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.**

Submission by the **European Covered Bond Council (**European Institutions' Transparency Register under ID Number 24967486965-09**).**[1]

On behalf of the European Covered Bond Council we are writing in response to two specific aspects of the MiFID/MiFIR 2 proposals to the extent that they may adversely impact the efficient operation of the covered bond market. Obviously there are many other aspects of the proposals that will influence this market and members of the ECBC. We confine ourselves here to the two key topics which have been raised as concerns by members of the ECBC's Market Related Issues Working Group.

[1] The European Covered Bond Council represents the covered bond industry, bringing together covered bond issuers, analysts, investment bankers, rating agencies and a wide range of interested stakeholders. The ECBC was created by the European Mortgage Federation (EMF) in 2004 to represent and promote the interests of covered bond market participants at international level. As of December 2011, the ECBC has over 110 members from more than 25 active covered bond jurisdictions. ECBC members represent over 95% of the €2.5 trillion covered bonds outstanding. The European Mortgage Federation is registered in the European Institutions' Transparency Register under ID Number 24967486965-09.

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 comments.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	No comments.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	No comments.
	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?	No comments.
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 comments.
Organisation of markets and trading	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and from	No comments.

	systematic internalisers in the proposal? If not, what changes are needed and why?	
	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 comments.
	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?	No comments.
	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 comments.
	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 comments.
	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 comments.
	12) Will SME gain a better access to capital market through the introduction of an	No comments.

	MTF SME growth market as foreseen in Article 35 of the Directive?	
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	No comments.
	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?	No comments.
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?	In the current MiFID directive (2004/39/EC) article 19 deals with the rules regarding information to clients and assessment of suitability and appropriateness. Article 19 (9) exempts from these additional requirements investment service offered as part of a financial product which is already subject to other provisions of Community legislation or common European standards related to credit institutions and consumer credits with respect to risk assessment of clients and/or information requirements.

		In the MiFID proposals, the current article 19 has been split into two new articles: article 24 (information) and article 25 (suitability and appropriateness). The above mentioned exemption in the current MiFID directive, article 19 (9), has, however, only been partly transferred to the MiFID proposals, since it is only repeated in article 24 and not in article 25. We note that financing through a mortgage bank is already covered by similar rules which is why this kind of financing is exempted from the requirements of the current article 19. We refer to the Consumer Credit Directive (2008/48/EC) e.g. to CCD article 5 on pre-contractual information, article 8 on the obligation to assess the creditworthiness of the consumer and article 10 on information to be included in credit agreements. On European level the lending advice is also covered by the European Code of Conduct on Home Loans which is the pre-cursor for the current European Standardised Information Sheet (ESIS). Therefore narrowing of the existing exemption will, in our opinion, only lead to a large and to all effects unnecessary extra administrative burden, dual regulation and information overload for the customers. We suggest, that any possible need for further European legislation in this area should therefore be covered by e.g. the Commission's proposal for a directive on Credit Agreements Relating to Residential Property (COM(2011) 142 final - 2011/0062 (COD)) which is currently being negotiated within the Council and the European Parliament.

		Some covered bond markets operate on a match-funding principle[2]. In these cases the proposal creates additional specific concerns for our members, specifically that the narrowing of the existing exemption will also be likely to adversely impact the borrowers. The principle is that mortgage banks fund loans by selling underlying bonds with matching characteristics, and that the mortgage banks – on behalf of the individual borrower - buys and sells mortgage bonds in connection with borrowing, refinancing, and redemption of mortgage loans. This means that mortgage bonds will always be traded with the borrower in connection with borrowing, refinancing, and redemption. Requiring a suitability assessment in these situations would be cumbersome, especially in refinancing situations where there is not necessarily any contact between the borrower and the mortgage bank. Also, it is difficult to imagine that a suitability assessment should lead to the conclusion that a borrower should not be able to refinance or prepay an existing loan, leaving the suitability assessment redundant in these situations.
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	Please refer to the answer to question 15.
	17) What if any changes are needed to the scope of the best execution requirements	No comments.

