Review of the Markets in Financial Instruments Directive

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 **by 13 January 2012.**

Theme	Question	BAML Response
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?	• We support exemptions for corporate end users and consider it is important for policymakers and regulators to appreciate the operational limitations of corporate end users which may inhibit their ability to comply or discourage corporate users from using these products as risk management tools; in particular for Commodities end users.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way ?	In relation to emission allowances: • We support the FOA response on this question. In relation to structured deposits: • We are supportive of including structured deposits within the MiFID / MiFIR framework.
	3) Are any further adjustments	• It is important to ensure that the 3rd country provisions do not restrict the ability of EU investors

	needed to reflect the inclusion of custody and safekeeping as a core service?	(whether retail, professionals or ECPs) to access custody services in non-EU markets. A particular concern arises in relation to emerging markets whose regulatory framework may not be equivalent to the EU's. • In markets where omnibus accounts are not recognised and an account must be opened in the client's own name directly with a local custodian/ depositary system, this should not trigger a requirement for that local custodian/depositary system to establish a branch in the EU. • Caution must be exercised before seeking to apply EU conduct rules to non-EU custodians. • Thought needs to be given as to which aspects of MiFID 2, particularly in relation to investor protection measures such as suitability and appropriateness and those relating to execution of orders, should apply to such services.
	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?	• Yes, it is appropriate to regulate third country access. • We welcome the proposals for third country firms to be able to benefit from a European "passport". • Consumers and investors will benefit from the competition this regime will encourage as it will bring opportunities to EU financial institutions arising from reciprocity, eg. Spanish & Portuguese FI's with access to growth markets in Latin America, and French FI's with access to growth markets in Africa etc. • It will have a significant impact in the establishment of a harmonised regime for the access of third country firms to the European markets, helping to create a level playing field and reducing the costs and risks associated with the management of European business. • We point to the following precedents that were beneficial to EU market participants

		- The EU 2008 declaration of foreign GAAP “equivalent” to international reporting standards. - The concept of consolidated supervisory entity within the BASELII framework. - International trade agreements, such as WTO and its predecessor GATT, in which non-financial service markets rely on a standards and equivalence concept to the general benefit of consumers - The success of implementation of these provisions will depend heavily on the definition of the requirements for equivalence and reciprocity of third country regimes, which should focus on a core set of principles of minimum standards. - The provisions by which European firms may request services from firms in non-equivalent third countries at their own exclusive initiative (i.e. on a reverse solicitation basis – see MiFIR Article 36(4)) will be key to ensuring an effective route for continued access to such services that may be critical to EU firms’ operations in third countries. To this end, we believe a harmonized definition of reverse solicitation should be included in Level 2 measures.
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?	- We support the AFME response on this question - In addition to that response we would like to point to the need to have regard for Company Law requirements by country, and specific country regulations; for example the CBI Corporate Governance code which requires major credit institutions to have a certain number of INEDs, and restricts the number and type of directorships held, also states which board committees are required.
Organisation of	6) Is the Organised Trading Facility category appropriately defined	Article 20 With respect to Cash Equities, the proposals to prohibit execution against an OTF operator’s principal

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<td>markets and trading</td>
<td>and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what changes are needed and why?</td>
<td>capital (see Article 20 of MiFID 2) will imply a significant change to the operating model of the current broker crossing networks (which will become OTF markets), to the detriment of investor activity and the provision of liquidity. To facilitate client business, brokers often execute OTC trades with clients, using principal capital, and hedge the resulting positions also using their principal capital. Prohibiting such hedging activities of client-driven business within OTFs will limit the extent to which investors can take advantage of the liquidity and spreads available in the broker’s crossing network / OTF. The net effect will be to increase the cost of providing capital to clients, and to limit clients’ execution choices.

