Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Response by BlackRock – a Global Independent Investment and Risk Manager

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.

Please note: BlackRock is a global independent investment and risk manager. Striving to achieve optimal investment performance for end-investors - Europe's households, pensioners and savers - is therefore a key objective.

A number of areas of the MiFID II proposals will enhance investor protection and mitigate risk in and from markets. However, some elements of the proposals would impair outcomes for investors by de facto *radically restricting investment possibilities and potential returns. We have, therefore, focussed on responding to the questions in the areas where it is particularly important to flag possible unintended negative consequences for Europe's end-investors.*

"N/a" reflects that we have considered the question and deemed it to be of a lower-order of priority in terms of direct impact on end-investors.

Theme	Question	Answers
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?	N/a
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	We agree with the inclusion of structured deposits in the scope as it ensures a level playing field in the retail investment products distribution. We do not have comments regarding the inclusion of emission allowances.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	We think that a further alignment with Undertakings for Collective Investment in Transferable Securities V (UCITS V) and (Alternative Investment Fund Managers Directive (AIFMD) is needed in order to ensure the duty of custodian is consistently described. Also, further adjustments are needed for the non-application of appropriateness test in article 25 para. 2 of MiFID. This would apply to the opening of client account as safekeeping of assets is qualified as a core service. In this case, it is not relevant that investment firms test clients' knowledge and experience as the service of asset safekeeping should be deemed appropriate whatever the client's individual background is. Asset safekeeping is not the sort of service that requires proper knowledge and experience from clients.
	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?	There are a number of key uncertainties as to the application of the proposed third country rules in particular the scope of application. It is essential to define whether the third country provisions regulate access to EU markets and/or to EU investors.

		There are very different implications if the aim is to govern business being transacted on EU markets or business being transacted outside the EU with EU investors. In our view the third country regime should focus on access to EU markets with additional protection for retail investors. We see it is important to ensure that retail investors are entitled to receive consistent levels of protection and service when they are dealing with providers of professional services and that they have a clear point of contact for complaints and redress in the EU. As an alternative to the establishment of a branch, we would also consider the appointment of a permanent representative in relevant EU member states to deal with retail investor claims, along the lines of the legislative solution agreed in AIFMD. However, the proposals do not differentiate between services provided to retail investors and those provided to professional investors in the EU. We consider merging the existing retail client regime with that applied to professional investors is inappropriate. For example, most EU asset managers will want retain professional investor status and do not wish to act as eligible counterparties to retain the benefits of best execution for their underlying clients. It is important to allow continued access by both professional clients and eligible counterparties to non EU markets, in order to meet the requirements for client mandates. Managers routinely delegate management of all or part of the assets included in the mandate to third country expert managers. These experts may be

		set up within or outside their own groups. In addition, where the manager wishes to buy a security in an emerging market it may have to use a local exchange member to comply with national clearing arrangements. Delegation is not an unregulated activity and it is key to ensure that the interaction of third country rules with the existing MiFID Level 2 rules on delegation under Article 14 of Directive 2006/73/EC continue to work effectively. Under this, an EU firm cannot absolve itself of its responsibility when outsourcing services such as delegation of portfolio management and must not alter its relationships and obligations to its clients. The MiFID Review should allow firms to continue to delegate activities outside the EU using the existing outsourcing and delegation framework. In particular in terms of the delegation of portfolio and risk management by investment firms, where the EU firm remains liable to its customers for the activities of its delegates, the regime should be consistent with the regime set out in UCITS and AIFMD for the delegation of portfolio and risk management e.g. Article 20 of AIFMD as clarified by recent Level 2 advice by ESMA to the EU Commission on AIFMD Level 2 implementing measures. It should be clarified that the proposed third country rules do not apply where an outsourcing applies generally, or at the very least that they do not apply in respect of the delegation to group companies to allow portfolio managers appointed in the EU to offer their EU clients access to the experience of their group

		companies in markets outside the EU provided they are authorised to provide asset management services in the third country and appropriate cooperation agreements are in place. Where services are offered on EU markets then we see the justification for the proposed rules for the provision of certain services provided to eligible counterparties in Article 36 of MiFIR.
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 strongly support the principles of ensuring responsible management of boards. However, the direct copy of requirements across from CRD IV is too tightly drawn. In terms of board directorships the limit on the number of directorships does not allow for application proportionate to the type of company and the different reasons corporate structures are set up. The requirements to set up a nomination committee of independent directors will be difficult for smaller and medium–sized investment firms structured as private companies or partnerships. While a proportionality test is to be applied it is unclear to what extent this will be applied by different competent authorities. We recommend focusing on board governance across all firms and in particular on the role of the chairman in the selection and monitoring of directors and their performance to achieve the objectives in the MiFID Review of ensuring sound and prudent management of firms.
Organisation of markets	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and	BlackRock is concerned about the exclusion of use of all proprietary capital for transactions executed on an OTF as the

