

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

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**.

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?	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

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?	<p>The prohibition on Organised Trading Facility (OTF) venue operators from using their own proprietary capital to systematically cross against client orders will have a fundamental impact on the whole of the European trading landscape.</p> <p>We believe that the decision to operate a Systematic Internaliser (SI) or a Multilateral Trading Facility (MTF) to cross own proprietary capital against client orders will be substantially conditioned by the calibration of not just the pre-trade transparency waivers for MTFs but, more importantly, how the dark trading exemptions in the SI regime are calibrated for broker dealers to cross their own proprietary trading orders against client order flow.</p> <p>For this reason, we believe the European Parliament should consider establishing a level playing field for dark orders and make the SI regime subject to the same pre-trade transparency regime that the other regulated trading venues are subject to.</p>
	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,	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

	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>ITG supports the European Commission (the Commission) and the European Securities and Markets Authority (ESMA) proposals to update and enhance the rules and the regulatory toolkit to deal with the market structure risks and market abuse issues that certain automated trading strategies may create. In this respect, we welcome the work of: a) the Commission in proposing certain changes to the Market Abuse Directive and the proposals (COM(2011)0652 and COM(2011)0656) for amending the Markets in Financial Instruments Directive (the MiFID/ MiFIR proposals); and b) ESMA's guidelines on automated trading¹.</p> <p>However, we share the deep concern (and which a considerable number of other market participants have already voiced) on the severe and disproportionately negative impact that the proposed quasi-market making obligations² will have on asset managers (and other buy-side institutional clients) that operate algorithmic trading strategies. The TABB Group says that 37% of European</p>

¹ Final Report: Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, European Securities and Markets Authority, 22 December 2011 | ESMA/2011/456

² Article 17, paragraph 3 of the Proposal for a Directive of the European Parliament and of the Council on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council (COM(2011)0656) – underlined and bolded for emphasis only: *“An algorithmic trading strategy shall be in continuous operation during the trading hours of the trading venue to which it sends orders or through the systems of which it executes transactions. The trading parameters or limits of an algorithmic trading strategy **shall ensure that the strategy posts firm quotes at competitive prices with the result of providing liquidity on a regular and ongoing basis to these trading venues at all times, regardless of prevailing market conditions.**”*

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

		<p>institutional buy-side order flow used algorithms in 2011 and that they estimate this will jump to 39% in 2012³. Importantly, the asset manager/ institutional buy-side participants execute orders for funds (e.g. pension funds) and clients that have a direct link to the European real economy. We expect that certain important segments of the buy-side will be forced to consider if they can continue to satisfy their fiduciary obligations to their underlying clients by making available fund assets to satisfy those quasi-market making obligations or whether they should cease using algorithmic strategies altogether. We also expect that those buy-side clients that cease using algorithmic strategies will be severely disadvantaged vis-à-vis other market participants who will be happy to shoulder the proposed quasi-market making obligations in return for the undisputed advantage of algorithmic trading against those market participants that are forced to trade without such algorithms.</p> <p>If the intention is to ensure that quasi-market making obligations only apply to a discrete segment of the market then, the requirements should be framed in the context of the relevant cohort to be captured and not the trading strategy used (whether</p>
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³ See Exhibit 9 of the “European Equity Trading 2011/12: Looking for Allies in the Face of Adversity”, TABB Group, Rebecca Healy, December 2011.

⁴ High Frequency Trading definition (underlined and bolded for emphasis only): “*Trading activities that employ sophisticated, algorithmic technologies to interpret signals from the market and, in response, implement trading strategies that generally involve the high frequency generation of orders and a low latency transmission of these orders to the market. Related trading strategies mostly consist of either quasi market making or arbitraging within very short time horizons. **They usually involve the execution of trades on own account (rather than for a client)** and positions usually being closed out at the end of the day.*”; see paragraph 12 of Final Report: Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, European Securities and Markets Authority, 22 December 2011 | ESMA/2011/456.

⁵ Commissioner Scott O’Malia’s letter to the Commodities Futures Trading Commission Technology Advisory Committee Members on a definition of High Frequency Trading.

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

		algorithmic or otherwise). In this respect, ESMA has already considered a definition of high frequency trading which defines entities engaging in those strategies by reference to trading on a proprietary basis rather than for a client ⁴ . In addition, Commissioner Scott O'Malia of the United States Commodities Futures Trading Commission has already undertaken work on defining a High Frequency Trading entity as being one that, amongst other six characteristics, is "Ending the trading day in as close to a flat position as possible (not carrying significant, un-hedged positions overnight)" ⁵ . We would urge the European Parliament to review the Commission's proposal and narrow the scope of the quasi-market making obligation by specifically defining the group that such obligations should apply to.
	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?	
	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?	
	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	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

	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?	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

	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?	Please see response to question 23.
	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?	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

	<p>23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?</p>	<p>We agree with the acknowledgement in the European Parliament’s resolution on regulation of trading in financial instruments – ‘dark pools’ etc. (P7_TA(2010)0466) that the establishment of MTFs and pre-trade transparency waivers were intended to facilitate a shift towards more regulated and transparent venues. We also wholly agree with Herr Ferber, MdEP’s article on ‘Financial Markets’⁶ that says that there is a clear distinction between regulated and unregulated dark trading and the implication from that statement that executing orders on an MTF under the authorized pre-trade transparency waivers is a ‘regulated venue’.</p> <p>In the same vein, we fully agree with approach taken in the MiFID/ MiFIR proposals to deliver a ‘regulatory toolkit’ for assessing existing and future pre-trade transparency waivers rather than prescriptively defining the scope of those waivers. The regulatory toolkit should allow regulators to balance the transparency requirements of the equity markets at large with the needs of European asset managers that require protection for their orders from over-exposure to market participants who would otherwise detrimentally use that order information to their own profit.</p> <p>In this respect, we strongly support the Commission’s view in its Impact Assessment that abolishing the pre-trade transparency waiver would cause “substantial damage to market liquidity” and we would encourage an approach that prudently calibrates the pre-trade transparency waivers only after technical consideration</p>
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⁶ Europe must take the whole market into account when regulating the financial markets, The Parliament.com, 18 November 2011.

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

		<p>by ESMA and a considerably more detailed scientific impact assessment.</p> <p>With one exception, to date ITG is not aware of any research on European markets that has demonstrated the impact of the pre-trade transparency regime on market quality. The only data that is available for Europe highlights the value that dark pools bring to the investment process by significantly reducing implementation costs compared to lit markets⁷. A continuation of this research (updated for 2010)⁸ shows that the benefit of dark pool trading remains even as the volume of dark pool trading increases in comparison to 2009 (Source: Thomson Reuters). Citing evidence from further afield, a recent US based study⁹ shows that higher dark pool activity is associated with lower spreads, smaller price impact and lower short term volatility. Those stocks with large amounts of dark pool trading are also characterised by greater depth of book.</p>
	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	

⁷ Y Brandes and Domowitz, Alternative Trading Systems in Europe, Trading Performance by European Venues post-MiFID, April 2010

⁸ Brandes, Domowitz – Alternative Trading Systems in Europe, Trading Performance by European Venues Post-MiFID, An update for 2010

⁹ S. Buti, B. Rindi and I.M. Werner 2010, Diving into Dark Pools, Working paper, Fisher College of Business, Ohio State University

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

	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		
Article number	Comments	

ITG RESPONSE TO EP MiFID QUESTIONNAIRE (enc.)

Article ... :	
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Detailed comments on specific articles of the draft Regulation	
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