The proposed conduct of business rules relating to conflict of interests management, the obligation to execute orders on terms most favourable to the client, and order handling provisions included in Articles 27 and 28 MiFID 2 can be used effectively to resolve any conflict of interests that may arise between OTF operators and clients, as an alternative to a restriction on use of principal capital.
While not related directly to the definition of an OTF, we believe that there are some regulatory and operational issues that should be addressed in respect of the OTF requirements as currently drafted.

Articles 32, 33 (MTFs & OTFs) and 53 (RMs)

These introduce an obligation on an investment firm or market operator operating an MTF, OTF or RM to notify other RMs, MTFs & OTFs trading the same instrument if it suspends or removes an instrument from trading. This is in addition to a notification to the relevant competent authority. This creates the potential for operational difficulties in that it may not be clear which other MTFs or OTFs a particular instrument is traded on.

Article 18

ESMA is required to establish a list of all MTFs and OTFs. This list should be expanded to include the instruments admitted to trading on each MTF/OTF, along with a contact email address for which the notifications can be sent.

Articles 34 (MTFs/OTFs) and 54 (RMs)

These require an investment firm or a market operator operating an MTF, OTF or RM to notify other

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		RMs, MTFs & OTFs of disorderly trading conditions, conduct that may indicate abusive behaviour within the scope of MAR/MAD and system disruptions.
		
		• In addition to the operational difficulties above, this creates a couple of other concerns:
		    o The requirement requires you to notify all other RMs, MTFs and OTFs even if they did not trade the instrument. This seems unnecessary as the operator of a FICC OTF does not need to know of a system disruption in a MTF/OTF that is trading cash equities. The wording in paragraph 1 should be amended to include a reference to RMs, MTFs and OTFs trading the same class of financial instrument.
		    o Paragraph 1b) should be removed. The requirement here should be to notify the competent authority only, (via an STR). In fact if an STR is warranted, sending notification to others would in itself be a breach of the requirements under MAD/FSA rules.

	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?	• The current references to "OTC" are in our opinion sufficient, provided that the definitions for Systematic Internaliser and "organised trading facility (OTF)" are made sufficiently clear.
		
		• Provided sufficient liquidity, product standardization, infrastructure and clearing support is available, OTC trading will be channelled into organised venues such as OTFs:
		    o We anticipate that the majority of European Fixed Income liquidity currently counted as OTC will become captured within the new OTF regime.
		    o In Equities, liquidity currently in broker crossing networks (BCNs) may migrate to Systematic Internalisers or OTC, if current proposed legislation continues to prohibit use of OTF operators' own capital.
		
		• Ad hoc, non-systematic, OTC should remain as it currently exists as it serves a critical risk management function for investors and dealers, particularly in allowing the broad use of available instruments which may be bespoke or illiquid in nature.

	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location	• As discussed below, we believe that a key aspect of Article 17(3) needs to change significantly in order to achieve the overall objectives of addressing the risks involved; and elsewhere. We stress the need for appropriate proportionality in any proposals.

	in Directive Articles 17, 19, 20 and 51 address the risks involved?	Article 17(3): • We believe that the requirements for algorithmic market participants to provide liquidity on a "regular and ongoing basis.......at all times, regardless of market conditions" will detract from the aims of promoting robust, stable markets and the provision of liquidity. • The requirement to provide ongoing liquidity is in tension with general considerations of risk management as it requires firms to actively make markets in conditions which may be outside their risk limits. Furthermore, we do not believe such a market making commitment is compatible with execution-focused algorithms (such as volume-weighted average price algorithms), offered on a widespread basis to numerous institutional clients by many broker dealers. • To promote liquidity from algorithmic traders who are willing and able to make markets, we believe that it is important to use the incentive frameworks that have developed organically in the European markets. Without appropriate incentives, adverse consequences are likely, potentially including traders being able to commit only to substantially wider spreads, or exiting the markets altogether, to the detriment of the overall investor community. Article 17(2): • We believe it is important to ensure that the level of detail required to be disclosed on a periodic basis to the regulatory authorities is appropriately tailored and proportionate (e.g. focusing on the overall purpose of the algorithm and broad characteristics, not the source code/trading model itself). Article 51: • We believe it will be key for the Directive to ensure appropriate calibration of circuit breakers, order to cancellation ratios, slowing down mechanisms, tick sizes, etc. – most of which markets have already developed organically.
	9) How appropriately do the requirements on resilience, contingency arrangements and	• We note the existing practices and requirements at trading firms, which in concert with current regulatory oversight are, for investment firms such as ourselves, in place for all trading infrastructures,