and trading	from systematic internalisers in the proposal? If not, what changes are needed and why?	use of such capital is typical for inventory driven (usually non-equity) markets. Otherwise firms that both match client orders and act as market makers (implicitly using their own capital) would be required to split out their trading operations into entities fulfilling the Systematic Internaliser and OTF category, fragmenting liquidity and reducing market efficiency. We suggest that the implementation of regulation should be able to differentiate between capital applied for *bona-fide* market making versus discretionary proprietary risk taking. More broadly, we would see broker crossing networks (which are sometimes pejoratively called "dark pools") where orders are matched within the same book of business as a positive component part of the OTF category. An investment manager, such as BlackRock, best serves institutional clients, such as pension funds, by executing large orders in "dark pools" minimising market impact and transaction costs and hence improving performance for end-investors. The eventual requirements of OTFs should strike the right balance between maintaining efficiency and liquidity with transparency to regulators.
	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?	We predict that a good deal of trades currently deemed to be OTC would eventually be channelled onto OTF venues. 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. We would be concerned that by having a precise definition of OTC in MiFID an investment manager's ability to trade in the

		optimal way to return performance to clients – Europe's pensioners and savers – could be compromised.
	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?	The European Commission did not make any distinction between algorithmic execution methodology and the High Frequency Trading (HFT) business model. This would result in requiring market participants using execution algorithms to become *de facto* market makers forced to provide liquidity on a regular and on-going basis to trading venues at all times, regardless of prevailing market conditions. This would also mean that market participants would have to manufacture orders for their algorithms even without end user participation at a particular point in time. This would be contrary to regulators' intentions to reduce market participants' risk-taking practices. To avoid this inappropriate interpretation, it is important to draw a distinction between the broad population of participants that use algorithmic trading tools and the specific subset of users defined as HFT firms. "Algorithmic trading" is an execution method used to implement trade strategies over broad range of investment horizons. These tools are frequently used by pension funds, insurance companies and asset managers to implement long term investment decisions – typically to divide large trades into many smaller slices in order to mitigate market impact and transaction costs. HFT is only a subset of the much broader universe of trading tools described as 'algorithmic'. HFT strategies are generally conceived as self-contained profit generating routines, associated with short (normally intra-day) holding periods. Also note that

		some firms classified as HFT will implement strategies that may be defined as market-making, placing concurrent buy and sell orders in a given security. Frequently such firms have contractual agreements with exchanges and MTFs and hence this regulatory requirement may have little or no direct impact on such participants. The provision on algorithms needs to be given further consideration as its current scope is far too broad and as the initially targeted institutions may not eventually be impacted by it. We are, however, comfortable with the provisions on direct electronic access and co-location in the Directive.
	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?	N/a
	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?	N/a
	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?	The European Commission requires that all "sufficiently liquid" and central clearing eligible OTC derivatives should be traded on electronic platforms. We think that this will have minimal impact (and some possible benefits) for highly standardised and liquid contracts. 'Voice execution' option as part the definition of an OTF, even if only for periods of market stress, would also facilitate market efficiency.

		However, more broadly any *ex-ante* definition of liquidity is fraught with difficulties. It is therefore important that ESMA be required to obtain consensus with the industry before defining an instrument as "sufficiently liquid" and that these definitions are periodically reviewed.
	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?	N/a
	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?	N/a
	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 transparent, orderly and well-functioning markets. Appropriate regulation of commodity markets is necessary, and we believe that regulators must receive timely and accurate information from physical and derivative markets that allows them to monitor market evolutions and, in exceptional cases, intervene to prevent or identify market abuse. However, any regulation needs to be implemented after careful consideration of all the facts. Liquidity in these markets would suffer were the final MiFID requirements to introduce overly onerous public reporting requirements and/or overly restrictive limits around commodity positions. Likewise, investor confidence in these markets could be undermined were regulators to have a wide ranging ability to introduce drastic

