

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	<p>International Regulatory Strategy Group</p> <p>The International Regulatory Strategy Group (IRSG) of the City of London is a cross-sectoral practitioner-led body comprising leading UK-based figures from the financial and professional services industry. It aims to contribute to the shaping of the international regulatory regime, at global, regional and national levels, so that it promotes open, competitive and fair capital markets globally, supporting sustainable economic growth. It is an advisory body both to the City of London Corporation, and to TheCityUK.</p> <p>The IRSG appreciates the opportunity to respond to this questionnaire on the MiFID review. We have limited ourselves to commenting on those issues that are priorities for the IRSG and that have already been agreed by the group.</p>
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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?	No comment from IRSG

	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	No comment from IRSG
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	No comment from IRSG
	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?	<ul style="list-style-type: none"> • It is important to differentiate between third country access to retail investors, who need adequate and equivalent investor protection, and wholesale investors, many of whom routinely need access to services provided from outside the EU and who do not need the same assurances. It is vital to many EU corporates and asset managers in particular that they continue to have access to third country firms in areas such as debt issuance, fund management, trade execution, investment research, and safe keeping of assets. • We therefore agree with the proposed harmonised regime for third country branches seeking to operate EU wide and to provide services to the retail market. This should be based on an equivalence provision. However, we do not agree that an equivalence provision is required for wholesale market activity. A reciprocity requirement is also not needed in our view. • Instead, we believe an appropriate exemptive third country regime would bring significant benefits to EU investors, issuers and firms by continuing to facilitate their access to a wider range of providers of products and services. The regime should take effect as a form of minimum harmonisation incorporating a uniform exemption allowing third country firms that meet certain standards to deal with EU investors and counterparties – at least eligible counterparties and professional clients. • Under the exemptive third country regime, third country firms would be required to be authorised by their home country regulator. Further conditions should include that their home country should be on neither the Financial Action Task Force nor on any anti money laundering and terrorist financing blacklists and a memorandum of understanding should exist with local regulators.

		<ul style="list-style-type: none"> • Business with EU eligible counterparties, non EU business intermediated by MiFID authorised firms, and business regarded as taking place extraterritorially should be subject to this harmonised exemption. • Such a regime would be more consistent with EU GATS commitments and provide a further platform for further harmonisation if warranted. • IRSG is preparing a more detailed paper on these issues.
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 comment from IRSG
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?	<ul style="list-style-type: none"> • Market participants need flexibility and choice as to where to best execute their transactions, depending on, for example, the nature of the product and the size of the transaction. We are therefore concerned about the prescriptive nature of the proposals in relation to execution as they could directly impact market structure and harm the functioning of the non-equity markets. • Organised trading venues and OTC execution meet different kinds of needs. They should be considered as complementary trading models that often co-exist for the same product. The availability of different forms of execution, including request-for-quote (RFQ) or voice based mechanisms, is crucially important particularly in stressed market conditions (such as a bond issuer being close to default, a natural disaster (the Japanese Tsunami) or a systemic event (the fall of Lehman Brothers)) where certain other types of execution might simply no longer be available. • The original intention of creating the OTF category was to address perceived transparency issues in the equity markets in relation to Broker Crossing Networks. However, the use of OTFs as execution venues in the non-equity markets needs to be carefully considered and, in any case, needs to reflect the different characteristics of these products. • The prohibition on the OTF operator from using its own capital to supply liquidity

