateral Trading Facility (MTF).*

(4) It is appropriate to include in the list of financial instruments *certain* commodity *and other* derivatives which are constituted and traded in such a way as to give rise to regulatory issues comparable to traditional financial instruments.

¹ Texts Adopted, P5_TA(2003)0410.

² OJ C 71 E, 25.3.2003, p. 62.

Justification

See justification to Amendment to Annex I.

Amendment 2

Recital 8

(8) Persons ***administrating*** their own assets and undertakings, who do not provide investment services and/or perform investment activities other than dealing on own account ***and who cannot be categorised as*** market makers or ***as dealing*** on own account outside a regulated market or an MTF on an organised, regular and systematic basis, should not be covered by the scope of this Directive.

(8) Persons ***administering*** their own assets and undertakings, who do not provide investment services and/or perform investment activities other than dealing on own account ***unless they are*** market makers or ***they hold themselves out to the public on a continuous basis as providing a facility within which they will*** deal on own account outside a regulated market or an MTF on an organised, regular and systematic basis, should not be covered by the scope of this Directive.

Justification

The Council common position would adversely affect the activity of many professional investors who are dealing on own account and who are not providing a service to third parties, by imposing authorisation requirements on them. Therefore, it is essential to broaden this exemption to make it available to investors who are not market makers or who do not hold themselves out to the public, on a continuous basis, as providing a facility within which they will deal for own account on an organised, regular and systematic basis. Unless an investor does this should not be treated as requiring authorisation.

Amendment 3

Recital 16

(16) In order to benefit from the exemptions from this Directive the person concerned should comply on a continuous basis with the conditions laid down for such exemptions. In particular, if a person provides investment services or performs investment activities and is exempted from this Directive because such services or activities are ancillary to his ***main*** business, ***when considered on a group basis***, he should no longer be covered by the exemption related to ancillary services where the provision of those services or

(16) In order to benefit from the exemptions from this Directive the person concerned should comply on a continuous basis with the conditions laid down for such exemptions. In particular, if a person provides investment services or performs investment activities and is exempted from this Directive because such services or activities are ancillary to his business he should no longer be covered by the exemption related to ancillary services where the provision of those services or activities ceases to be ancillary to his

activities ceases to be ancillary to his *main* business.
business.

Justification

The common position would place subsidiaries within banking groups at a competitive disadvantage and would violate the principle that the same regulatory framework should apply to the same activities. It would adversely affect entities within financial groups that engage in other, non-financial activities. It would also have an effect on the ability of bank or investment firm owned private equity firms to invest in ordinary commercial business and will produce many of the same arbitrary results referred to in the discussion of the proposed amendments to article 2.1(k).

Amendment 4 Recital 24

(24) Since the scope of prudential regulation should be limited to those entities which, by virtue of running a trading book on a professional basis, represent a source of counterparty risk to other market participants, entities which deal on own account in financial instruments, including those commodity derivatives covered by this Directive, as well as those that provide investment services in commodity derivatives to the clients of *their main business on an ancillary basis to their main business when considered on a group basis*, provided that this *main* business is not the provision of investment services within the meaning of this Directive, should be excluded from the scope of this Directive.

(24) Since the scope of prudential regulation should be limited to those entities which, by virtue of running a trading book on a professional basis, represent a source of counterparty risk to other market participants, entities which deal on own account in financial instruments, including those commodity derivatives covered by this Directive, *as an ancillary activity to a business of theirs or of another undertaking in the same group*, as well as those that provide investment services in commodity derivatives to the clients of *a business of theirs or of another undertaking in the same group as an ancillary activity to that business*, provided that this business is not the provision of investment services within the meaning of this Directive, should be excluded from the scope of this Directive.

Justification

The common position would place subsidiaries within banking groups at a competitive disadvantage and would violate the principle that the same regulatory framework should apply to the same activities. It would adversely affect entities within financial groups that engage in other, non-financial activities. It would also have an effect on the ability of bank or investment firm owned private equity firms to invest in ordinary commercial business and will produce many of the same arbitrary results referred to in the discussion of the proposed amendments to article 2.1(k).

Amendment 5
Recital 31

(31) By way of derogation from the principle of home country authorisation, supervision and enforcement of obligations in respect of the operation of branches, it is appropriate for the competent authority of the host Member State to assume responsibility for enforcing certain obligations laid down in Articles 19, 21, 22, 25, 27 and 28 in relation to business conducted through a branch within the territory where the branch is located, since that authority is closest to the branch, and is better placed to detect and intervene in respect of infringements of rules governing the operation of the branch.

(31) By way of derogation from the principle of home country authorisation, supervision and enforcement of obligations in respect of the operation of branches, it is appropriate for the competent authority of the host Member State to assume responsibility for enforcing certain obligations laid down in Articles 19, 21, 22, 25, 27 and 28 in relation to business conducted through a branch within ***or from*** the territory where the branch is located, since that authority is closest to the branch, and is better placed to detect and intervene in respect of infringements of rules governing the operation of the branch. ***In cases where the investment firm has several places of business, it is important to determine from which place of business the service concerned is provided. In cases where it is difficult to determine from which of several places of business a given service is provided, this is the place where the investment firm has the centre of its activities relating to this particular service.***

Justification

The amendment is necessary to ensure that regulatory responsibility for services provided through branches is properly allocated to the place of business from which a particular service is provided, and in cases of doubt, or if a branch was artificially established solely to evade home State regulation, to allocate responsibility to the competent authority where the centre of activity relating to the service is located.

Amendment 6
Recital 39

(39) For the purposes of this Directive eligible counterparties should be considered as acting as clients.

deleted

Justification

This recital contradicts Article 24.2, second paragraph, which states that eligible counterparties can request client treatment.

Amendment 7

Recital 43

(43) With the two-fold aim of protecting investors and ensuring the smooth operation of securities markets, it is necessary to ensure that transparency of transactions is achieved and that the rules laid down for that purpose apply to investment firms when they operate on the markets. In order to enable investors or market participants to assess at any time the terms of a transaction in shares that they are considering and to verify afterwards the conditions in which it was carried out, common rules should be established for the publication of details of completed transactions in shares and for the disclosure of details of current opportunities to trade in shares. These rules are needed to ensure the effective integration of Member State equity markets, to promote the efficiency of the overall price formation process for equity instruments, and to assist the effective operation of "best execution" obligations. These considerations require a comprehensive transparency regime applicable to all transactions in shares irrespective of their execution by an investment firm on a bilateral basis or through regulated markets or MTFs.;

(43) With the two-fold aim of protecting investors and ensuring the smooth operation of securities markets, it is necessary to ensure that transparency of transactions is achieved and that the rules laid down for that purpose apply to investment firms when they operate on the markets. In order to enable investors or market participants to assess at any time the terms of a transaction in shares that they are considering and to verify afterwards the conditions in which it was carried out, common rules should be established for the publication of details of completed transactions in shares and for the disclosure of details of current opportunities to trade in shares. These rules are needed to ensure the effective integration of Member State equity markets, to promote the efficiency of the overall price formation process for equity instruments, and to assist the effective operation of "best execution" obligations. These considerations require a comprehensive transparency regime applicable to all transactions in shares irrespective of their execution by an investment firm on a bilateral basis or through regulated markets or MTFs. ***The obligations for investment firms under this Directive to quote a bid and offer price and to execute an order at the quoted price should not prevent an investment firm from routing an order to another execution venue when such internalisation could prevent the firm from complying with best execution obligations.***

Justification

This amendment gives interesting details when the text of the common position does not

provide any legal certainty on the possibility for investment firms to route an order to another execution venue.

