Submission from Nomura International Plc

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?	Nomura believes that the exemptions proposed in Articles 2 and 3 are appropriate. Nomura favours the proposal to bring more directly into the regime own-account dealing in commodity derivatives.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	Nomura has no specific comment on this matter.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	Nomura does not view additional adjustments as necessary to reflect the inclusion of custody and safekeeping as a core service.

		The provision of these services is currently regulated in the UK and, as Nomura would not in any case passport these services into other Member States on a stand-alone basis, we do not believe that these proposals will have a significant impact on us. To the extent that this may presage Level 2 rulemaking provisions regarding conducting these businesses, the impact would be greater.
	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?	Nomura believes that it is appropriate to regulate third countries in this way. Third country access should be subject to a broad equivalence regime that provides consistent levels of investor protection across regulatory standards for, among other things, market abuse, conduct of business and financial crime. However, care should be taken to facilitate access to EU markets without creating unreasonable barriers to entry.
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?	As it will be appropriate for different kinds of firms to comply with the underlying principles in different ways, it is important these rules should not be overly prescriptive either in the Directive or in the technical standard to be promulgated by ESMA (for example, in specifying the permitted number of non-executive directorships). The pool of talent to which investment firms have access is relatively limited and overly prescriptive rules could amplify this problem. Nomura also recommends amending the Directive so that it does not treat all companies as wholly free standing entities. In global firms such as Nomura, there are inevitably some overlaps between entities in a group. Consequently, we recommend that the text expressly refers to the position of a firm within the group as one of the factors that can be taken into account in applying the requirements of Art 9 proportionately (in addition to "the nature, scale and complexity" of the investment firm).

		In addition to this, the Directive should recognise the supervisory function of the board and its separation from the executive. A full understanding of the supervisory role of non-executive directors needs to be appreciated. Their role is to challenge management and act as a sounding board if required. Nomura recommends amending the Directive text so that the board is required to "take reasonable steps to ensure" that the firm is managed in a sound and prudent way, rather than simply to "ensure" this.
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 there is a reasonably clear distinction between Organised Trading Facilities (OTFs) and other categories. However, we believe that the OTF category is not appropriately defined for two key reasons. These are: **the ban on the use of proprietary capital;** and a **lack of clarity as to how an investment firm registers an OTF**. i. **The use of proprietary capital:** In trying to differentiate OTFs from Systematic Internalisers (SIs), we believe that that the OTF category has become too restrictive in preventing firms from executing orders against their own proprietary capital. This ban on own capital threatens to make the model essentially unusable for most trades in Equities and for almost all trades in the Fixed Income market. Investment firms typically deal with counterparties on a principal (mostly "riskless principal") basis. The restrictions on the use of proprietary capital will prevent firms from trading in this way. Nomura considers the OTF category to be an important addition in bringing greater transparency to European financial markets and could encourage more trades away from pure OTC and onto the more transparent OTF venue. In order for this to be achieved, we recommend that the Parliament amends the OTF rules to allow the limited use of proprietary capital within certain “low-risk limits” or under

		specified circumstances to be defined by implementing technical standards at Level 2. Without this amendment, it is likely that investment firms will choose to transact business in an MTF or, more commonly, in an SI or on a pure OTC basis. ii. **Registration of an OTF:** The definition of an OTF needs to give greater clarity as to the nature of an OTF and how investment firms are expected to put them to use. It is unclear at this stage whether an investment firm is expected to have a number of OTFs for each trading desk, or one registration for the whole firm. While we suspect that the former is the intention of the Commission, greater clarity on this point is necessary in order to fully understand the practical implications of the proposals.
	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?	An OTC trade should be defined as one which is an irregular, non-systematic (non-automated) off-exchange trade. Furthermore, a client should be able to choose how his/her trade is conducted. If, for whatever reason, a client chooses to trade by voice, then this trade should be considered as irregular and non-systematic. MiFID/MiFIR should also consider the nature of the product being sold. It is usually the case that non-standardised products are best sold OTC. As things stand, we believe that most OTC volume will move to the SI category, not the OTF category. This is because the bulk of OTC reporting represents double reporting of on-exchange business where an investment firm has provided a price guarantee or other price adjustment. As noted above, the OTF category will be more likely to attract OTC trades if the rules are amended to allow the limited use of proprietary capital.

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	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?	Nomura believes that these requirements fail to address the risk involved. The measures are unworkable and demonstrate a poor understanding of the way algorithmic trading works. It is our concern that these requirements have mixed up the notion of algorithmic trading and market making. The provisions in the text would directly shut down agency brokers, who would no longer be able to use algorithms. Algorithms are used not only to make markets but also extensively in the industry to trade for clients by algorithmically working an order over time - for example parcelling up an order to be traded over the next two hours. In the institutional client segment with reasonably large orders, virtually all trading is conducted using algorithms. To oblige all operators to also make markets would have a material impact on all participants, and especially those constitutionally unable to make markets such as agency brokers.
	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?	Nomura believes that these requirements adequately cover the risk
	10) How appropriate are the requirements for investment firms to keep records of all trades on own account as well as for	Nomura believes that these requirements are appropriate. Proper books and records should be kept for all financial transactions, whether for a customer or for own account.