		measures, such as position limits, at short notice or in an unpredictable manner. The proposals around "equivalent effect" would appear to offer a balanced approach to this issue.
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?	The definition of independent advice focuses on what constitutes a sufficiently large number of financial instruments. This sets a very high standard to be treated as independent, thereby providing an economic incentive for many advisers who do not want to change their existing commission-based business model to provide more restricted advice and still receive commissions. Conflicts of interest relating to advice given by tied or restricted advisors are not addressed by the proposals. This creates an un-level playing field between different advice models to the detriment of investors. We recommend a level playing field for all distribution models with focus on targeted transparency of costs (e.g. €500 per annum) and the introduction of European-wide standards for the training of financial advisers to improve the levels of service across all advisers whatever their status.
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	We recognise that there are real concerns about the ability of investors to understand the design of some financial products but would recommend that these are best dealt with by focusing on a rigorous product development and governance regime for providers of all retail investment products focussing on whether products deliver appropriate and understandable outcomes for investors rather than attempting to draw lines between products. In particular, we do not favour breaking up the UCITS brand but rather focus on the standards of disclosure given to investors.

		Consumers should, however, be able to invest in a range of products using sophisticated techniques with clear outcomes. Complex strategies (such as the use of derivatives) can deliver favourable results, but they must be explained in a way that is transparent to investors so that they can make informed investment decisions. The use of more complex management techniques does not, for example, lead to increased volatility or risk for investors. On the contrary more complex techniques can often be used to smooth returns and dampen volatility of market movements. The use of clear and readily understandable UCITS KIID-style disclosures should be harmonised across all competing bank, asset management and insurance-packaged products as part of the PRIPS initiative, with transparency on the total cost of ownership.
	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?	N/a
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	We have noted concerns in relation to the third country regime in the answer to question 4.
	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?	The product intervention rules only focus on MiFID financial instruments. They do not draw any distinction between financial products such as UCITS which are subject to prior regulatory approval and other balance sheet products such as bank and insurance products which are not. The proposals also exclude certain types of UCITS from being sold on an execution-only

		basis because they are too complex to understand. Even more important than post launch powers to intervene to prevent marketing of unsuitable products should be a focus on the product launch process. All products should be subject to equivalent levels of product governance regardless of whether they are subject to prior regulatory approval or not. Regulators should have powers to set and review the governance standards for all providers of retail investment products, by requiring product manufactures to focus how products are designed, marketed, distributed and monitored during their lifecycle.
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?	N/a
	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?	We believe the current level of pre-and post-trade transparency for "non-equity" markets in Europe to be broadly appropriate. These markets are typically fragmented, inventory-based and are characterised by low or dispersed liquidity. Forcing these markets to report in a similar way to equity markets, as proposed, could impact liquidity and efficiency in these markets, as buyers and sellers would be less willing to reveal quotes to the whole market.
	22) Are the pre-trade transparency requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured	N/a

	products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?	
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	N/a
	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)?	We fear that competing and vested interests could hinder the delivery of the Commission's draft proposals. We would have preferred a tender process for a single operator solution to avoid the possibility of these issues arising. In the absence of this, we would advocate that any proposed solutions actually be delivered, at cost, so that investors have a single view on liquidity in Europe.
	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?	We flag that ESMA has a significant responsibility at Level 2 to ensure that the calibration of transparency per liquidity profile, volume and asset class is appropriate to the diverse range of instruments caught by the umbrella term of "non-equity". ESMA should therefore engage market experts to advise on the most appropriate solutions. We feel that the Transaction Reporting and Compliance Engine (TRACE) system currently in place in the US offers a reasonable starting point for a European post-trade reporting framework.
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing	We welcome cooperation between the European Supervisory Authorities (ESAs) in the area of consumer protection. This is

	and implementing MiFID/MiFIR 2?	essential to ensure that a consistent consumer protection regime is applied across competing banking, insurance and investment products. The common conference due to be held in Q3 2012 is welcome but needs to be part of ongoing liaison between the ESAs.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	N/a
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	The MiFID review focuses on a number of investment products (such as funds) and services (investment advice) provided to retail investors. Significantly not all such products or services are included within the scope of MiFID: insurance, pension and certain banking products fall outside the scope of the proposals. Additional elements of the consumer protection regime are left to future proposals such as PRIPs (Package Retail Investment Products) or amendments to existing directives such as the UCITS Directive or the Insurance Mediation Directive. This gives rise to a concern as to whether MiFID can deliver a consistent consumer protection regime across different products and services. Unless consumer protection legislation is negotiated in parallel, there is a risk that different retail financial products will be subject to different degrees of regulation. This would encourage a move to selling less regulated products to investors as they will be able to be manufactured at a lower cost. This would create an unequal regulatory playing field among different types of product manufacturers to the detriment of end investors.