Amendment 8
Recital 44 a (new)

(44a). For the purposes of this Directive, dealing on own account outside of an automated system (including those types of activities commonly referred to as wholesale OTC trading, such as telephone trading) is not regarded as being within the definition of systematic internalisation contained in this Directive and is not therefore covered by the rules on systematic internalisation.

Justification

It is important that ordinary wholesale OTC trading is not disrupted by the new ISD. This type of inter-professional business has been in use for many years. It contributes in a positive way to the overall liquidity of the markets. It also provides services which are vital if institutional investors like pension funds and UCITS are to manage the savings of their customers in an efficient manner and maximise the returns for the thousands of retail investors who are their customers.

Amendment 9
Recital 45

(45) A Member State may decide to apply the pre- and post-trade transparency requirements laid down in this Directive to financial instruments other than shares. In that case those requirements should apply to all investment firms for which that Member State is the home Member State for their operations within the territory of that Member State and those carried out cross-border through the freedom to provide services. They should also apply to the operations carried out within the territory of that Member State by the branches established in its territory of investment firms authorised in another Member State. ***deleted***

Justification

The European Parliament clearly rejected an extension of the transparency framework of the ISD to bonds. Bond markets are structured very differently and application of inappropriate transparency requirements could be highly disruptive in a successful integrated pan-European market. MEPs also expressed a preference in first reading that, wherever possible, common rules should be used rather than Member State opt outs. This recital would also conflict with Articles 31 and 32.

Lastly, Article 65.1 requires the Commission to make an early report on the possible extension of scope of the relevant Articles to non-share financial instruments. Individual Member States should not pre-judge the outcome of this report.

Amendment 10 Recital 49

(49) Systematic internalisers might decide to give access to their quotes only to retail clients, only to professional clients, or to both. They should not be allowed to discriminate within those categories of clients. *deleted*

Justification

The suggested amendment brings the text in line with the outcome of Parliament's first reading.

Amendment 11 Recital 50

(50) Revision of Directive 93/6/EEC should fix the minimum capital requirements with which regulated markets should comply in order to be authorised. *deleted*

Justification

There is no need to introduce EU rules on capital requirements for operators of regulated markets. Operators of regulated markets are not subject to the same risks as investment firms. In particular, regulated markets are almost never subject to trading risk because neither their business model nor the proposed quote disclosure rule would require them to deploy their

own capital to facilitate the trades of their customers.

Amendment 12
Article 2, paragraph 1, point (d)

(d) persons which do not provide any investment services or activities other than dealing on own account ***and which cannot be categorised as market makers or as dealing*** on own account outside a regulated market or an MTF on an organised, regular and systematic basis;

(d) persons which do not provide any investment services or activities other than dealing on own account ***unless they are market makers or they hold themselves out to the public on a continuous basis as providing a facility within which they will deal*** on own account outside a regulated market or an MTF on an organised, regular and systematic basis;

Justification

The Council common position would adversely affect the activity of many professional investors who are dealing on own account and who are not providing a service to third parties, by imposing authorisation requirements on them. Therefore, it is essential to broaden this exemption to make it available to investors who are not market makers or who do not hold themselves out to the public, on a continuous basis, as providing a facility within which they will deal for own account on an organised, regular and systematic basis. Unless an investor does this should not be treated as requiring authorisation.

Amendment 13
Article 2, paragraph 1, point (i)

(i) persons dealing on own account in financial instruments, or providing investment services in commodity derivatives to the clients of ***their main business, provided this is an ancillary activity to their main business, when considered on a group basis, and*** that main business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2000/12/EC;

(i) persons dealing on own account in financial instruments ***as an ancillary activity to a business of theirs or of another undertaking in the same group,*** or providing investment services in commodity derivatives to the clients of ***a business of theirs or of another undertaking in the same group as an ancillary activity to that business,*** provided that business is not the provision of investment services within the meaning of this Directive or banking services under Directive 2000/12/EC;

Justification

The common position would place subsidiaries within banking groups at a competitive disadvantage and would violate the principle that the same regulatory framework should apply to the same activities. It would adversely affect entities within financial groups that engage in other, non-financial activities. It would also have an effect on the ability of bank or investment firm owned private equity firms to invest in ordinary commercial business and will produce many of the same arbitrary results referred to in the discussion of the proposed amendments to article 2.1(k).

Amendment 14

Article 2, paragraph 1, point (k)

(k) persons whose main business consists of dealing on own account in commodities and/or commodity derivatives. ***This exception shall not apply where the persons that deal on own account in commodities and/or commodity derivatives are part of a group the main business of which is the provision of other investment services;***

(k) persons whose main business consists of dealing on own account in commodities and/or commodity derivatives;

Justification

The Council's common position discriminates against commodity dealers who are part of a group of companies whose main activity is investment services. The Council's common position would produce unequal treatment of different commodity dealers who are carrying the same business and would produce competitive distortions. It is therefore very important that the same licensing regime apply to all specialised commodity dealers based on the nature of the entity's own business. The cross group risk in financial groups is adequately addressed through the consolidated supervision requirements of the Capital Adequacy Directive and the Financial Groups Directive.

Amendment 15

Article 4, paragraph 1, subparagraph 5

5) "Execution of orders on behalf of clients" means acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients;

5) "Execution of orders on behalf of clients" means acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients, ***including situations where an investment firm enters into transactions solely for the purpose of matching transactions between clients, or where by virtue of the rules of the regulated market, a multilateral trading facility or comparable third country system on which it executes such client orders, it is regarded as acting as principal;***

Justification

The amendment is important because of the directive's read-across to the proposed Basel II/CAD3 framework. Without such amendment "matched principal brokers" risk being inappropriately classified under the Commission's forthcoming Basel II/CAD3 framework and therefore risk being subject to crippling and inappropriate additional regulatory capital requirements.

Amendment 16

Article 4, paragraph 1, subparagraph 7

7) "Systematic internaliser" means an investment firm which, on an organised, regular, and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF;

7) "Systematic internalisation" means the execution, on a systematic, regular and continuous basis, of:

(1) orders up to a standard market size undertaken by any type of clients or counterparties,

(2) in shares admitted to or included in trading on a regulated market,

(3) on own account or by means of matching with other client orders,

(4) within a system, a component of which is primarily aimed at facilitating the activities set out in points (1) to (3),

(5) outside a regulated market or an MTF.

Where executions in several securities are part of one transaction (such as a portfolio transaction), the size of the total transaction shall determine whether the transaction was of a standard market size;

Justification

The European Parliament first reading definition of systematic internalisation commands a wide range of support and focuses the operation of the quote disclosure rule in a more sensible and workable way than the Council text. The Council formulation could cover a range of ordinary wholesale OTC business (often conducted by small as well as large investment firms and banks) rather than those activities where the aim is actively to seek order flow from exchanges and set up in competition with them.

The sophistication of modern wholesale financial markets means that almost all OTC and wholesale business could be described as being performed on an "organised, regular and systematic basis" and is therefore potentially caught by the Council definition. An order size cap is also essential to prevent unnecessary disruption of traditional and well established

forms of OTC trading.

Amendment 17
Article 4, paragraph 1, subparagraph 8

8) "Market maker" means a person who holds himself out on the financial markets as being willing to deal on own account by buying and selling financial instruments against his proprietary capital;

8) "Market maker" means a person who holds himself out on the financial markets **on a continuous basis** as being willing to deal on own account by buying and selling financial instruments against his proprietary capital **at prices defined by him**;

Justification

This definition is important because professional investors should not be treated as "market makers" if their activities lack the two essential elements of, first, continuity in the way that they hold themselves out on financial markets and, secondly, the willingness to trade on the basis of their own (two way) prices. Unless this definition is amended, there is a risk that many professional investors would be wrongly labelled as "market makers" and subjected to authorisation requirements, even though they are users of markets and are not in any sense intermediaries in those markets.

