

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**.

Name of the person/ organisation responding to the questionnaire	Remco Lenterman Chairman FIA European Principal Traders Association (EPTA) remco.lenterman@imc.nl
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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?	
	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?	
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?	
Corporate governance	5) What changes, if any, are needed to the new requirements on corporate governance for investment firms and trading venues in Directive Articles 9 and 48 and for data service providers in Directive Article 65 to ensure that they are proportionate and effective, and why?	
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?	
	7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to the channelling of	

	trades which are currently OTC onto organised venues and, if so, which type of venue?	
	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?	<p><u>Introduction</u></p> <p>To begin analysing how risks are addressed through the articles in the Directive covered in question 8 necessitates a clear definition of the risks perceived and substantiated. Whilst FIA EPTA supports all efforts to minimise the systemic and other risks associated with the operation of automated trading systems, it must be stressed that the risks are not well defined and there is a lack of consensus over the specific risks Articles 17, 19, 20 and 51 are designed to address.</p> <p>Nevertheless, in responding to this question, FIA EPTA acknowledges and strongly supports initiatives designed to protect the stability and integrity of the markets, especially the deployment of robust risk management controls by all market participants. It is FIA EPTA's opinion that focus should be placed on the development of controls and internal procedures by firms, access providers and trading platforms, to mitigate the risks associated with trading in today's markets. All market participants have the potential to create risks and regulation should require that these risks be managed through risk management controls and supervisory procedures.</p> <p>Finally, FIA EPTA notes that caution is also required over the use of words such as "ensure" and "prevent" throughout the Articles concerned. These words are vague and set unreasonable and unattainable standards for compliance regarding the complete mitigation of risks; risks may be</p>

		<p>rendered benign but are frequently not possible to eliminate in their entirety. Instead, we believe that investment firms should be obligated to have in place effective systems and controls that are reasonably designed to establish compliance with the specified requirements.</p> <p>Section 17(1)</p> <p>FIA EPTA supports efforts to require <i>all</i> investment firms – whether engaged in algorithmic trading or not – to establish effective systems and risk controls. Both human traders and computers have been shown to be prone to make trading errors and investment firms should establish policies and procedures that mitigate the risk of such errors. An approach that is not dependent on the definition of “algorithmic trading strategy,” which is subject to differing interpretations and pressure to limit its scope, would be more comprehensive and avoid the potential for regulatory gaps.</p> <p>Trading limits and thresholds should be appropriate to the asset class or asset classes traded. For example, pre-trade controls for each asset should be selected to target the risk parameters most pertinent to that asset.</p> <p>FIA EPTA supports efforts to minimise the market impact of challenges to a firm’s business continuity through the adequate deployment of business continuity arrangements. However we must stress that contingency plans should be proportionate to the firm’s business based on an assessment of the firm’s responsibilities to clients and counterparties.</p>
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		<p>Section 17(2)</p> <p>Competent Authorities should have a full understanding of a firm's activities and types of trading strategies employed. Accordingly, FIA EPTA supports the requirement for an investment firm to have in place policies and procedures that can be shared and explained and that access to these policies and procedures is provided to the firm's Competent Authority. However, descriptions of algorithmic trading strategies will only assist Competent Authorities in capturing risks if it is clear what risks the Directive aims to address such that the information delivered is both targeted and appropriate. In this regard, we believe the objectives and the benefits of requiring firms to provide "details of the trading parameters or limits to which the system is subject" are unclear.</p> <p>The focus of regulators should be on the key risks associated with the deployment of an electronic system and on a firm's systems and controls, including:</p> <ul style="list-style-type: none"> ▪ Compliance & risk control frameworks ▪ Appropriate pre-trade limit checking ▪ Software conformance testing ▪ Systems capacity planning at the firm and trading venue levels
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		<ul style="list-style-type: none"> ▪ Proportionate business continuity planning <p>Section 17(3)</p> <p>The risks that Article 17(3) is designed to address are not clear. It is, therefore, not possible to opine, as the question asks, whether the article “addresses the risks involved”. On the other hand, this provision, if adopted, would introduce new risks. In particular, continuous quotation regardless of prevailing market conditions presents significant risks to an investment firm. FIA EPTA believes that firms must be allowed to pause and assess current market conditions, especially if market information is unavailable or unreliable or trading would require firms to take on positions outside of their risk tolerances. This was recognized by ESMA in the Final Report on systems and controls in an automated trading environment.¹ In Guideline 2(d) subparagraph 1 ESMA states that “working effectively in stressed market conditions may imply (but not necessarily) that the system or algorithm switches off under those conditions”. In addition in Guideline 2(e) subparagraph 1, ESMA states that investments firms “should deal adequately with problems identified as soon as reasonably possible in order of priority and be able when necessary to adjust, wind down, or immediately shut down their electronic trading system or trading algorithm.”</p> <p>A prohibition on a firm to cease trading under such circumstances would not only expose the firm to risks that it</p>
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¹ ESMA: Final Report - Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, 22 December 2011 [[Link](#)]

