CME Group

Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

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

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

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

Please send your answers to econ-secretariat@europarl.europa.eu by 13 January 2012.

General Comment

When determining new regulations for derivative markets, legislators should be mindful of the risks of distorting markets that may arise and conduct an appropriate cost-benefit analysis before rules are finalized. Reducing the types of participant who can trade on a market, the amount they can trade or the means by which they can trade is likely to reduce the number and quality of potential counterparties for a trade, and hence lead to higher prices and more risk (e.g. if a party is unable to hedge its risk), meaning end users in the real economy are likely to face higher and more volatile prices and potentially reduced access to certain goods and services. All regulation of such markets should be tailored to address specific risks, must be proportionate to the risks and must understand and minimise unintended damage and distortion to the markets.

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?	*No comment*
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	*No comment*
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	*No comment*
	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?	• CME Group supports a global regulatory framework under the concepts of equivalence and mutual recognition which facilitates cross-border transactions. • Standards imposed on third country firms and markets should not be higher than those imposed on EU firms, and equivalence should not be used as a barrier to entry. • Therefore any equivalence test must be based on transparent, proportionate, fair, and objective grounds. Equivalence should be judged in terms of effect rather than process. • International standards for setting minimum requirements – such as the CPSS-IOSCO guidelines when finalised – are an appropriate framework for the EU to reference when determining what minimum standards are relevant.

Theme	Question	Answers
		• High compliance costs are likely to negatively impact businesses (especially SMEs) and lead such businesses to relocate to other jurisdictions or cease current business.
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?	*No comment*
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?	*No comment*
	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?	*No comment*
	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?	• Which risks have been identified by regulators that need mitigation? • Algorithmic trading should not be regulated without an impact assessment on the entire spectrum of market participants and their different business models. We do not believe that one size fits all.

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		• Once an appropriate analysis has been undertaken, regulations should be proportionate to and intended to reduce the likely specific risk and not unduly prescriptive. • In addition, we believe that the use of algorithmic and high frequency trading by the variety of firms participating in the markets, including proprietary trading firms, investment banks, hedge funds and index traders, among others, has made the marketplace more efficient and competitive for all market participants.
	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?	*No comment*
	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?	*No comment*
	11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?	*No comment*

Theme	Question	Answers
	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?	*No comment*
	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?	**Non-discriminatory access to market infrastructure** • If this issue is not recognised as having anti-competitive effects under competition law, then it need not and should not be prohibited under a separate regulatory structure. • In any case, any non discriminatory access provisions should mirror the related provisions in EMIR. • A large concern is that open access will curtail if not stop innovation in the derivatives market since it may remove commercial incentives to bring new products to the marketplace which is likely to increase the difficulty and cost of hedging and risk management, which is ultimately likely to be detrimental to the end customer. In addition, genuine competition between CCPs and trading venues based on technology, service or product improvements would be eliminated. • The provisions as drafted place a substantial burden on the CCPs which will have to undertake proper due diligence on each trading venue that would apply to be connected (either to accept to clear its trades, or to refuse it). This may be a major issue if numerous venues apply

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		altogether –particularly likely during the first couple of years of these provisions becoming effective. This is highly likely to increase operational risk and costs of the CCP. • In addition we believe that open access should be a commercially viable model and that a CCP should retain the ability to manage its risk, including by choosing the parties with which it interacts. In this respect, we would question the possibility for various categories of trading venues to be able to benefit from open access. Indeed, this means that one could open a position on one trading venue (for example a Regulated Market) and close out this position on another trading venue (for example an MTF). We believe that this could lead to some regulatory arbitrage and increase CCPs risks since trading venues may have different execution/trade validation Rules. • It is important to acknowledge the difference between cash equities and derivatives in order to assess the consequences of imposing open access: In a cash equities market the application of an open access principle is opening competition. Indeed, one share is one share (each listed security has the same properties and will entitle its owner to the same proportion of capital in the company it has been issued from), regardless of where it is effectively being traded.

