

## **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](mailto:econ-secretariat@europarl.europa.eu) by 13 January 2012.**

Name of the person/ organisation responding to the questionnaire	<b>British Bankers' Association</b> <b>Pinners Hall</b> <b>105-108 Old Broad Street</b> <b>London</b> <b>EC2N 1EX</b>
--	---

<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?	The exemptions are broadly welcomed.  Our members believe that entities that conduct the same activities should be regulated in the same manner, regardless of their corporate status. However our members are concerned, exemption 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 'ancillary' – which will be drafted at Level 2. It is therefore important to ensure that delegated acts under MiFID Article 2.3 are carefully drafted so that they eliminate the possibility of regulatory arbitrage and provide for consistent treatment of the same activities.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	<p>Yes. A definition of what constitutes a 'MiFID structured deposit' is however required at Level 1 to achieve certainty and clarity on the products to be captured. The Joint Association Committee (JAC) on Retail Structured Products in the context of the PRIPS review would, our members believe, more precisely capture the type of products which the legislators wish to target:</p> <p>“a deposit paid on terms under which any interest or premium will be paid, or is at risk, according to a formula which involves the performance of:</p> <ul style="list-style-type: none"> <li>(i) an index or combination of indices (other than (i) money market indices or (ii) interest rate indices) a financial instrument or combination of financial instruments (other than (i) money market instruments, (ii) debt securities issued by a government or central bank or (iii) interest rate derivatives); or</li> <li>(ii) a commodity (or combination of commodities)".</li> </ul> <p>It is important to take into account the substantial difference between structured deposits and other financial instruments including the fact that structured deposits benefit from deposit protection.</p>

		<p>As the products that will be covered under the recast Deposit Guarantee Schemes Directive and the recast Investor Compensation Scheme Directive have not yet been determined, members highlight that there should not be dual coverage of SDs.</p> <p>Given that the revised MiFID will introduce regulation to the emission allowances market for the first time, it will be particularly important to design a regime to meet the needs of market users and avoid disruption to this important market.</p>
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	<p>Our members do not agree with the inclusion of custody as a core service. If custody continues to be included as a core service there needs to be a clear definition of this service and clarity on which provisions apply.</p> <p>Custodians do not generally execute client orders. Custodians do carry out corporate action instructions as directed by their clients and allocate odd lots on corporate actions, but this is not "execution of orders" in accordance with the intended meaning of MiFID I.</p> <p>The suitability, execution of orders and appropriateness requirements do not have any meaning in this context. Whilst members welcome the proposal to make custody passportable, they also believe that making custody a core service creates confusion for custodians as to the obligations required of them, bearing in mind that custodians generally provide a post trade service. This is an area where there is already, or will shortly be, appropriate EU regulation, for example under AIFMD, UCITS V</p>

		<p>and the Securities Law Directive. Additional paperwork and determinations (if required) could result in increased cost to end investors but without any increased investor protection.</p> <p>Recital 19 states that Investment firms in charge of the administration of employee participation schemes are not covered by the Directive if they don't provide any other investment services for third parties. As safekeeping and custody are considered in the proposal as core investment services, investment firms in charge of employee participation schemes providing safekeeping of employees' assets would be covered by the Directive.</p> <p>This section should be deleted from Annex I of MiFID (recast) and Recital 3.4.7 of the same text.</p>
	<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>An EU passport for third country firms has the potential to improve EU investors' and issuers' access to third country markets. But it needs to be carefully designed not to limit or discourage third country participation in EU markets or routine professional and counterparty interactions with third country firms to the detriment of EU investors and corporates, or the access of third country issuers to funds in the EU markets (particularly less developed markets).</p> <p>The proposals as they stand may seriously hinder global trade.</p> <p>Particular amendments that are needed:</p> <p>(1) Any equivalence requirement needs to be based on broad</p>

		<ul style="list-style-type: none"> <li>(2) To maintain the openness and attractiveness of EU markets to international investors and issuers there should be no condition of reciprocal recognition;</li> <li>(3) There should be harmonised exemptions at least for eligible counterparties; governments and authorised intermediaries; 3<sup>rd</sup> country group members of EU authorised firms; and for business that is intermediated by a MIFID-authorised firm; (or which is delegated to a third country firm under MiFID rules);</li> <li>(4) The exemption for unsolicited business should allow interaction within an existing client relationship, and provision of information about services the third country firm provides;</li> <li>(5) National regimes should continue at least until an equivalence decision has been made for any particular country. The process will be complex, and rigid deadlines, even with a four-year transitional period, risk disrupting essential, legitimate and well-regulated interactions;</li> <li>(6) Restrictions should not apply when the third country firm complies with MiFID standards;</li> <li>(7) There is a need to enable third country firms to provide services to professional clients without establishing a branch; and</li> <li>(8) The legislation should provide for grandfathering.</li> </ul>
--	--	--

