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	Fidelity Worldwide Investment

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?	We support the exemption given for insurance undertakings, given in the recognition that such undertakings are subject to Solvency 2. We do not support the exemption in Article 3.1 through which a Member State may choose not to apply the rules to firms providing advice in relation to the execution of orders relating to securities and UCITS. We believe that such an exemption could lead to a lack of harmonisation across Europe.

	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	No comment.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	No comment.
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?	While we agree that it is appropriate to regulate third country access to EU markets, we have concerns that the proposal's drafting is not sufficiently clear in two key areas: ▪ The proposal does not address how professional clients will be treated – but instead mentions only retail clients and eligible counterparties; and ▪ The proposal does not adequately deal with an EU investment firm's delegation of services to a third country firm. In terms of this latter point, while Article 36.4 offers an exemption for any 'reverse enquiry' a 3rd country firm may receive from an EU investor, we are concerned that the use of distribution terminology here may give the incorrect impression that the exemption only applies on a limited or even one-off basis. This would rule out of scope of the exemption any ongoing delegation a 3rd country firm receives from an EU firm which would, in turn, compromise the powers of delegation enshrined in both UCITS and AIFMD legislation. Here EU portfolio managers are free to delegate certain services to 3rd

		country firms, subject to condition but certainly on an ongoing rather than *ad hoc* solicited basis. Otherwise, in terms of any requirements for 3rd country access to EU markets, we would suggest the following underpinning principles: ▪ Market participants should have ex ante clarity as to the regulation to which they are subject. ▪ The assessment of whether the regulatory regime of a third country is equivalent should not be based on the extent of reciprocal market access. ▪ No two regulatory regimes are identical in all respects. Therefore equivalence should be defined in terms of intent rather than in terms of specific rules. ▪ There should be an appropriate degree of consistency in respect of third country issues across different pieces of European financial services legislation
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?	We agree with the new high level principles proposed in relation to good corporate governance but find the proposed solutions in Articles 9.1 and 9.4, and 48.1 and 48.4 to be too detailed and prescriptive. For Article 9.1, one particular problem arises for individuals with directorships on the Board of corporate-type funds (i.e

		those with a legal personality). Corporate-type funds will not qualify as entities held within the same group as the wider investment firm (even though they are managed by the same investment manager) as they are legally distinct entities. As such directors of the investment firm will not be able count their directorships of corporate-type funds alongside their directorship of the investment firm as a 'single directorship' – nor will they be able to multiple corporate-type fund directorships as a 'single directorship' – for the purposes of MiFID. This will give an unrepresentative view of the number of directorships held by an individual, while at the same time counting each towards the quota allowed by MiFID. We fully support the requirement for proportionality with respect to nomination committees in Article 9.2, and believe this committee is best placed to determine the commitment required from individual directors for a given investment firm. However, we would question the thrust of any regulation that seeks to transform Non-Executive Directors into something approaching quasi-regulators. We also question the requirements in Articles 9.4 and 48.4 that direct ESMA to develop regulatory standards to specify the notions of knowledge, integrity or diversity, etc.. We think these are particularly prescriptive and question whether ESMA should be tasked with codifying abstract concepts into law. Further requirements on these notions would also result in a

		tick box compliance exercise rather than genuine corporate governance.
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?	We believe that the requirements associated with OTFs could be helpfully amended to ensure that they are suited to OTC derivative and other non-equity markets. In particular, given the introduction of a trading obligation in respect of clearing eligible and sufficiently liquid derivatives, it will be vital that there is a suitable range of venues on which to execute OTC derivatives transactions, including voice-brokered facilities. OTFs should not have to conform to a central limit order book model – other trading models, including Request-for-Quote systems, should also be accommodated. As for the structure of the OTF regime, we believe that the proposed ban on an OTF operator executing client orders against their own proprietary capital overlooks the vital role that investment firms' risk capital plays in facilitating client business and thus enhancing liquidity – i.e. brokers' 'market making' services. For example, at one particular time, there may be a temporary disconnect between what clients wish to sell and what they will to buy. At times like this, the firm who operates the OTF may wish to deploy its capital to facilitate the business of the clients of the OTF. Market making is particularly important for non-equity instrument and OTC derivative markets, given the infrequency

		of trading, relatively small number of market participants, and need for customised solutions to meet specific corporate needs. If a broker firm's ability to make use of its own capital in such circumstances is removed, then its clients' ability to trade large sizes quickly, at a low cost, when they want, will be diminished. This is, in turn, a key concern for asset managers trading on behalf of open-ended mutual funds. The liquidity needs of such funds are *sui generis* open-ended in that they are driven in lock-step by investor redemptions and subscriptions as and when they arise. In the absence of a broker to make a market when an asset manager needs to trade on behalf of a fund, the efficiency – and even the viability – of such funds may be brought into question. Finally, we also believe that the definition of systematic internalisation (SI) for fixed income and derivatives should be aligned with that of equities – ensuring that the SI classification applies by class or sub-class of financial instrument, not at the level of legal entity. This would enable firm to be an SI for one or more instruments but that should not mean that it must act as an SI for all instruments that are not traded on a frequent and regular basis.
	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?	We would suggest that OTC trading should continue to be defined as trading outside regulated markets, as currently defined in MiFID. Therefore off-exchange trading should still be considered OTC.