[2] The match funding principle secures a complete match of the payments between the borrower and the bondholder at all times. Under the match funding principle covered bonds are issued and sold simultaneously with the fixing of the final term of granted loans. The interest and redemption payments are passed on 1:1 from borrower to bondholder, this is stated in the bond terms. Issued covered bonds mature either when the underlying loan mature or when the loan is refinanced. Thus the market risk is minimal for credit institutes which adhere the match funding principle.

	in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	No comments.
	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?	No comments.
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 comments.
	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?	Our understanding is that the proposed new category of Systematic Internalisers will include the vast majority of covered bond trading, most of which are traded by market making banks bilaterally, frequently on the basis of phone trades. As such they will fall within the scope of the pre-trade price transparency rules of Systematic Internalisers. The most straightforward objection to the rules is that there is no practical way in a largely 'phone based market to let the entire market know of a price provided to one customer. A price provided verbally could, in theory be posted to a system, but

		if investors do not normally use this system that would be of little or no practical benefit. Trading via phone, Systematic Internalisers have loose and irregular business relationships with several hundreds or thousands of customers, raising obstacles, how to define the customers, who must be kept informed about quotes on the basis of the SI's commercial policy as section 2 stipulates, and practical concerns regarding how in practice this can be implemented for customers who do not normally use any trading platform. More importantly making a price widely available will reduce the willingness or ability of market makers to provide competitive prices for larger ticket sizes for two reasons. Firstly, if the market generally knows about the trade, and if the position is too large to unwind in a short time period, the trader will be commercially compromised. Without prejudice to the principle of greater transparency, the ability to protect commercially sensitive information is the quid pro quo for the obligation put on market makers to take positions that would not normally be able to be liquidated. Secondly, it will reduce the ability of market makers to quote prices that differentiate by the size of the ticket. This is a necessary ability if a market maker is to be asked to take on exceptional ticket sizes (exceptional with reference to the normal trading volume in that bond). Article 17(3) has caused some confusion amongst members of the Market Issues Working Group. One interpretation of its intention is that other customers should not be able to trade at a price (but will be notified of it) for a ticket above a given size. Another member interpreted this as allowing customers to trade up to the volume - if for example the customer requesting the price transacts only a portion

		of the requested volume, other customers could trade the rest. A further concern is that the specific size limit refers to the instrument. Clearly a ticket size material for one covered bond will differ from that material for another. Even if this were to be introduced on a bond-by-bond basis, it would be difficult to calibrate and implement the appropriate ticket size. The size threshold must be set in such a way that adverse effects on pricing for investors are avoided and the firmness of quotes up to this threshold does not become an unacceptable business risk for the SI. Covered bond investors have developed an expectation that they will be able to trade in volumes that would not normally be justifiable by the characteristics of the specific bond. Anything which impairs the ability of market makers to deliver that quality of execution will be to the overall detriment of the market. In addition, only quotes up to the threshold referred to in paragraph 3 have to be made public under Art. 17(5) of the MiFIR draft. However, clients of an SI are informed about quotes of any size, leading to asymmetric information between investors.
	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 comments.
	23) Are the envisaged waivers from pre-trade	We understand that the proposed waivers in paragraph 3.4.4 only apply to MTFs

	transparency requirements for trading venues appropriate and why?	and OTFs and we would argue that they should also apply to Systematic Internalisers.
	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 comments.
	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?	Similarly, the publication of information post-trade which compromises the commercial position of the trader providing the price to the customer, risks reducing overall levels of liquidity, particularly for transactions of 'market moving' size (which are common in the covered bond market, far more so than in, for example the equity market). We recognise the benefits of full transparency for non-market moving positions and would therefore look to work with the competent authorities to identify an appropriate trade off between transaction size and disclosure. Developing an appropriate trade-off will be fraught, the definition of the appropriate cut-off point to qualify for delayed reporting will differ by product (and potentially by time). Also, needless to say, there will be different opinions about the appropriate cut-off points. The ECBC has in the past undertaken an extensive consultation on the topic of post-trade price transparency in the past, we would be happy to share the feedback that we received via this process at the appropriate time.

		Whatever reporting regime is implemented it is important that it is consistent between different national regulators given the cross-border nature of the market noted above. It is also worth mentioning the post-trade regimes already in place at some regulated markets and MTF's. These post trade regimes meets both national regulation as well as contractual obligations between markets participants and regulated markets and MTF's. Introducing detailed post-trade regulation will tamper these well-functioning systems. We recognise the benefit of delayed price reporting in principle but we would also highlight a number of practical concerns. In particular, the reporting of cash prices on a delayed basis is meaningless for a market that trades on an spread over swaps basis and where many investors, particularly smaller investors, would not have the capacity to translate a cash price plus time of trade into a spread. We would be happy to work with you on possible solutions to this.
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 comments.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	No comments.
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	No comments.

	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	No comments.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	No comments.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	No comments.

Detailed comments on specific articles of the draft Directive	
Article number	**Comments**
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Article ... :	
Article ... :	
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