		<p>Under the Level 1 legislative proposals, unless a service is provided at the exclusive initiative of the client, a third country firm seeking to access the retail market will be required to establish a branch. But a third country firm cannot seek authorisation for such a branch unless the European Commission has given an equivalence decision in respect of its home state and certain other conditions are met. As a result of this approach, large numbers of third country firms could be precluded from accessing EEA markets even where they are adequately capitalised and willing to follow MiFID rules in their dealings with EU investors. Accordingly, our members would suggest that at the very least, there should be a mechanism enabling third country firms from non-equivalent jurisdictions to be able to obtain authorisation.</p>
Corporate governance	<p>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>	<p>Our members agree that it is important to strengthen the corporate governance of financial firms, especially with regards to board capability and risk management processes. Members specifically highlight the importance of accommodating diversity of board structures in the EU. This will contribute to better governance structures within firms and will contribute to a higher level of best practice in corporate governments.</p> <p>With regard to requirements for boards, it is crucial that board members have sufficient experience and expertise, and that the time they are able to commit to their work in the board as well as diversity should be properly taken into account. Diversity and time commitment rules should be proportionate and appropriate to the institution in question and should never undermine the</p>

		<p>principle that firm's board members should have both the capability and capacity to carry out their duties in a rigorous and effective manner.</p> <p>Our members support an approach where the corporate governance provisions in MiFID/R replicate those set out in prudential legislation, (subject to the comments below with regard requirements not being applied at legal entity level).</p> <p>Our members believe provisions on diversity are more appropriately dealt with under non-sector specific EU legislation because including specific diversity requirements in sectoral legislation runs the risk that differences will emerge.</p> <p>Governance requirements should not be applied at legal entity level. Where firms operate globally and have strong central governance frameworks, replication should not be applied on an individual legal entity basis. With respect to international financial groups, some groups may have one committee for all entities. Other groups may establish regional committees or even have committees for specific (material) entities.</p> <p>Our members believe that the Board should include a mix of skills/competencies to allow the Board to function competently as a whole i.e. not all attributes should be required of each individual Board member. Current requirements and obligations, imposed on non-executive directors, together with the ensuing liability, make it increasingly difficult for international firms to find suitable directors particularly if applied at the legal entity level. Choice should not be limited by</p>
--	--	---

		<p>additional regulatory requirements.</p> <p>ESMA must take account of local market peculiarities when drafting technical standards for Article 9 which is of particular concern with regard to the unified definition of skills, experience or diversity.</p> <p>The proposals for firms to establish nomination committees made up entirely of non-executives to assess a management body's compliance with its obligations is inappropriate at sub-parent board level.</p>
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 changes are needed and why?	<p>Our members support a well calibrated definition of OTF but in its current form it is too high level and broadly drawn and would capture entities for which the regulation proposed is inappropriate. Further clarifications are needed to exclude other activities that should not be caught (e.g. phone-based booking/capital commitment).</p> <p>The Proposal rightly allows OTFs to exercise discretion on both participants in the OTF and how trades are executed. These discretions are consistent with firms' conduct of business obligations which investors value.</p> <p>There is a need to allow the operator of an OTF to deploy its own capital, because clients seek to use the dealer's balance sheet when they engage bilaterally. Strict separation of capacity between dealers and OTFs would make it more difficult, slower, and more costly for investors to obtain execution and could therefore ultimately result in harm to end users.</p>



		<p>The proposed prohibition for the operator of OTF platforms to use their own capital is also likely not to be consistent with meeting best execution objectives, and could potentially have a negative impact on trading activity in the following ways:</p> <ul style="list-style-type: none"> <li>i. No single provider could ever guarantee to provide a complete service on any one platform;</li> <li>ii. In order to provide a full service and meet the specific demands of investors, where an operator runs an OTF, it would have to run a separate offering in order to be able to provide liquidity using its own capital and thus be able to support client trading (this is even more of a problem if that liquidity is not available elsewhere). Fragmented service provision means fewer economies of scale, higher costs and less competition.</li> <li>iii. Reduced liquidity in the market for ‘trading mandated derivatives’: The present proposal prohibits bilateral trading when combined with the derivatives trading mandate (see question 11), which could ultimately increase risks rather than reduce them.</li> <li>iv. ‘Worse’ best execution in Europe: By removing a potential counterparty, it would reduce the possibility to ensure best execution for clients – a key objective of the MiFID architecture.</li> </ul> <p>Conflicts of interest can be, and are, managed in bilateral trading relationships currently under existing MiFID rules and Competent Authorities’ supervision and enforcement powers. Article 19.3 (for MTFs) could be replicated for OTFs.</p>
--	--	---