Amendment 18
Article 5, paragraph 2

2. Member States shall allow market operators to **be authorised to** operate an MTF **in accordance with the provisions of this Chapter, excluding Articles 11 and 15.**

2. **By way of derogation from paragraph 1**, Member States shall allow **any** market operator to operate an MTF, **subject to compliance with Articles 13, 14, 18, 26, 29 and 30**

Any existing system falling under the definition of an MTF run by a market operator, shall be deemed to be an MTF without the need for specific authorisation.

Justification

This amendment is necessary to restore the Commission position on this issue: "Once recognised as being in compliance with this provision, the market operator will be entitled to operate an MTF, without having to obtain an additional authorisation to operate such a facility" (Explanatory Memorandum Nov 2002). Once a market operator has complied with

the standards needed for authorisation to run a regulated market, this should give them the right (so long as they comply with any specific MTF requirements) to operate an MTF without requiring a second authorisation as an investment firm.

Amendment 19
Article 19, paragraph 5

5. Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 4, ask the client or potential client to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to ***assess whether the investment service or product envisaged is appropriate for the client.***

In case the investment firm considers, on the basis of the information received under the previous subparagraph, that the product or service ***is not*** appropriate to the client ***or potential client***, the investment firm shall warn the client ***or potential client***. This warning may be provided in a standardised format.

In cases where the client or potential client elects not to provide the information referred to under the first subparagraph, or where he provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision will not allow the firm to determine whether the service or product envisaged is appropriate for him. This warning may be provided in a standardised format.

5. Member States shall ensure that investment firms, when providing investment services other than those referred to in paragraph 4 ***and 6***, ask the client or potential client to provide information regarding his Knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded, ***at the latest before the client may start to use the specific type of product or service***, so as to enable the investment firm to ***assist the client or potential client to decide whether the product or service is appropriate for him.***

In case the investment firm considers, on the basis of the information received under the previous sub-paragraph, that the product or service ***may not be*** appropriate for the client, the investment firm shall warn the client ***at the latest before the client may start to use the product or service***. This warning may be provided in a standardised format.

In cases where the client or potential client elects not to provide the information referred to in the first sub-paragraph, or where he provides insufficient information regarding his knowledge and experience, the investment firm shall warn the client or potential client that such a decision ***may affect*** whether the service or product ***provided*** is appropriate for him. This warning may be provided in a standardised format.

Or. en

Justification

This Article constitutes the Council's recognition of a 'light touch' sales regime but as currently drafted it is unclear how far this could be distinguished from full advice Article 19

(4).

In providing a light touch sales regime, the consumer is encouraged to focus on the risks associated with buying a particular product or service. The impetus behind a light touch sales regime is to simplify current sales practices, to reduce costs to the consumer and to encourage them to make active choices about the products or services offered, so that they, in turn will be more alert to any potential risks involved in buying a particular investment product or service.

It is also important from an investor's protection point of view to establish that the information needs to be provided at the latest before the product/service is being offered.

Amendment 20

Article 19, paragraph 6, introductory part and indents 1 and 2

6. Member States shall allow investment firms when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services to provide those investment services to their clients without the need to obtain the information or make the determination provided for in **paragraph 5** where all the following conditions are met:

– the above services relate to shares admitted to trading on a regulated market, money market instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a derivative), UCITS and other non-complex financial instruments,

– the service is provided at the initiative of the client or potential client,

6. Member States shall allow investment firms when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services to provide those investment services to their clients without the need to obtain the information or make the determination provided for in **paragraph 4** where all the following conditions are met:

Justification

The European Parliament First Reading's approach to execution-only did not include any restriction in relation to the scope of instruments. The only restriction that the European Parliament envisaged was to make clear that no advice was being provided. This restriction is in line with the proposed amendment.

Amendment 21
Article 19, paragraph 10, introductory part

10. In order to ensure the necessary protection of investors and the **uniform** application of paragraphs 1 to 8, the Commission shall adopt, in accordance with the procedure referred to in Article 64 (2), implementing measures to ensure that investment firms comply with the principles set out therein when providing investment or ancillary services to their clients. Those implementing measures shall take into account:

10. In order to ensure the necessary protection of investors and the **consistent** application of paragraphs 1 to 8, the Commission shall adopt, in accordance with the procedure referred to in Article 64 (2), implementing measures to ensure that investment firms comply with the principles set out therein when providing investment or ancillary services to their clients. Those implementing measures shall take into account:

Justification

This amendment maintains Parliament's position from the first reading. The wording "uniform application" suggests that every detail of regulatory protection has to be harmonised.

Amendment 22
Article 19, paragraph 10, point (c)

(c) the retail or professional nature of the client or potential clients.

(c) the retail or professional nature of the client or potential clients **including adequate grandfathering provisions for the categorisation of existing clients and leaving a sufficient degree of flexibility for investment firms when implementing the categorisation set out in Annex II.**

Where appropriate, the implementing measures adopted under this paragraph may provide that the principles set out in paragraphs 1 to 8 shall not apply to professional clients or potential professional clients and/or that conduct of business rules may be waived by professional clients, if they so wish.

Justification

Sensible grandfathering provisions are essential in this context otherwise millions of contracts might have to be examined and revised (including around 36 million in Germany alone).

It should also be made clear that the Commission's duty to differentiate between different classes of client extends to considering which rules should be applied to professionals and which should not. Failure to differentiate properly between professional and retail clients could severely disrupt markets.

Amendment 23
Article 21, paragraph 1

1. Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best **possible** result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction.

1. Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best result **reasonably achievable** for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction.

In the case of professional clients who have retained discretion over the manner and market of execution, the investment firm's best-execution duty shall consist only of a need to follow the client's instructions.

Justification

Parliament First Reading amendment is clearer in terms of the obligations and duties of the intermediary vis-à-vis the client, and is in particular clear in terms of the reasonability test, which is implicit but not well formulated in the Council version. Furthermore, as Parliament's agreed, there is a need to make a differentiation between professional and non-professional clients.

Amendment 24
Article 21, paragraph 2

2. Member States shall require investment firms to establish and implement effective arrangements for complying with paragraph 1. In particular Member States shall require investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best **possible** result in accordance with paragraph 1.

2. Member States shall require investment firms to establish and implement effective arrangements for complying with paragraph 1. In particular Member States shall require investment firms to establish and implement an order execution policy to allow them to obtain, for their client orders, the best result **reasonably achievable** in accordance with paragraph 1.

Justification

Consistent with previous amendment.

Amendment 25
Article 21, paragraph 3

3. The order execution policy shall include, ***in respect of each class of instruments***, information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best ***possible*** result for the execution of client orders.

Member States shall require that investment firms provide appropriate information to their clients on their order execution policy. ***Member States shall require that investment firms obtain the prior consent of their clients to the execution policy.***

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the investment firm ***shall, in particular, inform their clients or potential clients about this possibility. Member States shall require that investment firms*** obtain the ***prior express*** consent of their clients before proceeding to execute their orders outside a regulated market of an MTF. Investment firms may obtain this consent either in the form of a general agreement or in respect of individual transactions.

3. The order execution policy shall include information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the investment firm to obtain on a consistent basis the best result ***reasonably achievable*** for the execution of client orders.

Member States shall require that investment firms provide appropriate information to their clients on their order execution policy.

Member States shall require that, where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or an MTF, the investment firm obtain the consent of their clients before proceeding to execute their orders outside a regulated market of an MTF. Investment firms may obtain this consent either in the form of a general agreement or in respect of individual transactions.

Justification

The wording of the first paragraph should be modified in line with the first reading of the Parliament.

