Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Respondent: Citi

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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	Answers
Scope	1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in	We agree with the response of the Association for Financial Markets in Europe (AFME) and the British Bankers Association (BBA.)

	which more could be done to exempt corporate end users?	
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	While Citi recognises there are concerns regarding integrity issues in the emissions market, Citi does not believe that the proposal to define EU Allowance Units (EUAs) as financial instruments addresses these concerns. EUAs are designed to aid companies in complying with their climate change obligations and not as an investment product. If classified as a financial instrument, the additional obligations in MiFID/MiFIR 2 could result in changes that could discourage some industry participants and as a result damage market liquidity and competitiveness, with resulting impacts on the EU's climate change objectives. Citi believes it would be better to address current concerns in the emission market via greater oversight of registry operation.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	Citi does not disagree with this approach in principle, one consequence of including custody services as a core investment service would be that the requirement to assess appropriateness (Article 25) would apply. We question whether this consequence is intentional as this requirement seems more appropriate to the dealing activities and services to which it presently relates. If the appropriateness regime is to apply to safekeeping and administration services, detailed guidance would be needed as to how in practice firms would be able to meet these requirements since to us this is very unclear. In fact, we would suggest that the current MiFID I already applies a high and more appropriate level of additional investor protection in the context of safekeeping and administration and question whether the introduction of the appropriateness requirement would further enhance investor protection at all.
	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?	
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 agree with the comments from the British Bankers Association (BBA).
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?	Citi has concerns with a few points in this section, most notably (1) the restriction on the use of proprietary capital within an organised trading facility (OTF) in Article 20 of MiFID 2, as well as (2) the lack of clarify surrounding the ability of a firm to operate SIs and OTFs in the same or similar asset classed (acknowledging that you cannot operate a SI within an OTF.) Citi has concerns with the restriction in Article 20 of MiFID 2 on an operator of an OTF being prohibited from trading against its own proprietary capital. We believe this will impact on our ability to provide the best possible service to our clients. This restriction, as currently drafted, is very broad and would endanger services demanded by clients, and will also having a detrimental effect on liquidity. At present, a firm's own capital is deployed within broker crossing networks in a variety of forms in order to facilitate its clients' business. This helps drive down execution costs and also provides greater liquidity to certain illiquid financial instruments. One way in which capital is currently deployed on behalf of assisting clients in their trades is in

		riskless principal transactions which are an efficient settlement model used on an industry-wide basis. Therefore, while we support regulation to ensure that facilities such as broker crossing networks are more transparent, we believe it would be detrimental to clients to impose a wholesale ban on principal trading on such facilities. We believe that it would be beneficial to draw a distinction between the use of proprietary capital within an OTF which helps facilitate client transactions and the use of proprietary capital for other means, and allowing the former in the new OTF regime. Further, we think clients should be given a clear choice as to what "flow" they are willing to be executed against. This would allow clients to indicate that they are opposed to interacting against a firm's own inventory or pure principal book (and proprietary capital). With regards to the definitions of systemic internalisers (SIs) and OTFs, recital 8 of MiFIR and Article 20 of MiFID 2 imply that the intention is to allow the same firm to act as a SI and operator of an OTF for the same asset class (as long as the investment firm does not act as a SI within an OTF operated by itself). We believe this is the right interpretation and achieves the objectives as outlined by the European Commission. However, the definition of a SI (recital 13 of the MiFID 2 and recital 16 of MiFIR) do not make this wholly clear. Therefore, for legal certainty the definition and relevant recitals need to be amended to make clear that a firm which is an SI can also operate an OTF or MTF for the same asset class. They should specify that when a firm is acting in its capacity as a SI, 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 MTF or OTF for the same asset class. In addition, clarification is needed that a firm operating an OTF in certain financial instruments may deal in other classes of instrument outside of its capacity as an operator of an OTF – i.e. it will be treated as an investment firm/SI when dealing in instruments

		not traded on its OTF.
	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?	
	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 definition and provisions surrounding algorithmic trading do not seem to accomplish the aims of the regulators. As a defined term we are also not sure whether the use of the use of “algorithmic trading” is helpful and it may be more appropriate to use the term “computer assisted trading.” With regards to the current definition, it is too broad and the definition itself and Article 17 should provide exclusions for “agency algorithms”, such as benchmark and order execution algorithms, that help facilitate the execution of client orders in the most efficient way possible. We are concerned with the requirement in Article 17.2 to annually provide a description of the nature of its algorithmic trading strategies**.** While it may be useful for competent authorities to have certain types of information during investigation or enforcement proceedings, we do not believe a blanket requirement on a firm to provide what would amount to volumes of largely raw information would be beneficial to a competent authority. Instead we believe it would be more useful for regulators to make more focussed and targeted requests on an investment firm’s algorithms upon request. We are also concerned with the requirement in paragraph 17.3 that an algorithmic trading strategy shall be in continuous operation and that liquidity should be provided on a regular and ongoing process regardless of prevailing market conditions. The current requirements do not take into account those algorithms which cannot function

