Deutsche Bank

To:

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Deutsche Bank's response to your questionniare on the MIFID review

London, 13 January 2012

Dear Mr Ferber,

Deutsche Bank welcomes the opportunity to comment on the review of the Markets in Financial Instruments Directive (MiFID). MiFID is a crucial piece of legislation for the European economy which we feel has worked well. It has created better protections for investors, more transparent markets and has contributed to harmonisation of standards in the EU financial services sector. Markets have, however, continued to develop and the regulatory framework needs to evolve accordingly.

With regard to investor protection, the key objective should be to ensure that consumers have access to affordable and appropriate products. This should be accompanied with high quality advice that allows investors to make the right choices, save for the future and for funds to be efficiently channelled to investment in the real economy. By focussing narrowly on – for example – independence of advice and not on the broader objectives of investor protection, we feel that the proposal does not yet deliver in this area.

More focus is needed on effective enforcement of the present rules, consistency of implementation and on consumer protection issues. The European Supervisory Authorities should play an important role in this. In fact, were the existing rules to be implemented and enforced fully and on a consistent basis across Member States, there would be limited need for further legislation in this area.

With regard to issues relating to trading, the proposals make good progress in ensuring that all organised trading and financial instruments are covered within the scope of MiFID. They will also bring some benefits to the market from increased transparency. However, it must be ensured that the proposals are appropriate for the many different underlying markets. Specifically, the proposals appear to be drafted largely from the perspective of exchange based markets, where market operators primarily match client trades with each other, without due attention paid to those markets where market makers are required to commit capital to ensure a transaction can take place.

This is particularly true for markets such as fixed income, which are characterised by 'lumpy' transactions and intermittent liquidity. Here it is often necessary for market makers such as banks to bridge the gap between buyers and sellers and provide the liquidity necessary for transactions to take place.

The ability of European corporates to issue debt and the willingness of institutional investors, such as pension funds, insurance companies and asset managers, to invest, depends on the existence of sufficient market liquidity. This in turn depends in part on the willingness or ability of market makers, such as banks, to provide such liquidity. The overall effect of less liquidity, wider bid and ask spreads and market makers less able to perform their role, will be reduced returns for investors and savers and an increased risk of investing in the EU.

In our specific comments, we provide a number of suggestions for ways in which the objectives of legislators can be met in a way that supports the functioning of markets in the EU. We would be happy to discuss these further if helpful.

Yours sincerely,

Andrew Procter
Global Head of Government and Regulatory Affairs

A. Scope

1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in which more could be done to exempt corporate end users?

The exemptions proposed appear balanced and appropriate. In most cases, corporate end users will be exempt from the obligations contained in MiFID. This does not however imply that corporate end users will not be affected by the proposals.

2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?

To ensure a level playing field, instruments that have the same characteristics as financial instruments included within the scope of MiFID should be covered. Where this is true for instruments such as structured deposits, they should be covered.

Simple deposits such as savings books and fixed and floating rate deposits should remain outside the remit of MiFID. The broad definition of the scope in Article 1(3) of the MiFID II proposal only exempts deposits with a "rate of return which is determined in relation to an interest rate". Strictly speaking, this exemption covers only deposits whose rate of return is linked to a benchmark such as Euribor or Eonia. This exemption should be extended to include all simple deposits.

3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?

More clarity is needed on the objective of this re-categorisation and what it will mean for the applicability of the MiFID rules. As custody services are distinct from the other core services, consideration should be given to which MiFID requirements should apply.

Additionally, the current proposal is not conclusive about whether the rules relate to client assets as determined by the home state rules of a firm or of the country into which a firm has been passported under MiFID. We would strongly recommend that the home state rules of an entity apply to all its custody services (provided cross border or via a branch) because it is simple and clear and removes any ambiguity arising from the question where the custody service is actually taking place.

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?

The harmonisation of rules regarding the access of third country firms to EU markets is a positive development in principle. However, it comes with a number of practical considerations that should be dealt with if legislators choose to create an EU level third country regime.

Firstly, the resource burden and complexities involved in establishing equivalence for a large number jurisdictions and for ESMA to register a large number of third country firms that offer services to eligible counterparties only, should not be underestimated. If legislators deem this to be a priority, existing authorisations or exemptions granted by EU member state authorities to third country firms and existing client agreements should be allowed to continue in the interim so as not to disrupt services into and out of the EU.

