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"I" ITEM NOTE

from: Presidency
to: Coreper

Subject: Revised rules for markets in financial instruments
a) Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (Recast) (MiFID)
b) Proposal for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories (MiFIR)

- Progress Report

INTRODUCTION

1. The abovementioned proposals were transmitted to the Council on 20 October 2011. The objective of this legislative package is, inter alia, to further the integration, competitiveness, and efficiency of EU financial markets by responding to the challenges created by developments in financial markets, and dealing with the weaknesses the financial crisis has exposed.

2. All member states recognise the importance of the adoption of this legislative package and are committed to working towards an agreement.
3. The legislative package amending MiFID has two parts:
 - A Regulation that sets out requirements in relation to the disclosure of trade transparency data to the public and transaction data to competent authorities, removing barriers to non-discriminatory access to clearing facilities, the mandatory trading of derivatives on organised venues, specific supervisory actions regarding financial instruments and positions in derivatives.
 - A Directive that amends specific requirements regarding the provision of investment services, the scope of exemptions from the current Directive, organisational and conduct of business requirements for investment firms, organisational requirements for trading venues, the authorisation and ongoing obligations applicable to providers of data services, powers available to competent authorities, sanctions, and rules applicable to third-country firms operating via a branch.
4. To date, the Working Party on Financial Services has met 23 times (2 times during the Polish Presidency, 6 times during the Danish Presidency and 15 times during the Cyprus Presidency) to examine and discuss these texts. During these discussions at Working Party level, together with written comments, the Cyprus Presidency has collected the views of the Member States and has tabled several overall compromise proposals and other texts with the aim of making significant progress on the files. The latest Presidency compromise proposals are set out in docs. 17179/12 (MiFID) and 17176/12 (MiFIR).
5. The EP ECON Committee voted on its reports on 26 September 2012, and the EP position was further confirmed by the Plenary on 26 October 2012.

6. Without prejudice to the outcome of upcoming discussions on the proposals, the Presidency is of the view that there is in principle agreement on a number of the proposed provisions, but that a small number of key issues remain outstanding. The three outstanding key political issues were discussed at the Permanent Representatives Committee meeting on 15 November 2012, where it was manifested that, although a number of member states were willing to accept the overall compromise, there was not yet a qualified majority supporting that compromise.
7. In this progress report, the Presidency aims to give an overview of the situation regarding the more important issues, including those which may require further discussion at political level. The report is without prejudice to the scope and content of other issues that could require further negotiations in the preparatory bodies of the Council.

SCOPE INCLUDING EXEMPTIONS

8. This part of the proposal deals with the scope of the proposal and the exemptions including the optional exemptions.
9. As a consequence of the Commission proposal to modify the exemptions from MiFID and reclassify emission allowances as a financial instrument, the draft compromise text includes additional exemptions regarding joint ventures of electricity undertakings or natural gas undertakings and joint ventures of operators of industrial installations covered by the EU Emission Trading Scheme, as well as operators or administrators of energy balancing mechanisms. Several delegations were of the opinion that the additional exemptions regarding joint ventures should be included but that they should be narrowly framed in order to avoid misuse. The Presidency has made further improvements on the wording and believes that it has found the right solutions on this.

10. Furthermore, based on the position of the majority of the Member States that further elements should be included in the list of criteria to determine whether an activity is ancillary to the main business of a non-financial firm, clear criteria have been introduced in the text as well as an explanation of the overall intention underlying the ancillary activity exemptions.
11. Additionally, it is now explicitly stated which provisions apply to credit institutions and investment firms when selling or advising clients in relation to structured deposits. Although Central Securities Depositories (CSDs) are explicitly exempted from the scope of MiFID, it is clarified in a recital that they are subject to the requirements of MiFID concerning their internal organisation and the operating conditions as well as MiFIR when they provide investment services or perform investment activities.
12. A broad agreement has been reached on this part of the proposal since the Presidency compromise proposal provides for a clear scope and narrowly framed exemptions with a view to avoid unintended consequences and loopholes.