		continuously or act as a market maker. In addition, this requirement could have unintended consequences of not letting an algorithm exit in stressed market conditions. In certain situations, leaving a trading algorithm to operate could exasperate the problem and in some scenarios it would be better if an algorithm shuts-down and withdraws immediately from the market. There are other mechanisms to ensure liquidity does not disappear altogether during periods of high activity and volatility. One way to clarify the paragraph would be to look at the existing market maker definition in the Short Selling regulations, as Article 17.3 seems to be targeted primarily at people that are market makers due to the requirement to maintain ongoing liquidity. To make the above workable, there would need to be some exclusion for market makers based on the order to trade ratios as by the very nature of what market makers do these will be very high. It has been discussed that using trade ratios and circuit breakers can prevent volatility and flash crash scenarios more effectively by going after ACTIONS that can lead to problems, rather than going after METHODS which may or may not create problematic actions. Some mention would need to be included that regulators will need to mandate that the exchanges support market-making programs to anyone who qualifies in order to ensure that the desired liquidity can be provided. The exact terms of these schemes could be left to Level II or III regulation for clarification. We would endorse the Futures and Options Associations ("FOA") comments in relation to 17.4. The latter half of 17.4 requires investment firms to include a provision in their agreements with clients to make clear that a firm is contractually responsible for ensuring a client's trading is in compliance with MiFID, MAD and the rules of the trading venue. This would enable a direct electronic access client which had, for example, committed a market abuse offence, to seek contractual redress from the firm. Further, if Citi is contractually responsible for the improper activity of its client, this may have the consequence of disincentivising that client from adhering to proper market conduct, that neither we nor the FOA believe is the intention of the European Commission and

		therefore believe this provision needs to be amended. As the FOA suggest we think the latter half of this provision should be deleted and instead the requirement should be to only have a written agreement in place between the investment firm and client.
	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?	
	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?	
	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 agree with the response of the Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA.)
	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?	
	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?	We agree with the response of the Association for Financial Markets in Europe (AFME) and the International Swaps and Derivatives Association (ISDA.)
	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	Citi does not believe position limits are an effective management tool in commodities or commodity derivatives, but rather favours position management by exchanges with local regulator supervision. As such, we support the response of the International Swaps and Derivatives Association (ISDA).

	could be considered as well or instead?	
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?	
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	In particular, Citi believe that further consideration should be given to defining certain UCITS as "complex" and others as "non-complex". UCITS are regulated at the product manufacturing level pursuant to very specific concentration and organisational principles. We question whether "complex UCITS" should be subject to a looser product regulation regime if the differentiation is to be made at the MiFID-level.
	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?	The new provision in Article 27.2 requires every "execution venue" to make available to the public data relating to the quality of execution of transactions on that venue on at least an annual basis. The term "execution venue" is not defined in MiFID and so this could lead to confusion as to whom this provision applies. Therefore the drafting needs to be made clearer as to whether this requirement applies to "Trading Venues" as defined in the new text or whether the intention was to broaden its scope to other venues beyond Regulated Markets, MTFs and OTFs.

	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	The provisions, as currently drafted, leave it unclear how professional clients will be treated in circumstances involving firms located in third countries. We believe that the regime for professional clients should be broadly similar to that for eligible counterparties, as opposed to the regime for retail clients.
	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?	We agree with response of Association for Financial Markets in Europe (AFME).
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?	We agree with response of Association for Financial Markets in Europe (AFME).
	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,	The obligation on systematic internalisers (SIs) in Article 17.2 of MiFIR to make firm quotes available to other clients is unrealistic. In derivatives trading, for example, counterparty risk, collateral and margining differences prevail (even for different clearing houses) and it is essential that the price be allowed to reflect those costs. If this requirement is imposed in its current format, SIs would have no choice other than to either (i) limit the counterparties it can trade with (which would potentially provide less

