Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Answers of the Cyprus Stock Exchange (CSE)

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 which more could be done to exempt corporate end users?	The CSE believes that in case custody and safekeeping would remain in Annex I section A of the revised directive as a core investment service, a specific carve-out for Central Securities Depositories (CSDs) would have to be foreseen, which means that CSDs should be added to the list of exempted entities under Article 2 of MiFID II (see our answer to question 3).
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	-

	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	The CSE believes that the inclusion of "safekeeping and administration of financial instruments" in the list of investment services (Annex I section A of the directive) will be problematic if it results in the unintended inclusion of Central Securities Depositories (CSDs) in the scope of the revised MiFID. Securities account provision is one of the most important functions of a CSD (as part of its safekeeping function). Given the nature of CSD activities, which do not fit with the objectives of the MiFID we believe these should remain outside the scope of MIFID and they are to be fully regulated under upcoming EU Regulation on CSDs. More generally we believe that the proposal to include "safekeeping and administration of financial instruments" in the list of investment services (Annex I section A of the new MiFID instead of section B on "ancillary services") appears unjustified for at least two reasons: ***(1) Safekeeping activities carried out by entities holding securities accounts for their clients, whether custodian banks or CSDs, are already regulated:*** - Custodian banks are already subject to authorisation either as investment firms and/or as credit institutions under existing EU legislation; - CSDs are soon to be regulated under the EU Regulation on CSDs, which will cover both their core and ancillary services. Overlapping regulations should thus be avoided, not only because duplication could lead to inconsistencies in implementation, but also because the proposed reclassification of the safekeeping and administration of financial instruments

		services as investment services would not lead to a stricter authorisation and supervision regime. ***(2) The MiFID requirements are not applicable per se to CSD safekeeping services.*** Indeed, safekeeping as offered by CSDs differs significantly from the trading and distribution of financial instruments targeted by the MiFID and is only very loosely associated with the investment decisions of clients. For instance, it is unclear how and if suitability or assessment of appropriateness could be applied to the processing of corporate actions on securities such as client instructions to participate in a General Meeting. Moreover, it should be clarified which of the general principles would apply to CSDs because of the provision of such services. In case custody and safekeeping would remain in Annex I section A of the revised directive as a core investment service, a specific carve-out for CSDs would have to be foreseen (see our answer to question 1).
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?	Yes, it is appropriate to regulate third country access for a number of different reasons (protection of European investors, fair competition in the Single Market, etc). We support the Commission's proposal on 3rd country access should be based on equivalence and reciprocity. However, we believe that level 1 text needs to give more guidance to implementation.

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?	
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?	In our reading of the current MiFID, an operator can bring together investors who want to buy and sell a financial instrument in a trading platform, either in a 'neutral' way (the operator is never a party to any trade, so the trading is 'multilateral') or based on the operator's own trading book (the operator runs an inventory of some instruments, so the trading is 'bilateral'). A multilateral platform can be operated by a market operator or broker, while the internalisation platform is run by a dealer. The **market as a whole wants to be reassured that any liquidity pool set up in any financial instrument will result in properly priced trades, will be accessible to all investors, and will be monitored for market integrity**. While these concerns are common whether the platform is multilateral or bilateral, it is only in the case of the neutral platform that rules can be very stringent, because it is natural that a dealer than runs his own inventory should not be subject to all the exchange rules as he is running the risk of the instrument going up or down in price. Hence, for example, both types of trading platforms should be subject to rules on pre-trade transparency to ensure proper pricing of instruments. But these need to be calibrated in the case of the bilateral (internalisation) platforms. Similarly, while all investors must have access to all multilateral trading platforms, it is accepted that a bilateral

