

## **Review of the Markets in Financial Instruments Directive**

### **Response by AFME (Association for Financial Markets in Europe)**

#### **Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP**

The questionnaire takes as its starting point the Commission's proposals for MiFID/MiFIR 2 of 20 October 2011 (COM(2011)0652 and COM(2011)0656).

All interested stakeholders are invited to complete the questionnaire. You are invited to answer the following questions and to provide any detailed comments on specific Articles in the table below. Responses which are not provided in this format may not be reviewed.

Respondents to this questionnaire should be aware that responses may be published.

Please send your answers to [econ-secretariat@europarl.europa.eu](mailto:econ-secretariat@europarl.europa.eu) by **13 January 2012**.

<b>Theme</b>	<b>Question</b>	<b>Answers</b>
Scope	1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in which more could be done to exempt corporate end users?	<p>AFME welcomes appropriate and balanced exemptions and any regulatory efforts in supporting the real economy. In practice, end users of financial products will be heavily impacted by the Directive and AFME urges all legislative bodies to work closely with the relevant industries to set the criteria correctly.</p> <p>While we agree with the general approach proposed we would favour a level playing field where all entities</p>

		<p>conducting the same activities should be subject to the same regulation for the protection of participants, end consumers and market integrity, and subject to an appropriate capital regime. A level regulatory playing field would eliminate the possibility of regulatory arbitrage and provide for consistent treatment of the same activities.</p> <p>We believe that entities that conduct the same activities should be regulated in the same manner, regardless of their corporate form and consequently have concerns that as drafted, the exemption in article 2.1.i could still potentially result in an unlevel playing field between financial and commodity firms as much will depend on what is considered '<i>ancillary</i>'.</p> <p>We support the proposal in article 2.3 for the Commission to adopt delegated acts clarifying when an activity is to be considered as ancillary to the main business. While the details would be considered further at level 2, we consider that it is important that the criteria for determining whether an activity is ancillary to the main business should be proportionate to the characteristics and the nature of the activity.</p>
	<p>2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?</p>	<p>AFME endorses the comments made by the International Swaps and Derivatives Association (ISDA) in its response to question 2 of the Ferber questionnaire and also makes the following comments:</p>

		<p><b>Emission allowances</b></p> <p>While we support the creation of a regime regulating the trading of emission allowances, we consider that it is not yet clear that the most appropriate way to achieve this is to include emission allowances as financial instruments under MiFID.</p> <p>The Commission should ensure that a full cost benefit analysis is conducted of the potential impact of including emission allowances as financial instruments under MiFID, weighing up the advantages and the risks.</p> <p>In particular, it is not clear that it is appropriate to impose a full licensing, conduct of business and prudential regime on participants in the market in emission allowances. There are many other underlying commodity markets which are important to trading in the EU, but where participants are not currently required to be regulated or where they are regulated in accordance with a regime developed specifically for their market.</p> <p>While it may be appropriate to develop a licensing regime for intermediaries in the emission allowances market, a simpler regime may be more appropriate. For example, REMIT has introduced a registration regime for participants in wholesale energy markets. A similar registration regime may be more appropriate for emission allowances market participants.</p>
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		<p>submissions of the JAC on structured products in the context of PRIPs.</p> <p>It will also be necessary to consider carefully whether any protections currently afforded to depositors may be lost as a result of re-classifying structured deposits as financial instruments (for example, eligibility for any deposit protection scheme), and whether any modifications should be made to the regime to permit these protections to continue if appropriate.</p>
	<p>3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?</p>	<p>Yes, we oppose the proposed reclassification of custody services as investment services for the following reasons:</p> <ul style="list-style-type: none"> <li>• Such reclassification would result in unnecessary regulatory duplication as custodians generally are authorised investment firms and/or credit institutions.</li> <li>• It would therefore not result in regulatory benefits such as improved authorisation and supervision but in disadvantages such as additional costs for custodians and their customers.</li> <li>• It would be an uncharacteristic element as custody services differ significantly from the areas that are in scope of MiFID. The relations between securities account holder (investor) and securities account provider (custodian), including the protection of investors in the case of insolvency of the custodian, are best placed in the planned Securities Law Directive.</li> </ul>

	<p>4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?</p>	<p>Yes, overall we support the objective of globally consistent requirements and a level playing field for financial services in Europe whilst bearing in mind any practical difficulties this may cause and the need not to limit investor choice. It will be important to carefully calibrate the benefits of a more structured and harmonized pan-European approach to third country access with concerns over EU markets becoming less accessible or the range of services currently available to clients being limited.</p> <p>Some of our members are concerned that protracted discussions between the Commission and non-EU states regarding a yet undefined notion of equivalence may not be the best use of EU resource, especially as the implementation of the equivalence concept is also likely to result in ongoing monitoring requirements regarding a multitude of non-EU national legislative regimes.</p> <p>The legislative proposals should be informed by the precedents of the third country debates under the AIFM and EMIR, where third country provisions were amongst the most heavily debated. When comparing the precedents, it has to be recognised that the remit of MiFID/MiFIR is much wider than those of e.g. AIFM or EMIR. For example, unlike in the context of AIFMD/UCITS, it may be very difficult if not impossible to identify specific legislation in a particular country which could be deemed to have an equivalent effect to all or parts of MiFID/MiFIR. Therefore a cautious approach should be taken when considering imposing a significantly new</p>
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		<p>regime.</p> <p>This may entail providing greater flexibility regarding continuation of existing national regimes until appropriate equivalence decisions have been made as the 4-year transitional period may not be sufficient. We would suggest that national regimes should continue at least until an equivalence decision has been made for a particular country. In addition, grandfathering should be provided for branches which have already been authorised by a Member State.</p> <p>Principles that should be followed include: a regime appropriately tailored to the needs of different client categories (retail vs professional vs ECPs) combined with sufficiently comprehensive exemptions for example for non-solicited business so that client choice is not circumscribed. There must also be a pragmatic interpretation of the equivalence requirement for third country jurisdictions which focuses on achieving comparable regulatory objectives. Care needs to be taken to ensure EU investors are not prevented from being informed about investing opportunities in emerging markets, as these countries are unlikely to be able to comply with a strict notion of equivalence and the non-solicited business option is unlikely to provide sufficient protection. This is of particular concern for professional clients and eligible counterparties. We also believe that the MiFID Third country provisions need to take into account the work on extra-territorial issues of the US/EU high</p>
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		<p>level group.</p> <p>Financial firms are likely to be able to exert limited influence on the development of their home country's financial services law. An interesting suggestion that could be explored further and would be subject to further review and analysis, proposes that there should be the possibility for non-EU firms which are willing and able to render MiFID compliant services (Opt-in) to provide services to EU customers to avoid negatively impacting consumer choice and reducing competition.</p> <p>There are drafting issues with the current provisions. The Directive and Regulation, as drafted, set out the requirements for firms dealing with retail clients and firms providing certain services to ECPs. However, the text does not provide clarity regarding the requirements applying to non-EEA firms dealing with professional clients. This creates considerable uncertainty and there is a need to clarify the provisions. We note that the Commission's FAQ on MiFID II Q24 state that "A firm which is authorised in a third country will be able to provide services directly to professional investors on condition that the country where it is based is deemed by the Commission to have equivalent rules and supervision".</p>
Corporate governance	5) What changes, if any, are needed to the new requirements on corporate governance for investment firms and trading venues in Directive Articles 9 and 48 and for data service providers in Directive Article 65 to ensure that they are proportionate and effective, and why?	<p>We recognise that competent authorities will assess the performance of directors and the management body as a whole and that investment firms will have to satisfy regulators that regulatory standards have been met or, if not, undertake agreed corrective actions.</p>