		<p>The prohibition of interoperability between OTFs and of OTF operators acting as SIs in the OTF, could cause detriment to large buy side investors. There is a benefit to them being able to interface with a single offering allowing firms to view and transact against available liquidity across multiple sources in a single local for the benefit of investors and clients. The proposals may lead to significant market fragmentation and will increase the complexity of execution whilst not catering for investors' needs.</p> <p>OTFs are equally valid methods of trading to RMs and MTFs: as such, there should not be a requirement for OTFs to explain why they do not need to be regulated as an MTF.</p> <p>Investors should be allowed the flexibility to execute via order book, Request For Quote (RFQ) or voice where appropriate (all execution forms should be protected). The proposals are based on cash equities (order book) concepts which are not directly transferable across into other products. The RFQ model should be preserved for all venues.</p>
	<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>It is important to note that OTC trading is already subject to post trade transparency and COB rules. OTC trading is a residual category and therefore should not be defined in an exclusive and closed way; indeed the definition needs to be open-ended particularly as it is becoming relevant to non-equity where there is a great variety of OTC activity. If a definition is required then whilst Recital 18 of the Regulation provides a good starting point, the extension of MiFID rules into non-equities would</p>

		<p>mean a broader range of criteria would need to be considered. The impact of the new OTF category is difficult to predict particularly as noted in Q6 there is a need for clarity regarding what would be captured on an OTF regime, though it will no doubt result in more trading going through organised venues. It is important to be aware that investors view OTC and organised markets as complementary, not mutually exclusive. For example, investors will use OTC when a tailored solution is required; organised trading venues will be used when a standardised solution is acceptable. This is entirely appropriate – standardising all products so that they may be traded on organised venues would mean that many investors would not have a solution which fully suits their needs and this could impede economic activity and drive businesses to take on more risk than is appropriate.</p> <p>A study, which is publicly available, undertaken by AFME refutes that 40% of Pan European trading is OTC trading. The majority of this flow is so called reporting events instead of real liquidity. Exclusion of these reporting events leaves around 15% of the market as OTC “Real Liquidity”. Of this around 5% is broker to broker flow (It is difficult to imagine how this flow would move onto order books) and another 5% of the market is through Broker Crossing Systems. This flow would be captured by the new OTF category. The main users of BCNs are institutional investors with large orders. If institutional investors could only execute their orders on lit markets, their execution costs would increase due to the potential of increased information leakage and as a result market impact and cost. Through BCNs’ institutional investors are able to reduce their</p>
--	--	--

		market impact for a proportion of their flow and benefit from executing against like minded investors.
	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>It is appropriate to base the regulatory approach on management control of the risks associated with algorithms, direct access, and co-location. However the definition and requirements of direct electronic access does not distinguish between direct market access and sponsored access, despite their different risk profiles.</p> <p>The MIFID text defines both high frequency trading and algorithmic trading, but then does not distinguish the two concepts in the proposals. Many algorithms reduce risk and serve a very useful purpose for clients (and market users) and, for example, avoiding market impact or achieving an average execution price over a given time period. It is unclear why algorithmic trading is subject to a two-way market making obligation given the above. Some of the draft wording requires redrafting or careful consideration, for example:</p> <ul style="list-style-type: none"> <li>• firms cannot “ensure” that algorithmic trading systems are not used by traders or clients inappropriately;</li> <li>• clients, rather than firms, need to retain responsibility for compliance with regulatory requirements, including market abuse requirements. The text does not encourage responsible trading by clients who may be absolved of responsibility. Firms accept responsibilities to build appropriate systems, controls and monitoring of algorithms.</li> </ul> <p>Our members find Article 17 particularly onerous and question</p>

		its effectiveness in promoting orderly markets. For example a number of strategies only trade at certain times of the day e.g. certain strategies operate only in the closing auction. Equally, 'facilitation' algorithms trade in one direction only and so it would be impractical to provide quotes in the other direction. Additionally the requirement to continuously quote at competitive prices at all times, regardless of prevailing market conditions can, for example, not be met by fund managers using electronic systems to manage their orders to initiate transactions on behalf of their clients.
	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?	The requirements are broadly appropriate and should be consistent with those detailed in the ESMA guidelines on systems and controls in automated trading. Our members suggest that circuit breakers between different EU market venues should be coordinated where possible.
	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?	It is appropriate to require records of all trade on own account.
	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>Our members stress the importance of the proper application of the criteria in Article 26 for determining when a clearing-eligible derivative must be traded on organised venues. Hedgers and investors must be able to trade contracts at any time, so the criteria on actual admission to trading and sufficient liquidity are essential.</p> <p>As with the pre- and post-trade transparency proposals, provision</p>

		<p>does exist at Level 2 for a calibrated approach in determining when an OTC derivative is sufficiently liquid and therefore subject to the trading obligation. The factors (set out under MiFIR Art 26.3) to be taken into account in determining where the obligation arises do appear to cover key areas of concern and it is helpful to see that public consultation is also envisaged as part of the process. However, the final outcome of the proposals will not be determined until Level 2 meaning that in assessing the Level 1 proposals, a number of assumptions have to be made.</p> <p>Article 24.1: the new mandatory trading obligations requiring eligible OTC derivatives subject to the trading obligation to be traded exclusively on organised venues means that client orders in an OTF cannot be executed against the proprietary capital of the operator of the OTF which prevents Single Dealer Platforms ('SDPs') from qualifying as OTFs and means SDPs would not be regarded as organised venues on which eligible OTC derivatives could be traded. In effect firms will be prohibited from using their own proprietary capital in transactions with such designated OTC derivatives as highlighted in Question 6 above. The Directive should at least provide for an exemption or mechanism whereby sophisticated clients or clients with very large orders or where a derivative provides exposure via a wrapper can opt to make trades with a firm operating an OTF.</p> <p>Our members welcome the link up of the obligations under MiFID to those under EMIR; however, implementing non-financial counterparties' clearing thresholds will pose practical challenges as firms' activity fluctuates above and below the threshold. The legislation should mandate ESMA to define the</p>
--	--	---