		platform can take on board only its clients. Against this background, we believe that the introduction of an additional OTF category is against the spirit and letter of MiFID, as it will create a multilateral trading venue that is subject to less stringent rules than RMs and MTFs. Instead, t**he correct solution is to use the MiFID review to clarify the intention of MiFID and to draw a clear line between trading platform activity and OTC business.** With a limited number of clarifications, it should be possible to re-establish the line that MiFID intended to establish between trading platform and OTC business and to ensure that no trading activity (such as BCNs) fall outside the scope of trading platforms. Importantly, we believe that the existing MiFID equity venue classification is already sufficiently exhaustive to capture most types of BCN activity, which should fall under either the MTF or SI categories. Therefore MiFID does not need to be revised in any fundamental way to "capture" BCNs. The same intended definitions should be used, but improved by eliminating any wording that creates ambiguity. **<u>Practically, we recommend:</u>** • The OTF category as proposed **is not necessary to capture BCN activity or to implement G20 reforms**, but will instead add unnecessary complexity to the trading landscape; undermine the principle of 'same business, same rules'; and essentially downgrade the safety and quality of

		• **Instead, we need revised and improved definitions of RM, MTF and SI:** The RM and MTF definitions should not refer to 'non-discretionary execution' and should focus only on defining the attributes of multilateral trading. The SI definition should be clarified to capture all systematic bilateral trading business. • **A clear definition in the main definitions article (not a recital) of the activities allowed in the OTC space):** As in the existing Recital 53 but this time in the main body of the text, OTC should be defined as bilateral, ad hoc, irregular, large trades with wholesale counterparties.
	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, we believe that the OTF category will not channel all trades that are currently escaping MTF or SI rules. For this we need clearer MTF and SI definitions and a separate OTC definition. We agree with the vision of the original MiFID that stated that all the main trading venue requirements should apply to all platforms that bring together multiple buying and selling interests and that the only instances when such rules should not apply at all are when a broker is executing a large order for a wholesale client on its account on an occasional basis. Therefore we propose that the previous implicit definition of OTC is retained and even strengthened. Moreover, the OTC definition should not be included as a recital but as a definition in the main text of the directive. In order to ensure that only those trades that should be conducted OTC are, we would advocate the inclusion of a further requirement for OTC trading.

		Unless the MTF and SI definitions are clearer and there is an explicit definition of OTC, there is no guarantee that the OTF proposal will solve the issue of OTC. We are concerned that in fact this proposal will not see business move from OTC to OTF, but instead from MTF to OTF. This could happen as certain venue operators will change their MTF licence to an OTF licence as this trading venue will be subject to lighter rules and will allow these venue operators to give a more favourable deal to their biggest clients. Furthermore, even if a certain amount of OTC trading mover to OTF, this will not be optimal for proper market regulation or fair competition since OTFs will be less regulated than RMs or MTFs.
	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 Commission proposes mostly sensible solutions to reduce the systemic risks, counter potential for market abuse, and ensure fair treatment of clients.** We agree that all parties involved in high frequency trading – the high frequency firm, the investment firm, the trading venue – should put in place the necessary safeguards to counter the risks for the public. It is important to note that ESMA has issued guidelines on systems and controls for both trading venues and investment firms. We request that any possible double regulation should be avoided. Of all the proposals, we find that only Article 17(3) (continuous quoting obligation) would have to be altered significantly to make it work. In this case, we believe that this obligation is not realistic in its current form and would request its deletion form the final text in order to ensure the efficient working of European capital markets.

		Concerning circuit breakers and limit ratios for orders to executions, we would advocate that these not be harmonised across platforms but take into account the different aspects of each particular market. Regarding temporary trading halts, it is important that when trading is suspended on the main market trading is also suspended on all other trading venues (unless this is due to a technical difficulty of systems). We would also note that ESMA may be charged with the enforcement of tick sizes; however, the decision to apply a certain tick size table to a certain share should be agreed upon by the industry.
	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?	We find these proposals appropriate for both properly functioning markets and investor protection.
	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 welcome the MiFIR proposal to oblige certain OTC derivatives to be traded in a well-regulated environment.** Given their link with the financial crisis, there are a number of different reforms needed to improve the functioning of OTC derivatives. In addition to reforms on risk management through post-trading and capital adequacy, it is also necessary to improve the transparency, safety and liquidity of standardised OTC derivatives markets by obliging standardised OTC