		<p>Article 9 (and also Articles 48 and 65) should distinguish between an authorised investment firm and a firm seeking authorisation. Clearly a firm which is not already authorised may be expected to meet specified requirements in order to be authorised by a competent authority. In such cases the competent authority's acceptance of any derogation of requirements would be required to obtain authorisation.</p> <p>With respect to any general standards set by a competent authority, it is the responsibility of the management board to satisfy the competent authority and its shareholders that it has met the standards. With respect to specific requirements which are in aid of standards (e.g. the chair of the nomination committee should be a non-executive director), the management board should have the authority to decide what course to take on a comply or explain basis taking into account the size of the company, the complexity of its businesses, the commercial situation of the company, and other relevant factors. The prior approval of the competent authority should not be required. However, such decisions and subsequent explanations will be subject to review by the competent authority as part of its supervisory review, and the management body will be required to demonstrate to the satisfaction of the competent authority that any decision derogating from specific organisational requirements in aid of general principles of corporate governance is reasonable and effective as well as conducive to sound corporate governance. If the competent authority is not in</p>
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		<p>agreement, it has the authority to put forward corrective steps to be taken by the investment firm.</p> <p>Articles 9 (and relevant sections of 48, 65): With respect to Article 9 (and in principle relevant sections in 48 and 65), we are concerned that the discretionary authority of the management body of an authorised investment firm to engage its members and to order its committees and processes in a proportionate way in view of the nature, scale, and complexity of its business should be made much clearer.</p> <p>Article 9, Section1(a) should make clear that a management board has the authority in the first instance to itself decide whether to permit exceptions to the stated criteria regarding the number and type of directorships held by any director on a comply or explain basis (rather than it being the decision of the competent authority).</p> <p>Article 9, Section 2 should be clear that a management body has the authority to decide on a “comply or explain” basis whether to create a nomination committee - with only non-executive leadership and members - who will assess the compliance of the management body as a whole and make suggestions regarding the effectiveness of the management body. There may be preferable and effective alternative approaches. For example, in the case of the management board of a wholly owned subsidiary, it may be best to use executive directors who are familiar with group policies and overarching principles.</p> <p>Decisions under Article 9, Section 3 regarding the</p>
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Organisation of markets and trading	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what	<p>The OTF category is quite loosely defined, resulting in a lack of clarity as to the systems that would be captured. Further clarity would help to determine the specific</p>

	<p>changes are needed and why?</p>	<p>activities which are included as at present there are certain activities which may be caught inadvertently.</p> <p>AFME are supportive in principle of the concept of the OTF regime. A new venue offers more choice for investors in terms of service providers, availability of financial instruments and trading models. It will increase the regulatory oversight and transparency of certain existing trading models.</p> <p>We support the discretion that the operator of an OTF will have, both in terms of the clients that shall have access to the OTF and in the matching of orders.</p> <p>However, we do not agree with the proposed rules which prevent an OTF operator from facilitating client orders with its own capital. This raises significant concerns: strict prohibition on interaction with a firm's proprietary capital would make client order execution more difficult, more costly and generally less efficient. Client choice would be diminished, as would the ability of the OTF operator to meet client needs, undermining the objectives of the OTF.</p> <p>The requirements should therefore be changed such that an investment firm can deploy its own capital in the OTFs that it operates.</p> <p>The regulatory objective of the ban on proprietary capital appears to be to ensure the operator's neutrality in relation to any transaction taking place on the OTF and that the</p>
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		<p>duties owed to clients are not compromised<sup>1</sup>. We agree with these objectives; however, we believe that enforcing a blanket ban on the operator in relation to using its own proprietary capital is not necessary to ensure these objectives are met.</p> <p>It is not our view that the use of own capital would disadvantage any clients, and we have not seen any evidence to that effect to date. To ensure a level playing field and allay any concerns around the risk that some clients could hypothetically be disadvantaged, rules around the management of conflicts of interest which currently apply to regulated markets and multilateral trading facilities (e.g. in article 19(3) should also apply to OTFs. To give investors additional comfort, any interaction with a broker's proprietary capital should be a clear choice and it should be clearly identified as such.</p> <p>Obligation to trade on organised venues</p> <p>Many of the considerations above also apply to execution in the FX and derivatives markets, where liquidity is currently provided through a range of channels including single dealer platforms (SDPs), multi-dealer platforms (MDPs), and interdealer platforms and through manual execution channels. We expect many of these venues to become subject to the new OTF and SI regimes. In particular, and as noted above, SDPs are unlikely to qualify as OTFs. Consequently, this means that</p>
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<sup>1</sup> See MiFIR, par. 3.4.1, pg. 7