Secondly, a clear and explicit differentiation should be made between services that are actively offered in the EU from a third country firm and those which are solicited by a European retail client from a third country firm. Only services of the latter should be within the remit of MiFID requirements.

Finally, there should be a distinction between third country firms which are not connected with any firm authorised in the EU and and those third country firms which are part of a group that is already subject to consolidated supervision as stipulated in the Capital Requirements Directive. The latter are known and accessible to EU competent authorities. There should be a possibility for such firms to register with ESMA without having to open a branch in the EU. They would be subject to MiFID requirements in the same way as European firms that provide cross border services via a passport today. Such an approach would be subject to the firm being authorised in the jurisdiction of its establisment, the existence of appropriate co-operation arrangements between the third country and EU authorities, and systems and controls within the EU parent to ensure that the third country entity meets all relevant requirements.

B. 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?

It is important to ensure strong corporate governance of financial firms, especially with regards to board capability and risk management processes. The proposed requirements should remain broadly in line with CRD 4 requirements, avoid too much distortion between financial and other sectors and allow proportionate application based on the scale, nature and complexity of a firm's activities.

With regard to requirements for boards, it is crucial that board members have sufficient experience and expertise. These rules should be proportionate and appropriate to the institution in question and should never undermine the principle that firms are satisfied board members have both the capability and capacity to carry out their duties in a rigorous and effective manner. We would specifically highlight the importance of adjusting the text to accommodate differences in board structures (e.g. unitary and dual boards) between EU Member States.

C. Organisation of markets and trading

6) Is the Organised Trading Facility (OTF) category appropriately defined and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what changes are needed and why?

All organised trading venues should be brought into the scope of MiFID. The establishment of a new trading categorisation – “Organised Trading Facilities” (OTFs) – to capture organised trading not within the scope of the current MiFID framework, with strong organisational and transparency requirements, will help to ensure MiFID maintains pace with the realities of today’s markets.

To support the objectives of MiFID II, we believe that the new OTF venue category should:

- Capture a broad range of venues. This recognises that MiFID II will now cover a much wider range of products and markets, which have different structures and operation;

- Promote competition between venues which will encourage investment in new platforms and services, and lead to decreased trading costs for market participants;

- Support the principles of best execution for market participants; and

- Meet the G20 commitments to trade standardised OTC derivatives on 'exchanges or electronic trading platforms, where appropriate'.

The proposed prohibition for OTF operators using their own capital to facilitate client trading is likely to conflict with a number of these objectives and will result in reduced liquidity and increased costs for market users:

- <u>Reduced competition</u>: Many existing platforms will no longer be permissible under MiFID II, removing valuable sources of existing liquidity for investors and reducing competition between platforms and services going forward;

- <u>Second-best execution</u>: OTF members will be unable to receive prices from the operator, even if these are superior to those displayed on the platform. This appears to conflict with best execution obligations; and

- <u>Meeting G20 commitments</u>: The proposals go beyond the G20 Pittsburgh commitments, which require trading on 'exchanges or electronic trading platforms, where appropriate' with no prohibition on own capital.

Furthermore, we are not aware of any empirical evidence that suggests potential conflicts of interest between operators and clients could be reconciled through organisational measures/supervisory approval and/or transparency to clients (who are almost exclusively professional investors and eligible counterparties). One possible way to strike a balance between these concerns and ensuring a viable OTF category would be to allow OTF members to request for the operator to be one of their potential counterparties within the OTF. This would have to be explicitly agreed with the member prior to trading, and would allow OTFs to better meet demands of investors.

Discretion of operators

We support the key distinction between OTFs and MTFs that the operator of an OTF has a degree of discretion over access and over how a transaction will be negotiated and executed based, among other things, on the role and obligations to their clients. This is a key distinction that could be made clearer in the legislative text.

Ownership structures and enforcement

The MiFID proposals would benefit from further clarity around ownership structures such as shareholdings in OTFs (for example, by clarifying that an owner of an OTF could deploy their own capital within the OTF if they were not operating it).