		<p>should avoid, but also potentially introduces a systemic risk. Accordingly, Article 17(3) is inconsistent with the requirement in Article 17(1) for firms to establish effective systems and risk controls. When an obligation is imposed on a firm to provide quotations to the market, the firm takes intrinsic risk which it must be able to adequately price. It is therefore key that the right incentives are in place to ensure that liquidity continues to be provided to the market. The appropriate balance between obligations and incentives will vary among products & platforms. It is FIA EPTA's view that such obligations and incentives would be best established and overseen by the trading platforms.</p> <p>In addition, because the requirement in Article 17(3) would make it difficult for firms to provide liquidity on public, transparent markets, market participants would need to find liquidity and trade in the over-the-counter market. Discouraging trading in the public markets is contrary to the goals in EMIR; i.e. to minimize risks by, among other things, requiring all standardized derivatives to be cleared through a central counterparty. By discouraging the provision of liquidity on public, transparent markets, Article 17(3) would make it more difficult for CCPs to value and manage the risks associated with cleared instruments.</p> <p>To the extent that Article 17(3) is designed to safeguard market integrity, FIA EPTA believes the following measures are a more appropriate point of focus:</p>
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		<ul style="list-style-type: none"> ▪ Transparent error trade policies ▪ Ensuring that reliable market data is available ▪ Circuit breakers <p>Section 17(4)</p> <p>FIA EPTA believes that appropriate supervision of <i>all</i> market access is an important tool in limiting risk to the financial markets. For this reason, FIA EPTA suggests the wording be adjusted to provide that Article 17(4) requirements apply to all firms providing access to a trading venue. Such an approach would avoid ambiguity over the definition of “direct” electronic access and the potential for such an ambiguity to create regulatory gaps.</p> <p>Article 51: Systems resilience, circuit breakers & electronic trading</p> <p>Section 51(4)</p> <p>FIA EPTA supports the proposals presented in Article 51(4), that regulated markets only allow MiFID authorized investment firms to provide direct electronic access.</p> <p>Section 51(5)</p> <p>FIA EPTA believes that co-location is a positive development. Co-location facilities equalise access for participants who choose to be near the centre of price discovery. We support the</p>
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		proposed requirement that regulated markets' co-location services and fee structures are transparent, fair and non-discriminatory.
	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?	<p>Introduction</p> <p>Several provisions in article 51 of MiFID draw appropriate conclusions from the 06 May 2010 US Flash Crash. The specific points that minimize the risks of a similar event in the European markets are the proposed circuit breakers/trading halts, which allow traders to pause, regroup and resume orderly trading, and the proposed pre-trade risk controls, which make sure orders are rejected when clearly erroneous or exceed pre-determined thresholds. Other proposed provisions, however, could harm market quality and raise costs for investors, such as regulatory limits on the ratio of orders to transactions and minimum tick sizes.</p> <p>Article 51: Systems resilience, circuit breakers & electronic trading</p> <p>Article 51(1)</p> <p>FIA EPTA believes that trading venues should be resilient and have robust business continuity plans in place. This includes having sufficient capacity to handle sudden increases in message volumes. Trading venues typically slow down when they receive significantly increased message data over a short time period. When exchanges slow down their market data becomes less reliable.</p>