		<p>instruments subject to the obligation to trade on organised venues (Article 24) may not be traded on SDPs.</p> <p>SDPs provide significant liquidity to the dealer-to-customer FX and derivatives markets as well as facilitating a direct trading relationship. Also, the ability to use an investment firm's own capital in such transactions promotes innovation and quality in executing client business. The model is highly competitive, providing end users with a variety of products based on their specific needs particularly given the bespoke hedging nature required for FX and derivatives products. SDPs also enable clients to develop relationships that cover more than solely execution including research and advice.</p> <p>It is not clear that forcing certain instruments to trade away from these venues would provide overall benefit to the end user and may increase costs and risks. Accordingly, we believe the final text should retain the ability for instruments subject to the mandatory trading obligations to be traded through SDPs through a widening of the possible venues for execution.</p> <p>Alternatively the OTF regime could be adjusted to allow SDPs to qualify as OTFs, principally through enabling the use of proprietary capital. However, further adjustments would be required since SDPs in the FX and derivatives markets do not conform with the requirement to bring together multiple third party buying and selling interests.</p>
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	<p>7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to the channelling of trades which are currently OTC onto organised venues and, if so, which type of venue?</p>	<p>The proposals will lead to the channelling of trades that are currently OTC onto organised venues – principally OTFs. OTC need not be subject of a separate definition within MiFID as whatever falls outside of trading on the organised venues – RM, SI, MTF, OTF – would by default be OTC. In our view, the description in Recital 18 would provide a very narrow scope for what could be considered OTC.</p> <p>From an Equities perspective, the proposals will convert the automated internal matching of client orders currently performed within Broker Crossing Networks (BCNs) from being classified as OTC to being classified as OTF business. This will meet the objective of regulating all organised trading in a consistent manner.</p> <p>We believe that there should be more clarity on the distinction between trading via Systematic Internalisation and pure OTC trading. In addition, we believe the SI regime should also apply by class or sub-class of instrument rather than at firm or legal entity level.</p>
	<p>8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?</p>	<p>We are generally supportive of the proposals in Article 17, 19, 20 and 51 that relate to algorithmic trading, direct electronic access and co-location specifically, with the following exceptions:</p> <p>Art.17.3: The requirement for algorithms to be in continuous operation with the effect of posting firm quotes at competitive prices for the duration of the trading day</p>

		<p>would, as drafted, cause significant problems for the functioning of European capital markets. The provision needs to recognise the variety of uses that algorithms have, besides that of executing market making strategies. The text is unworkable because certain algorithms (which are not high frequency in nature) do not make markets, and therefore would be unable to post firm quotes. For example, a broker executing a client order using an algorithm would be unable to comply with the provisions of this article. The article needs to either be re-worded or removed.</p> <p>Art.17.4: An investment firm providing direct electronic access to a trading venue should not retain responsibility for ensuring that trading using that service complies with the requirements of the market abuse directive. Legal responsibility should reside with the end client. It would be practically impossible for an investment firm providing DEA to be able to police a client's trading so as to ensure that it complied with the market abuse directive, since the firm would only have restricted information on the client and their order flow. In addition, a client may commit market abuse via multiple brokers, meaning that a single broker would not have a complete picture of its client's activity.</p> <p>Art 51.3: the requirement that trading venues have in place systems <i>"to limit the ratio of unexecuted orders to transactions that may be entered into the system by a member or participant"</i> should instead refer to high level</p>
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		<p>descriptions of market abuse behaviour to more precisely target the type of behaviour that regulators wish to discourage i.e. behaviours which could be used to diminish price discovery, while not disincentivising the provision of genuine and tradable liquidity to the market.</p> <p>A high ratio of unexecuted orders to transactions can be a reflection of the market at a particular time e.g. no participants wish to sell. We also note that market makers hold a high ratio of unexecuted orders as they hold themselves out with quotes on both sides of the market.</p> <p>Referencing market abuse types will target more explicitly potentially abusive practices such as layering, spoofing etc (as identified by ESMA in its guidelines for investment firms and trading platforms).</p> <p>Separately, we think that the definition of algorithmic trading in Article 4 does not sufficiently differentiate between two broad types of algorithmic trading (1) market making type activity and (2) 'facilitation of orders' type activity where a trader enters an order with specific requirements and only trades in one direction. Equally, the boundary between manual and algorithmic trading is not clear in respect of the phrase 'limited or no human intervention', for example, a client may enter an order with specific parameters/instructions which is executed over the course of the day algorithmically. Instructions are provided at the top level of the order with restrictive criteria and the order is executed to those specifications by an algorithm.</p>
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	<p>9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?</p>	<p>Regarding Article 51, we support the requirement for regulated markets to temporarily halt trading if there is a significant price movement in a financial instrument. However, we think that the wording should be amended in order to clarify that circuit breakers should be coordinated between venues as far as possible. This was one of the conclusions reached by the SEC/CFTC following the flash crash. The SEC/CFTC concluded that the imposition of disparate volatility rules may have had the effect of exacerbating, rather than dampening, price volatility.</p> <p>We support the requirement in Art.51.3 for regulated markets to have systems to limit the ratio of unexecuted orders to transactions, providing that this ratio is appropriately calibrated.</p>
	<p>10) How appropriate are the requirements for investment firms to keep records of all trades on own account as well as for execution of client orders, and why?</p>	<p>Yes, we believe this requirement is appropriate although we note that investment firms should only be required to maintain records in the format and with the data retained at trade inception.</p> <p>With respect to the requirement under article 16(7) to record telephone conversations and electronic communications, the requirement to provide this to clients on request will add significant burden and cost. Such information may not be specifically allocated or stored on a client by client basis which would require data to be reviewed to identify specific client or trade related information. We believe the telephone record retention requirements should be reduced to a maximum of 6 months and not three years, as proposed under Article 16</p>