		derivatives to be traded on a RM or MTF. We therefore welcome the Commission's proposal to mandate these derivatives to be traded in a strictly regulated environment. Since we believe that the proposed category is not a sufficiently regulated environment, we believe that OTFs should not be included in Article 24 of MiFIR. With regard to article 25, we welcome the obligation to CCP clear derivatives transactions concluded on regulated markets. However, we believe that the obligation to ensure that the provision in article 25 is implemented should lie on ESMA rather than on the operator of the market as currently suggested. This would be in line with EMIR's Title II which defines the CCP clearing obligation procedure for which ESMA, , rather than the trading venue, is responsible. This would also create a level playing field between regulated markets, MTFs and OTFs. In addition, we believe it would be useful to clarify that a similar CCP clearing obligation for 'eligible' derivatives exists in EMIR for products traded on MTFs and OTFs.
	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?	We agree that an option should be given to MTF operators to be registered or not as an SME market.
	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 believe that the potential consequences of these provisions with respect to safety, efficiency and competition are not yet known and need to be analysed.

	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?	EU regulated markets currently have different 'position limit' regimes which are tailored to the needs of their markets: position management, delivery limits and lending guidance. Hence, **we welcome the proposal to oblige trading venues to apply position limits** (only post-trade) **or similar arrangements** to market members or participants in order to support liquidity, prevent market abuse and support orderly pricing and settlement conditions. The proposed Directive also gives power to competent authorities to impose position limits or alternative regimes in extreme situations. The regimes currently in place in EU Regulated Markets could be described as follows: o **Position Management**: Ongoing system that allows intervention when appropriate or necessary, in particular as the settlement time of physically settled commodities approaches. This mechanism is intended to prevent settlement squeezes while not interfering with the legitimate hedging requirements of physical market users. o **Delivery limits**: Systems that limit the quantity of physical commodities that can be delivered on expiry and the size of the associated positions that can be held in the weeks approaching that expiry. o **Lending Guidance**: Specific tool to the LME to deal with LME's daily settlement requirements (other regulated markets have monthly or less

		• **Regulated markets are in favour of increased transparency**
		  o An important step is to build an adequate trade repository regime. We welcome the provisions included in the EMIR legislative proposal in this sense.
		  o Position reporting is the most important first step - today, it is still difficult for regulators to know who is trading. The CFTC is working towards developing 'legal entity identifies' and 'unique counterparty identifiers'. The EU should be involved in any discussion setting global standards as there is no sense in several standards developing
		  o Regulators should have access to all relevant information.
		  o We should consider if a **more granular transparency** regime (i.e. similar to the CFTC Commitments of Traders Report) is appropriate.
		  o Certain transparency requirements could also improve the underlying physical market; however, this needs to be done on a global level.
		• **Regulated markets are in favour of well-organised oversight; there should be appropriate systems to limit the scope for price distortion through market abuse and/or pressure on the delivery mechanism**

		o We agree with the EU Commission that **strong oversight** of positions in derivatives is essential, especially commodity derivatives, as well as harmonisation in order **to avoid any regulatory arbitrage** and ensuring a level playing field within the EU. o We agree that regulated markets should have objective and transparent mechanisms which are designed to prevent settlement squeezes. The chosen mechanism for each market will need **to be tailored to the specific characteristics of that commodity/market**. Depending on the market concerned, it might be appropriate to apply delivery limits, LME-style lending guidance or US-style blunt position limits. **The EU should not simply opt for a regime based on US-style 'position limits' alone,** because it will not be suitable for each and every market. Furthermore, the introduction of such a mechanism into well-established markets may significantly undermine their effectiveness by reducing the existing trading activity and liquidity, resulting in higher operating costs for market users which will in turn be passed on in the form of higher costs to consumers or lower prices to producers.
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?	We believe that organisations such as the CFA Institute or EuroInvestors are better qualified to respond to this question and defer to their assessment.