	business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?	including electronic trading platforms.
	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?	BofAML: no comment.
	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?	• We would seek confirmation that derivatives within scope (i.e. standardized, sufficiently liquid and eligible for central clearing) are able to be traded OTC on a non-systematic basis under appropriate circumstances and in there is international harmonisation in approach e.g. ensuring maximum customer choice and protection by permitting individual request for quote functionality and allowing reporting delays for block trades (see rules implementing The Dodd-Frank Wall Street Reform and Consumer Protection Act - Title VII).
	12) Will SME gain a better access to capital market through the introduction of an MTF SME	• Additional detail will be critical here before assessing the potential impact, given the likely tension between making it easier for SME issuers to come to market by relaxing listing requirements, and giving potential investors confidence in SME securities by requiring issuers to uphold high standards.

	growth market as foreseen in Article 35 of the Directive?	
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	• In terms of the provisions' interaction with EMIR, given that the scope of EMIR appears likely to be restricted only to the clearing, margin, and reporting of OTC derivatives, it is important to ensure that the MiFIR provisions cater for all products in scope, including the listed derivatives markets as well as cash equities, equity-like instruments and other in-scope product types.
	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 producers and consumers which could be considered as well or instead?	We support the FOA response
Investor protectio	15) Are the new requirements in Directive Article 24 on	We support the AFME response

n	independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	• Financing and execution only prohibition: In line with our views on the complex / non-complex distinction for execution only, we do not believe that it is appropriate to limit the ability of certain parties (such as professional clients, in particular per se professional clients) to receive execution only services where they are also being provided financing for the transactions as this would substantially increase costs for clients who are already sufficiently sophisticated to appreciate any risks that may arise. • Complex/non-complex distinction: We do not believe that complexity is synonymous with risk. Relatively simple to understand products can pose more risk than relatively complex products. Therefore, in assessing whether clients should be able to access execution only services, the proposal should not only take into account the inherent characteristics of the product but also the sophistication of the client. We note that the automatic categorisation of a bond which embeds a derivative as a complex product will include convertible and exchangeable bonds. • Throughout, we believe that professional clients (and especially per se professional clients) should have the option of being able to access execution-only services regardless of whether the product is considered complex or non-complex.
	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	BofAML: no comment.

	best execution is achieved for clients without undue cost?	
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	BofAML: no comment.
	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?	BofAML: no comment.
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?	Article 4: • We seek confirmation that the reference price waiver will still be in operation (only the large in scale waiver is referred to as an example). • It is important to consider the phasing in of transparency requirements for equity-like instruments. In particular we recommend the introduction of the post-trade transparency regime before any pre-trade transparency regime so that market volumes are properly established before trading activity is required to become pre-trade transparent.
	21) Are any changes needed to the pre-trade transparency requirements in Regulation	Article 7: • We note that a broad range of products are captured by the current definition included in Article 7. Depending on the product, there are differing factors such as trading conventions and product liquidity

