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from: Presidency  
to: Coreper

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Subject: 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

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**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. To date the Working Party on Financial Services has met 8 times (2 times during the Polish Presidency: 10 November and 25 November and 6 times during the Danish Presidency: 18 January, 15 February, 9 March, 27 March, 25 April and 7 June) to examine and discuss these texts. During these discussions at Working Party Level, together with written comments, the Danish Presidency has collected the views of the Member States with the aim of producing a Draft Presidency Compromise text.
  
4. The compromise text has been sent out in three parts. The first part covered scope, Organised Trading Facility (OTF) requirements, Systematic Internaliser (SI) activity and post-trade transparency rules for investment firms, transparency for trading venues, investor protection and corporate governance, and algorithmic trading/direct access. This was sent out 9 May with a comment period ending 21 May. This part was discussed at the meeting 7 June, together with a compromise text on the third country regime which was sent out 1 June. The third part covered MTF (Multilateral Trading Facility), Regulated Markets and SME growth markets, authorisation and operating conditions for investment firms, data reporting services, standardised derivatives and clearing obligation, position limits and product intervention, competent authorities including sanctions, annexes and final provisions. This part was sent out 4 June with a comment period ending 13 June. It will be discussed at a Council Working Party meeting 26 June. The overall compromise texts are set out in docs, 11645/12 (MiFID) and 11646/12 (MiFIR). It should be noted that focus has been on finding compromise text for the articles and that not all consequential corrections have yet been made in the recitals. Consequential work on the recitals will continue.
  
5. 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 number of issues remain outstanding.

6. In this progress report the Presidency aims to give an overview of the situation regarding the more important issues, including those which may require 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**

7. This part of the proposal deals with the scope of the proposal and the exemptions including the optional exemptions.
8. The discussions have mainly been on the scope of the exemptions in Article 2 of MiFID including a request from several Member States to clarify the exemptions. 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. Regarding the wording, some further improvements were discussed and it was agreed that the Presidency should work with the Commission on finding the right solutions on this.
9. Furthermore, a majority of the Member States are of the opinion 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. Further elements have been suggested and were discussed at the meeting 7 June. It was agreed that the Presidency and the Commission would look further at finding a solution on this.

10. It is the expectation of the Presidency that it is possible to reach an agreement with some further mainly technical drafting and clarifications. The most difficult aspect seems to be finding agreement on the elements which should determine whether an activity is to be considered as ancillary.
11. Structured deposits have also been included in the scope of the MiFID proposal. There seems to be broad support for this, although some Member States have suggested expanding the scope even further to include all investment products (with reference to certain insurance products) in the MiFID regime. Furthermore, a majority have expressed support for the Presidency proposal to introduce a definition of structured deposits.
12. A number of Member States found it disproportionate to require persons exempt from the Directive who still provide certain investment services to be covered under an investor compensation scheme. The Presidency has therefore introduced the alternative option that those persons may be covered by indemnity insurance instead. This approach seems to have widespread support.

#### **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. There is strong support for the provisions concerning the management of conflicts of interest and for the restrictions around exercise of trading discretion.

15. However, in other areas Member States are largely divided in two camps regarding the OTF proposal. One side is in favour, but would like to make the OTF rules less strict. The other side would like to make the OTF rules more strict 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.
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 and a scope of application that is based on the level of activity of the investment firm in instrument by 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. On the other hand, Member States are divided on the question of the size of the quotes up to which the SI rules should apply; there is for example much resistance to setting this threshold at the retail size.
20. It is thus the conclusion of the Presidency that Member States are generally in favour of the amended SI regime. But more work needs to be done to reach agreement about the size of the quotes up to which the SI rules should apply.

## **TRANSPARENCY FOR TRADING VENUES**

21. This part of the proposals concerns the pre- and post-trade transparency obligations for trading venues.
22. There is general endorsement of the Commission proposal and the amendments by the Presidency which most importantly restrict the basis for granting waivers from pre-trade transparency for equity instruments.
23. However, Member States are divided over the application of general waivers from pre-trade transparency for non-equity instruments for request-for-quote and voice trading systems or for markets with trading restricted to professional participants.
24. To reach a more broad-based compromise, it may also be appropriate to consider allowing waivers from pre-trade transparency for equity and non-equity instruments, with minimum size limits, based on reference prices.
25. Some Member States have suggested that ESMA be given more power, making a decision rather than giving an opinion in regard of the legality of each waiver. The Presidency has not found a solution for this that would be in keeping with the ESMA Regulation.

## **CORPORATE GOVERNANCE**

26. The proposal introduces new requirements as regards the profile, role and responsibilities for the management bodies in investment firms, market operators and other regulated entities under MiFID.