		<p>threshold, monitor the activity of non-financial counterparties which are close to the threshold and make such information readily available to counterparts to enable them to meet this requirement.</p> <p>The requirement that third country trading venues be eligible only where the Commission has judged the third country regime to be strictly equivalent to the EU's is unrealistic and unworkable, and risks cutting EU hedgers and investors off from the ability to manage risks in properly regulated third country markets. Please also see our response to Question 4.</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?	Access to capital markets for SME's results from many factors, institutional, economic and social, including tax. Legislation can only facilitate such a market but cannot create it.
	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?	<p>Our members are very supportive of requirements to open up access which will benefit the market and its users. It is important that the operational and technical caveat in Article 28 should not be used as a barrier to access but equally those seeking access to market infrastructure and to benchmarks should make reasonable efforts to comply with relevant technical and operational requirements. Non-discriminatory access should be subject to reasonable commercial negotiation, when and where appropriate.</p> <p>It is important that the operational and technical caveat in Article 28 is not capable of being used as a barrier to entry, but that these caveats are based on legitimate assessment. Where access is denied, the applicant should have some recourse to challenge</p>

		<p>the assessment via competent authorities and ESMA.</p> <p>It is important that the broader scope of the MIFID provisions than those of EMIR is maintained.</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 producers and consumers which could be considered as well or instead?</p>	<p>Our members believe position management as an overall tool is the right approach and do not see any need for further alternative approaches.</p> <p>Commodity derivatives serve an important commercial role for the real economy for example corporate end users must retain the ability to hedge risk.</p> <p>Our members note that there are five potential levels of intervention in commodity derivatives. This may create deep uncertainty for markets and end users which may adversely impact end user pricing. So it is important to retain the provision for alternative arrangements with equivalent effect, and to interpret and apply it (taking account also of ESMA powers in the Regulation) in a way that does not disrupt these vital functions without very good reason. As competent authorities engage with one another in the forum provided by ESMA, we expect that supervisory skills will develop and improve. Exercise of supervisory powers should, therefore, negate the need for the wide scale exercise of position management powers.</p> <p>Increased transparency in commodities markets can help to improve market integrity. However, restricting large positions could also have negative effects on market volatility and liquidity, as there are many valid circumstances in which a large</p>



		<p>position can be built up. It would be difficult to capture these in specific exemptions. Competent authorities should seek better insight into large positions, and reinforced market abuse regulations should be relied on to address instances where trading activity is identified as abusive.</p> <p>Our members agree ESMA should publish details of position management arrangements in place but that the level of information provided should be sufficiently made anonymous so that the firm(s) concerned does not suffer undue market risk. Members also highlight that the imposition of position limits/management arrangements should not be viewed as disciplinary measures but rather as a measure to manage orderly markets if a firm has built up a position for <i>bona fide</i> reasons. The imposition of position management measures/limits should not be seen to result in reputational damage to the firm.</p> <p>Further, supervision should largely negate the need for the exercise of powers by the CAs to reduce/limit position limits.</p>
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	<p>Yes. It is important: (1) to ensure that other investor rights are protected, in particular their right to choose the type of advice they receive; (2) to retain the emphasis on informing the client about the basis of advice; and (3) to be aware that firms are already under a MIFID obligation to manage conflicts of interest.</p> <p>Our members are concerned that an outright ban on inducements for portfolio managers is inappropriate. Bans tend to create unintended consequences and are not market neutral. An</p>

		<p>example is the Retail Distribution Review in the UK, which (because it mandates separate payment for investment advice) will lead to the reduction of advised services in the UK (as only the top end clients will be willing to pay for advice, and many will choose to opt for execution only services instead, to save cost, at a risk).</p> <p>The existing MiFID rules on inducements provide sufficient safeguards as all investment advisors are already under the obligation to recommend products that are suitable for consumers and to disclose inducements. Any concerns around conflicts of interest would be better addressed by requiring firms that offer inducement-based services to obtain explicit consent from clients for the fees.</p> <p>Recital 52 should explicitly state that appropriate non-monetary benefits, goods or services are permitted, subject to them meeting the condition set in Recital 52.</p> <p>The cross selling proposals are not clearly defined and may adversely (and detrimentally) impact the Research industry (particularly for investment managers).</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>Aspects of the proposal are problematic. The focus should be on how a product's complexity impacts the expected return from the investment (i.e. return volatility), not necessarily the complexity of the investment's structure. Complex features often exist specifically to give a simple, stable, and predictable return.</p> <p>Members have concerns about the wholesale exclusion of</p>