Finally, some of the proposed rules on trading venues stem broadly from concerns around best execution and conflicts of interests. In principle, these concerns could already be managed via more robust enforcement of the existing rules.

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?

The derivatives trading obligation will channel a significant volume of trading onto organised venues. An inclusive OTF definition which captures a broad range of organised trading venues and supports competitive and attractive market models would increase the proportion of trading that would be suitable for, and attracted to, such venues.

The SI regime and its extension to fixed income

For trades not executed on organised venues, we expect an increased proportion to be subject to the Systemic Internaliser (SI) regime. However, for trading in a product to be suitable for the SI regime, the underlying market must trade systematically, and the market maker must trade systematically in those products.

However, the extension of the scope of the SI regime from equities to fixed income products introduces two main challenges:

- The interpretation of 'systematic' trading – fixed income markets have lower liquidity than equity markets as products often trade only intermittently (e.g. a few times a day or week) and a greater range of products. It is important for 'systematic' trading to be defined on a per product basis, where 'product' is defined as broadly interchangeable from a risk perspective; and

- The requirement to make quoted prices for one client available to other clients for execution.

For products such as corporate bonds, which sometimes only trade a few times per day or week, it is difficult to envisage much truly 'systematic trading' that could reasonably support such obligations. This is highly impractical for those low-liquidity products where the market maker has a limited inventory of products, or derivatives, where there are likely to be client-specific factors in the price.

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?

We support the proposed requirement for all firms involved in automated trading to be subject to regulation. This will strengthen the market structure framework and minimise potential risks.

We also support the requirements in Art 51 on systems resilience, circuit breakers and electronic trading, and agree that regulated market volatility rules should be harmonised. This will avoid the risk of liquidity becoming 'trapped' on venues during times of high volatility. Disparate volatility rules risk prolonging or increasing market volatility by restricting the flow of liquidity and causing market confusion. Two aspects of the proposals are likely to have unintended consequences:

Requiring all algorithms to post continuous liquidity

The term "algorithmic trading" covers many different types of strategy, some of which involve "high frequency trading". Algorithms are used by a range of financial institutions, including investment firms, institutional investors managing the funds of retail investors, pension funds and hedge funds. Algorithms are used for a variety of different reasons, including:

- Facilitating the execution of an order (i.e. helping to ensure that the investor's order is completed for the best possible price);
- Creating a derivative product;
- Hedging a risk; and
- Liquidity provision (often referred to as market making). This strategy may involve "frequent trading".

It is important that any requirements designed to address high frequency trading do not prevent the proper pursuit of algorithmic trading strategies for the purposes above. The current requirements relating in Article 17(3) could have that effect. Market making algorithms are typically active in the market on a near-continuous basis, whereas those algorithms that are used to facilitate an order are only active in the market for short periods of time. Mandating all types of algorithm to operate on a continuous basis will introduce significant risk, requiring firms to be constantly exposed to the market, regardless of the prevailing conditions.

This is unlikely to be a risk that many firms will be able to tolerate leading to a large reduction in the use of all types of algorithms, including those used to help investors complete their orders for the best possible price. Reduced use of algorithms will increase risk and costs for investors, ultimately decreasing returns. The obligation may also lead to a reduction in posted size leading to lots of very small quotes, which will further increase the cost of trading and market inefficiency. High frequency trading firms that operate market making algorithms may choose to continue to operate but since they tend only to trade in very liquid stocks, these may become more liquid and less liquid stocks (ie mid and small cap stocks) may become comparatively less liquid.

Furthermore, if a client has asked for their order to be executed via algorithm then requiring that algorithm to also post quotes continuously will conflict with the client instruction and broker obligations to achieve best execution.

Alternatively, trading venues should be required to set their own market making rules, appropriate to their markets, closely monitored by the competent authority or ESMA. For example, in addition to traditional market making, a trading venue could incentivise participants to provide liquidity in periods of particularly high volatility or low turnover, or set up a second tier of market makers that have reduced obligations compared to the venue's other market makers.

If it is deemed necessary to require algorithms to operate continuously, then, to avoid unintended consequences, a more robust definitional framework should be devised to ensure that only the most relevent algorithms are covered.

