Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Responses from MarketAxess Europe Limited

Question	Answers
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?	1. Given the globalised nature of trading in financial instruments and the rationale behind the MiFID review, MarketAxess agrees with regulating access by third-country operators to EU markets. 2. However we believe that a regime of strict equivalence and reciprocity could severely damage the European economy. It would constrain international flows, which are crucial to a wide range of financial organisations in Europe. It could be perceived as overly restrictive and protectionist, and could limit European users from accessing overseas markets in a way which is beneficial to their interests. 3. We would encourage a balanced approach in this area. We believe that the EU framework should follow a general set of minimum standards rather than strict equivalence of jurisdictions as currently stipulated in Article 37 MiFIR. 4. MarketAxess proposes that these minimum standards should be based on the work done by international regulators such as IOSCO. ESMA should be able to enter into cooperation agreements with third countries once these minimum standards are met.
5) What changes, if any, are needed to the new requirements on corporate governance for investment	We believe there are two major omissions in the governance arrangements proposed: 1. The management of MTFs and OTFs should not be over-duly influenced by any one particular group of market participants: they should operate in the interests of the market as a whole. This

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?	requirement is critical, to avoid decision processes, commercial arrangements, and trading protocols favouring any one such group. This is a subject on which much consideration has been given in the US, including a restriction on ownership of swap execution facilities by dealer firms. We believe that similar considerations should be included in the European provisions. 2. Grave inherent conflicts of interest exist where consolidated tape providers (CTPs) are also market makers or operate trading venues. MiFID should include specific wording to warrant that the operator of a CTP should not be associated in any way with the provision of market making or market operator services. This matter is discussed in greater depth in our response to question 24.
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?	1. We do not believe that the OTF category is appropriately defined; indeed, the purpose of the Organised Trading Facility (OTF) category is unclear to us. 2. Furthermore it is not clear how this category is differentiated from other categories of organised trading venues, particularly MTFs. Paragraph 3.4.1 of the MiFID proposal states that 'the requirements in terms of organisational aspects and market surveillance applicable to all three venues are nearly identical'. We fully support this principle, and believe it is crucial in ensuring a 'level playing field'. 3. However, this principle does not appear to be borne out in the specific provisions. Articles 19 and 20 set out requirements for OTFs and MTFs which differ markedly, for reasons which are not apparent. For example it is not clear why there should be differences in the conflicts-of-interest provisions or the circumstances under which they need to comply with Article 51. 4. We believe that the transparency, organisational and market surveillance arrangements applying to MTFs and OTFs should be identical wherever possible – differences should only exist to the extent there is a clear rationale. 5. Similarly, we believe that the transparency requirements should be defined by instrument, and should not differ between trading venues. We do not believe that pre-trade transparency requirements for systematic internalisers should differ from pre-trade transparency requirements

	for other organised trading venues. 6. In addition, any definition of trading venues should also contribute to a level playing field between market structures for derivatives trading between Europe and other jurisdictions, particularly the U.S. (swap execution facilities). We believe that it is particularly crucial that this area of regulation is consistent. Otherwise there will undoubtedly be a migration of business to the jurisdiction with the more permissive arrangements. 7. Given the points set out in 1) to 5) above, it is questionable whether the proposed new OTF category is necessary, as opposed to the alternative approach of expanding the scope of the MTF category as needed.
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?	1. We believe that OTC trading should be defined as trading not conducted on regulated markets. 2. We agree that Articles 24-27 MiFIR will bring more OTC trades onto trading platforms in accordance with G20 commitments. We also agree with the inclusion of the MTF and OTF in Article 24(1) MiFIR as venues of choice for standardized OTC derivatives transactions, as these bring together multiple buying and selling interests. 3. The question of the type of venue OTC business is channelled into is addressed in our response to question 6. The regulation and directive should aim to provide choice to customers and facilitate competition between different venues and different types of venue. This competition should take place on a level playing field – i.e. no venue should have a competitive advantage or disadvantage based on the category under which it is regulated. If such a regulatory level playing field is not achieved, there is a likelihood that market operators and some customer business will gravitate towards the venues with the least regulatory requirements.
8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles	1. We agree with the approach set out by the Commission that robust systems and controls should be used to ensure that markets remain orderly. 2. Neither high frequency trading (HFT) nor algorithmic trading of the type which we believe Article 17 is intended to address takes place on markets such as MarketAxess. The lack of sufficient