	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?	that will influence the feasibility and desirability of transparency requirements, especially pre-trade transparency requirements in the fixed income asset classes. o As in our response to Question 20, we consider that it would be advisable to introduce the post-trade transparency regime for non-equity products ahead of any pre-trade regime in order that the system can be tested and effects on the efficiency and liquidity of markets monitored for a few years prior to consideration of a pre-trade transparency regime. • Secondly, we note that the current scope as defined as "Investment firms which…conclude transactions in bonds and structured finance products admitted to trading on a regulated market or for which a prospectus has been published" is broad. The current definitions would include structured notes traded in the secondary market and private placement securities. • We recommend that listed, non private placement securities should be considered first with respect to a post trade reporting requirements. • Finally, we would advocate that rather than including a blanket pre-trade transparency obligation for the non-equity markets at Level 1 as is included in Article 7 of MiFIR, it should be left to ESMA to determine a suitable and calibrated regime for the non-equity markets.
	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?	• As per Q21, we would stress that is would be advisable to introduce the post-trade transparency regime for non-equity products ahead of any pre-trade regime. Further, in the case of proposals for pre trade transparency requirements for fixed income securities and derivatives, we note the characteristics of the market trading conventions that could make pre trade transparency detrimental to dealer participants as well as asset managers and increase costs to clients. In particular, debt security and derivative markets are request for quote driven (as opposed to order driven), with the majority of bonds traded off market or over the counter through a dealer. • In the case of proposals for pre trade reporting for derivatives we note the characteristics of derivative contracts that would make pre trade reporting particularly challenging, where numerous variables and

		permutations of traded instruments exist. As an example, there are typically 240 different permutations of a credit default swap (CDS) contract relating to each particular underlying entity – comprising 40 different maturities and 6 different standard premium payment criteria - of which only a few will be frequently and actively traded. • We believe that the ongoing innovations in electronic markets, the growth of bond and derivative trading on platforms such as MarketAxess, Tradeweb, and Bloomberg currently provide a sufficient level of pre trade transparency for dealers and clients. • Data aggregators such as Markit, Xtrakter, and TRAX currently provide comprehensive fixed income security and derivative information to dealers and investors.
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	• As per our response to question 20, we seek confirmation that the reference price waiver will still be in operation (in MiFIR Article 4, only the large in scale waiver is referred to as an example).
	24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs), Authorised Publication Authorities (APAs)?	• While we agree with the provisions in Articles 61 – 68, the necessary spend/effort to implement these should be appropriate. We recommend that particular attention is spent on: o Agreeing common data standards with industry-wide consensus (sell-side, buy-side, platforms, data providers); initiatives such as the Market Model Typology project need support in this regard o Establishing an appropriate 'reasonable cost' framework o Ensuring appropriate unbundling of pre- and post-trade data, and of data by country / segment, etc. • For these detailed topics, we believe that industry consultation will be very important.
	25) What changes if any are needed	• As per answer to question 24

	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?	
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?	BofAML: no comment.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	BofAML: no comment.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	• EMIR: definition of derivatives to be brought into scope for mandatory central clearing and mandatory platform trading; provisions for competition amongst CCPs/trading venues & treatment of 3rd country regimes. • MAD 2/MAR : link to algorithmic trading provisions and initial MiFID 2 proposals apparently designed to tackle market abuse via 'slowing down' measures (see Q8 above and MiFID 2 Article 51, for example), extension of scope to OTFs.

		- ESMA "Guidelines on Systems and Controls in an Automated Trading Environment" – linking to the proposals for algorithmic trading - AIFMD: on (i) equivalence of third country regimes and (ii) for the authorisation/licensing and passporting for fund managers managing investments in the EU - PRIPS: link to Investor Protection and Conduct of Business provisions for the sale and distribution of financial instruments - CRD: corporate governance, third country firm access - REMIT: commodities matters
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	- To the extent provisions have extra-territorial application, interaction with local regulation must always be borne in mind. Our interests lie in effective harmonisation and co-ordination by regulators in relation to global markets and globally traded instruments. Particular instances include: - US Dodd Frank Wall Street Reform and Consumer Protection Act: - Title VII: definitions of covered swaps/derivatives (eg FX), mandatory platform trading and reporting requirements for derivatives, conformity of swap execution facility (SEF)/OTF definition
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	BofAML: no comment.