Ensuring clear and appropriate responsibilities for all market participants

All firms should take responsibility for ensuring that they adhere to the (future) Market Abuse Regulation (MAR) and the rules of the trading venues that they operate on. Regulatory responsibilities should be allocated appropriately. Art 17(1) and (4) imply that investment firms are responsible for ensuring that their direct electronic access clients adhere to MAR and trading venue rules, rather than the clients themselves.

It is not feasible for investment firms to monitor all market orders and executions for potential abuse as investment firms are only able to monitor the subset of orders provided to it by their particular clients (clients will often send orders to more than one investment firm). Given that an investment firm is unlikely to be able to see all the necessary information pertaining to a client, it seems inappropriate to expect firms to retain responsibility contractually in all circumstances for ensuring client trading is MIFID, MAD and trading venue compliant.

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?

We agree with the proposed requirements on resilience, contingency arrangements and business continuity arrangements. The implementing measures should be allowed to be consistent with those detailed in the ESMA guidelines on systems and controls in an automated trading environment, published in December 2012.

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?

The proposed requirements will allow regulators to construct a clear overview of all trades. We would caution against the approach outlined in the Volcker Rule proposals in the US. There, banking entities engaged in permitted trading activities may face new reporting and record keeping requirements, including various quantitative metrics which must be calculated daily by each trading unit (with up to 17 different metrics for banks engaged in permitted market making activities). Adopting similar rules in the EU would not add any additional clarity to the data available to regulators in the EU.

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 proposals in the MiFID review go beyond the G20 commitments to trade standardised derivatives on "exchanges or electronic trading platforms, where appropriate". We support the G20 commitments and believe that the extensions proposed within MiFID will have more negative than positive benefits.

Improving the trading obligation

There are two main areas in which we think it is important to improve the text:

- Support all forms of electronic trading - under the proposed rules, trading in standardised derivatives will be restricted to RMs, MTFs or OTFs. The G20 commitment also includes bilateral platforms, where they are electronic. However, the own capital prohibition within the OTF definition excludes such venues.

- Large trade facilitation – rules relating to Swap Execution Facilities (SEFs) in the US contain a block trade exemption that recognises that larger trades may need to be negotiated away from the platform. Minimising the market impact of large trade execution is of critical importance to all market participants, and is a key concern for corporate end-users and institutional investors, which represent the interests of millions of EU retail investors. In many markets with visible order books, these "market slippage costs"[1] are by far the largest cost associated with executing trades.

Average liquidity as a determinant for the trading obligation

The trading obligation requires that 'sufficiently liquid' OTC derivatives are mandated to trade on MTFs or OTFs. Two of the key determinants of 'sufficiently liquid' are stated as the average frequency and size of trades. However the liquidity both of overall markets and specific products varies significantly over time, and a market that is on average 'sufficiently liquid' may clearly be 'insufficiently liquid' for much of the time.

Basing the mandate on 'average' liquidity is therefore likely to impose rules that are not compatible with periods of lower liquidity, and drive what little liquidity there might be out of the market, seizing up trading activity and preventing efficient transfer of risk. This impact on liquidity raises systematic risk concerns, as liquidity drops are most likely to occur in a crisis situation such as if a market participant defaults and counterparties suddenly have large unhedged exposures.

Swaps

A proportion of OTC derivatives are traded to fill investors' demand to take a directional position in shares or bonds, while at the same time avoiding the administrative burden of holding these instruments directly. In this case, the trades occur in essence *before* the derivative is created: a trade is executed in a cash market and the derivative (e.g. an equity swap) is the resulting risk transfer to the client, mirroring the pricing of the cash market trades. Although MiFID is not entirely clear on this, we assume these derivatives would not fall under the trading obligation. Given the nature of these trades, there should be a clear criterion in the level 2 mandates to ensure ESMA can decide to not subject them to the trading obligation.

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?

These changes (combined with improvements in other legislative initiatives such as the Market Abuse Regulation and the Transparency Directive) will lighten the administrative burden SMEs

[1] Slippage costs are increased costs a trader incurs when the market moves against him as he tries to execute a trade. This occurrence is particularly pronounced for larger trades as these take longer to execute and are easier for other participants and the market to spot. Therefore, the initial price on a screen is not always the final price.

would face to list and be listed on a platform. However, this is not a guarantee for better access to capital markets and other initiatives may needed to ensure this.