		As for trading that occurs off organised venues altogether, we would welcome greater clarity in respect of the boundary between SIs and 'pure OTC' business, the latter being limited to transactions that occur on an "occasional, ad hoc and irregular basis". The interpretive hazard here lies in the potential gap between the "organised, frequent and systematic" trading that characterises the SI regime and the "occasional, ad hoc and irregular" trading that will be viewed as pure OTC. We would also urge that the Commission delays work in this area of MiFID until the effects of the European Markets Infrastructure Regulation (EMIR) have made themselves felt. We suspect, in particular, that the compulsory central clearing of OTC derivatives under EMIR will give rise to natural pools of OTC derivative instruments settling at the same CCPs (around shared or similar risk characteristics, for example) and that these natural pools will in turn lend themselves to the transition onto organised venues once they have attained a workable volume / depth. It would be duplicative – possibly even counterproductive – to have MiFID anticipate at a policy level effects that EMIR may have on the pool of OTC derivative assets as a matter of market force.
	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?	At a fundamental level we would urge that the proposal is much clearer in terms of its policy intention with regard to 'algorithmic trading' and 'high frequency trading'.

		There is a crucial difference between high frequency trading (a trading strategy and an end in itself) and algorithmic trading (a trading technique and a means to any number of ends) that is simply not reflected in the proposal. The proposal needs to distinguish properly between the 'ends' it wishes to control (high-frequency trading strategies with their implications for market stability) from the 'means' HFT traders might employ to attain these ends (algorithmic trading techniques) but that other market participants may also employ to attain entirely different and benign – even self-defensive – ends. For example, while proprietary HFTs might well employ algorithmic trading techniques to take intra-day profits out of the market, so too agency traders such as investment managers may use them to deliver best execution for their clients or to manage the market impact of agency trading in a time-efficient way. Investment managers may even be forced to employ algorithmic trading techniques to circumnavigate the negative effect of proprietary HFT on behalf of their clients. Whilst we acknowledge the difficulty of legislating to regulate strategies or objectives – especially compared with the relative ease of legislating to regulate techniques or tools (it is easier to regulate cars than it is to regulate the speed at which people drive cars) – we think the proposal needs to take this fundamental step nevertheless. Drafting should begin by seeking a workable definition of

		proprietary as distinct from agency algorithmic trading – for example, by using intra-day profit motives (flat at the start and end of day) and/or high cancellation rates as defining characteristics of proprietary algorithmic trading. It should then seek to control proprietary algorithmic strategies while leaving non-proprietary – and certainly agency – algorithmic strategies unencumbered. We would also ask that the proposal remains clearly focused on its policy objective relating to HFT (systemic risk) and not stray into the policy realm of the Market Abuse Directive (HFT and market manipulation).
	9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?	No comment
	10) How appropriate are the requirements for investment firms to keep records of all trades on own account as well as for execution of client orders, and why?	No comment – asset managers are agency not proprietary traders and as such do not 'trade on their own account'.
	11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?	We would refer to our answer to questions 6 and 7. We believe that the proposed ban on an OTF operator executing client orders against his own capital will have the impact of restricting the range of available venues for trading in OTC derivatives subject to the trading obligation. We would also urge that the legislative process delays work in

		this area of MiFID until the effects of the European Markets Infrastructure Regulation (EMIR) have made themselves felt. We would also encourage European policymakers to maintain a close dialogue with other jurisdictions on this issue, given the wider G20 efforts to move standardised OTC derivatives contracts to exchanges and electronic venues, where appropriate. While there are some parallels between the OTF concept and the US Swap Execution Facility, the European architecture for derivatives trading – also including SIs, regulated markets and MTFs – will be quite complex, making it more challenging to ensure that there is a level playing field across jurisdictions
	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?	As active investors in SME securities we welcome the proposed creation of MTF SME growth markets. Our only concern is that other elements of MiFID will detract from the benefits accruing to SME investment via such dedicated trading venues. In particular, we are concerned about the effect that removing large in size (LIS) waivers from post-trade transparency obligations might have on the tradability of SME securities – regardless of whether those SME securities are traded on dedicated SME trading venues or not. By their very nature, SMEs will have a smaller number of securities in circulation at any one time – compared with mid- or large-cap entities. This means that institutional investment in SMEs will almost always be 'large in size' (i.e. above the