17, 19, 20 and 51 address the risks involved?	continuous liquidity and the form of the trading protocol (primarily request for quote) are not conducive to such practices. 3. Nevertheless, the definition of algorithmic trading in the proposed directive is extremely wide ranging and will encompass a range of automated facilities operated by participants that facilitate transaction execution but which do not resemble high frequency trading systems. We believe the definition of algorithmic trading should be restricted to systems intended to be used to trade rapidly in and out of positions in asset classes for which such activity is considered to present threats to the orderly functioning of markets.
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?	1. We agree with Article 24(1) the Commission's proposal that for standardized OTC transactions, execution should take place through regulated multilateral venues, which bring together multiple buying and selling interests. Multi-dealer venues improve market efficiencies through enhanced transparency and increased competition. This is supported by detailed, quantifiable analysis which demonstrates that in less liquid OTC markets, investors receive a better price of execution when a larger group of dealers are put into competition. 2. We believe also that the introduction of electronic execution has brought substantial benefits to a wide range of markets, in terms of enhanced transparency and market efficiency. We believe that existing electronic platforms have the technology required to provide both pre- and post-trade transparency for OTC instruments that are standardized and sufficiently liquid. 3. To date electronic trading only makes up a small minority of OTC derivatives business in the dealer-to-customer market, although this proportion is growing as customers become increasingly aware of the benefits of electronic trading. 4. We are therefore supportive of the G20 commitment that OTC derivatives be traded on exchanges or electronic platforms where appropriate. The draft MiFID proposals have focussed instead on the migration of business to regulated platforms. Whilst we believe this migration will result in significant benefits, it will not result in the substantial benefits to the transparency and efficiency of the market available from a move to electronic trading.

	5. In conclusion, whilst we agree with the MiFIR proposals in requiring specified derivatives transactions to be executed through regulated multilateral platforms, we believe that the MiFIR proposals should follow the G20 commitments, in requiring specified derivatives to be traded on electronic platforms.
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 – Equities are not traded on the MarketAxess platform.
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?	1. Electronic trading platforms such as MarketAxess have brought considerable trade transparency to the markets in which they operate. For example, for corporate bonds, MarketAxess displays historic trade data and continuous indicative real-time bid and offer prices for all bonds for which such information is available. 2. Whilst we are consequently supportive in principle of enhanced transparency being an objective of MiFID II and MiFIR, it is crucial that the transparency requirements take into account the following: a) <u>Recognition of market characteristics</u> • The transparency arrangements for each market should, as pointed out by the Commission, accommodate the specific characteristics of each market. • In particular, it should be taken into account that there are a very large number of fixed income products (eg over 200,000 corporate bonds) of which only a small proportion trade regularly, and an even smaller proportion for which continuous prices are available. Our experience shows that around 85% of U.S. high-grade corporate bonds on average trade 10

	times or less per day. This is considerably less than equity instruments. • Especially in less liquid markets, where the range of instruments traded is numerous but the volume in each instrument traded is low, participants are not generally prepared to publish pre-trade information on larger trade sizes or to make pre-trade prices executable. The wholesale market depends crucially on organisations making markets in these instruments, by committing proprietary capital in order to smooth flows. It is crucial that the transparency regime put in place does not dis-incentivise the provision of liquidity by these market makers. • We believe that a robust post-trade reporting regime provides the necessary transparency in less liquid markets. This can be enhanced by indicative real time price quotes which we believe should be at the discretion of market participants and platform operators. b) <u>Competition and customer choice</u> • MarketAxess believes that an overly prescriptive pre-trade transparency regime in OTC bond markets would be counter-productive. **The transparency requirements should not in effect stipulate the trading protocol.** We believe that customers should be able to choose between different competing platforms, with differing protocols. • The trading protocol typically used by electronic wholesale bond markets is a form of request-for-quote (RFQ) protocol, incorporating the following steps: o Publication of indicative prices o One-to-many negotiations on a trade-by-trade basis, through the RFQ protocol. o Publication of trade details following trade completion, with appropriate time-delays calibrated according to the particularities of the market. • We believe that this trading protocol is well-tuned to the particular requirements of the wholesale bond markets, as set out in point a) above, and should be accommodated within the transparency regime. Nevertheless, the transparency requirements should permit alternative trading protocols, to encourage competition and customer choice. 3. In conclusion, we are supportive of enhanced transparency requirements properly calibrated to the characteristics of the specific market, and providing scope for customer choice and competition.

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?	1. Pre-trade transparency requirements need to be carefully calibrated to the characteristics of each financial product, for the range of non-equity products is diverse, in particular in terms of frequency of trading. Less liquid assets such as corporate bonds and OTC derivatives such as CDS or interest rate swaps are not traded as frequently as equities or ETFs. 2. We suggest making changes to Article 8(4) of MiFIR to ensure that the delegated acts by the Commission look at the characteristics of individual financial products rather than classes of instruments when calibrating pre-trade transparency requirements for non-equities. For instance the Commission should consider high grade corporate bonds separately from other bonds such as sovereign bonds or high yield corporate bonds. In addition, as set out in our response to question 31, guidelines should be established in Level 1 to limit the scope of discretion in Level 2 in this area. 3. MarketAxess also believes that competitive multi-dealer electronic trading venues, operating within a regime that provides sufficient flexibility to encourage innovation, will themselves provide a high level of price transparency.
23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	1. MarketAxess welcomes the envisaged waiver regime for classes of financial instruments laid down in Article 8 MiFIR, but we urge the European Parliament to ensure that where appropriate, waivers are based on the individual characteristics of a financial product, rather than per asset classes. 2. We believe that the transparency requirements should be defined by instrument, and should not differ between trading venues. The Commission proposals, for the most part, are consistent in adopting this approach, except in relation to systematic internalisers, for which a different transparency regime is proposed. We do not believe that pre-trade transparency requirements for systemic internalisers should differ from pre-trade transparency requirements for other organised trading venues. 3. It is also important that the pre-trade transparency requirements and associated waivers are harmonised between different jurisdictions – particularly between Europe and the US. Otherwise there is a likelihood that market operators and some market participants will migrate business to the jurisdiction with the least onerous requirements.