ORGANISED TRADING FACILITY (OTF)

13. The Commission has introduced a new trading venue category, the Organised Trading Facility (OTF), in order to make European markets more transparent and to level the playing field between various venues offering trading services that are very similar to each other.
14. Delegations have been largely divided in two groups regarding the OTF proposal. One side is in favour of the introduction of OTF, but would like to make the OTF rules less strict. The other side would like to make the OTF rules stricter or perhaps even remove this new trading venue category and ensure that organised trading can only take place on the existing types of execution venues, Regulated Markets (RM) and Multilateral Trading Facilities (MTF). These delegations have particular concerns on the possibility to execute clients' orders in an OTF against the proprietary capital of the investment firm or market operator.

15. The overall aim of the Presidency is to ensure that as much as possible of trading will in the future take place on open, transparent and regulated platforms, i.e. RM, MTF and OTF. For this purpose the Presidency has proposed to keep the new OTF category in the text, and also allow matched principal trading, which the Presidency does not consider as proprietary trading. Furthermore, the Presidency has limited the OTF category only to non-equity instruments and thus, it introduced the definition of bilateral systems in order to ensure that trading will take place on transparent and regulated platforms.
16. The Presidency compromise text strikes a balance between these views, with around half of the amendments supported by one group, and the other half supported by the other group. However, the OTF category appears to be an important issue for Member States, and further work will be required to reconcile the opposing positions.

SI AND POST-TRADE TRANSPARENCY RULES FOR INVESTMENT FIRMS

17. This section of the proposals revolves around the organised trading of investment firms outside a regulated trading venue, called systematic internalisation (SI), as well as the obligation for investment firms to publish post-trade information about transactions.
18. Member States are supportive of the definition of systematic internalisation, which has been further improved and of the scope of application that is based on the level of activity of the investment firm per financial instrument. The proposed elaboration of the terms for a systematic internaliser to restrict access to its quotes appears to be acceptable to a majority of Member States.

19. Additionally, the Presidency has introduced a definition of liquid market with clear criteria for both equities and non-equities markets for the purposes of legal certainty and clarity, a definition that is widely supported by the Council.
20. It is thus the conclusion of the Presidency that Member States are generally in favour of the amended SI regime.

TRANSPARENCY FOR TRADING VENUES

21. This part of the proposals concerns the pre- and post-trade transparency obligations for trading venues. It aims to improve the transparency of trading activities in equity markets and to introduce a new trade transparency regime for non-equity markets. Pre and post trade transparency requirements are extended to all instruments and all trading venues and waivers to these requirements will only be allowed under prescribed circumstances.
22. There are four types of pre-trade transparency waivers currently allowed for equities markets: (1) large in scale waiver, (2) reference price waiver, (3) negotiated price waiver, and (4) order management system waiver. These waivers have been defined by the Commission in existing implementing Regulations but the Commission has now proposed to deal with the issue in the Regulation (MiFIR) itself. The Commission and several delegations would, however, like to maintain only the so-called large in scale waiver, whereas a group of delegations would like to keep also the others, in particular the so-called reference price waiver and the so-called negotiated transactions waiver. The Presidency has proposed to maintain all the existing four waivers, but to narrow down their scope.

23. Regarding the non-equity instruments, although the Presidency's intention is to allow for waivers that are justified and narrowed down, Member States are also divided over the application of general waivers from pre-trade transparency for request-for-quote and voice trading systems.
24. The Presidency has also introduced a mechanism to deal with the sudden changes in liquidity which allows a competent authority to temporarily suspend the transparency requirements when an instrument falls below a dynamic liquidity threshold, a mechanism that is widely supported by the member states.

CORPORATE COVERNANCE

25. The proposal introduces new requirements as regards the profile, role and responsibilities of the management bodies of investment firms, market operators and other regulated entities under MiFID.
26. Among Member States there is general agreement to further strengthen the effectiveness of governance in investment firms, market operators and other actors regulated under MiFID, although opting for a more flexible approach than the one suggested by the Commission. Moreover, there seems to be a broad consensus on the Presidency approach which aligns the provisions in MiFID with the ones that are agreed upon in the CRD IV, while acknowledging the need to keep specific requirements that are only relevant for investment firms.
27. After aligning the provisions with the corresponding ones in the CRD IV the Presidency expects that an agreement will be reached on this provision.