		<p>structured UCITS on the basis that not all structured UCITS are complex. Whilst members agree that products which are both highly complex and highly risky should not be sold to retail clients on an execution only basis, the current definition of “complex product” should be amended to reflect that a product with certain amount of complexity and with a low level of risk can be sold to retail clients under the execution only regime. As such, it does not follow that all structured UCITS will by definition be complex.</p> <p>Additionally our members have concerns about the exclusion of certain securities that “incorporate a structure which makes it difficult for the client to understand the risk involved”. The ‘difficult to understand’ criterion is too subjective to be an appropriate obligation to impose on firms.</p>
	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>The revised best execution requirements are generally workable. Operators of OTFs would be happy to provide the information suggested under 27(2) to clients but question whether it is necessary or of real benefit to end-investors to have this information. Investors are primarily concerned that the price achieved is to their benefit and that the transaction is safe, e.g delivery occurs.</p>
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	<p>Yes, there is no evidence of the current regime having failed. The current tiered approach works well in providing appropriate levels of investor protection to the three categories.</p> <p>There needs to be a non-comprehensive reference in COB rules</p>

		<p>to differentiate between professional and retail clients.</p> <p>It is important to retain the ability of local authorities (some of which are large and skilled managers of public funds) to act as professional clients.</p>
	<p>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>	<p>Product intervention powers should be exercisable as a last resort only on proof of damage, not risk of damage; only when other measures are ineffective; and only in relation to a specific product not a class of product.</p> <p>Powers should furthermore rest with national competent authorities as they are able to tailor the intervention more closely to the requirements of the local market. Only in very limited instances of an EU-wide problem should ESMA powers apply.</p> <p>Firms subject to an intervention whether from ESMA or a Competent Authority should have advance warning of the intervention to prevent mass disruption when a notice comes in with immediate effect. Also, firms should be accorded a ‘right to reply’ to a notice prior to its enforcement to an independent arbiter, e.g., an ESMA panel of the competent authorities’ peers which excludes the Competent Authority that wishes to issue the notice. This will help to ensure appropriate regulatory accountability and respects principles of natural justice.</p> <p>Product intervention powers should also be stated to be exercisable only where there is a significant threat to investor protection.</p>

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?	Calibration of pre-trade transparency requirements will be a fundamental element in the regime and if not appropriately calibrated, could harm users of equity trading venues. It will be important to ensure that Level 2 waivers cater for OTF users' needs.
	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>The revised rules on pre-trade transparency could cause drastic structural change (with unintended consequences) if not appropriately considered and defined with clear objectives in the text.</p> <p>Pre trade transparency should be limited to the most standardised and liquid and frequently traded instruments, in particular government bonds.</p> <p>As a general comment our members note that the high-level transparency obligations proposed at Level 1 for non-equities, are drafted with an order book mechanism in mind (with calibration to happen at Level 2). Neither the draft recitals nor articles make it clear whether or how the continuum of other existing execution models (e.g. RFQ based models) would be supported. It needs to be clear that existing mechanisms to provide information in RFQ mechanisms either satisfy the requirements or fall under a waiver.</p> <p>The incremental impacts of the pre-trade transparency proposals are likely to be almost exclusively negative for the following reasons:</p>

		<ul style="list-style-type: none"> <li>• Pre-trade transparency does not require a visible order book of actionable prices, or broadcasting of all request for quote enquiries: submitting a RFQ to identify market prices, for example, is a valid mechanism to establish prices pre-trade.</li> <li>• Similarly, in many markets, broadcasting non-executed RFQs would have a negative effect on market liquidity, as it would alert market participants to likely demand and allows them to trade ahead of those trying to execute trades. This would then impact the prices and sizes shown in response to the RFQ: spreads would widen and sizes reduce as counterparties take into account the cost of the market movements that result from this information leakage – increasing the cost of trading.</li> <li>• Prices are based on a number of factors which may be client-specific. These prices and depth are therefore unlikely to be available to other participants with different execution/clearing relationships and a different credit profile, and therefore do not represent ‘depth of trading interest available’ in a meaningful way.</li> </ul> <p>Fundamentally, the design of transparency arrangements must focus on end-users’ needs and expectations. For less liquid and infrequently traded instruments, it will be important for the requirements, either through the Level 1 text or in Level 2 measures or technical standards, to allow for the current range and diversity of pre-trade arrangements that have been designed to meet market users’ needs. A simple requirement for RMs, MTFs, and OTFs to disclose price and depth of trading interest is</p>
--	--	---