		<p>into its OTF seems unduly restrictive:</p> <ul style="list-style-type: none"> Investment firms are often committed to providing liquidity to clients with whom they have relationships. However, there is little incentive for them to provide liquidity using their own capital on any “neutral” trading platform. As a consequence, clients might have less opportunity to hedge risks that they cannot properly manage themselves, or only at a higher cost. Since the OTF operator has a best execution duty it is imperative that it has discretion over how to handle client orders to achieve best execution in practice. Arbitrarily denying access to a source of liquidity undermines this objective and is likely to result in sub-optimal outcomes for clients. Effective monitoring of best execution and transparent order handling rules are likely to be more effective and proportionate means of achieving the Commission’s objective in this regard.
	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 comment from IRSG
	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?	<ul style="list-style-type: none"> We broadly welcome the Guidelines recently issued by ESMA on algorithmic trading. Legislative changes to MiFID/R should take full account of the ESMA Guidelines and be compatible with them to the extent possible We support moves to ensure that all firms with direct access to order books are regulated appropriately. We do not, however, believe that it would be appropriate to seek to regulate all firms conducting HFT strategies where these firms are accessing the order book via an intermediate broker (i.e. “sponsored access”). Sponsored access providers should be authorised and supervised according to harmonised rules to ensure they apply adequate safeguards. We fully support the ability of regulators under MiFID to interrogate algorithmic trading strategies and infrastructure. But if the level of detail is too granular, pre-notification of all algorithms to regulators would be unduly burdensome and of limited value given that the potential risks deemed to be posed by a single algorithm are unlikely to be identifiable by analysing that algorithm in abstraction. Rather, it is the interaction of that algorithm in the market that is important.

		<ul style="list-style-type: none"> • We urge caution over any plans to introduce new rules that are specific to HFT strategies. It is unlikely that a single definition could be drafted that captures all HFT activities, while being precise enough to provide legal certainty. Any strategy that constitutes market abuse should be covered by the existing Market Abuse Directive or its subsequent revision – no special treatment should be given to HFT activities. • Introducing market making obligations on HFT firms would not be beneficial in our view and would lead to a number of firms ceasing to undertake HFT, leading to a (potentially very large) drop in liquidity. This is because firms will not wish to be obliged to provide liquidity in times of market volatility. • If policymakers wish to incentivise liquidity provision, we would suggest that it may be more effective to have regulated markets and MTFs operate a liquidity incentive scheme with rights and obligations similar to traditional market makers. In any case, the current wording should be more tightly defined. As it is currently written, for example, an execution algorithm designed to buy France Telecom according to a VWAP (volume weighted average price) benchmark over the day would be obliged to generate sell orders as well as buy orders, which cannot be the true intention.
	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 from IRSG
	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 from IRSG
	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	<ul style="list-style-type: none"> • Market participants need flexibility and choice where to best execute their transactions in derivatives, depending on, for example, the nature of the product and the size of the transaction. The availability of different forms of execution, including request-for-quote or voice based mechanisms, is crucially important

	<p>requirement practical to apply?</p>	<p>particularly in stressed market conditions where certain other types of execution might simply no longer be available.</p> <ul style="list-style-type: none"> As mentioned above, the OTF category was mainly created in order to address perceived shortcomings to the transparency in equity markets. The proposed use of OTFs to also satisfy the trading requirement for derivatives should therefore be treated with caution. One needs to ensure that various forms of execution remain available for derivatives products while not causing damage to liquidity or restricting end user choice.
	<p>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?</p>	<ul style="list-style-type: none"> We welcome the proposals in the draft MiFID for the creation within the MTF category of a new sub-category of SME Growth Market. This should raise their visibility and profile and develop a capital-raising environment for Europe's entrepreneurs and growth companies. We support the definition of an SME company for the purposes of the MiFID, which means a company with an average market capitalisation of less than €100,000,000 on the basis of year-end quotes for the past 3 calendar years. We would caution against lowering the thresholds for market capitalisation and for the percentage of "growth companies" below what is currently proposed in the Directive. If either or both of these thresholds were to be lowered, could trap SMEs between the resulting smaller cap market and main listing, with no suitable market to support their development and growth. We also welcome the proposal in the Directive to reclassify ordinary shares on SME markets as "non-complex". This will facilitate retail and professional investor involvement in these markets. It is important not to confuse complexity with risk.
	<p>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?</p>	<ul style="list-style-type: none"> We welcome these provisions. It is probable that clearing activity will become quite concentrated in very few clearing houses, so competing trading venues will all need fair access to them.