	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	The Dodd-Frank Act in the United States has implications for numerous provisions in MiFID 2 /MiFIR, primarily those relating to the oversight and reform of the derivatives markets, in view of the global nature of these markets.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	N/a
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	Given the importance of many sections of the existing Level 2 text to the effectiveness of the whole MiFID regime (e.g. the outsourcing and delegation regime), it is key that these are borne in mind while negotiating the new Level 1 text. If the existing Level 2 text is to be repealed then there are a number of areas which will need clarification, such as the definition of independent advice.

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 9(a)	Delete the second, third and fourth paragraphs
Article 9(2)	Exclude non-listed companies and corporate UCITS from the requirements for a nomination committee
Article 9(4)	Delete in its entirety

Article 17.3:	An investment firm whose principal activity is market making, using an algorithmic trading strategy, shall ensure that it remains in continuous operation during the trading hours of the trading venue to which it sends orders or through the systems of which it executes transactions. The trading parameters or limits of such an algorithmic trading strategy shall ensure that the strategy posts firm quotes at competitive prices with the result of providing liquidity on a regular and on-going basis to these trading venues at all times, regardless of prevailing market conditions.
Article 24	Delete Article 24.5. Replace with a new provisions stating that the total cost of investment advice in a single monetary amount including both fees paid directly by the client to the investment adviser as well as any fees, commissions and monetary benefits paid by a third party ("inducements") must be provided to the client manner prior to the provision of the investment advice. This provision is to apply whether advice is to be provided on an independent basis or not. Where the cost of inducements cannot be ascertained prior to the provision of the advice, then the manner of calculation must be disclosed in a comprehensive, accurate and understandable manner with the total aggregate cost of the advice being disclosed to the client as soon as practically possible. Where investment advice is provided on an ongoing basis disclosure as to the cost of investment advice, including inducements must be provided at least annually. Insert a new Article 24.9 which requires that the provision of financial advice to retail investors is subject to the adviser being qualified to a standard European level. ESMA to be given powers to advise on the mandatory contents of the underlying certification and training programmes. ESMA to agree in consultation with national competent authorities which existing qualifications are deemed equivalent.
Article 41 Recital 74	Third country firms to whom asset management has been delegated by an EU-professional investor should be exempt from the requirement to be directly MiFID authorised themselves by a specific exemption under Article 41. Provisions of Article 15 of MiFID Level 2 should be amended to reflect those in AIFMD Article 20.1(c) and (d) so that they apply to the delegation of portfolio management to professional clients by ensuring that the delegate is subject to (i) authorisation or registration for the purpose of asset management and (ii) and the existence of an appropriate cooperation agreement between the supervisor of the MiFID firm and that of the supervisory authority of the third country firm. Recital 74 should be amended to reflect this position. An exemption from authorisation should also apply to third country broking firms appointed to provide broking services by an EU professional investor acting under a client mandate.

	Recital 74 should also be amended to make it clear that contact by a third country firm with professional investors in the course of existing arrangements is out of scope.
Article 32 :	Insert a new Article 32A in MiFIR under which investment firms must establish a product development process before launching any instrument aimed at retail investors. ESMA should have the power to set technical standards setting out appropriate levels of product governance designed to prevent inappropriate products coming to market. Product governance should include: • Due diligence taken by product manufacturers on product launches to assess investor needs and, particularly the ability to explain to retail investors the use of complex management techniques; • Establishing appropriate internal product development and management governance procedures; • Establishing an appropriate and hierarchically independent risk management function; • Using specialist derivative oversight and counterparty management teams for products using complex management strategies; • Preparing supporting materials appropriate for the targeted investor base for their distribution channels; • Performing regular assessments of products, particularly in the light of any market changes; • Clearly communicating to distributors and end investors any changes to the way a product is structured or to its objectives
	Competent authorities should ensure that appropriate product governance processes are in place prior to authorisation of an investment firms and should conduct ongoing monitoring to ensure appropriate product developments processes are in place and are being monitored. Only if there is a failure on the part of an investment firm to follow these processes should the product intervention powers by national authorities under Article 32 and in by ESMA under Article 31 be used Insert a new Recital in MiFIR noting that the product development process is also intend to apply to financial products such as insurance products and pensions which do not fall within the scope of MiFIR to ensure a level playing field.