		<p>not necessarily as well adapted to these markets as it is to equities and publication of depth of trading interest could be particularly harmful for non-equities. These matters need to be catered for either in the regulation or through waivers.</p> <p>Making quotes public is problematic for less liquid instruments especially when coupled with the requirement to state ‘depth of trading interest’ which implies quotes must be firm/in an executable form and made public on a continuous basis (which implies continually live pricing).</p> <p>Our members suggest consideration is given to removing the references to ‘depth of trading interests’ and ‘on a continuous basis’ or qualifying both by inserting the phrase ‘where appropriate’. The objective of the provisions should be to ensure that the best possible price discovery can continue to occur in each market. The imposition of the requirements for continuous executable pricing for markets that are illiquid is impractical (i.e. there is no continuous pricing for many instruments) and will reduce the quality of pricing (i.e would lead to widening of spreads as market makers need to factor in increased risk). Indicative pricing, however, provides some protection to the party providing the quote.</p> <p>Article 17 is particularly problematic: the Proposal is more draconian than the equity SI regime, and not well adapted to non-equity markets, particularly at the illiquid end: in particular, there is a need for a well-designed liquidity filter (as there is in Article 13.1, but not 17); for a well-designed size filter (as there is in Article 13.2, but not 17); for more work on the ‘size specific</p>
--	--	--

		<p>to the instrument' criterion in Article 17.3; and for Level 2 measures or technical standards that allow for a more flexible approach. As it stands, Article 17 imposes commercially unrealistic obligations on firms, and Article 18 imposes unrealisable expectations on ESMA.</p> <p>There are many differences between equities and non-equities that make the proposed approach unworkable. The average trade size in non-equities is much larger than in the equities markets while non-equities markets are generally less liquid than equities. The lower levels of liquidity in non-equities markets (caused by a bid-offer mismatch) means the role of dealer as liquidity provider is vital. Members are concerned that should the Systematic Internaliser regime for non-equities be implemented as currently drafted, it has the potential to decrease the attractiveness of providing market liquidity to the detriment of clients. This, for the reasons outlined above, is particularly acute in fixed income and derivatives markets on account of the vast numbers of different instruments and differing levels of liquidity.</p> <p>For larger trades in illiquid instruments our members disagree with proposals to require SIs (for non-equities) to publish firm (or transactable) quotes to clients when the quoted size is at or below a size specific to the instrument (the threshold) in a manner which is easily accessible to other market participants on a reasonable commercial basis. Indeed, as mentioned above, such a regime would replace the current well-adapted request-for-quote model with a central limit order book approach not adapted to wholesale clients' needs. This is because the request-</p>
--	--	--



		<p>for-quote model can only exist if dealers can price transactions to reflect client specific considerations , notably counterparty credit risk, or the risk that a party to a transaction will fail to fulfil its obligations. Counterparty credit risk is particularly relevant to derivative transactions which are not cleared by a central counterparty. A SI regime may be workable for small size transactions in liquid instruments (e.g. some government bond markets) but similar issues may arise if requirements are not calibrated correctly.</p> <p>Different clients (counterparties) carry different levels of counterparty credit risk. Firms are likely to offer better pricing to clients that clear through a central counterparty (all other things being equal) than those that do not centrally clear their transactions. If the SI regime forces firms to quote the same price to all clients, firms will be forced to quote prices based upon the lowest common (or most risky) denominator. In other words, firms will implement defensive pricing strategies in order to protect themselves, which would create a widening of spreads, and ultimately poorer execution for the client.</p> <p>Besides counterparty credit risk, there are a number of other factors that firms need to take into consideration when making pricing decisions, including:</p> <ul style="list-style-type: none"> <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 (conduct of business obligations placed on us as the liquidity provider)</li> </ul>
--	--	--

		<ul style="list-style-type: none"> <li>• Competitive nature of the client</li> <li>• Purpose of the client</li> <li>• Size of the order</li> <li>• Portfolio impacts (Credit Valuation Adjustment etc)</li> <li>• Choice of channel through which we quote (including connectivity costs, brokerage, latency etc)</li> </ul> <p>Obliging the SIs to provide any one client with access to the same quote as another client who has different characteristics, as outlined above, is not an appropriate solution. As explained, there are counterparty risks and concerns that have to be taken into account in pricing. For these reasons, the expectation that Systematic Internalisers “should not be allowed to discriminate within categories of clients [professional or retail]” is unworkable as it is inconsistent with sound business practices (please see Recital 17 of the Regulation).</p> <p>Our members question whether pre-trade transparency for SIs (in anything but a liquid market) will have any positive benefit: if dealers have capacity limits - these could quickly be reached, such that publication of their quote will confuse as it will not indicate availability. Article 17.6 under MiFIR requires an SI dealing in non-equities instruments to comply with best execution obligations (Art 27, MiFiD) and quotes must ‘reflect prevailing market conditions in relation to prices at which transactions are concluded for the same or similar instruments on RMs, MTRs or OTFs’. It is not clear how firms will be able to meet the best execution obligation under the RFQ model where instruments are illiquid given there is no reference price. This</p>
--	--	---