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?

The proposals appear sufficient, in particular, the elements relating to collateral, netting and cross-margining are crucial to ensuring sufficient competition between providers.

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?

Increased transparency in commodities markets can help to improve market integrity. However, restricting large positions could also have negative effects on market volatility and liquidity, as there are many valid circumstances in which a large position can be built up. It would be difficult to capture these in specific exemptions. Competent authorities should seek better insight into large positions, and reinforced market abuse regulations should be relied on to address instances where trading activity is identified as abusive.

It is important that commodity derivatives markets are underpinned by a sound regulatory framework to limit the potential for abusive behaviour in these markets and to provide a transparent trading environment for optimal price formation. We are fully supportive of increased levels of position transparency and reporting to regulators. Behaviour that is considered abusive or manipulative should be addressed in the Market Abuse Regulation.

Large trades should not be specifically targeted by regulation. There are many examples, often related to hedging commercial or other financial exposures that require large positions to be taken by end-users or market-makers. Restrictions would inhibit the ability of these counterparties to conduct bona-fide risk hedging activity.

Position limits

Position limits are sometimes seen as a mechanism to limit volatility as a result of speculation. However, as many studies have shown, fundamental supply and demand dynamics drive commodity prices in the medium and long term. In the short term, investors might intensify price trends but they cannot lead to a sustained departure of prices from fundamentals.

“Hard” position limits are likely to exacerbate volatility by inhibiting genuine hedging activity and the ability of commodity markets to respond to shocks. The ability to absorb shocks is particularly important for the commodity markets that are characterised by concentration of production (for example cocoa) and are therefore more vulnerable to unpredictable events. Commodity markets are all very different and it would be exceptionally difficult to calibrate any hard position limits to each market in such a way that they do not damage market activity.

D. 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 key objective for MiFID should be to ensure that consumers have access to affordable and appropriate products accompanied by high quality advice. This allows them to make the right choices, save for the future and channel funds efficiently to investment in the real economy. Regulation should allow for a diversity of products within a level playing field to ensure different risk profiles, levels of financial awareness, willingness to pay and affordability can be accommodated.

We are concerned that the proposals in the MiFID review oversimplify issues relating to the quality of advice, the basis on which it is given and the remuneration arrangements, conflating them as a single issue. It is possible to have differing levels of the three and consumers should be made aware of this. For example it is possible to have high quality, 'non independent' advice with commissions paid by product providers and low quality, 'independent' advice with fees charged directly to the consumer. The proposals in the MiFID review seem to suggest that the latter is better than the former. However, this may not be the case. Whatever legislators choose, they will need to ensure sufficient time to implement and appropriate transitional arrangements for existing contracts.

Independence of advice and conflicts of interest

In the proposed regime on independent advice, the rules seek to avoid conflicts and product suitability. It does not address the quality of advice, the more important issue for Europe. If legislators choose to create a category of 'independence' in MiFID, they must avoid giving consumers false expectations. Independence as a label means only one thing: the adviser will consider a wide range of products. It does not mean they will get the advice right. Independent advisors acting on a fee basis might also be influenced by own interests, such as turnover (i.e. selling as many products as possible, regardless of consumer welfare). To avoid this risk, it should be clear that the term "independent" does not say anything about the depth of an advisor's understanding of the selected products. Therefore, it may be more appropriate to define the category in a less subjective manner, as 'open ended' or 'fee based' advice.

An alternative solution to avoid or manage any conflicts of interests would be to require advisors to clearly disclose: a) the range of products they will consider, b) the commission they receive for each product and c) the fees they charge for their advice. In addition, the already existing disclosure obligations could be improved, for example by implementing a requirement to inform a client prior to the transaction about the maximum provision (in percent per year) that is paid to an advisor for the sale of a financial instrument.

Transparency and clarity of information can be improved in the following ways: firstly, a KIID for all investment products (not just for UCITS or packaged retail investment products) would provide clear and accessible information about a product and any imbedded costs. Secondly, it should be clearly disclosed when an advisor advises products that are produced by the advisor's firm or by a firm that has close links with the advisor's firm.