		average daily volume (ADV) of the security). It has thus traditionally fallen to market makers to provide liquidity to SME transaction the absence of sufficiently deep pools of assets. In other words, market making brokers have traditionally used their own proprietary capital to temporarily bridge the gap between supply and demand. In turn, in order to risk their own capital (or at least to do so at a reasonable cost), market makers have also traditionally relied on LIS waivers. Such waivers allow brokers to temporarily withhold their positions from the view of the market, giving them the respite needed to trade out of the positions they have taken on behalf of their clients but at risk to themselves. In other words, LIS waivers reduce the cost of the risk that market makers assume on behalf of their clients – and in some cases make market making possible in the first instance. While the emergence of SME MTFs may see a decline in made markets for SME securities, SME transactions will still be large in size wherever they are traded. They will therefore still require LIS waivers if they are to be executed at a reasonable cost – indeed at all.
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit appropriately with EMIR?	We welcome efforts to ensure that there is robust competition between trading venues and between providers of post-trade market infrastructure. We therefore support the requirement that CCPs provide non-discriminatory clearing access for financial instruments regardless of execution venue and

		specifically, the fact that this covers access to the associated margin pool within the CCP.
	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 comment
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	We strongly welcome the embodiment of the concept of independent advice in this legislation. We also welcome the requirement for advisers to state at the outset details of the nature of the services they provide. We are less clear about the way in which the proposals are designed to handle the flow of inducements within portfolio management. We conceive of two potential impacts. There are certainly occasions when portfolio managers using funds for investments on behalf of clients (e.g. private or wealth managers) may be exposed to commission bias via commission payments form product providers. In that context we support a proposal that would drive commission bias out of the act of discretionary fund-of-fund management as it will out of investment advice. However a different issue arises when portfolio managers 'share' commission with brokers that they then disburse (for

		want of a better word) on independent investment research on behalf of their clients – their funds. Although in this scenario there is technically a flow of benefit from a third party (the broker) to the portfolio manager, in reality the portfolio manager acts solely as the conduit for this payment to flow on to a second third party (the independent research provider) where it purchases independent research for the benefit of the underling client – the fund. Under a robust commission sharing arrangement (CSA), then, the portfolio manager receives no benefit from a third party and there is thus no inherent conflict of interest between portfolio manager and client. Rather the opposite: the portfolio manager's intermediation in winning rebates from brokers in the first instance and in using such rebates to bulk purchase independent research in the second brings an economy of scale and efficiency to a process that the end client could never marshal if left to his own devices – i.e. negotiated on a fund by fund basis. Under the proposal's current definition, this type of non-conflicted and formalised CSA would be prohibited on the grounds that it constitutes an 'inducement' taken by the portfolio manager. We would ask that the drafting is altered so that it excludes CSA from the definition of an 'inducement' or, failing this, that CSA is automatically understood to 'enhance the quality of the relevant service to the client in a way that does not impair the portfolio manager's ability to pursue the

		best interest of their clients' (paraphrasing) as *per* the exemption currently in force in Art 26 (b)(ii) of MiFID.
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	We disagree with the proposal's limitation of 'complexity' with regard to UCITS to so-called "structured UCITS" alone. Instead, we attach a discussion paper which we have sent to the Commission and ESMA which builds on work done by ESMA which we believe offers a better way to define complex UCITS. It is also worth noting that any work carried forward here would also have to be matched in amendments to the UCITS Directive.
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	No comment
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	We believe that portfolio managers should be classified as professional investors *ab initio* with an option to opt up to the status of an eligible counterparty (ECP) status if they wish. Portfolio managers typically seek professional client designation with their brokers in order to receive best execution from their brokers because they in turn owe this same best execution to their clients. Indeed, without the portfolio manager's professional client designation, the retail client would not be in a position to receive best execution from the broker as the 'chain' linking the two would be broken by the portfolio manager's relinquishing of best execution as an ECP.