Deleting “in respect of each class of instruments” allows the firm to formulate its execution policy in the level of detail best suited to its investors.

Furthermore, there should be no general requirement to obtain consent to the execution policy; as in the Parliament’s First Reading Opinion, the consent requirement should be

focused on the cases where orders are executed outside the regulated markets.

Finally, the third subparagraph as it stands would force the intermediary to inform the client of an element of its execution policy twice: The fact that the order may be executed outside a regulated market will be in the execution policy, which will be disclosed to the client, so there is no reason why the firm should have to state again what is already said in the execution policy. In addition to an unnecessary cost for the client, this might also create a prejudice against alternative execution venues. Also, requiring prior express consent is not in line with the Parliament's First Reading amendment which only required consent. Prior express consent will entail unnecessary costs for firms since they will require a specific paper mailing to be returned with the signature of the client. If the client does not return the signed letter back, the firm will not be able to execute orders of the client and will thus breach its best execution obligations.

Amendment 26
Article 21, paragraph 4

4. Member States shall require investment firms to monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best **possible** result for the client or whether they need to make changes to their execution arrangements. Member States shall require investment firms to notify clients of any material changes to their **order execution arrangements or** execution policy.

4. Member States shall require investment firms to monitor the effectiveness of their order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, they shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best result **reasonably achievable** for the client or whether they need to make changes to their execution arrangements. Member States shall require investment firms to notify clients of any material changes to their execution policy.

Justification

The first amendment is in line with previous amendments in relation to best reasonably achievable results. The second amendment is in line with the Parliament's First Reading which required notification of changes to the execution policy but not to execution arrangements.

Amendment 27
Article 21, paragraph 6, points (a) to (c)

(a) the criteria for determining the relative importance of the different factors that,

(a) the different factors that, pursuant to

pursuant to paragraph 1, may be taken into account for determining the best **possible** result taking into account the size and type of order and the retail or professional nature of the client;

(b) factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate. In particular, the factors for determining which venues enable investment firms to obtain on a consistent basis the best possible result for executing the client orders;

(c) the nature and extent of the information to be provided to clients on their execution policies, pursuant to paragraph 3.

paragraph 1, may be taken into account for determining the best **reasonably achievable** result taking into account the size and type of order and the retail or professional nature of the client;

(b) factors that may be taken into account by an investment firm when reviewing its execution arrangements and the circumstances under which changes to such arrangements may be appropriate. In particular, the factors for determining which venues enable investment firms to obtain on a consistent basis the best **reasonably achievable** result for executing the client orders;

Justification

There is no reason why the Commission should adopt an implementing measure to identify “the criteria for determining the relative importance of the different factors” nor the extent of information on execution policies. This is clearly an excess of comitology.

The other amendments are consistent with previous amendments.

Amendment 28 Article 24, paragraph 3

3. Member States **may** also recognise as eligible counterparties other undertakings meeting pre-determined proportionate requirements, including quantitative thresholds. ***In the event of a transaction where the prospective counterparties are located in different jurisdictions, the investment firm shall defer to the status of the other undertaking as determined by the law or measures of the Member State in which that undertaking is established.***

Member States shall ensure that the investment firm, when it enters into transactions in accordance with paragraph 1 with such undertakings, obtains the express confirmation from the prospective counterparty that it agrees to

3. Member States **shall** also recognise as eligible counterparties other undertakings meeting pre-determined proportionate requirements, including quantitative thresholds.

*be treated as an eligible counterparty.
Member States shall allow the investment
firm to obtain this confirmation either in
the form of a general agreement or in
respect of each individual transaction.*

Justification

The European Parliament first reading compromise is preferable. The Council text would produce uncertainty and complexity, making it difficult for firms to determine whether they were or were not dealing with an eligible counterparty and forcing them to check the laws of 25 Member States on how to define counterparties.

The second paragraph should be deleted because the entities listed in the directive as eligible counterparties are the most sophisticated firms operating in financial markets. Therefore there is no need for a confirmation to be obtained of their counterparty status.

Amendment 29

Article 24, paragraph 5, point (b)

(b) the procedures for obtaining the express confirmation from prospective counterparties under paragraph 3; **deleted**

Or. en

Justification

This deletion is proposed in order to ensure consistency with the deletion of part of Article 24.3 in Amendment 12 of the Draft Report, relating to express confirmation.

Amendment 30

Article 25, paragraph 5

5. Member States shall provide for the reports to be made to the competent authority either by the investment firm itself, or by a trade-matching or reporting system approved by the competent authority or by the regulated market or MTF through whose systems the transaction was completed. In cases where transactions are reported directly to the competent authority by a

5. Member States shall provide for the reports to be made to the competent authority either by the investment firm itself, **by a third party acting on its behalf** or by a trade-matching or reporting system approved by the competent authority or by the regulated market or MTF through whose systems the transaction was completed. In cases where transactions are reported

regulated market, an MTF, or a trade-matching or reporting system approved by the competent authority, the obligation on the investment firm laid down in paragraph 3 may be waived.

directly to the competent authority by a regulated market, an MTF, or a trade-matching or reporting system approved by the competent authority, the obligation on the investment firm laid down in paragraph 3 may be waived.

Justification

Many investment firms report transactions through a suitable third party (e.g. a parent company or a transaction bank). For reasons of clarification such an option should be explicitly permitted at level 1 of the Directive as provided for in the EP's first reading.

Amendment 31 Article 27, paragraph 1

1. Member States shall require ***systematic internalisers to publish a firm quote in those shares admitted to trading on a regulated market and for which they want to trade.***

1. Member States shall require ***investment firms which practise systematic internalisation in shares to make public firm bid and offer quotes of a standard market size in those shares, where those shares are admitted to trading on a regulated market and for which there is a liquid market.***

The quote shall include a firm bid and/or offer price or prices as well as the size or sizes attached to those price or prices. It shall also reflect the prevailing market conditions for that share.

The obligation referred to in the first subparagraph shall not apply to transactions of a size which is large in scale compared to the normal market size.

In case of shares for which there is not a liquid market, systematic internalisers shall disclose quotes to their clients on request.

Justification

The European Parliament first reading text was a balanced compromise commanding a wide range of support for the obligation to quote in a "standard market size". The EP compromise has therefore been re-tabled, with the exception of the deletion of the reference to transactions. It is clearer to refer to quotes rather than transactions in this context.

Amendment 32 Article 27, paragraph 2

2. Systematic internalisers shall make public their quotes on a regular and continuous basis during normal trading hours. They shall be entitled to update their quotes. They shall also be allowed, under exceptional market conditions, to withdraw their quotes.

The quote shall be made public in a manner which is easily accessible to other market participants on a reasonable commercial basis.

Systematic internalisers shall execute the orders they receive from their retail clients at the quoted prices.

Systematic internalisers shall execute the orders they receive from their professional clients at the quoted price. However, they may execute those orders at a better price in justified cases provided that this price falls within a public range close to market conditions and provided that the orders are of a size bigger than the size customarily undertaken by a retail investor.

Furthermore, systematic internalisers may execute orders they receive from their professional clients at prices different than their quoted ones without having to comply with the conditions established in the fourth subparagraph, in respect of transactions where execution in several securities is part of one transaction or in respect of orders that are subject to conditions other than price.

2. Member States shall ensure that the bid and offer prices required under paragraph 1 are made public in a manner which is easily accessible to other market participants on reasonable commercial terms, on a regular and continuous basis during normal trading hours.

Investment firms which practise systematic internalisation shall execute the systematic internalisation orders they receive from their retail clients at the quoted prices, provided execution at such prices complies with the best execution obligation.