	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?	access to liquidity for certain other clients), or (ii) reduce the size at which orders can be executed in order to limit the capital at risk. As a general comment, we believe that the SI regime is not sufficiently clear or well thought out and will result in increased costs for end users. Specifically, and by way of example, it is unclear whether voice trades will be treated in the same fashion as electronic trades; whether the "commercial policy" referred to in Article 17.2 of MiFIR is permitted to differentiate between customers on the basis of their credit-worthiness allowing differential pricing; and, what happens to customer orders for which a firm is not willing to give a firm quote.
	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?	We agree with the response of the Association of Financial Markets in Europe (AFME). Furthermore, fixed income traders already produce indicative prices which they make available through "runs" which they post on Bloomberg on a daily basis. Given the concerns that we have already raised in response to Q21 about being unable to provide the same quote to all clients, we would argue that this would be a more practicable means of providing (indicative) pricing at which a trader reserves the right to decide not to trade.
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	We are concerned that there is not sufficient detail in MiFID/MiFIR 2 about the waivers permitted for bonds, derivatives and structured finance products. We would prefer to see both more detail and more flexibility in terms of what will be permitted and how a level playing field between Member States will be maintained. Additionally, we would echo the view in the Association for Financial Markets in Europe (AFME) response that the three-month time period during which ESMA is empowered to

		issue an opinion whether or not to grant a waiver would be too long. Indeed, on top of this, Article 8 in MiFIR requires a notification by the competent authority to ESMA not less than 6 months before the waiver is intended to take effect which in our view would be greatly excessive. AFME's point that the regulator should allow for flexibility in the event of abnormal market conditions is important and something that we wish to reiterate.
	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)?	
	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?	There needs to be careful calibration of the requirements (and exemptions there from) between the pre- and post-trade transparency regimes – particularly in the case of the additional product classes now covered by MiFID/MiFIR 2. In particular, in respect of post-trade transparency, the authorisation of a deferral for publication of large or illiquid trades may not be sufficient to protect the market as it will be possible for the informed to identify the counterparties. We believe that there should be a complete exemption for certain trades and not just a deferral.
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?	

	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	EMIR and CRDIV, as well as upcoming work on Central Securities Depositories (CSDs), will interact with MiFID/MiFIR 2. CRD IV, in particular, will create financial incentives for firms to review their business models and should be carefully considered. The forthcoming Data Protection Directive may also contain some provisions that interact with requirements in MiFID/MiFIR 2. Last, Article 24 of the MiFID 2 should be considered together with the PRIPs initiative to ensure consistency.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	There are many requirements that may be faced by firms attempting to assist clients in completing their transactions in various jurisdictions around the world. For a US based firm like Citi, that is located in more than 100 countries and operates in over 170 different markets, we would stress that anything that can be done to minimise differences in legislation and regulatory regimes would ensure a level playing field and a safer, more secure global financial system. In this instance, as a US headquartered firm, we have most immediately seen complex interactions between the proposed MiFID/MiFIR 2 rules with the requirements of the U.S. Dodd-Frank Act, specific rulings of the US Regulatory agencies (CFTC and SEC, in particular), as well the implementation of the new Volker rule provisions. This, coupled with other EU legislation and recent ESMA guidance on high-frequency trading, forthcoming legislation on data protection and on central securities depositories, plus developments in jurisdictions in Asia and elsewhere, creates an extremely complicated operating environment for a firm attempting to serve clients that operate on a global scale.
	30) Is the sanctions regime foreseen	

	in Articles 73-78 of the Directive effective, proportionate and dissuasive?	
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 23.1	We fully support the objectives of the transaction reporting regime in assisting competent authorities with the detection of market abuse.
Article 23.2	However, there should be exemptions for asset classes for example FX, primary market issuance, Equity/Fixed Income Derivatives referencing multiple underliers and Interest Rate derivative contracts. The volume of additional transaction reports would swamp competent authorities and the TREM and it is not clear which other national regulators would be interested in these products for the detection of market abuse. We also wish to draw attention to the absence of product identifiers for many of the assets listed above.
Article 23.3	We do not believe that providing the Algo ID or the Trader ID will enhance regulators' ability to detect market abuse. The means of identifying traders and algorithms would inevitably be firm specific as there are no international standards of identification. It is also important that the overwhelming majority of transactions are in response to a client order therefore the original investment decision makers reside with the client and not the investment firm. UK firms already provide client identification. Additional fields in the messaging would be required to support these additional data elements and such a change which would impact firms, competent authorities and ESMA's TREM alike. It is suggested that this additional information will allow National Competent

	Authorities to detect fraudulent activity by individual traders, detect market abuse such as front running research notes & client orders etc. Firms already have regulatory obligations to detect / police for market abuse. National competent authorities we respectfully suggest are better suited to target market abuse across the market as a whole.
Detailed comments on specific articles of the draft Regulation	
Article number	**Comments**
Article ... :	
Article ... :	
Article ... :	