	4. Please also see our response to question 22 above.
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)?	1. We welcome the Commission's proposal for multiple competing commercial CTPs in Article 67 MiFID, provided these are subject to strict regulatory oversight to avoid conflicts of interest. 2. In our view grave inherent conflicts of interest exist where consolidated tape providers are market makers or operate trading venues. It is of critical importance that CTP providers are totally impartial and are unquestionably perceived to be impartial. This would be impossible to achieve if the CTP provider competes with the providers of prices – whether market makers or market operators. Particular examples of reasons why strict impartiality is crucial include: • The CTP will have privileged access to trading data from all market makers and market operators. No market maker or market operators will wish to allow a CTP access to such information if it acts as a competitor, and such access will distort fair competition. • The CTP will be required to establish fair and impartial commercial arrangements amongst market operators (eg in determining how revenues from the consolidated tape are apportioned between providers of the data). This will be impossible if the CTP has a direct commercial interest in these arrangements. 3. In the US the consolidated tape provider is FINRA, avoiding such conflicts of interests. 4. We suggest to include in Article 67(1) MiFID specific wording to warrant that a CTP is not associated in any way with the provision of market making or market operator services – while maintaining the existing conditions proposed by the Commission (i.e. non-discriminatory access and in formats that are easily accessible and utilisable for market participants). 5. In addition, as the Commission proposals state in a number of instances, there are substantial differences in the characteristics of different markets and products. It is critical that these different characteristics be fully and properly reflected in the regulations. This is very relevant to the regulations and parameters relating to CTPs, ARMs and APAs. As an example to illustrate this point, whilst it is general practice that data be made available free of charge 15 minutes after execution for equities, it is likely that this parameter might be very different for other asset classes which have different product and market characteristics.

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?	1. For any given product, it is important that all trading venues should have identical post-trade transparency requirements, as set out in our response to question 6. 2. We believe that post-trade transparency requirements should be closely aligned to the specific characteristics of the particular product. We do not believe that a single post-trade transparency regime can be applied to all non-equities, as there is great variety in product classes, issuers and traders of non-equity products. 3. We believe that in less liquid markets, timely post-trade data is the foundation for price transparency to maintain liquidity in the market and hence better pricing for investors. 4. For large-size trades which could have an impact on liquidity in a market, we welcome the mechanism included in Article 10 MiFIR that prevents such trades from being immediately disseminated with full trade details. 5. The U.S. TRACE system uses bucket amounts for disclosing trade sizes. This is a simple and effective system, which provides a clear framework facilitating a range of post-trade and best execution analyses. Such analyses would be greatly hampered by a more complex classification system which for instance resulted in securities being reported in one period but excluded in another. We would encourage the European Parliament to adopt a similar uncomplicated approach for post-trade transparency in the EU.
26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	Whatever the nature of the supervisory and authorisation arrangements put in place, it is of crucial importance that they provide clarity about respective responsibilities, and facilitate a rapid and streamlined authorisation process.

28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	The main financial services legislation that in our view needs to be taken into account is the European Market Infrastructure Regulation (EMIR), in particular Article 4 EMIR on the classes of OTC derivatives that are subject to the clearing obligation.
29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	1. As noted in our response to question 6 above, we underline the importance of a regulatory level playing field between the EU and U.S. As the European Commission and European Parliament clearly appreciate, the financial markets operate on a global basis, and for this reason it is important that the provisions relating to transparency and derivatives execution be harmonised as much as possible with similar requirements in other jurisdictions. This is particularly true for the US, but the point is relevant to other jurisdictions also. 2. In particular, we have concerns around potential divergence between organized trading facilities (OTFs) in the EU, and swap execution facilities (SEFs) in the U.S.
31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	In several key instances the degree of discretion delegated to Level 2 measures will have a very major overall impact on the regulation / directive. Guidance should be included in Level 1 to limit this degree of discretion. Particular examples include the following: • The outline calibration framework for transparency should be established within Level 1. Without this, the level of discretion in Level 2, and range of potential impacts on the markets, is too broad. • Guidance should be included in Level 1 on the scope of derivatives subject to the trading obligations set out in Article 24. The form and granularity of the measurement of the liquidity test currently delegated to Level 2 will have a major impact on the scope of derivatives covered, effectively allowing very substantial discretion within Level 2.