Commissions/inducements

Investment advisors are already under the obligation to recommend products that are suitable for consumers and to disclose inducements. These requirements should be appropriately enforced. Evidence suggests that the implementation of the MiFID 1 regime on inducements has not been fully satisfactory and that fee based advice is more expensive than current advisory services that include inducements. The proposed rules would therefore penalise retail clients – particularly those on lower levels of income - and discourage them from obtaining investment advice.[2]

The existing regime offers two key advantages for retail clients:

- It offers retail clients the opportunity to get free advice from several providers before they decide which investment product they would like to choose. They are thus able to compare the offerings of the banks without any obligation to buy a financial product.

- Commission based advice offers retail clients access to a wider range of products. Elimination of inducements is likely to lead to a more restricted and potentially poorer quality product offering than at the present time.

Furthermore, MiFID I did not specifically target those inducements that create the biggest risk for conflicts of interest but instead included every single fee that is comprised in a product. This should be clarified. A better definition of "inducement" could seek to identify the nature of any conflict of interest created, and whether it is reconcilable with the legal obligation to recommend the most suitable products.

Finally, in order to be able to continue to offer high quality advice, recital 52 of the MiFID proposal should be amended to ensure the current understanding under MiFID and ESMA guidance that the provision or reception of research is considered as a non-monetary inducement and is permissible provided that the requirements of current art. 26(b) of the Level 2 Directive are met, is maintained.

Portfolio management

According to the European Commission impact assessment, inducements form an inherent conflict of interest. The impact assessment also indicates that the current requirements around inducements "have not always proven to be very clear or well articulated to the client". In light of this it makes more sense to clarify the regime around inducements than to introduce a full ban of inducements in portfolio management. This is disproportionate and will lead to less flexible service provision.

Firms that offer inducement-based services should obtain explicit consent from clients for the fees. In this scenario, clients should be able to choose between contractual agreements without inducements and an increased portfolio management fee, or portfolio management for which the firm receives non-monetary inducements from third parties up to the agreed annual maximum percentage combined with a lower management fee.

16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?

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[2] N. Franke, C. Funke, T. Gebken & L. Johanning - *Provisions und Honorarberatung; Eine Bewertung der Anlageberatung vor dem Hintergrund des Anlegerschutzes und der Vermögensbildung in Deutschland*, January 2011.

Complexity is not an objective measure and can take many forms. There can be complexity in terms of payoff structures, product design, counterparty risks, securities lending and relative complexity from the perspective of a particular client. Complexity and risk interact, i.e. the use of derivatives in a capital protected product can decrease risk. The present proposal only focuses on complexity and does not take into account risk. As such, it does not follow that all structured UCITS will by definition be complex. The primary objective should be to ensure product suitability.

In addition, the exclusion of certain securities that "incorporate a structure which makes it difficult for the client to understand the risk involved" does not sufficiently differentiate between client types, these provisions should be calibrated by client type since the level of understanding of, for example, a professional client and a retail client will generally be very different. Indeed, there are also different types of retail investor with different levels of sophistication.

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 generally agree with the existing rules and feel that there is enough scope for firms to provide evidence that best execution is achieved (for example via smart order routing systems). The enforcement of the existing rules could be strengthened further.

With reference to our response to question 6, we would add that the proposed definition of the new 'OTF' category is not supportive of best execution in general due to the prohibition of the use of operators' capital to facilitate client trading.

18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?

We agree with the levels of protection provided in the present proposal in most cases. They recognise the general philosophy of MiFID I that different clients have different expertise and access to markets, thus providing them with differing levels of information about these markets and a differing need for protection.

There are some instances, however, where the level of protection required by the European Commission's proposal does not reflect the needs of different categories of clients. Examples are the new standards for cross-selling services in Article 24(7) and the proposed requirement in Article 25(5) which sets out how advice should meet the personal characteristics of clients.

Finally, the regime for third country firms wanting to offer services in the EU does not specifically mention professional clients – many of whom are asset managers. The regime for professional clients should be analogous to that for eligible counterparties.

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?

To avoid arbitrary decisions, uncertainty in the market and impediments to product innovation, decisions to prohibit certain services and financial instruments on grounds of investor protection should be subject to clear criteria and requirements. For example, there would have to be a significant economic risk for investors which cannot be taken away by more proportionate measures.