Investment firms which practise systematic internalisation may execute the systematic internalisation orders they receive from their retail clients at a better price than that publicly quoted in distinctive circumstances while ensuring, however, that, in general, the systematic internalisation orders of retail clients are executed at the quoted price.

Investment firms which practise systematic internalisation may execute systematic internalisation orders from professional clients at a better price than that publicly quoted.

Investment firms may refuse to execute the orders of a systematic internalisation client where justified by legitimate commercial considerations such as the investor credit status, the counterparty risk and the final settlement of the transaction.

The competent authorities shall:

(a) verify whether investment firms

fulfil the criteria laid down in Article 4(1)(7)

(b) monitor whether investment firms regularly update the bid and offer prices published in accordance with paragraph 1 and maintain prices which are generally representative of overall market conditions.

Justification

Price improvement was an important part of our first reading compromise. It is a valuable means of ensuring customers get the best deal and that investment firms manage their trading risk prudently. Without some flexibility on price improvement, consumer choice and competition would suffer because firms would find it almost impossible to internalise without incurring excessive risk. To give best execution, firms need to trade at prices which are as good as or better than the best bid or offer on the exchange. However, a firm's public quote cannot beat the best bid and offer on the market at all times because this would involve too much risk. The best bid or offer on an exchange represents a single order by an investor who wishes to buy or sell. When this single order is hit, the person who placed it has no further liability. By contrast, a quote is an advertisement to which anyone who has dealing access can respond. It can be hit repeatedly. A public quote is therefore far more risky than making the best bid and offer on an exchange.

Because of the extreme sensitivity of this issue within the Council, however, it is proposed to place restrictions on price improvement for retail clients.

Amendment 33

Article 27, paragraph 3

3. Systematic internalisers shall be allowed to decide, on the basis of their commercial policy and in a non-discriminatory way, the investors to whom they give access to their quotes.

Investment firms may refuse to enter into or discontinue business relationships with investors on the basis of commercial considerations such as the investor credit status, the counterparty risk and the final settlement of the transaction.

3. Investment firms are permitted to decide, on the basis of their own commercial policies, which persons they accept as clients and consequently with whom they deal on their prices quoted under paragraph 1. However, Member States shall require that the investment firms subject to the obligation under paragraph 1 which do not exercise their option under paragraph 5, point (d)(i) of providing their quotes through the facilities of a regulated market or MTF have clear standards for governing access for new systematic internalisation clients, based on objective, non-discriminatory, commercial criteria.

Investment firms may refuse to enter into or discontinue business relationships with

investors on the basis of commercial considerations such as the investor credit status, the counterparty risk and the final settlement of the transaction.

Justification

Imposing access requirements on systematic internalisers was an extremely contentious issue in the European Parliament's first reading and the resulting compromise should be re-tabled.

Amendment 34 Article 27, paragraph 4

4. In order to limit the risk of being exposed to multiple transactions **from the same client** systematic **internalisers** shall be allowed to limit **in a non-discriminatory way** the **number of** transactions **from that same client** which they **undertake to enter** at the published conditions.

4. In order to limit the risk of being exposed to multiple transactions **investment firms that practise systematic internalisation** shall be allowed to limit the **aggregate** transactions which they **execute** at the published conditions **to the size in which they are quoting, and shall be allowed to update a quote after it has been executed against.**

Justification

The issue of multiple hits from the same client was identified at an early stage as a potential problem with the quote disclosure rule. However, the issue of hits from multiple clients is an even more serious problem. This will inevitably occur with the continuous quoting required by Article 27 (formerly 25). This amendment is designed to modify the Council's new text on this issue to reduce the counterparty risk suffered by those who have to comply with the quote disclosure rule.

Amendment 35 Article 27, paragraph 5

5. In order to ensure the uniform application of **paragraphs 1 to 4**, in a manner which supports the efficient valuation of shares and maximises the possibility of investment firms of obtaining the best deal for their clients, the Commission shall, in accordance with the procedure referred to in **Article 64(2)**, adopt implementing measures which:

(a) specify the criteria for application of paragraph 1 and, in particular, for determining when a size of a transaction

5. In order to ensure the uniform application of **paragraphs 1, 2 and 3**, in a manner which supports the efficient valuation of shares and maximises the possibility of investment firms to obtain the best deal for their clients, the Commission shall, in accordance with the procedure referred to in **Article 60(2)**, adopt implementing measures which:

(a) specify what is a standard market size in respect of which the investment firm shall make public firm bid and offer

is large in scale compared to normal market size, when a quote reflects current market conditions and when there is an illiquid market on specific shares;

(b) specify the criteria for application of paragraph 2, with the exception of the fourth subparagraph and, in particular, the means by which investment firms may comply with their obligation to make public their quotes, which shall include the following possibilities:

(i) through the facilities of any regulated market which has admitted the instrument in question to trading;

(ii) through the offices of a third party;

(iii) through proprietary arrangements;

(c) specify the criteria for application of paragraph 3;

(d) specify the criteria under which the quotes can be withdrawn;

(e) by way of derogation from point (b), specify the criteria for determining what is a size customarily undertaken by a retail investor.

quotes, having regard to at least the following factors and with the aim of ensuring transparent, competitive and liquid markets:

(i) prevailing local market conditions and practices and respective trading volumes in different Member States and the views of local competent authorities,

(ii) the effect on liquidity, competition, price formation and the general functioning of the market in different Member States,

(iii) the risks to which the obligation under paragraph 1 exposes firms, including associated obligations and risks regulated under the Capital Adequacy Directives;

(b) specify what is an order of standard market size for the purposes of Article 4(1)(7). The Commission shall take into account the aim and factors referred to in point (a)(i) to (iii) but shall not be obliged to adopt the same specification or definition of standard market size for the purposes of Article 4(1)(7) and Article 27(1) and may, if it considers this to be appropriate, adopt a different approach to the term in the two different contexts;

(c) define the shares or classes of share for which there is sufficient liquidity to allow application of the obligation under paragraph 1;

(d) specify the means whereby investment firms may comply with their obligations under paragraph 1. These shall include the following possibilities:

(i) through the facilities of any regulated market which has admitted the instrument in question to trading;

(ii) through the offices of a third party;

(iii) through proprietary arrangements.

Justification

One of the major defects of the Council's text is the excessive width of the powers granted to CESR and the Commission to specify how Article 27 will work in practice. This clause, combined with the ambiguities in Article 27, would undermine the parliamentary process by leaving the key decisions on Article 27 to CESR and the Commission.

The European Parliament first reading compromise places much needed constraints on the comitology process. It was a balanced amendment which sought to tackle the concerns of the different sides of the debate in an analytical and intelligent way. It has significant support and should be reinstated.

Amendment 36
Article 29, paragraph 2

2. Member States shall provide for the competent authorities to be able to waive the obligation for investment firms or market operators operating an MTF to make public the information referred to in paragraph 1 based on the market model or the type and size of orders. In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

2. Member States shall provide for the competent authorities to be able to waive the obligation for investment firms or market operators operating an MTF to make public the information referred to in paragraph 1 based on the market model or the type and size of orders ***in the cases defined according to paragraph 3***. In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

Justification

This amendment modifies the Council version in the sense of the EP's first reading. To ensure a level playing field between different trading systems it is important that the exemptions from pre-trade transparency requirements for MTFs are defined in a uniform manner. This also holds for the amendment to article 44 (2).

Amendment 37
Article 31, paragraph 5

5. Member States shall, without further legal or administrative requirement, allow

5. Member States shall, without further legal or administrative requirement, allow

investment firms operating MTFs from other Member States to provide appropriate arrangements on their territory so as to facilitate access to and use of their systems by remote users or participants established in their territory.

investment firms **and market operators** operating MTFs from other Member States to provide appropriate arrangements on their territory so as to facilitate access to and use of their systems by remote users or participants established in their territory.