		<p>High volumes of messages and/or transactions are manageable so long as they are not concentrated in a short time period. FIA EPTA members believe that trading venues need to have ample headroom to deal with peak message volumes. Prudent risk management dictates that trading venues measure, monitor and manage capacity for various scenarios in order to ensure that message volumes per member are controlled appropriately. This would prevent disorderly trading.</p> <p>Finally, Article 51(1) focuses on capacity issues for trading platforms and matching systems. However, post-trade settlement systems should also be incorporated into this analysis in order to fully address the risks associated with inadequate capacity planning.</p> <p>Article 51(2)</p> <p>FIA EPTA supports a requirement for trading platforms to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous. It should be noted that pre-determined thresholds should be asset specific. In addition, we agree that markets should establish volatility controls to pause trading when there is a significant price move. Finally, rules to break or modify trades should be clear and objective so that there is certainty for market participants. This certainty is especially important during periods of market stress, as any uncertainty about whether a trade might be cancelled could lead some market participants</p>
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		<p>to withdraw from the market.</p> <p>Article 51(3)</p> <p>FIA EPTA supports trading venues putting in place reasonable order-trade ratios to ensure that market participants do not send more messages than exchange systems can process. These order-trade ratios should be tailored to the liquidity of particular financial instruments and not discourage participants from posting and modifying quotations. The ability to execute, update, and cancel orders contributes to market quality by allowing market participants to manage positions and risk. In particular, to avoid the systemic risks associated with a continuous quoting obligation whilst restricting a firm's ability to update prices, it is necessary to fundamentally link the continuous quoting obligations addressed in Article 17 (3) with proposals to control order / transaction ratios addressed in Article 51(3).</p> <p>An appropriate message ratio will also differ by trading venue. A uniform ratio across markets, would detract from market quality, and be anti-competitive to new trading venues or products that often see many orders go unexecuted.</p> <p>Whilst it is prudent that trading venues are permitted to employ throttles to slow down the flow of orders to a market if there is a threat to market integrity FIA EPTA stresses that the risks are not addressed by the use of throttles. Throttles disguise underlying problems derived from inadequate capacity planning. In addition, throttles introduce risk by</p>
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		<p>creating unpredictable behaviour at the matching engine, the true value of an instrument becomes hidden within a queue management system, disrupting price discovery and valuations for the purpose of risk management. Furthermore, this creates risk for those firms pricing derived assets. Instead, trading venue capacity planning should be more rigorous as suggested in our comments to Article 51.1.</p> <p>Regarding minimum tick sizes that may be executed, FIA EPTA believes that it is important to get tick increments right. A financial instrument's price, liquidity, and volume are all factors that are relevant.. Therefore, a one-size tick does not fit all instruments. FIA EPTA members believe that European trading venues are managing this issue responsibly.</p> <p>Article 51(4)</p> <p>FIA EPTA supports the proposals presented in Article 51(4) that regulated markets only allow MiFID authorized investment firms to provide direct electronic access.</p> <p>Article 51.7(c)</p> <p>FIA EPTA believes that any limitation on order-trade ratios should be left to the trading platforms. Article 51.1 requires exchanges to have systems, procedures and arrangements to ensure their trading systems are resilient and have sufficient capacity to deal with peak order and message volumes. Exchanges that do this well, can allow their participants higher order-trade ratios. Regulators should not impose limits</p>
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		<p>on order-trade ratios that minimize the need, or reduce the incentive, for exchanges to build systems with adequate capacity or resilience.</p> <p>Moreover, because limits on the ratio of orders to transactions can harm market quality by reducing the ability of participants to control their risks, particularly in less liquid instruments, it is important that regulators not artificially limit order-trade ratios. Order-trade ratios that limit the ability of participants to adjust orders based on current information and thereby provide tight and deep quotation will result in wider quotations and raise costs for investors. Therefore FIA EPTA would propose that Article 51.7(c) should be reworded in order to remove the suggestion of a <i>minimum</i> ratio of unexecuted orders to transactions.</p> <p>FIA EPTA would also advise against regulators prescribing minimum tick sizes as it will have a negative effect on the quality of the market. Tick sizes which are too large because they conform to a rigid minimum will prevent transactions between willing buyers and sellers inside the tick. Furthermore, a big tick size will often prevent participants from showing their best prices, which will limit competition as the participants cannot compete on price anymore.</p>
	<p>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?</p>	

	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?	
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article 35 of the Directive?	
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	
	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?	
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	
	16) How appropriate is the proposal in Directive Article 25 on	

	which products are complex and which are non-complex products, and why?	
	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?	
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	
	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?	
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?	
	24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs), Authorised Publication Authorities (APAs)?	
	25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?	
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	

	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	
Detailed comments on specific articles of the draft Directive		
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