In any case, to avoid market disruption, product intervention should address specific products and not relate to a whole product category, and should only be forward looking.

E. 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?

The pre-trade transparency requirements in these articles are broadly appropriate.

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?

The MiFID proposals could do more to recognise that equity and non-equity markets are substantially different. Where equities are normally traded on a large scale, continuously, and in various sizes, many non-equity financial instruments trade sporadically and in volumes that vary considerably.

Pre-trade transparency is important for all market participants, but already exists in many forms across many different markets and has been developed on the basis of the demands of market participants:

- More liquid markets may have streamed prices of firm or indicative quotes;

- Less liquid markets may use Request for Quote (RFQ) submission as a mechanism to identify market prices. This is a valid mechanism to establish prices pre-trade where a visible order book of actionable prices does not naturally exist, or the broadcasting of all RFQ enquiries would harm the price or size counterparties are willing to quote; and

- In all markets, post-trade transparency requirements will provide market participants with pre-trade information for subsequent trades, and the extensions proposed to post-trade reporting will benefit price formation.

It is not clear to what extent there is demand from either the buy or sell-side for greater pre-trade transparency beyond the formalisation of market best practices into legislation. We understand that the market impact costs associated with inappropriate pre-trade transparency is one of the main concerns of institutional investors and end-users, and believe it is crucial to fully understand the impacts these proposals could have on this group of stakeholders and their ability to manage risk. The pre-trade transparency proposals are problematic for the following reasons:

- In many markets, broadcasting non-executed RFQs would alert market participants to likely demand, allowing others to trade ahead of the original firm with genuine trading needs. This would reduce liquidity and impact the prices and sizes shown in response to the RFQ: spreads would widen and sizes reduce as counterparties take into account the cost of the market movements that result from this information leakage. Large trades would become significantly more difficult and expensive to execute.

- Prices are based on a number of factors which may be client-specific. The quoted prices and depth are therefore unlikely to be available to other participants with different execution/clearing relationships and a different credit profile, and therefore do not represent 'depth of trading interest available' in a meaningful way.

Instead, the pre-trade transparency regime should ensure that:

- OTF operators have appropriate discretion to implement the optimal level of pre-trade transparency for their marketplace to support an efficient process of price-formation and risk clearing. The nature of products and participants varies greatly across equity and non-equity products, and applying the same requirements to each will not support smooth market functioning.

- Pre-trade quote information can be published but, as this contains similar market-moving information to the post-trade reporting (see below), it should be subject to a similar framework of delays. This adds to the post-trade reporting by giving market participants information on non-executed orders, but in such a way that market operation is not harmed.

- In order to support different levels of transparency, market participants could be given a choice of whether or not to broadcast an RFQ and the responses they receive to it. The participant can then balance the market impact costs with the potential competitive benefits of wider distribution of the 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?

Please see our response to question 21.

23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?

With regard to non-equities the concern with regard to the impact of proposed transparency requirements on large trades has been correctly identified. However, market liquidity should also be considered. Most non-equity markets are much less liquid than their equity equivalents, and hence the proposals are likely to be damaging to smaller-scale orders.

Reducing liquidity in fixed income markets through inadequate waivers will increase the funding and hedging costs for corporate and institutional investors. There have been recent examples in both the corporate and sovereign bond markets of falling liquidity resulting in increased bid-offer spreads and issuance costs for new debt. It is difficult for investors to absorb new primary issues if there is not a liquid secondary market to rebalance other exposures.

With regard to equity markets, it is difficult to predict the impact of the proposals as the calibration of the transparency requirements will take place in implementing measures. However, if existing waivers are amended considerably, there is a large probability that the ability of the market to serve large trades will be negatively impacted. Therefore, the scope for the implementing measures should be limited in such a way that the existing waivers will not lose their effectiveness.

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)?

While we do not have specific comments on the data service provider provisions, we stress the importance of the central objective of producing a single tape. The mandate for level 2 should ensure that all data providers publish the same data and that regular reviews take place to ensure that the single tape is effective.

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 support the "ECT Blueprint" published by the European Fund and Asset Management Association (EFAMA). In particular, it will be important to regulate the cost of a single tape as at the moment data fees of various venues differ substantially (for example some exchanges charge very high fees, while some MTFs waive them).

