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ITEM 9 OF THE AGENDA: MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE

(ex – Investments services Directive)

1. OBJECTIVE OF THE DIRECTIVE

The revision of Investment Services Directive (1993) was conceived in 2000, when the European Commission started its first consultation to inquire whether there was a need to revise the ISD and if so what its main objectives should be. It was recognized early on that the old ISD had only introduced a mutual recognition system in name, but there was no effective passport for investment firms and banks carrying out investment services cross border. This was because of loopholes in the Directive which have the host Member State additional powers to impose its own rules on incoming service providers, and also the lack of a common framework for investor protection. In addition, it was felt that the old ISD, which allowed Member States to impose the so-called “concentration rule” to concentrate trading on exchanges, was not up to date with the new realities of the market place, which included a multitude of execution venues.

Throughout 2001 and 2002, the Commission carried out further consultations on its proposal for a directive, based on two key objectives:

- to introduce a truly effective passport for investment firms, along with a new common framework for investor protection;
- to abolish the concentration rule across Europe and to replace it with a revised regime for best execution, appropriate transparency rules for investment firms carrying out execution of clients.

2. LEGISLATIVE HISTORY

- Formal proposal for a Directive submitted to the Parliament and Council: November 2002
- First Reading at the Parliament: March 2003
- Council Common Position: December 2003
- Adoption of the Second Reading at the Parliament: July 2004
- Level 2 work started in January 2004 and is expected to continue until June 2005
- Formal adoption of the Directive: April 2004
- Entry into force of the Directive: May 2006

3. KEY ISSUES FOR THE FBE

- Ensuring overall an evidence-based approach to legislation
- Establishing a good precedent for the first Lamfalussy Directive
- Making sure that the passport regime is effective, with no loopholes
- Preventing overly prescriptive investor protection rules
- Allowing the continuation of a range of different services provided to clients, including investment advice and non-advisory services
- Supporting the abolition of the concentration rule
- Striking a balance between the need to introduce legally clear rules for best execution obligation and the need to allow firms sufficient flexibility
- Calibrating the pre- and post-trade transparency rules for intermediaries to demonstrated benefit to the market and clients
- Supporting appropriate grandfathering arrangements and transitional provisions

4. KEY FBE ACTIONS

- Responses to all of the consultations conducted by the Commission
- Bilateral meetings with the Commission
- Presentation at the Parliament Expert Panel: February 2003
- Contact with Parliamentarians and Permanent Representations

5. RESULT

Due to the intense early consultation on the pre-draft Directive, much of what the industry advocated was incorporated and or resolved in an alternative way within the formal proposal for a Directive adopted in November 2002. The most significant changes (positive and negative) made during the co-decision process can be summarized as follows:

Issue	Original Commission Proposal	Final Result
Investment advice and non-advisory services	Two-tier structure with differentiation by client and service to defined at Level 2	A three-tier structure: <ul style="list-style-type: none"> - Advice (Article 19.4) - Light suitability (Article 19.5) - Execution-only (Article 19.6) With more detail at level 1 already concerning the differences between them; to be further differentiated at Level 2.
Best execution obligation	Multi-factor; process-based; all details left to Level 2	Strengthening of process basis with reasonability test; clear duty to follow client instructions; greater detail in expectations from firm, procedures (e.g. appropriate disclosure to clients).
In-house matching of client orders	Mandatory firm quotes for retail size transactions in shares, in liquid markets.	Restriction to systematic internalizers trading up to standard market size, with choice of size left to firm; some flexibility in deviation from quoted prices; possibility for MSs to extend the regime to non-shares.

6. NEXT STEPS

Level 2 is being conducted in two separate “mandates”:

- 1st mandate: Compliance, information and reporting to clients, safeguarding of assets, best execution, pre-trade and post-trade transparency for RMs and MTFs, post-trade transparency for intermediaries.
- 2nd mandate: Pre-trade transparency for intermediaries, investment advice and non-advisory services.

7. ACCESS TO REFERENCE DOCUMENTS:

Final version of the Directive:

http://europa.eu.int/eur-lex/en/archive/2004/l_14520040430en.html

(click on 1 at the far right end)

Original Proposal for a Directive:

<http://europa.eu.int/cgi-bin/eur-lex/udl.pl?REQUEST=Service-Search&LANGUAGE=en&GUILANGUAGE=en&SERVICE=all&COLLECTION=com&DOCID=502PC0625>

Formal mandate for technical advice – June 2004

http://europa.eu.int/comm/internal_market/securities/docs/cesr/final-mandate-isd_en.pdf

Adoption of the Directive – April 2004

<http://europa.eu.int/rapid/pressReleasesAction.do?reference=IP/04/399&format=HTML&aged=0&language=EN&guiLanguage=en>

Provisional mandate – January 2004

http://europa.eu.int/comm/internal_market/securities/docs/isd/esc37-mandate_en.pdf

FBE positions:

September 2004:

http://www.fbe.be/pdf/Enclosure_FBEletter_0611.pdf

July 2004:

http://www.fbe.be/pdf/FMC_CESR_MiFid04.pdf

March 2004:

http://www.fbe.be/pdf/ISD_CESR04.pdf

January 2004:

http://www.fbe.be/pdf/FBE_ISD_2004.pdf

February 2003:

http://www.fbe.be/pdf/fbe_presentation_180203.pdf

June 2002:

http://www.fbe.be/downloads/publications/01_DOCUMENTS/ISD%20Position.pdf