		<p>should be removed as there is no reference price against which firms can evidence they have met best execution.</p> <p>For non-cleared trades, pre-trade transparency may lead to misleading information (because the price may not be available to other counterparties with a different credit risk). This will impose a cost on end users for little or no corresponding benefit.</p> <p>The requirements may cause/force liquidity to move outside the EU, or may irreparably damage liquidity available to investors in the EU, if they are not appropriate.</p> <p>See also our responses to the following questions.</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>See our comments on question 21.</p> <p>The requirements set at Level 1 are very broad and capture many instruments and activities for which price transparency is either ineffective or harmful to market liquidity. Broad provisions with broad parameters have the potential to distort price formation and significantly affect the operation of existing market models and liquidity. This would limit the ability of end users to appropriately manage their risks which would in turn have an impact on the wider economy. The requirements may also result in imposing ill-suited trading models on existing markets (e.g. order book trading) and otherwise impact that way that trading is done. For example, if it is too risky to complete large size trades (i.e. counterparty would not be able to hedge adequately due to the transparency requirement), trades will be broken up into smaller lots reducing market efficiency and potentially forcing</p>

		<p>such trades into an HTF type model where large size trades can be broken down and completed quickly. At a minimum, the requirements should leave sufficient flexibility for different trading models to exist (e.g. in illiquid markets, indicative pricing and RFQ should be available and operate as they do today). We appreciate that this is likely to be deferred to level 2.</p> <p>Members welcome the recognition in this questionnaire that there is a need for appropriate calibration by instrument and highlight that in the draft legislative text reference that transparency requirements will be "calibrated" is only noted in recital 14 of MiFIR. Members believe there should be an explicit statement in the articles that pre-trade transparency requirements will be calibrated. We would also welcome a statement that calibration of pre-trade transparency requirements will <u>not</u> solely be driven by waivers but should also be hardwired into legislation (FYI see article 17 of MiFID I, Implementing Regulation which references different market models – for example, quote driven trading system, periodic auction trading system).</p> <p>Appropriate calibration depends on the characteristics of the product, the investor base and the market in which it is traded. There may be no single “correct” level of transparency; so a flexible approach is needed, in particular where levels of liquidity vary over time or over the life of a product. This will require intensive monitoring and resourcing from ESMA to track products and markets on a near real time basis and monitor requirements.</p>
--	--	---

		<p>The pre-trade transparency requirements for OTFs are quite broadly stated, and, beyond the most liquid government bond and similar markets, ‘prices and the depth of trading interests’ may need to be adapted to the range of possible non-equity OTFs, by allowing an appropriate structure for waivers or calibration.</p> <p>See also our specific comments under question 21 on the proposed SI regime for non-equities in Article 17.</p>
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	<p>It would be better to: (1) develop a regime which is specifically adapted to the range of non-equity markets, rather than just copying across the equity model. Most non-equity markets are much less liquid than their equity equivalents and hence the proposals are likely to be damaging to smaller scale orders. Reducing liquidity in fixed income markets in this way will potentially increase the funding and hedging costs for corporates and institutional investors. Additionally if the existing waivers for the equity market are transposed to the fixed income market, they would not provide sufficient relief to allow the currently existing range of trading models to exist (including RFQ mechanisms); (2) distinguish clearly between wholesale and retail markets; and (3) establish requirements appropriate to each product.</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), Authorised Publication Authorities (APAs)?	<p>In principle, the data service provider provisions are appropriate. However, for markets where reporting or consolidation systems are not already in place, the timetable of two years to build a consolidated tape is extremely ambitious.</p>

		<p>It is important to ensure that the data service provider provisions are consistent with the trade transparency regimes and to make clear that they do not apply to transaction reporting requirements.</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>It is important to distinguish between (1) the authorities, who should receive granular, settlement-level information about transactions, either directly or via utilities or trade repositories, under the transaction reporting rules; (2) market participants, who need timely accurate information about already executed trades so that they both know where the market is and can accurately value their books at the end of the day / month / year; and (3) the public, who have an interest in aggregated, after the event data.</p> <p>Market data also have a role to play in monitoring best execution. Members also note that in non-equity markets there is a significant interaction between trade size, liquidity, the potential for market movements and thus the risk of poor execution and market instability from early publication of illiquid trades. The need to provide for proper calibration of trade reporting delays, to protect investors and seek to ensure reasonable market quality, follows from this, and should be reflected in the text of the Regulation.</p>
Horizontal issues	<p>26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?</p>	<p>Consistency is a challenge which the ESAs and the Joint Committee can help address. Both consistency within and among legal texts, and a consistent approach to supervision are</p>

		<p>needed. The latter is particularly important in current circumstances. There should be more focus on best practice across the EU so that what is generally seen as good behaviour or compliance in one Member State is adopted in other Member States as well.</p> <p>Generally, members welcome Parliament inserting an overarching provision in the text of the Regulation and the Directive which requires ESMA to apply internationally agreed standards and codes. For example, current work on Legal Entity Identifiers should be accepted by ESMA for the purposes of reporting requirements.</p> <p>In addition, it would be helpful if the ESAs and Joint Committee were required to seek proper technical advice when developing standards which require IT systems to be built or modified. It is very clear that there is a lack of understanding of the time it takes to build and, particularly, to test IT solutions when we see the text of legislative proposals. The Joint Committee should develop and maintain a strong understanding of these issues to serve all the ESAs.</p> <p>Enough time needs to be allowed to finalise and implement the regime to ensure that the interest of market users are protected and market stability is not damaged. The industry stands ready to provide technical assistance through consultation.</p>
	<p>27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?</p>	<p>At this level, no specific amendments are needed to implement this requirement placed on authorities but members suggest the inclusion of private warnings to the list of regulatory tools. The</p>