We also agree that the centralisation of data is essential. Provisions would have to be prescriptive and establish a common data feed format so that consumers would only have to understand one single protocol. While individual venues already support multiple feed formats – and should be allowed to continue to do so if they so wish – one of their feed formats should be in a prescribed non proprietary free and open standard format.

Finally, there is a need to balance the desire of market users for immediate and fully transparent information on all trading activity with the disruption to the liquidity of less liquid parts of the market. It is inevitable that where currently market making and position taking market participants provide liquidity on the basis that there is delayed or no publication of trades, their willingness to take on large positions from market users and their ability to hedge or trade out of the position effectively will be reduced as transparency requirements increase. Considerable care is therefore needed to define exemptions from immediate publication.

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?

Some of the barriers to cross border integration arise from Member States having implemented the directive inconsistently or from variations in the interpretation or enforcement of the rules by competent authorities. We support the effort in the present proposal to harmonise rules further. However, there should also be more focus on best practice across the EU so that what is generally seen as good behaviour or compliance in one Member States is also adopted in others.

27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?

We do not believe further changes are needed.

28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?

MiFID interacts with a number of pieces of EU legislation including the European markets infrastructure regulation, the short selling regulation and the UCITS and AIFM Directives. It will be important to assess the interactions carefully and avoid unintended consequences. In particular, each of the legislative texts contain a number of reporting requirements, some of which are different and some of which overlap. For those that overlap, the requirements should recognise this and be as consistent as possible.

29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?

Please see our response to question 11 regarding standardised trading mandated derivatives and the equivalent regime for large trades in the US.

30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?

We feel that the sanctions regime is sufficiently dissuasive.

31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?

This is largely a matter for the European Parliament and the Council to judge, however we would note that a number of issues left for calibration at level 2 and the relatively wide mandates that could come out of the present formulation of the delegated acts, means it is extremely difficult to assess the impact of the current proposals.

We would also ask that legislators are mindful of the challenges involved in preparing for implementation in the absence of clarity on level 2 calibration and that implementation/transitional periods should ideally begin after level 2 has been adopted (as opposed to level 1).

Annex: additional comments

Recording of telephone communications with retail clients – article 16

The cost of expanding recording requirements far outweighs its benefits and falls disproportionately on smaller firms. Firms would have to implement recording systems at very substantial costs and regulators have not demonstrated that the likely benefits of the requirements outweigh these costs. Additionally, private conversations will be subject to data protection rules which have not been harmonised across the EU.

Bundling – article 24 (7)

With regard to the requirements on product bundling as currently proposed, we note that in light of the volume of information that currently has to be provided to a client prior to providing a product (i.e. a prospectus or a KIID, information on inducements and conflicts of interests as well as periodic information to be provided) some customers may find it difficult to make an informed decision about a specific product. We urge policy makers to consider what kind of information has the highest priority for an average retail client in making an investment decision.

Transaction reporting – MiFIR article 23:

The scope of end of day transaction reporting should be tightly defined, have sensible exemptions and must clearly demonstrate that it contributes useful information for regulators to enable them to carry out systemic risk assessment and market abuse surveillance. The current proposals represent a significant increase in reporting requirements. The cost-benefit assessment of these requirements must demonstrate that the information will be useful to, and useable by, regulators.

The requirements in article 23 should be proportionate and have regard to whether that clas of financial instrument is subject to Market Abuse provisions (it should be clear that the provisions do not apply to FX, primary market issuance, derivatives referencing index/basket and interest rates). Furthermore, with regard to order data that is available from platform operators, it would be duplicative and inefficient to also require firms to report such information.

Periodic communications to clients – article 25

In order to ensure that clients continue to have access to financial products that are suitable and affordable, they should be free in choosing the terms of their contract and – specifically – the frequency of financial reports. While investors should receive at least the information/reports that are currently required under MiFID, any additional *periodic* communication or report should be subject to the agreement between a client and the investment firm as a part of a specific service. Prior to the service, investment firms should be required to inform potential investors of the frequency and nature of information provision.

Adhering to minimum information requirements and giving clients a choice in the amount of additional information they would like to receive would be a more proportionate and cost effective solution than blanket additional information requirements.