INVESTOR PROTECTION

28. Commissions paid by third parties (inducements) are viewed as a major source of conflicts of interest. The Presidency compromise text imposes stricter disclosure requirements on firms receiving inducements. A larger group of Member States seems to favour this regime, while also calling for more transparency through better disclosure of inducements. Still, a smaller group of Member States seems firmly committed to introducing a general ban on inducements. The Cyprus Presidency has added a provision which allows Member States to introduce additional requirements in exceptional cases while limiting potential divergences across Member States by providing the Commission with a degree of oversight of the additional requirements.

MTF, REGULATED MARKETS AND SME GROWTH MARKETS

29. This part deals with the rules for Multilateral Trading Facilities (MTFs), Regulated Markets and SME growth markets, including the monitoring of compliance with trading venue rules, and transparency, harmonisation and cooperation regarding trading suspensions and removals.
30. Member States are broadly content with the Commission proposals in this area. Discussions have focussed primarily on the transparency, harmonisation and cooperation arrangements around suspensions and removals of financial instruments from trading. The Presidency has made further improvements which aim at clarity and precision of these provisions and there is now a broad agreement in this area.

AUTHORISATION AND OPERATING CONDITIONS FOR INVESTMENT FIRMS

31. This part of the proposal deals with the conditions and procedures for authorisation for investment firms, the general provision regarding operating conditions for investment firms, and the rights of investment firms.

32. The discussions have mainly concentrated on the organisational requirement, particularly on the telephone recording requirement.
33. A few Member States have expressed concerns regarding the obligation to record telephone conversations and have asked for more clarity. One Member State has substantial concerns with the text as it is currently formulated, and has suggested allowing an alternative approach based on written documentation.
34. The Presidency compromise text aims to increase clarity and precision regarding the purpose of the recording of telephone conversation and electronic communication as also recommended by the European Data Protection Service. The latest draft compromise is supported by a significant number of Member States.

ALGORITHMIC TRADING, HIGH FREQUENCY TRADING AND DIRECT ELECTRONIC ACCESS

35. The Commission proposals contain a number of provisions for market operators and investment firms when they enable or engage in trading where a computer programme makes the investment decision (algorithmic trading, a subset of which is high frequency trading).
36. The latest compromise proposals provide that algorithmic traders will become properly regulated and whoever is engaging in high frequency trading falls within the scope of MiFID. Additionally, a definition of high frequency trading is introduced in the text for legal certainty and clarity. Investment firms engaging in algorithmic trading pursuing a market making strategy are obliged to provide appropriate liquidity on a regular and predictable basis to the trading venue.

37. With the changes the Presidency has proposed, most Member States can support this regime for direct electronic access, algorithmic trading and high frequency trading.

DATA REPORTING SERVICES AND TRANSACTION REPORTING

38. This part of the proposal concerns the operating requirements for data reporting services providers, the obligation to make pre- and post-trade data available, and the requirement for transactions to be reported by investment firms.
39. Discussions on these issues have been very constructive, with the objective being to clarify and strengthen the Commission's proposal further, as well as align the provisions with complementary legislation such as the Market Abuse Regulation and the Short Selling Regulation.
40. One of the main controversial issues in this area was that of the consolidated tape. The Council was initially split into two camps, the one asking for a single consolidated tape provider and the other requesting to maintain the multiple commercial model. The Presidency, in its latest compromise proposal, maintains the original Commission proposal of multiple commercial providers competing against one another while at the same time strengthens the review clause on this issue, under which, if there is a market failure, a public procurement process will be launched by ESMA for a single consolidated tape provider.
41. A significant majority of the member states can now support the latest compromise proposal by the Presidency on these issues.

DERIVATIVES AND CLEARING

42. This part of the proposal deals with the obligation to trade derivatives on regulated markets, MTFs or OTFs and the clearing obligation for derivatives traded on regulated markets, in line with the G20 commitments, as well as non-discriminatory access between clearing houses and trading venues. In addition, it deals with access to licenses of, and information relating to, benchmarks that are used to determine the value of financial instruments, to CCPs and trading venues.
43. Most Member States seem content with the provisions regarding the trading obligation. One Member State wants to restrict this to regulated markets and MTFs, while another Member State wants to extend it to systematic internalisers. In view of this, the Presidency has retained the original Commission proposal and has added a provision, which deals with the issue of conflicts or duplication between EU rules and those of third countries with regards to the trading obligation.
44. The non-discriminatory clearing access for financial instruments has proved to be a difficult issue throughout the negotiations on MiFIR, delegations being split into two groups. One group is in favor of maintaining the provisions that Central Counterparties (CCPs) should accept to clear transactions executed in different trading venues, to the extent that those venues comply with the operational and technical requirements by the CCP and that access should only be denied if certain access criteria are not met. They are also in favor of the provisions that trading venues should be required to provide access including data feeds on a transparent and non-discriminatory basis to CCPs that wish to clear transactions executed on the trading venue. They consider that there is a need to avoid any discriminatory practices and to remove various commercial barriers that can be used to prevent competition in the clearing of financial instruments. On the other hand, the other group is in favor of deleting these provisions as they believe that non-discriminatory access will lead to fragmentation at the trading level and to reduction in liquidity.