		<p>(7). We note that this is a potentially significant issue for FX given the high volume of trades and participants and even with a six month retention requirement is likely to add significant cost when required to segregate client records on client request.</p>
	<p>11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?</p>	<p><b><i>AFME endorses the ISDA response to this question (see below):</i></b></p> <p>To the extent that the trading obligation is intended to increase transparency, we believe that far greater benefit will be derived from appropriate pre- and post-trade requirements, including reporting to trade repositories and to the market, than from the trading obligation.</p> <p>In determining which contracts are ‘sufficiently liquid’, ESMA should be mandated to take account of the fact that liquidity can vary over time, meaning that the assessment of liquidity must be dynamic in nature and contracts should be liquid in a range of conceivable market stress scenarios. We also believe that MiFIR should acknowledge the risks associated with applying the trading obligation to inappropriate contracts, to ensure that only suitable contracts are caught.</p> <p>We support the fact that the trading obligation does not apply to transactions that are not cleared due to an exemption from the clearing obligation under EMIR. This will help ensure that the needs of end users are suitably accommodated. We also note the practical challenge associated with applying the trading obligation in the case</p>

		<p>of non-financial counterparties – this is dependent on whether a non-financial counterparty has exceeded the clearing threshold, and a firms’ activity may fluctuate above and below the threshold over time.</p> <p>Finally, we also encourage European policymakers to maintain a close dialogue with other jurisdictions on this issue, given the wider G20 efforts to move standardised OTC derivatives contracts to exchanges and electronic venues, where appropriate. While there are some parallels between the OTF concept and the US Swap Execution Facility, the European architecture for derivatives trading – also including SIs, regulated markets and MTFs – will be quite complex, making it more challenging to ensure that there is a level playing field across jurisdictions.</p>
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article 35 of the Directive?	<p>AFME welcomes the proposal to ensure that the European MTF SME growth segment has access to realistic levels of capital. However, post-trade publication must be calibrated in accordance with the characteristics of this market so as not to damage liquidity. AFME believes that further consideration is required in Article 35 for this MTF sub-category in order to serve the wide and highly-diversified range of the SME definition. AFME is concerned that if the issuing requirements in MiFID II and the Transparency Directive are not calibrated adequately, the smaller issuers will not have access to capital market funding.</p>
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to	<p>They are sufficient as drafted and we support the proposal.</p>

	<p>provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?</p>	<p>We strongly welcome the provision in Article 28.1., which clarifies that a venue has access to the existing margin pool of the CCP. This is vital in ensuring that effective competition is achieved. In the current scenario, although a trading venue might have access to a CCP, its contracts may not be cleared in the same margin pool, which would amount to a major barrier to effective competition.</p> <p>It is also important that the volume criteria (Art.28.6 (a)) accommodate the fact that there can be no expectation of volume in the absence of access (for exchange traded derivatives in particular) thus it is essential the rules do not create a Catch 22 type position.</p> <p>However, it is important that those seeking access to market infrastructure and to benchmarks should make all reasonable efforts to comply with relevant technical and operational requirements. We believe that non-discriminatory access must be subject to reasonable commercial negotiation, when and where appropriate.</p> <p>It is also important that the broader scope of the MIFID provisions compared to those of EMIR is maintained (i.e. that it covers all financial instruments, not just OTC derivatives).</p>
	<p>14) What is your view of the powers to impose position limits, alternative arrangements with equivalent effect or manage positions in relation to commodity derivatives or the underlying commodity? Are there any changes which could make the requirements easier to apply or less onerous in practice? Are there alternative approaches to protecting</p>	<p><b><i>AFME supports the ISDA response (see below):</i></b></p> <ul style="list-style-type: none"> <li>• a pragmatic approach consisting of granting regulators powers to put in place position management rules with the capacity, under certain conditions such as market dislocation, to set temporary position limits, is the right one. Position</li> </ul>