27. 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.
28. After aligning the provisions with the corresponding ones in the CRD IV the Presidency expects that an agreement can be reached on this provision.

## **INVESTOR PROTECTION**

### Inducements and independent investment advice:

29. 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. At the same time, it has introduced a possibility for firms to retain the ‘independent’ label if monetary inducements are passed on in full to their clients.
30. 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.
31. A possible way forward might be to allow Member States to reinforce or add further requirements that limit the possibilities of receiving inducements.

### Execution only – structured UCITS:

32. Under the current MiFID, all UCITS are considered “non-complex” products in MiFID. The Commission proposed to exclude structured UCITS from financial instruments that can be traded as execution only.
33. There seems to be overall agreement that certain UCITS are too complex for retail investors to trade as execution only. However, there is disagreement over how best to deal with the issue. A number of Member States feel that the original proposal does not accurately capture those UCITS that are too complex for investors to trade as execution only. Some Member States have welcomed Presidency efforts to include additional criteria, but others feel it overcomplicates matters.
34. It may be worth exploring options to assess possible distinctions through the UCITS Directive which is soon up for review. A solution for MiFID could therefore be to make reference to this in a Recital.

### **MTF, REGULATED MARKETS AND SME GROWTH MARKETS**

35. 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.
36. 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.
37. Without prejudging further discussions in the Council Working Party, the Presidency is of the view that it will be possible to reach an agreement in this area.



## **AUTHORISATION AND OPERATING CONDITIONS FOR INVESTMENT FIRMS**

38. 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.
39. The discussions have mainly been on the organisational requirement, particularly on the telephone recording requirement.
40. 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 and cannot support the text as currently formulated, and has suggested allowing an alternative approach based on written documentation.
41. 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 draft text will be discussed at the Working Group meeting 26 June 2012.

## **ALGORITHMIC TRADING AND DIRECT ELECTRONIC ACCESS**

42. 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).
43. With the changes the Presidency has proposed, most Member States can support this regime for direct electronic access and algorithmic trading.
44. However, there may still be a need to work more on the requirement for algorithmic traders to provide liquidity on a continuous basis regardless of prevailing market conditions.

## **DATA REPORTING SERVICES AND TRANSACTION REPORTING**

45. 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.
46. 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.
47. Without prejudging further discussions in the Council Working Party, the Presidency is of the view that it will be possible to reach an agreement in this area.

## **DERIVATIVES AND CLEARING**

48. 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.
49. 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.
50. One Member State has expressed strong reservations about the provisions regarding non-discriminatory clearing and would prefer to delete them. Another Member State feels that there should be fewer options for restricting access. A few Member States have also expressed a desire to align the access provisions further with EMIR.

51. The majority of Member States have not expressed any objections to the clearing access provisions. Therefore, the draft compromise text does not make substantial changes to the Commission proposal. The draft text will be discussed at the Council Working Party meeting 26 June 2012.
52. 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**

53. This part of the proposals covers position management in commodity derivatives, including position limits, 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.
54. Discussions have centred on the types of contracts which should be covered by position management, and the balance between position limits and other position management tools. Consideration has also been given to the benefits of a regime which is internationally consistent, including with the USA.
55. Without prejudging further discussions in the Council Working Party, the Presidency is hopeful that the additional clarifications provided in the compromise text should enable 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**

56. 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 draft compromise text will be discussed at the meeting 26 June.
57. 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 and the Market Abuse Regulation. A comprehensive list of possible breaches has been developed and a number of clarifications have been made. Whistle blower provisions have been aligned with the latest text in the Capital Requirements Directive (CRD IV).
58. It is the expectation of the Presidency that it is possible to reach an agreement on these provisions on the basis of this approach. The most difficult aspect seems to be the publication of sanctions, where a couple of member states have strong concerns.

## **THIRD COUNTRY REGIME**

59. 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.
60. The discussions have mainly been on the Commission proposal to introduce a third country regime for the provision of investment services in the EU.

61. 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.
62. Based on these concerns the Presidency has in its first draft compromise text 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 in order to retain benefits in terms of investment protection and financial stability which are brought by some level of harmonisation within the single market.
63. The first draft compromise text was discussed in the Working Party meeting 7 June 2012. Most delegations supported taking the starting point in the draft compromise text. A number of Member States still had scrutiny reservations and further discussions will be necessary.

## **DELEGATED ACTS AND FINAL PROVISIONS**

64. 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. For some of these further work is needed in order to make the text fully compliant with the ESMA Regulation.
65. There has not been any discussion of final provisions and transitional arrangements. It has been decided to wait until there is more clarity over the proposal as a whole.

## 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. 11645/12 (MiFID) and 11646/12 (MiFIR), and
- invites the incoming Cyprus 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.

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