Justification

As market operators are subject to the same obligations as investment firms, they should have the same right to provide appropriate arrangements for access and use by remote users.

Amendment 38
Article 32, paragraph 7

7. The competent authority of the Member State in which the branch is located shall assume responsibility for ensuring that the services provided by the branch within its territory comply with the obligations laid down in Articles 19, 21, 22, 25, 27 and 28 and in measures adopted pursuant thereto.

The competent authority of the Member State in which the branch is located shall have the right to examine branch arrangements and to request such changes as are strictly needed to enable the competent authority to enforce the obligations under Articles 19, 21, 22, 25, 27 and 28 and measures adopted pursuant thereto with respect to the services and/or activities provided by the branch within its territory.

7. The competent authority of the Member State in which the branch is located shall assume responsibility for ensuring that the services provided by the branch within **or from** its territory comply with the obligations laid down in Articles 19, 21, 22, 25, 27 and 28 and in measures adopted pursuant thereto.

The competent authority of the Member State in which the branch is located shall have the right to examine branch arrangements and to request such changes as are strictly needed to enable the competent authority to enforce the obligations under Articles 19, 21, 22, 25, 27 and 28 and measures adopted pursuant thereto with respect to the services and/or activities provided by the branch within **or from** its territory.

Justification

The amendments to Article 32.7 and Recital 31 seek to ensure that branches and their clients are not subject to different rules depending on where the customer is located, that the Directive does not discriminate against the provision of services through branches, or put pressure on branches to establish themselves as subsidiaries, and that the Directive is consistent with the E-Commerce Directive 2000.

Amendment 39
Article 35, paragraph 2

2. The competent authority of investment firms and market operators operating an MTF may not oppose the use of central counterparty, clearing houses and/or settlement systems in another Member State except where this is demonstrably necessary in order to maintain the orderly functioning of that MTF **and taking into account the conditions for settlement systems established in Article 34(2).**

In order to avoid undue duplication of control, the competent authority shall take into account the oversight/supervision already exercised by the national central banks as overseers of clearing and settlement systems or by other supervisory authorities with a competence in such systems.

2. The competent authority of investment firms and market operators operating an MTF may not oppose the use of central counterparty, clearing houses and/or settlement systems in another Member State except where this is demonstrably necessary in order to maintain the orderly functioning of that MTF.

Justification

The object of this amendment is to prevent host regulatory authorities refusing access to clearing and settlement systems by foreign MTFs and regulated markets in order to protect their own markets. The deletion of the cross-reference to Article 34 (2) is due this paragraph only relating to regulated markets.

Amendment 40 Article 44, paragraph 2

2. Member States shall provide that the competent authorities are to be able to waive the obligation for regulated markets to make public the information referred to in paragraph 1 based on the market model or the type and size of orders. In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

2. Member States shall provide that the competent authorities are to be able to waive the obligation for regulated markets to make public the information referred to in paragraph 1 based on the market model or the type and size of orders ***in the cases defined according to paragraph 3.*** In particular, the competent authorities shall be able to waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question.

Justification

This amendment modifies the Council version in the sense of the EP's first reading. To ensure a level playing field between different trading systems it is important that the exemptions from

pre-trade transparency requirements for regulated markets are defined in a uniform manner. This also holds for the amendment to article 29 (2).

Amendment 41
Article 46, paragraph 2, subparagraph 2

In order to avoid undue duplication of control, the competent authority shall take into account the oversight/supervision already exercised by the national central banks as overseers of clearing and settlement systems or by other supervisory authorities with competence in relation to such systems. ***deleted***

Justification

The object of this amendment is to prevent host regulatory authorities refusing access to clearing and settlement systems by foreign MTFs and regulated markets in order to protect their own markets.

Amendment 42
Article 56, paragraph 2

2. When, taking into account the situation of the securities markets in the host Member State, the operations of a regulated market that has established arrangements in a host Member State have become of substantial importance for the functioning of the securities markets and the protection of the investors in that host Member State, the home and host competent authorities of the regulated market shall establish proportionate cooperation arrangements. ***deleted***

Justification

The Council version frustrates the idea of home supervision of market participants in the integrated single market. The suggested version in the Parliament's first reading provides more flexibility in this respect.

Amendment 43
Article 62, paragraph 3, subparagraph 2

If, despite the measures taken by the competent authority of the home Member State or because such measures prove inadequate, the said regulated market or the MTF persists in acting in a manner that is clearly prejudicial to the interests of host Member State investors or the orderly functioning of markets, the competent authority of the host Member State, after informing the competent authority of the home Member State, ***shall take all the appropriate measures needed in order to protect investors and the proper functioning of the markets. This shall include the possibility of preventing the said regulated market or the MTF from making their arrangements available to remote members or participants established in the host Member State. The Commission shall be informed of such measures without delay.***

If, ***in exceptional circumstances***, despite the measures taken by the competent authority of the home Member State or because such measures prove inadequate, the said regulated market or the MTF persists in acting in a manner that is clearly prejudicial to the interests of host Member State investors or the orderly functioning of markets, the competent authority of the host Member State, after informing the competent authority of the home Member State, ***may take the alleged non compliance of the regulated market or MTF to the Commission for investigation.***

Justification

The ability of Member States to block the activities of a market authorised in another Member State undermines the attempt to create a single market. If a Member State has serious concerns over the activities of a regulated market authorised in another Member State, it should take its complaint to the Commission, not act unilaterally.

Amendment 44
Article 64 a (new)

Article 64a***The Commission shall seek to ensure that any implementing measures adopted under this directive are proportionate to the regulatory goals sought and shall take account of the impact of these measures (including cost impact) on the differing sizes, business activities and business structures of credit institutions authorised under Directive 2000/12/EC, investment firms and operators of regulated markets.***

Justification

Before adopting implementing measures, it is essential that the Commission take account of their impact of the different institutions within the scope of this directive, including small and medium size businesses. CESR and the Commission must consult widely with interested groups and take account of the cost of any proposed measures and ensure that comitology measures are proportionate to the problems they seek to address. This was an important aspect of the agreement which allowed the Lamfalussy process to go ahead.

Amendment 45

Article 65, paragraph 1 and 2

1. **Before***, the Commission shall, on the basis of public consultation and in the light of discussions with competent authorities, report to the European Parliament and Council on the possible extension of the scope of the provisions of the Directive concerning pre and post-trade transparency obligations to transactions in classes of financial instrument other than shares.

2. **Before**** the Commission shall present a report to the European Parliament and to the Council on the **application** of Article 27.

* 2 years after the **entry into force of this Directive**.

** 3 years after the **entry into force of this Directive**.

1. **No later than *0** the Commission shall, on the basis of public consultation and in the light of discussions with competent authorities, report to the European Parliament and Council on the possible extension of the scope of the provisions of the Directive concerning pre- and post-trade transparency obligations to transactions in classes of financial instrument other than shares.

2. **No later than**** the Commission shall present a report to the European Parliament and to the Council on the **continued appropriateness of the obligation in** Article 27.

2a The Commission shall assess the need to lay down at European level definitions of central counterparty and clearing and settlement systems. On the basis of this assessment, the Commission shall submit its conclusions to the European Parliament and Council.

* 2 years after the **date referred to in Article 70**

** 1 year after the **date referred to in Article 70**

Justification

It makes sense to conduct the assessment of the operation of Article 27 before consideration is given to its extension to other instruments.

Considerable concern was expressed in the European Parliament during its first reading about the impact of the ISD on forthcoming discussions on clearing and settlement. Hence it

is necessary to restore the proposal from the PSE group for a review of whether action is needed at a European level on clearing and settlement.