	<p>producers and consumers which could be considered as well or instead?</p>	<ul style="list-style-type: none"> <li>• position limits for individual classes of commodity derivatives risk undermining the efficient functioning of the commodity and associated derivative markets if they are not calibrated correctly. While position limits are used both in the EU and other jurisdictions it should be recognized that they are a blunt and inflexible tool which cannot hope to capture the complex and diverse interactions involved in the underlying production, movement and delivery of physical commodities and the genuine interrelationships between activities across different commodity classes and geographies. A poorly calibrated regime which does not recognise the complexities of the markets and different manner in which participants interact, could potentially fundamentally undermine the ability of producers, wholesale and consumers to manage their commercial risks efficiently.</li> <li>• exchanges and regulators need information on commodity derivatives positions to enable them to monitor the market (position information) and need mechanisms, subject to appropriate conditions, to allow them to intervene if any abusive behaviour or market distortion occurred or is likely to occur (position management);</li> </ul>
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		<ul style="list-style-type: none"> <li>• it is fundamentals, not financial investors, which drive commodity prices in the medium and long term, and while in the short term investors might intensify price trends, they cannot create them; we therefore consider that the emphasis placed on the impact of investors' behaviour on price volatility, which is the main reason raised as a justification for introducing position limit regimes, is misplaced.</li> </ul> <p>Position management rules are recognised by most stakeholders as an effective and sensitive tool to ensure that the markets function well and to help prevent market manipulation without negatively affecting liquidity, while the effectiveness of position limits is doubtful. The most appropriate regulatory regime should be based on the following three pillars:</p> <ul style="list-style-type: none"> <li>• Firstly, the general regime should be a sufficiently harmonised position management regime within which position limits should be only one tool among others and more specifically the tool that would be used only in the last resort.</li> <li>• Secondly, to avoid discrepancies between various national regimes, guidelines for a position management regime should be included within the directive.</li> <li>• Thirdly, the choice, within the 'position management toolbox', of the appropriate tool to</li> </ul>
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		<p>In applying the three pillars, we support the addition of the following guidelines relating to an effective position management regime:</p> <ul style="list-style-type: none"> <li>• The exchange shall monitor market activity of and the positions being taken by market participants. A member of an exchange will be required to submit daily or weekly reports of positions held for its own account and those held on behalf of its clients, that are not concluded through organised trading venues. For each contract, the exchange will determine if any participant is potentially building a position which raises a threat to the orderly functioning and integrity of financial markets, given the specific circumstances of the underlying market and taking into account such factors as the levels of open interest, liquidity and the supply of the underlying commodity.</li> <li>• Where the exchange determines that a position has arisen which has the potential to have an undue influence on the price of the contract, the exchange will call for all necessary information about the</li> </ul>
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		<ul style="list-style-type: none"> <li>• The entire position management regime is designed by the exchange and its effectiveness monitored by the national regulator who regularly reports to ESMA. Exchanges in conjunction with national regulators and following consultation with market participants may consider implementing other position management measures which consider the specific circumstances and structure of that market concerned. An example is the London Metal Exchange “Market Aberrations Regime”.</li> </ul> <p>From this perspective, we would support, instead of the</p>
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		<p>current wording of article 59, wording as close as possible to the G20 outcome<sup>2</sup>: <i>‘market authorities are granted with intervention powers such as formal position management powers, including the authority to set ex-ante position limits, as well as discretionary powers’</i>. That would highlight the idea that position management is the normal regime and position limits only a tool (under the oversight of the national regulator) within the position management regime which is employed as last resort measure in individual cases, if there is a threat to the orderly functioning and integrity of financial markets. Article 59 should only mandate position management by market operators.</p> <p>Finally, we encourage the European Parliament and ESMA to put in place appropriate aggregation rules for the purposes of monitoring positions. Any aggregation regime should be based upon control not ownership and should recognise that market participants can have completely separate management structures which operate independently and thus should not be viewed on a group basis for the purposes of aggregating positions. ESMA should put in place a system for entities to demonstrate to it or the relevant market that they are in fact independently controlled and thus qualify for independent limits.</p>
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient	Yes but they go too far. We believe that the current provisions on inducements do not strike the right

<sup>2</sup> FSB ‘Report to the G20 on the Overview of Progress in the Implementation of the G20 Recommendations for Strengthening Financial Stability’, 4 November 2011.

	<p>to protect investors from conflicts of interest in the provision of such services?</p>	<p>balance between consumer protection and consumer choice. The focus should be on prohibiting only those fees or benefits which conflict with firms' obligations to act in the best interests of their clients. We also believe that the list of permitted inducements (e.g. product training) is currently drafted too narrowly and should be widened to include other permissible inducements which are not likely to create conflicts of interests. This would include instances where the goods or services received in return for the charges are related to the execution of trades on behalf of the investment manager's customers or comprise the provision of research and will reasonably assist the investment manager in the provision of its services to its customers on whose behalf the orders are being executed.</p>
	<p>16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?</p>	<p>Product complexity is a conceptual debate which has not been fully developed in the Commission's proposals. Complexity can take many forms and what is complex for one consumer, may not be complex for another. Not all structured UCITS are likely to be complex under any definition of complexity, and not allowing them to be sold under the "execution only" regime, is likely to disadvantage European consumers in terms of product diversity and choice. For some products, complexity is embedded in the product with a view to reducing risk to the consumer.</p> <p>We also have concerns about the exclusion of certain securities that "incorporate a structure which makes it difficult for the client to understand the risk involved". We</p>

		would encourage the legislative bodies to focus on the risk rather than the complexity of the structure.
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	<p>We have some concerns regarding the revised best execution requirements. Specifically:</p> <p>Periodic information regarding execution quality (Article 27(2)) is of limited use to the general public. We agree that such information should be available to a firm's clients upon request or as decided by the firm on a commercial basis.</p> <p>There is a cost/time burden associated with publishing the top 5 execution venues for each class of financial instrument with little to no corresponding benefit to investors.</p> <p>We recommend that legislators generally consider the application of the investor protection provisions to OTFs as in some circumstances they will not be relevant. For example, where specific OTF activity does not incorporate discretion in execution, best execution requirements will not be relevant.</p>
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	<p>Firms and their counterparties welcome the Commission's statement that many of MiFID's conduct of business requirements are not meaningful in the relationship between ECPs and that there is no need to change existing requirements.</p> <p>We believe the current tiered approach to customer categorisation provides appropriate levels of investor</p>

		<p>protection to the three categories and that the regime establishes a proportionate and graduated system of investor protection. Although relatively recently introduced, the framework has been heavily invested in and is maturing well. We believe that municipalities and local authorities should not automatically be excluded from the list of ECPs and “per se” professionals although of course they should have the ability to opt down if they so wish.</p> <p>We note that under Annex II of MiFID, Member States may adopt specific criteria for the assessment and knowledge of municipalities and local public authorities to be treated as professional clients. These criteria can be alternative or additional to the ones listed as the criteria for clients who may be treated as professionals on request. Given MiFID’s overall objective of achieving a level playing field, we believe that the approach should be harmonised across Member States. A classification regime for these entities that reflects financial size, exposure to, and experience in, the financial markets would appear appropriate.</p> <p>Whilst we support the general principle of firms acting honestly, fairly and professionally in dealings with all clients, we object to additional information requirements in dealings with Eligible Counterparties. We believe that the current MiFID requirements remain fit for purpose.</p> <p>We also believe that ECP’s should be able to opt-out of any additional communications they do not wish to</p>
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		receive. The ability of clients to opt for greater regulatory protection at any time is an important safety feature already built into the process.
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of investors and market integrity without unduly damaging financial markets?	<p>Yes we believe so. AFME are supporters of the current national regimes that efficiently address this topic at present. Current investor protection and suitability requirements combined with day-to-day supervisory activity already set the appropriate regulatory framework and the Commission has not conclusively demonstrated that there is a need for the superimposition of any additional requirements which may restrict investor choice.</p> <p>We believe that there are significant issues both in theory and practice with a European system of prohibitions and bans on individual products and services given the diversity of financial markets and differing investor needs. Historically it has been difficult to decide whether a product should be prohibited in a pre-emptive way. It is very hard to know what causes market disorder and to assign any such disorder to a specific instrument. We are concerned that bans may increase uncertainty and systemic risks, while also being seriously detrimental to investor confidence. Suitability requirements and rules on mis-selling should ensure adequate levels of investor protection and we believe concerns regarding particular products, practices or operations should always, in the first instance, be addressed as part of the ongoing supervision of individual firms.</p>