	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?	No comment from IRSG
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?	No comment from IRSG
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	<ul style="list-style-type: none"> • The product provider should be responsible for determining whether or not an instrument is complex or non complex. The outcome should be clearly displayed in the product description. For certain types of instruments, such as very infrequently traded shares, the responsibility would fall on the intermediary firm. • Articles 25 3 (ii) and (iii) refer to the effects of the incorporation of a structure in a financial instrument which makes it difficult for the client to understand the risk involved. The determination as to whether or not an instrument is complex or non complex by reference to whether or not it is difficult for the client to understand the risk involved means that an instrument may be complex or non complex depending on the knowledge and experience of the client. Such an approach will create variable results and be very costly to implement. A definition which determined complexity by instrument rather than by client could be more efficiently administered and would be consistent with the approach in the rest of Article 25. • It is also important in determining complexity and risk not to confuse the two: it may sometimes be hard to understand how a complex product is put together and

		how it works in the market, but such products may be inherently less risky than a non-complex product that a client may be permitted to purchase without an appropriateness test. The language in the Directive should be such as to ensure a clear distinction between the concepts of complexity and risk.
	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 from IRSG
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	No comment from IRSG
	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 comment from IRSG
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 comment from IRSG
	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?	<ul style="list-style-type: none"> • Institutional market participants typically have access to a wide range of pre-trade data for non-equity products at present. On the other hand, to provide competitive pricing to their customers, market makers need to retain discretion over which orders they are prepared to take on, reflecting their market risk appetite, their capital constraints and, not least, their ability to access the instruments in question. • Any requirement to quote is likely to cause market makers to withdraw liquidity, it would increase the overall costs of trading non-equity products which could, in turn, force smaller participants out of the market and will increase hedging costs

		<p>for end users. The CESR Technical Advice of 29 July 2010 to the Commission said that any future pre-trade transparency regime must allow Member States to introduce local requirements if deemed necessary. We agree.</p> <ul style="list-style-type: none"> • By obliging firms that have provided a quote to a client to transact with any other client on the same basis, the proposals effectively go beyond transparency requirements and establish a market making requirement. Introducing such general quoting obligation for investment firms could unintentionally reduce market liquidity while providing little benefit. It should therefore be avoided.
	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 comment from IRSG
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	No comment from IRSG
	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)?	<ul style="list-style-type: none"> • The provision of consolidated data of a high quality and at a reasonable cost is important for investors but has yet to be achieved for European equities. We therefore support the proposals to enhance data quality, granularity and consistency, including the introduction of the APA regime. This should build on the work undertaken by the CESR Technical Working Group and the Market Model Typology (MMT) developed through the collaborative efforts of exchanges, MTFs, market data vendors and trade reporting venues. • We suggest it should not be the role of the Commission or ESMA task to set post trade data pricing. Any such determination certainly cannot be a one-size-fits-all and we suggest the task should be to take a number of relevant factors into account in order to establish relevant pricing principles.

		<ul style="list-style-type: none"> • In principle, the introduction of the CTP concept seems a good idea. However, given the existence of competing data sources and uncertainty about demand, it is unclear whether a CTP is commercially viable, and hence whether a European Consolidated Tape (“ECT”) will actually “emerge” on that basis. • Given the diversity and complexity of non-equity products the introduction of a consolidated post-trade tape for these asset classes represents an even bigger challenge, and it cannot simply be a wholesale extension of the data regime designed for equities. We welcome the intention to phase the implementation of a non-equities product by 2 years to take advantage of the experience gained from the introduction of an ECT for equities.
	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?	<ul style="list-style-type: none"> • The universe of non-equity products is diverse, products are numerous and most of them trade only infrequently, with trading velocity a fraction of that in the equities markets. Any post-trade transparency regime for non-equity markets that simply mirrors the one that is used in the equity markets is therefore likely to damage liquidity and limit end user choice. It should be structured to be flexible enough to handle a spectrum from liquid futures and options (which are generally exchange-traded) through moderately liquid government and corporate bonds (which in some member states are commonly held by retail investors) to customized OTC derivatives, which may only ever trade once. • Any post-trade transparency regime for non-equity markets needs to be carefully calibrated based on product liquidity and characteristics to ensure the continued proper market functioning, as was reflected in CESR's technical advice in summer 2010. A properly calibrated post-trade transparency regime with the use of thresholds and delays is preferable to the proposed real-time dissemination across asset classes and products with the potential for deferred publication being authorized by competent authorities.
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 comment from IRSG
	27) Are any changes needed to the proposal to	No comment from IRSG

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