	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	-
	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?	We support the Commission's proposal.
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	In general, we believe that the crisis has shown that all clients and counterparties need better protection.
	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 support the Commission's proposal.
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?	
	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?	
	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?	
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	We do not believe that trading venues should be exempted from transparency entirely. It should be specific types of orders or trading that is exempted. Moreover, any exemption from pre-trade transparency should be more restrictive.
	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 very much welcome the pro-competition framework for consolidating the data and the improvements to the main stumbling block to consolidation, which concerns the availability, quality, and reliability of OTC data and its comparability with other sources of data. However, Articles 65, 66 and 67 of the MiFID proposal should be explored in more detail to ensure an appropriate regime for CTPs avoiding unnecessary cumbersome obligations which may keep some firm providers away from the business. We believe that it would be in the interest of the market to have a decentralised CTP to ensure the most efficient solution of data consolidation.

		At present, the priority should be to focus on the equity markets. The need to extend the proposed arrangements beyond equity markets should be reviewed when the market organisation for non-equity products will foster more information from different sources on the same products that need to be consolidated. Furthermore, we would like to point out that the introduction of APAs alone will likely not be fully sufficient to improve the reliability of OTC post-trade data. Due to the lack of harmonised Pan-EU OTC trade reporting rules, IFs have no clarity which counterpart of a trade has to report and where. Therefore, OTC post-trade transparency tends to be unreliable regarding the published volumes. In order fully improve OTC data quality a combination of APAS and clear and Pan –EU harmonized OTC trade reporting rules is required. In order to come up with a meaningful consolidation, OTC data shortcomings must first be addressed. In this context, CSE supports the proposed APA regime. However, in order to address the problems described under b) above, CSE strongly recommends the EU Commission to introduce Pan-EU harmonized OTC Post-Trade transparency requirements at a very detailed level. ESMA could play a major rule here
	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	With regard to **derivatives**, we welcome the post-trade transparency regime proposed by the European Commission. This regime is in line with the G20 objective of providing further transparency to the OTC derivatives markets.

	reasonable cost, and that competent authorities receive the right data?	Nonetheless, as with bond markets, it is inappropriate to envisage a mere extension of requirements from one market to another. We agree with the proposed measures and in particular with the following obligations: • **Trading venues**: Price, volume and time of executed transaction • **Investment firms**: Price, volume and time of executed transaction on derivatives which are clearing eligible, reported to trade repositories or admitted to trading on RM or traded on MTF or OTF. For Bonds: (i) Price, volume and time of the execution (ii) Deferred publication will be based on the type of the transaction • **Deferred publication** by type and size of the contract • **Publication will be offered** in real time at a reasonable costs and 15 minute data will be free although this will need to be tailored because in some instances 15 minute data is still highly sensitive due to the nature of the instrument or market. We **welcome the suggestion to calibrate** such a transparency regime **by type of derivative product/market/commodity derivatives** as we consider that some calibration may need to be performed because products/markets are very different from each other.
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?	1. **ESMA resources**: The proposal should ensure that adequate resources are given to ESMA in order to perform the substantial number of tasks that are proposed in MiFID and MiFIR.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	The CSE believes that consistency must be ensured between the MiFID/MiFIR II, EMIR, CRD and the upcoming regulation on CSDs. The three pieces of legislation together will form the backbone of the EU financial market infrastructure and the existence of overlapping provisions means that the three texts should be aligned to ensure reciprocity across the different layers of the value chain (trading, clearing, and settlement).
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	Interaction with United States' **Dodd-Frank Act** is relevant. Global consistency and avoidance of regulatory arbitrage is important. Equally, we cannot seek to align our legislation with a 3rd country legislation. Our circumstances and legislation are different.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	Yes, we think so.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	No, we believe that too much is left to Level 2 on many issues. This has to be readdressed by adding more guidance and clear decisions to Level 1.

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
Article 34	We do not disagree with the proposal of this article, however a procedure to ensure that the MTF operator has knowledge of which RM, other MTF's are also trading the same instrument must be laid down.
Article 53	We do not disagree with the proposal that it is described in this article, however a procedure to ensure that the RM has knowledge of which RM, other MTF's / OTF's are also trading the same instrument must be laid down.
Article 54	We do not disagree with the proposal that it is described in this article, however a procedure to ensure that the RM has knowledge of which RM, other MTF's / OTF's are also trading the same instrument must be laid down.
Detailed comments on specific articles of the draft Regulation	
Article number	**Comments**
Article ... :	
Article ... :	
Article ... :	