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		A derivative contract is designed by the exchange or the clearing house itself and is the result of market research and development, and extensive legal and regulatory due diligence. It is therefore unique to the exchange or clearing house. There is no guarantee that this contract will be traded once it is listed, and a large number of contracts are launched but never gain traction and re-pay for the investment made in creating them. **Non-discriminatory access to benchmarks** • It is unclear in Article 30 what indices would constitute a "benchmark" and, consequently be subject to the compulsory licensing requirements. • An entity may own the intellectual property rights to an index but not the rights to distribute data to the marketplace based on or derived from that index and, consequently, would be unable to comply with the compulsory licensing requirements, • In relation to compulsory licensing of benchmarks, there currently exists a highly complex global network of licenses (exclusive and non exclusive). It is unclear how the proposal would apply in a context of existing arrangements. The proposal would potentially undermine legitimate contract rights granted to market participants in countries outside the EU given the global nature of the

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		derivatives market location of IP owners (for example, how would this apply if an EU exchange sought to clear a product based on a benchmark index owned by a non-EU entity?). • The proposal would materially diminish the economic value of numerous existing index licenses and agreements for data distribution that are currently in place, retroactively revising the negotiated contractual rights of the parties.
	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?	• Concern that policy makers globally have not yet explained their reasons for concluding that hard position limits are necessary or appropriate. • Price volatility is an inherent aspect of derivatives contracts as markets respond instantaneously to new information concerning supply and demand – these contracts are based on underlying which evolve in spot markets (not regulated). Although prices may fluctuate rapidly, such fluctuation does not necessarily mean that the price changes are unreasonable or unwarranted. • Position limits may have unintended consequences. For example, when improperly calibrated and administered, they can distort markets, increase the costs to hedgers and effectively increase costs to consumers. • Regulators and the industry must support the shared goal of combating price manipulation and other disruptions to the integrity of commodity prices. Such misconduct

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		destroys public confidence in the integrity of our markets and harms the acknowledged public interest in legitimate price discovery. • However, speculation is not manipulation, nor is it an abusive practice. Speculation is essential to the orderly functioning of futures markets—it provides market liquidity which promotes more effective commodity price discovery and allows for the efficient transfer of price risk. • We believe it should be the trading venue's responsibility to set such position limits or alternative arrangements such as position management and accountability regimes. Regulatory intervention should therefore only be considered under exceptional circumstances. In any case, an impact analysis needs be performed prior to any limits being set. • The entity in charge of intervening, whether it is ESMA, the Commission or the National Regulators (this should be clarified in the draft) should be legally obligated to determine that limits are necessary and conduct an appropriate cost-benefit analysis, including public consultation, before any such limits are imposed. • CME Group for decades has employed exchange set limits in most of our physically delivered contracts. We use limits and accountability levels to mitigate potential congestion during delivery periods and to help us identify and respond in advance to any threat to manipulate our

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		markets. We do not use these devices as a means to control trading in our markets or impact the prices of contracts in our markets.
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?	*No comment*
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	*No comment*
	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?	*No comment*
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	*No comment*
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of	*No comment*

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	investors and market integrity without unduly damaging financial markets?	
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?	*No comment*
	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?	*No comment*
	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?	*No comment*
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	*No comment*

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	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)?	*No comment*
	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?	*No comment*
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?	*No comment*
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	*No comment*
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	*No comment*
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	*No comment*

Theme	Question	Answers
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	*No comment*
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	*No comment*

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 17 2):	An investment firm that engages in algorithmic trading shall at least annually provide to its Home Competent Authority a description of the nature of its algorithmic trading strategies, details of the trading parameters or limits to which the system is subject, the key compliance and risk controls that it has in place to ensure the conditions in paragraph 1 are satisfied and details of the testing of its systems. A Competent Authority may at any time request further information from an investment firm about its algorithmic trading and the systems used for the trading. We believe that these provisions need to be proportionate and not become an unjustified burden for firms.
Article 17 3):	We do not believe that an algorithmic trading strategy should be in continuous operation during the trading hours of the trading venue to which it send orders or through the systems on which it executes transactions. Only a proportion of traders using algorithmic or high frequency trading operate a market making business; many others operate a different model which has different risks and rewards. There seems little logic in imposing this market making requirement simply because algorithmic or high frequency trading techniques are used, and doing so is likely to mean many legitimate businesses are unable to continue to operate .