		Although MiFID permits a portfolio manager to make such a request, a broker can legitimately refuse it. This seems inappropriate – not least because it places the retail client's best execution at the mercy of the brokers' commercial interests.
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of investors and market integrity without unduly damaging financial markets?	We recommend an equal focus on product governance for all retail products under the PRIPs initiative. This is particularly important given the pre-existing bias towards product regulation for funds (via UCITS and AIFMD) in the absence of equivalent product regimes for bank and insurance PRIPS. Indeed, funds are in danger of becoming victims of their own success: because of their success as investment vehicles funds have become regulated over time; while because funds are regulated– where banking or insurance PRIPS are less so – they seem to attract regulatory policy change before – even instead – of comparative and comparatively less regulated PRIPS – e.g. UCITS IV, V and VI, MiFID. We would urge the Commission to guard against this in levelling the playing-field for all PRIPS at the level of both product and distribution regulation – via PRIPS and MiFID as well as at the level of product intervention.
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?	Although lack of data aggregation and data standardization provisions in MiFID arguably worsened the quality of information available to investors, intermediaries and issuers , we are of the opinion that the same cannot be said for the

		impact of trading venue innovation and transparency provisions. Existing market structures are overall well-functioning, and improvements are already being promoted by the G20 and Dodd-Frank initiatives. We would therefore urge that the Commission waits to assess the impact of structural changes to financial markets before introducing any new regulation, and also weigh the possible costs to the final investor. We agree that trade transparency is key for price formation but would observe that the needs of retail and institutional investors are different. There are also major differences between equity and non-equity markets. Asset managers also have a duty of best execution towards their clients (pension funds, insurance companies, retail funds) for which market impact minimization plays a key part. As mentioned above (question 12) the market's knowledge of large in size (LIS) transactions will tend to move the price of market making very quickly, therefore mechanisms such as waivers/delayed publication, or the possible exemption from pre-trade transparency rules are necessary to ensure the smooth operation of non-equity and OTC derivative markets in particular – and for managers of open-ended funds in particular – via effective market making. We therefore oppose the extension of pre-trade transparency beyond equities. If transparency is deemed necessary for retail clients for some instruments, however, we would urge that specific rules should be introduced, tailored to that segment and appropriately

		calibrated.
	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?	See our response to question 20
	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?	See our response to question 20
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	We are not convinced of the merits of using the cash equity market as a model on which to base that of other financial instruments due to their considerable diversity.
	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 welcome the introduction on a consolidated tape, we do not support the approach suggested in the text and will continue to state our preference for a single CT rather than various competing commercial tapes as suggested in the proposal.

		We would suggest that the ARMs and APAs collect their data in a way that could be delivered directly to the CT operator.
	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 welcome the post-trade transparency proposals for fixed income and OTC derivative. Asset managers need good quality post-trade information both to value their portfolios and funds, and as valuable input for their trading activities (including proving best execution for clients). We also welcome the fact that calibration in publication delays in post-trade transparency are due to be detailed at Level 2. As outlined above, these delays are essential (in the hands of our brokers) if asset managers are to effectively operate open-ended funds or to invest in SME securities or any other securities over an ADV. Post-trade data must be designed to be consolidated from the outset, to avoid the mistakes made in equity data consolidation in MiFID I.
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?	We believe there will be a need for considerable co-operation between the three ESAs in the field of PRIPS, of which MiFID is a key part, especially.
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements	We would push for a truly level playing field.

	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?	Consistency should be ensured with UCITS, PRIPS, and AIFMD. A harmonized approach of corporate governance should be adopted across various initiatives, in particular the Green Paper on Corporate Governance for financial Institutions, and the specificities of the investment management business should be taken into account in this context. We would also welcome the removal of the plethora of conflicts of interest elements in disparate regulations in favour of reference to MiFID as the central arbiter on conflicts of interest controls.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	Internationally, MiFID needs to fit with regulations consistent with those led by G20, IOSCO and the Financial Stability Board. There are many unanswered questions in the text on third country equivalence and work is required to ensure that both the qualifying criteria and period of application of this arrangement do not exclude certain jurisdictions from trading in the EU or discourage them from moving towards an equivalent standard. In terms of regulatory change in other major jurisdictions, the Dodd-Frank Act is seeking to make a number of parallel changes within the US capital markets and should be borne in mind (and *vice versa* should bear MiFID in mind). In particular, the "Volcker Rule" is seeking to prohibit US (and qualifying non-

		US) brokers from trading against their proprietary capital while simultaneously seeking to retain market making as a service that brokers can offer clients via but not against their own proprietary capital. As with MiFID (see our responses to questions 6 and 7 above) the separation of market making (as a permitted service) from proprietary trading (as a prohibited activity) is proving difficult to effect.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	We support national competent authorities being able to apply sanctions to ensure a consistent application of MiFID, but also believe that too much prescription will not allow for wide enough differences of application across European financial markets.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	We are not convinced that the balance is yet correct. We would like sight of more public policy principles at Level 1 to gain a better understanding of the rules, and greater signposting of the required outcomes for the Level 2 provisions.