		<p>We are also concerned about the anti-competitive impact of these provisions given that products could be banned in Europe but may still be available in non-European markets.</p> <p>We note that whilst ESMA’s intervention powers are described as “temporary”, there is no clear articulation of the time limits on ESMA’s powers beyond a requirement for a 3-monthly review and we believe that there should be a requirement for a thorough impact assessment (rather than just a review) before interventions are rolled over into the next 3-month period.</p> <p>Our preferred option would be to remove this requirement.</p> <p>An alternative solution may be to define more narrowly the conditions under which such actions could be taken, for example by requiring both ESMA and the competent authorities to undertake formal market failure analysis and consultation to demonstrate that the action is proportionate and takes into account the likely effect on investors and market participants. Furthermore, regulators should be encouraged to exploit other more established supervisory tools before resorting to such measures. The provisions should also contain a “sunset clause” for competent authorities i.e. if these are not able to provide appropriate evidence within a specified timeframe (say 3 months) to justify the measures taken, these should automatically expire. There should also be considerably stricter parameters around the scope and operation of such powers which could for example include the obligation to monitor</p>
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		<p>conditions leading to intervention, obligation to undertake some form of industry consultation, right of appeal and due process.</p> <p>We also believe that the current drafting is too wide with regards to authorities' ability to intervene in "certain financial instruments or types of financial activity or practice". The provisions should be clearly restricted to the list of services and activities and financial instruments in so far as they relate to the investments and activities listed in Annex I of MiFID.</p> <p>There are a number of practical considerations regarding the publication of supervisory notifications which are not currently adequately covered in the Level 1 text and for which there are currently no provisions for additional Level 2 standards. These for example include the language in which decisions taken by ESMA/competent authorities are published or the minimum time limit from which ESMA's measures will take effect. Lessons from recent product interventions have shown that clarity and consistency are required in order to prevent market disruption. Our Members are currently exploring whether a protocol which outlines the conditions under which powers can be exercised can be agreed.</p>
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Transparency	20) Are any adjustments needed to the pre-trade transparency requirements for shares, depositary receipts, ETFs, certificates and similar in Regulation Articles 3, 4 and 13 to make them workable in practice? If so what changes are needed and why?	It should be clarified that pre trade transparency waivers should apply to orders based on their type <i>or</i> size. This would allow for the reference price waiver to be maintained by ESMA. The reference price waiver is important because evidence suggests that posting small orders on lit markets does cause market impact. In tandem with this, there is no evidence that dark pool trading is damaging price discovery. In fact, exposure to dark pools and improved execution quality go hand in hand.
	21) Are any changes needed to the pre-trade transparency requirements in Regulation Articles 7, 8, 17 for all organised trading venues for bonds, structured products, emission allowances and derivatives to ensure they are appropriate to the different instruments? Which instruments are the highest priority for the introduction of pre-trade transparency requirements and why?	<p>Yes changes are needed. The transparency requirements for systematic internalisers in non-equity instruments under Article 17 are unworkable. It is important that the SI regime recognise the critical role that investment firms that deploy their capital play in providing market liquidity by assuming risk to accommodate client needs. We are concerned that various aspects of the regime as drafted have the potential to decrease the attractiveness of providing market liquidity to the detriment of clients. This is particularly acute in fixed income and derivatives markets on account of the vast numbers of different instruments and differing levels of liquidity. In particular we would disagree with:</p> <p>1) The requirement for SIs to provide transactable quotes to clients below a size specific to the instrument in a manner which is easily accessible to other market participants on a reasonable commercial basis. If firms were compelled to quote the same price to all clients, they would quote based on the lowest common (or risky)</p>

		<p>denominator. Specifically, firms would implement defensive pricing strategies to protect themselves, resulting in widening of spreads and poorer execution for clients.</p> <p>The Commission’s objective for ensuring that SIs provide all their clients with fair quotes and that no client is discriminated, can be fulfilled by introducing a “non-discriminatory quoting policy”. This means that transactable quotes must be made available to clients on an objective basis measured against clear criteria. However, we argue that obliging the SIs to provide any one client with access to the same quote as another client is not an appropriate solution. This is because there are counterparty risks and concerns that have to be taken into account in pricing.</p> <p>The criteria that will be included in non-discriminatory policy include those in Article 16 MiFIR and others; for example:</p> <ul style="list-style-type: none"> <li>- Counterparty credit risk</li> <li>- Investor credit status</li> <li>- Settlement risk/final settlement of the transaction</li> <li>- Whether the transaction is clearable or not</li> <li>- Wholesale V retail</li> <li>- Competitive nature of the client</li> <li>- Purpose of the client</li> <li>- Size of the order</li> <li>- Portfolio impacts (eg CVA)</li> <li>- The channel through which a firm quotes (and related</li> </ul>
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		<p>2) The absence of reference to waivers in relation disclosure of quotes in the SI regime. AFME recommends a more targeted approach, which takes into account a broad spectrum of assets and liquidity profiles in the Fixed Income markets. Hence the obligations to disclose quotes should only apply to the liquid instruments and appropriate waivers (e.g. large size orders) should be in place.</p> <p>3) The obligation to disclose quotes introduces significant operational challenges, including:</p> <ul style="list-style-type: none"> <li>- What mechanisms would enable firms to communicate to all clients that they are offering firm prices in a specific instrument</li> <li>- The length of time “live” prices are advertised This clearly needs to be in conjunction with what would be deemed a ‘reasonable’ amount of time that a client should hold a price, again different by instrument.</li> <li>- The mechanism by which an SI will communicate to its clients that a price is no longer live. The only method of achieving this would be to stream live prices. However this is a decision that currently should remain with the client. Many corporate clients do not want prices streamed, firstly because of the significant physical expense involved in establishing the stream and secondly, because they prefer simplistic methods of trading and</li> </ul>
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		<p>interacting with liquidity providers (i.e. phone).</p> <p>4) The obligation for SIs dealing in non-equities instruments to comply with best execution obligations and for quotes to <i>"reflect prevailing market conditions in relation to prices at which transactions are concluded for the same or similar instruments on RMs, MTFs or OTFS"</i>. We question how firms will be able to meet the best execution obligation under the RFQ model where instruments are illiquid and there is no reference price against which firms can evidence they have met best execution.</p>
	<p>22) Are the pre-trade transparency requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?</p>	<p>We believe that the continuous quoting obligation in Art. 7 is appropriate for the quote-driven trading model in fixed income platforms provided that the quotes are indicative and for liquid instruments only.</p> <p>In the Fixed Income markets, the platforms allow clients to raise a request for quote to single or multiple dealers in competition and select the best price. These platforms also provide benchmark/composite/indicative pricing on a continuous basis. These prices give clients an indication as to the potential liquidity, therefore sufficient price discovery. As MiFIR Recital 14 expressly specifies that <i>'[...] The transparency requirements should be calibrated [...] for different types of trading, including quote-driven systems'</i>, we believe that composite/benchmark/average pricing meets the pre-trade requirements for RFQ venues and similar styles.</p>