45. The Presidency has proposed an alternative option in which the provisions in relation to non-discriminatory clearing access for financial instruments are to a large extent aligned with the relevant provisions of EMIR.
46. Furthermore, some delegations have doubts on the articulation between the provisions on non-discriminatory access and obligation to licence benchmarks and the intellectual property rights whereas other delegations consider that these provisions are necessary as they tackle the issue of monopolies and thus enhance competition.
47. It is the expectation of the Presidency that it will be difficult to solve the reservations on a technical level and it will probably be necessary to seek guidance at political level.

POSITION MANAGEMENT, POSITION LIMITS AND PRODUCT INTERVENTION

48. This part of the proposals covers position limits and position management tools in commodity derivatives as well as position reporting, and product and position intervention. It also deals with the role of ESMA in coordinating national measures as well as its powers to intervene itself.
49. Discussions have centred on the types of contracts that should be covered and the balance between position limits and position management tools. The Presidency has provided additional clarifications in the compromise text which enabled a qualified majority to be reached on this issue. However, one Member State remains concerned over the legality of some of the powers which are being assigned to ESMA.

COMPETENT AUTHORITIES AND SANCTIONS

50. This part of the proposal deals with the designation and powers of national competent authorities, as well as redress procedures and cooperation between competent authorities and with ESMA. The discussions have mainly been on sanctions, based on a text revised by Council Legal Service. It has been the aim of the Presidency to align the provisions as far as possible with the sanctions provisions in the Transparency Directive, the Capital Requirements Directive (CRD IV) and the Market Abuse Regulation.
51. One of the most difficult aspects is the publication of sanctions, where a couple of member states have strong concerns. The Presidency managed to find a balance between an as much as possible harmonized sanctioning regime and one which respects the legal traditions of each member state. It is the opinion of the Presidency that most Member States can support this regime, in the overall compromise.

THIRD COUNTRY REGIME

52. This part of the proposal deals with the provision of investment services or activities by third country firms with and without the establishment of a branch, cooperation with third countries and transitional provisions.
53. The discussions have mainly been on the Commission proposal to introduce a third country regime for the provision of investment services in the EU.
54. Several Member States have expressed serious concerns and have strong reservations regarding the Commission proposal introducing a third country regime. Many seem to be of the opinion that the introduction of a third country regime is unnecessary and disproportionate and would prefer to keep national rules by deleting the equivalence decision for the provision of services by third country firms and the possibility for third country firms to passport into other Member States.

55. Based on these concerns, the Presidency has attempted to preserve the effect of the current regime, but at the same time retained the requirement that a third country firm shall establish a branch in the Member State where it intends to provide investment services or perform investment activities to retail clients, including retail clients who have requested to be treated as professionals. This compromise retains the benefits in terms of investment protection and financial stability which are brought by some level of harmonisation within the single market. There is a broad agreement in the Council on this issue.

DELEGATED ACTS AND FINAL PROVISIONS

56. The Commission proposal included a large number of provisions on delegated acts. Following a widespread desire from Member States, the Presidency compromise text has converted many of these into Binding Technical Standards to be developed by ESMA. Additionally, the Presidency has allowed for an adequate timeframe for Member States to be able to apply the provisions under this legislative package.

CONCLUSION

66. Against this background the Presidency proposes that the Permanent Representatives Committee:

- takes note of the progress achieved with regard to the proposals;
- takes note of the latest Presidency compromise proposals, as set out in docs. 17179/12 (MiFID) and 17176/12 (MiFIR), and
- invites the incoming Irish Presidency to continue work on the basis of these compromise proposals in order to reach an agreement on a general approach on both files in the near future.