		ESAs have an important role to work towards supervisory cooperation and consistency, and the Commission has an important role in monitoring and policing this process at 'Level 4'. It is important in particular to ensure that product intervention powers are not used to distort the Single Market.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	There is a need for consistency of treatment and reporting rules in the following cross-cutting legislations: EMIR: access and interoperability PRIPS UCITS IV CRD: application of bank governance rules to investment firms MAR/D: extension to OTFs AIFMD SLD
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	Members emphasise the need for MIFID to be revised, in all contexts, from the point of view of the EU not just as a single market, but also as a leading element of the international market, providing EU investors and issuers with opportunities and funding worldwide, and attracting third country investors and issuers to invest and raise capital in the EU. There needs to be well judged regulation consistent with international standards led and set by the G20, the Financial Stability Board and IOSCO.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	Broadly our members believe the sanctioning regime is sufficient



	<p>31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?</p>	<p>Members suggest that some Articles (e.g. pre-trade transparency for non-equities) may need to be examined specifically to ensure that the balance between public policy principles and technical detail is right and to ensure appropriate signposting of Level 2 measures in the Level 1 text.</p> <p>Specifically where members believe more certainty is required at Level 1 include:</p> <ul style="list-style-type: none"> <li>• The objectives of the rules on pre-trade transparency or how markets are expected to operate. These revised rules could lead to drastic structural changes and unintended consequences.</li> <li>• The definition of MiFID structured deposits.</li> <li>• Precise drafting of the application of cross selling (applies when providing a MiFID service in conjunction with a non-MiFID service for packaged products).</li> <li>• Granting credit loans to investors to allow them to carry out a transaction in which the investment firm is involved: restrict the requirement to perform the Appropriateness text to Retail clients only.</li> </ul> <p>Our Members additionally point out that some requirements sit more naturally within Level 2 provisions. These include:</p> <ul style="list-style-type: none"> <li>• The provision for an ongoing assessment of suitability and any relevant considerations (together with the other Level 2 suitability provisions).</li> <li>• Types of UCITS which can be classified as complex</li> </ul>
--	---	---

		<ul style="list-style-type: none"><li>Requirements for firms safeguarding and administering financial instruments to provide information to clients.</li></ul>
Detailed comments on specific articles of the draft Directive		
Article number	Comments	
Recital 13 (and Recital 16 MiFIR)	These recitals need to be amended to make clear that a firm which is an SI can also operate an OTF or MTF. They should specify that when a firm is acting in its capacity as a Systematic Internaliser, the firm should not be allowed to bring together third party buying and selling interests, but should not prevent the same firm from also operating a separate MTF or OTF.	
Article 16:	It is right to introduce a telephone recording requirement, but the blanket three-year retention period for recordings should be reduced, with a provision for Competent Authorities to require firms to retain specific records for longer. Competent authorities should be able to identify suspicious transactions and therefore which recordings they want retained within 6 months.	
Art 16(7)	<p>The words 'at least' will allow Member State Competent Authorities to extend the requirements beyond that specified in the Directive which may subject some firms to more onerous requirements than others.</p> <p>Also, the requirement to provide records of telephone conversations to clients raises some questions – can this be a paper transcript or is there an expectation that the firm will provide an audio record? There are no parameters around clients being able to ask for recorded information (including no Level 2 to flesh this out).</p>	
Art 32(1)	If it is correct not to suspend an instrument due to information disclosure failure if doing so would cause significant damage to investor interest or orderly markets, then (notwithstanding that some investors may suffer detriment due to the continued trading of the instrument) should there not be some action designed to rectify the disclosure failure so that the market is in possession of all necessary information?	
Detailed comments on specific articles of the draft Regulation		
Article	Comments	

number	
Art 19	If the firm submits the information to the APA is its obligation fully discharged so that if the APA somehow fails to publish, the responsibility for the fault will rest with the APA?
Art 23	There should be exemptions for asset classes of financial instruments where market abuse does not arise. For example, FX, primary market issuance, derivatives referencing index/basket and interest rates.
Art 23(2)	Financial instruments admitted to trading on an OTF only, should not be transaction reported. If they were to be reported this could mean firms are reporting transactions in financial instruments to their home regulator which the Competent Authority of where the shares are primarily issued and admitted to trading may not require or request the information.
Art 23(3)	Inclusion of the identity of the person or algorithm responsible for the investment will not assist competent authorities in detecting market abuse and the ability to accurately identify individuals accurately may prove problematic.
Art 35	Third country firms should be able to provide services to per se Professional Clients without establishing a branch