	<p>23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?</p>	<p>No, we believe some changes are needed. We are of the view that waivers should be approved by ESMA within a reasonable timeframe. The proposed time period should be halved so that a competent authority must notify ESMA 3 months before the waiver is intended to take effect and within 6 weeks of receipt, ESMA must give its opinion on the waiver. See also our answer to Question 20.</p> <p>Additionally, there appears to be no scope to accommodate market conditions that change liquidity characteristics of instruments within a short time period (and certainly less than 6 months). Especially considering the current environment of market stress, the text needs to ensure flexibility, so that the criteria for granting a waiver can be reassessed and recalibrated on a regular basis to account for changes in the market.</p> <p>Given the likely need for a large number of waivers, we would support a more targeted solution to pre-trade transparency for non-equity markets, rather than a blanket approach. Inappropriate pre-trade transparency obligations could ultimately raise costs for end users of the market. Furthermore, we support measures in the text to ensure that waivers are applied consistently across member states and in a timely manner. However, the overall need for ESMA to be given sufficient time to develop new standards in different areas is recognised.</p>
	<p>24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs),</p>	<p>The European Commission anticipates that multiple providers would be able to register to provide a Consolidated Tape in Europe. Whilst we support the</p>

	<p>Authorised Publication Authorities (APAs)?</p>	<p>European Commission objective of creating competitive pressures on ECT provision, we believe that multiple operators may make it more difficult to deliver the other elements of the ECT, including price control and the concept of a single official tape of record.</p> <p>We therefore propose that a single provider should be appointed subject to a tender process every 3 years.</p>
	<p>25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?</p>	<p>The post trade transparency requirements will be identical for both trading venues and investment firms trading OTC. All market participants will be obliged to make public the price, volume and the time of a transaction as close to real time as is technically possible. As the Commission has proposed in its Level 1 text, deferred publication and omission of the transaction should be allowed. The criteria for public reporting should include the liquidity profile and trading activity of the bond in question. These criteria are taken into consideration in the pre trade text. Failure to take into account the above criteria would prevent the resale of products, damaging liquidity.</p> <p>The Level 1 text should enable a time delay assessment system that recalibrates on a periodic basis.</p> <p>Any post trade reporting framework should be relevant for future market conditions as well as the current environment.</p> <p>The industry is already working on developing a post trade calibration framework that ensures the correct balance between high levels of transparency and adequate levels of</p>

		<p>market liquidity, under normal and stress conditions. The calibration considers criteria such as the transaction size and the liquidity profile of a bond. Factors determining the liquidity profile of a bond include the trading frequencies, trading volumes and issuance sizes. The framework also allows for periodic recalibration of the criteria for deferred publication. A market led calibration will thereby have the flexibility to adjust for changes in market conditions, such as periods of stress or boom. It is crucial that the design of the Level 1 proposal does take account of this work.</p>
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	<p>We welcome close co-ordination on issues of cross-sector importance between ESMA, EIOPA and EBA. We also welcome the creation of a Joint Committee and the exchange of information between all three ESAs. It is important that cooperation takes place on a number of cross-cutting issues impacting wholesale markets such as corporate governance or sanctions where there are similar provisions in e.g. MiFID and CRDIV.</p> <p>AFME is generally supportive of the process that delegates detailed technical requirements to the European Supervisory Authorities. However, it is important that what ESMA is asked to deliver is realistic in view of the resources it currently has and is phased in such a way that it is consistent with the growth of ESMA's resources over time. It is critical that the ESAs are provided with sufficient time and opportunity to undertake their obligations and meet the challenges they face with the strongest possible chance of success.</p>