Amendment 46
Annex I, section b, point (6 a) (new)

(6a) Services and activities related to commodities

Justification

Passported Firms should be able to provide services and activities related to commodities as an ancillary service to the passported business. Otherwise there would be barriers to business in the single market.

Amendment 47
Annex I, section c, point (5)

(5) Options, futures, swaps, and any other derivative contract relating to commodities that **can** be settled in cash;

(5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that **must** be settled in cash **or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event)**;

Justification

The common position text suggests that a contract will be treated as a financial instrument within this category if there is simply the possibility of cash settlement. This could deter firms from using industry standard netting master agreements to manage their credit risks on physically settled transactions in commodities. Those contracts provide for the close and netting of individual transactions, on a default by one of the parties or other specified termination event, so that a single cash sum is payable by one or other of the parties. The possibility of this form of cash settlement should not itself be enough to bring the transaction within the scope of this provision.

Amendment 48
Annex I, section c, point (6)

(6) Options, futures, swaps, and any other derivative contract relating to commodities that can **only** be physically settled provided

(6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that

that they are traded on a regulated market
and/or an MTF;

they are traded on a regulated market and/or
an MTF;

Justification

An exchange traded contract for physical settlement should still be a financial instrument even if in some circumstances there may be the possibility of settlement in cash.

Amendment 49

Annex I, section c, point (6 a) (new)

(6a) Other options, futures, swaps, forwards and any other derivative contracts relating to commodities, not being commodity contracts for spot delivery or commodity contracts for commercial purposes having a deferred delivery, which the Commission determines, acting in accordance with the procedure referred to in Article 64(2), have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded for commercial or investment purposes, are cleared and settled through recognised clearing houses or are subject to regular margin calls;

Justification

The Directive should provide flexibility to accommodate within it other classes of commodity derivatives which are determined to have the characteristics of other derivative financial instruments. However, the existence of any of these specified factors is not conclusive that the instrument should be treated as financial instrument. On the other hand, commodity contracts for spot delivery and commodity contracts for commercial purposes and for deferred delivery should not be treated as financial instruments where they are not traded on a regulated market or MTF.

Amendment 50

Annex I, section c, point (8 a) (new)

(8a) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic

statistics that must be settled in cash or may be settled in cash at the option of one of the parties (otherwise than by reason of a default or other termination event);

Justification

There is a market for cash settled derivatives related to new classes of underlying subject matter, such as weather, freight rates, emissions allowances and economic statistics. These classes of derivatives should be treated as financial instruments. This will ensure that investment firms have the benefit of the passport to offer these derivatives across Europe subject to the regulatory regime of the Directive.

Amendment 51

Annex I, section c, point (8 b) (new)

(8b) Options, futures, swaps, and any other derivative contracts relating to assets, rights, obligations, indices and measures not otherwise mentioned in this Section C, which the Commission determines, acting in accordance with the procedure referred to in Article 64(2), have the characteristics of other derivative financial instruments, having regard to whether, inter alia, they are traded for commercial or investment purposes, are cleared and settled through recognised clearing houses or are subject to regular margin calls;

Justification

The Directive should provide flexibility to accommodate within it other existing and future classes of derivatives which are determined to have the characteristics of other derivative financial instruments. In order to facilitate the decision as to whether a particular instrument should be treated as a financial instrument, it is important to identify factors that should be taken into account. However, the existence of any of these factors, in any particular case, is not conclusive that the instrument should be treated as a financial instrument .

Amendment 52

Annex II, section I, point 2, indent 1 and 2

- | | |
|--|--|
| - balance sheet total: EUR 20 000 000 , | - balance sheet total: EUR 12 500 000 , |
| - net turnover: EUR 40 000 000 , | - net turnover: EUR 25 000 000 , |

Justification

The thresholds for the definition of professional investor have been set at too high a level by the Council. The EP first reading amendment should be restored to ensure that a wider range of companies can be classified as professional investors, in accordance with the sophistication of such companies.

Amendment 53

Annex II, section I, point (3 a) (new)

(3a) Other institutional investors whose corporate purpose is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

Justification

This amendment restores the position of the Commission and European Parliament first reading following the deletion of Annex II paragraph 1.2.b by the Council. There are categories of institutional investors who are not authorised or regulated to operate on financial markets within paragraph 1(1) of Annex II but who should nevertheless be treated as professional investors, regardless of whether they meet the size tests set out in paragraph 1(2). It would be wholly inappropriate if an investment firm were required to treat sophisticated institutional investors such as special purpose vehicles as a retail investors.

EXPLANATORY STATEMENT

The goal of your Rapporteur is to reach an agreement with the Council to secure the adoption of the directive within the current Parliamentary term. To be as constructive as possible, she has kept the number of proposed amendments to a minimum. Given the hugely important issues covered by the EP's 144 first reading amendments, this has been very difficult. In particular, refraining from re-tableting EP amendments on best execution, the limit order rule and branches/country of origin should be viewed as an important gesture of goodwill towards the Council.

MEPs worked extremely hard to produce a workable and balanced first reading compromise. Our extensive consultation contributed to the quality of the result. Our text continues to command wider public support than the Council's. During its first reading, the Council gave insufficient consideration to the views of the European Parliament and we will have to consider conciliation if the Council again fails to give proper weight to our views. The need for prompt completion of the legislative process is no justification for signing off on a deal that would damage investors and European financial markets.

Article 27 (former 25) – Quote Obligation

Our goal should be to protect investors and maintain an efficient price formation process while encouraging liquidity and competition. The European Parliament's first reading compromise maintains a better balance between these factors than the Council's common position. Hence the EP compromise has been re-tableted almost in its entirety.

The Council text is difficult to understand and ambiguous. It contains a wide-ranging comitology clause which is considerably broader than the Commission's text and far more extensive than the constrained comitology in the EP compromise. The combination of ambiguity and comitology means that it is not clear how the Council text would work in practice. *The key decisions would be left to CESR and the Commission. This is not acceptable and would prevent proper parliamentary scrutiny.*

Ambiguity and loopholes in the Council text could also render it ineffectual. Therefore, not only would the Council text damage liquidity and deter competition (as set out below), it would not produce an effective transparency requirement. Put simply, neither side of the debate gets a satisfactory result from the Council's amendment.

It is difficult to determine what, if any, quote size is imposed by the Council, particularly with the confusion between "quote" and "transaction." A quoting obligation is imposed for all transactions except those which are large in scale compared to normal market size. (Normal market size in a share could be well above €3m, as it's defined on some securities markets in the EU.) One plausible interpretation is that the Council text would require firms to quote publicly in any size of trade that they were actually carrying out, unless the trades were "*large in scale compared to normal market size*". Hence if the firm were to give a quote to one client for an order worth, say, €3.5m Glaxo shares (i.e. around normal market size for that share on the London market), it would have to post a public quote for €3.5m worth of Glaxo shares and be prepared to deal on that quote with all clients.

To require firms to hold themselves out on a continuous basis as willing to buy and sell shares in blocks of €3m and above – quotes which could be hit an indefinite number of times by an indefinite number of clients - would involve a huge liability which would be impossible to reconcile with a prudent approach under Basel rules. Investment firms would find it impossible to comply. There is thus a real danger that the Council text could act as an EU-wide mandatory concentration rule, since no firm could cope with the risks and regulatory costs of this interpretation of Article 27.

As well as placing very significant obstacles to internalisation, the Council text would also disrupt many areas of wholesale and OTC trading which are long-standing and accepted ways to promote liquidity and facilitate trades by institutional investors. The Council text would, for example, damage telephone OTC trading which has been a successful business model in Germany for many years without damage to liquidity at the main exchange. Traditional wholesale OTC trading can enhance liquidity across the market, including at the exchanges which are the main centres of liquidity.