		<p>Developing technical standards, setting thresholds and collecting and analysing enormous amounts of data, as well as participating fully in supervision and regulatory oversight processes, will create a major burden on a developing institution. Inappropriate and poorly thought out regulation has the potential to cause additional significant systemic risk, rather than removing it from the financial services and markets systems.</p>
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	<p>No, we do not currently envisage a need for specific changes but would suggest including private warnings in the minimum list of regulatory tools available for competent authorities (see our answer to Q. 30).</p>
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	<p>There are a significant number of other important policy initiatives which overlap in certain elements with MiFID/MiFIR. In particular these are the Market Abuse Directive and Regulation (MAD/MAR), Packaged Retail Investment Products Initiative (PRIP), the European Market Infrastructure Regulation (EMIR) and the Alternative Investment Fund Managers Directive (AIFMD). A number of specific provisions cut across Directives, for example there are provisions on sanctions and corporate governance in both CRDIV and MiFID and third country proposals form part of MiFID/MiFIR, the AIFMD and EMIR. The MiFIR transaction reporting requirements have been extended to mirror the scope of MAR and the retail focused conduct of business/investor protection provisions are relevant to the PRIPS initiative.</p> <p>Many elements of these initiatives are interrelated and it is</p>



		critical that a process is in place that ensures definitional consistencies across the various measures, especially given that most of these Directives are in different stages of the EU legislative process.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	<p>There are numerous international requirements that will need to be borne in mind but probably the most significant is Dodd-Frank in the US.</p> <p>The most significant areas covered by both Dodd-Frank and MiFID, relate to OTC derivatives, business conduct, trading platforms (OTF category vs SEFs), pre-trade transparency (e.g. Shares traded on exchanges or ATS only) and post trade transparency (shares, bonds, derivatives vs all instruments regardless where traded for MiFID) and 3rd country access. For example, in so far as they are relevant platforms for meeting the derivatives trading obligation, the OTF and SEF concept should be aligned as far as possible. In addition, post trade public reporting obligations should be harmonised given the global nature of these markets.</p>
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	<p>We are in favour of a consistent application of MiFID rules, and the capacity of competent authorities to impose sanctions with a deterrent effect.</p> <p>We welcome the Commission's proposed clarification of the factors that must be taken into account when determining sanctions, such as the gravity and duration of the breach or the level of cooperation with the competent authority. A minimum level of financial penalty may help move towards a more consistent regime, however, there is</p>

		<p>a risk that narrowly defined numerical levels may not meet regulators' needs given the diversity of financial markets across Europe.</p> <p>We would caution against introducing new provisions in the absence of a broader EU-wide agreed framework and also requirements will need to be developed in recognition of the proposals on sanctions in CRDIV. We believe it is important that national authorities retain the ability to tailor judgments to the particular circumstances of the case which may in certain circumstances require sanctions potentially higher than the limits suggested by the Directive.</p> <p>It is our view that day to day supervisory activity and private censure remain valid and effective regulatory tools and we would therefore propose to formally include private censure in the list of remedies available to competent authorities. We would also suggest removing the highly detailed disclosure requirements in Article 74 that automatically apply for the publication of any sanctions including the disclosure of the identity of the person(s) responsible for the breach unless the disclosure would "seriously jeopardize financial markets". The competent authorities should have the option to make actions public as part of their toolkit, but only after the investigation and enforcement process is complete. Even in the extreme circumstances where sanctions information could be published on "anonymous basis", competent authorities would need to exercise extreme caution as it may be possible to infer the identity of the impacted</p>
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		<p>parties or incorrect and damaging speculation could ensue.</p> <p>There needs to be a clear process to determine when the publication would be proportionate given the potential damage to the persons involved.</p> <p>We also believe that the provisions in Recital 99 regarding appropriate procedures and safeguards for the protection of accused persons should be strengthened and included in the main body of the Directive.</p>
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	<p>No, at this stage we do not believe that the appropriate balance has been achieved. Whilst we appreciate that the Level 1 should provide the appropriate high-level framework, a significant amount has been left to Level 2 implementation with certain technical standards not due to be implemented until the end of 2016. This can create uncertainty. It will be important the Commission revisits the current requirements for Level 2 rules to ensure that further technical details are provided only where there is a need for further clarity and legal certainty whilst avoiding over-prescriptive legislation likely to add undue burdens and unnecessary costs to the firms.</p> <p>The scope for using Level 1 to “signpost” more clearly the nature of the delegated requirements that ESMA will need to develop should be maximised by the European Parliament. It will also be important for the European Parliament to take a view on which Level 2 measures should be mandatory for ESMA to produce and which should be optional.</p>

		<p>We suggest that Level 1 instruments adopt a general approach in that Level 2 implementation is not set in absolute date-specific terms but by specifying a period starting when the Level 1 measure is adopted.</p> <p>We believe that it is appropriate that the ESAs should be given a period of no less than 9 months post-adoption to prepare and finalise implementing standards, with 12 months as the preferred norm. In setting the appropriate Level for additional Level 2, the limited resources available to ESMA need to be kept in mind. The Commission has to avoid burdening ESMA with delivering additional technical work it does not have the resources to deliver to a high standard. For example during 2012 ESMA will be expected to deliver on at least 40 technical separate standards.</p> <p>Appropriate focus on quality will be especially important now give the strengthening of ESMA's role with minimal intervention by the Commission before adoption and given the changes in ESMA's decision making process which is now based on majority voting. Each piece of legislation should take an integrated view of the existing and proposed work programme of the relevant ESA. To the extent that it may be considered impracticable for the ESA to complete all of the envisaged mandates to a high quality and within a particular timeframe (given available resources), we would suggest that a principle of prioritisation should be incorporated in the Level 1 mandates. Where not everything can be achieved in the</p>
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		same period, a phased approach should be established.
Detailed comments on specific articles of the draft Directive		
Article number	Comments	
Article 1.3:	We welcome the clear articulation of the MiFID provisions that also apply to credit institutions which are authorised under Directive 2006/48/EC (Banking Consolidation Directive) but note that the drafting of Article 2(3)(1) of CRD4 lacks similar clarity. As CRD4 repeals and re-enacts provisions from the BCD - and particularly given that the proposals for CRD4 and MiFID2 contain similar non-financial resource related provisions (e.g. relating to authorisation, corporate governance and sanctions) - it is vital that there is complete clarity in respect of which provisions apply to investment firms. We believe, however, that the proposed more general, drafting of Art 2(3)(1) of CRDIV makes it unclear whether provisions in CRD4 that are similar, but not necessarily identical to MiFID 2 provisions, would be disapplied for an investment firm or whether an investment firm would be subject to two sets of potentially overlapping, non-financial resource-related provisions.	
Article ... :		
Detailed comments on specific articles of the draft Regulation		
Article ... :		
Article ... :		