The Council text would damage the ability of institutional investors to manage their equity positions to maximise returns for investors. That means a reduced savings income for consumers who invest in UCITS and pensions. Institutional investors often seek an off-exchange solution because the central order book cannot always readily deliver the service they want – immediate execution of wholesale size orders at an agreed price.

Take a UCITS manager, Mrs B, who wants to sell 100,000 shares in a listed company – a size which is more than the number of shares normally quoted for that company. Presently, she has 3 choices: (a) she can trade slowly on an exchange and risk the price moving against her over time; (b) she can reveal the whole order on the order book, meaning the price will almost inevitably fall with the sudden increase in supply (to the detriment of Mrs B's UCITS and other investors who are selling at the same time); or (c) she can ring one of several banks and ask if they are willing to buy the shares.

If a price is agreed, the bank buys the shares from the UCITS and puts them on its own book - i.e. the bank then owns the shares and is at risk in relation to movements in the price. The bank subsequently unwinds this position, occasionally by direct sales to other clients, but more often via smaller trades through the order book of a regulated market. Either way, the order usually ends up going through the main exchange because that is where most of the liquidity is concentrated. In such trades, the investment bank is acting, not as a competitor to the exchange, but as an intermediary to smooth transactions into the main centre of liquidity.

Under the Council text, firms regularly carrying out ordinary OTC trades, such as Mrs B's, could trigger an Article 27 obligation. Option (c) would become much more difficult for Mrs B as firms withdraw from the market because of the difficulty of compliance with Article 27.

In contrast, the EP compromise focused on systematic internalisation as an *activity* and targeted those activities where the intention is to compete with exchanges for order flow and market share. The Council's definition of systematic internaliser is very broad and could impose a market-making obligation on a wide range of large/small banks and investment firms which are not in competition with exchanges. The EP compromise (in particular, the concept of Standard Market Size, introduced into the debate by the PSE group, and the focus

on activities carried out within an automated system) does not trigger the problems outlined above and is a much better way to produce a workable quote obligation.

Price improvement

Price improvement was an important part of our first reading compromise but the Council text places significant restrictions on it.

A public quote under Article 27 and a best bid and offer price posted on an exchange differ in crucial respects. The best bid or offer on an exchange represents a single order by an investor who wishes to buy or sell. When this single order is hit, the person who placed it has no further liability. By contrast, a quote is an advertisement to which anyone who has dealing access can respond. It can be hit repeatedly. *A public quote is therefore far more risky than making the best bid or offer on an exchange.* To protect against this increased risk, quoted spreads often need to be a little wider than the best bid and offer on the exchange. Firms can then improve on their publicly quoted price for individual customers in order to ensure best execution. The actual price agreed with the customer is then promptly made public using post trade transparency (under Article 28).

Not only is price improvement important in ensuring customers get the best deal (in the US, price improvement is not just accepted, it is actively encouraged by regulators) but it is also important in ensuring that investment firms manage their trading risk prudently. Without some flexibility on price improvement, consumer choice and competition will suffer because firms would find it almost impossible to internalise without incurring excessive risk. In order to provide best execution, firms need to buy/sell at prices which are as good as or better than the best bid and offer on the exchange. But firms cannot quote publicly at the best bid and offer price on the market all the time because (as set out above) this would involve too much risk.

Even with price improvement, publicly quoted prices would be very close to the actual price given to the customer because firms will wish their public quote to be as competitive as possible, in order to attract customers. Also, regulators will supervise prices to make sure they are not out of line with market conditions i.e. to ensure that the ability to price improve can't be used by firms to evade their obligations under Article 27 by quoting prices which are so wide of the spread that no one would want to hit them.

The Council decided that firms should not be able to improve on their public quote when dealing with retail clients. It is difficult to see why the new ISD should discriminate against retail clients by not allowing them the freedom to seek a better price in the same way professional clients can, especially since members of Econ have repeatedly expressed the desire not to unduly divide the retail from the wholesale markets.

Your Rapporteur supports price improvement for all. However, in recognition of the hostility to unqualified retail price improvement from the majority of Council delegations, she has proposed a compromise which restricts price improvement for retail clients. This is designed to make it clear that prices quoted publicly will generally match or be very close to the prices actually given to retail clients. This is an important move which hopefully will be met with goodwill from the Council.

Access to quotes

Open access for new clients was an important part of the EP compromise. The terms for the admission of new clients and access to quotes are unclear and confused in the Council text.

Council Recital 44 (new) - Bonds

The EP rejected the extension of transparency requirements to bonds. Many Member States have established forms of OTC trading in these instruments. These markets are highly diverse. The prices of such instruments do not have any significant declarative force or price formation impact. Nor is there any transmission effect to other sectors such as accounting, take-overs etc. Member State optionality could also undermine the attempt to set up a common EU framework.

Article 19 (former 18) Suitability Tests

There are 1.2m execution-only customers in France, 3.5m in the UK and over 2m in Germany. Several million buy UCITS without advice, e.g. through direct offer and funds supermarkets. These basic “no frills” services – fast, low cost and value for money - are a vital part of the range of choices which should be available to investors. As the EP first reading compromise clearly provided, investors should not be compelled to pay for advice which they neither need nor want. This would deter saving and be an unreasonable restriction on investor choice.

There are significant flaws with the Council text which is over-detailed and complex. In particular, a suitability/appropriateness test will apply unless it can be shown that it was the client who initiated the transaction. This could lead to disputes about whether bank staff first mentioned the non-advice option or whether the client specifically asked about these services. There is also doubt about the extent to which non-advice services could be advertised without triggering a suitability/appropriateness test.

Because of difficulty in assessing which changes can best solve problems caused in different Member States, no amendment has yet been proposed on para 5. However, the concept of an “appropriateness test” is unclear and amendments to clarify this paragraph will need to be considered at the amendment stage.

Your Rapporteur's strong preference is for the clear carve-out adopted at first reading but she have instead opted for much more limited technical amendments to the Council text. This is a highly significant concession, reflecting the sensitivity of this issue in Council.

The EP amendment to guarantee grandfathering provisions for conduct of business rules is essential, to avoid the renegotiation of millions of contracts (36 million in Germany alone).

Article 24 (former 22)

Eligible counterparties are highly sophisticated players. There is no need for them to execute a confirmation document declaring that they accept eligible counterparty status. The Council

text also adopts a confusing and bureaucratic method for determining which corporates qualify as eligible counterparties, requiring firms to check the rules for defining eligible counterparties in 25 different Member States. The EP text should therefore be re-tabled.

Recital 50 (new) - Capital

There is no need for EU rules on capital requirements for operators of regulated markets since they are not subject to the same risks as investment firms. In particular, they very seldom subject to trading risk because neither their business model nor the quote disclosure rule would require them to deploy their own capital to facilitate the trades of their customers.

Article 5.2 (former 4.2) – M.T.F.s run by Exchanges

An amendment is necessary to restore the Commission proposal that once a market operator has complied with the standards needed for authorisation as a regulated market, this should give them the right (so long as they comply with any specific MTF requirements) to operate an MTF without a second authorisation as an investment firm.

Impact Assessments

Before adopting implementing measures, it is essential that the Commission take account of their cost impact to ensure that they are proportionate to the problems they seek to address. This was part of the agreement on the Lamfalussy process. In particular, it is vital to assess the impact on small businesses (e.g. Sparkassen and small broking firms).

Commodity derivatives

Issues relating to commodity derivatives have not been covered in the report in order to enable further discussion to take place in Econ, with a view to tabling technical changes to clarify the Council text, at the amendment stage.