	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?	Nomura appreciates the desire of global regulators to move more standardised derivatives contracts onto exchange. We are committed to working with regulators to help them achieve this goal. We believe that Title V is targeting the appropriate areas. However, as the substantive rules in this area will not be decided until Level 2, it is difficult to give a material response to this question at this time.
	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?	Nomura does not have specific comment on this question.
	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?	The provisions for non-discriminatory access are logical and fair. Nomura considers these provisions to be very positive and ones which will greatly improve competitiveness in the post-trade space. While there is not a great deal of detail available as most of the specifics will be decided at Level 2, we generally see these proposals as workable.
	14) What is your view of the powers to impose position limits, alternative	Nomura does not have a significant commodity derivatives business in Europe. Consequently, we have no specific comment on this question.

	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?	Nomura considers that these proposed requirements would be sufficient to protect investors from conflicts of interest in the provision of independent investment advice and portfolio management. It is important that the definition of "fees, commissions, or any monetary benefit" be refined to prevent uncertainty as to what is or is not permissible. Consideration should also be given to the balance between increased costs and increased protections for investors: this must be proportionate.
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	While Nomura generally believes that the proposals are appropriate, further consideration needs to be given to the desired outcome of categorising products. For instance, a product may contain features that would fall into the "difficult to understand" category but nevertheless produce a return that is straightforward and offers greater protections to the investor than some non-complex products.

	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?	It is clear that there will be an increase in costs associated with the new best execution requirements outlined in MiFID Article 27. However, as paragraph 8 of the Article leaves the establishment of the detailed regulation to Level 2, it is difficult to comment further or in more detail at this stage as to the scope of the provisions or how costs of compliance will increase.
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	Nomura believes that these are 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?	Nomura believes that adjustments are needed to these provisions in order to provide greater clarity on their use. Specifically, clarification is required to ensure that powers of intervention can only be exercised where there is a demonstrable need to ensure investor protection. It should be clear that the fact of innovation in the form of a new product, potentially carrying unknown outcomes, should not of itself be grounds for prohibition. Regulators should be able to intervene on a pre-launch basis only where a product: a) is the same or very similar to previous products that have caused harm to investors owing to the structure or behaviour of the product; or b) is clearly unsuitable for the intended client base owing to inherent risk. In particular, in no circumstances should actual poor performance of a previous similar investment – which is not dictated by the product structure itself – be used as a reason for

		intervention. Nomura would prefer this text to be amended to ensure that ESMA and competent authorities can only act where there is a genuine demonstrable risk of harm to investors.
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?	Nomura appreciates the important role that pre-trade transparency has in equity markets. Pre-trade transparency brings competition and fair price discovery to investors. However, it is also widely recognised that too much transparency eventually begins to damage markets and investors. It is crucial to the quality of the pre-trade regime that the balance between transparency and liquidity is correctly struck. The waiver regime will be central to achieving this balance. As the specifics of how the waiver regime will be applied have now moved to Level 2, we are unable to comment further at this stage.
	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	Nomura believes that a number of changes are needed to these rules in order to ensure that they do not have a seriously detrimental effect on the efficiency, transparency and access of markets. One of the main difficulties of the proposals is that they seek to apply rules to Fixed Income markets which were developed for improving transparency in Equity markets. Regulators and policymakers should acknowledge that Equity and Fixed Income markets operate in fundamentally different ways, making it hard for rules to be easily translated from one to the other without resulting in deep inefficiencies and unintended consequences.

	are the highest priority for the introduction of pre-trade transparency requirements and why?	For Fixed Income markets, a reliably referenced post-trade record, made public on a real time basis for small transactions, could prove to be the best form of pre-trade transparency for most fixed income products. We answer this question from the perspective of bonds and structured products and then from the perspective of derivatives separately. **Bonds and structured products** A degree of pre-trade transparency for these products is currently provided by existing 'MTF-style' platforms such as TradeWeb. Investment firms use this platform to post indicative prices from which other firms and investors deduce a fair price for the product. Consequently, it is clear that for MTF and OTFs the provisions for pre-trade transparency could be workable providing that a fair system for the granting of appropriate waivers is also introduced. It is widely understood that waivers are necessary to ensure that markets can function effectively and fairly. We support the categories listed in MiFIR Article 8(4)b as appropriate for use in determining whether a waiver can be granted. However, a change is necessary in the timeframes given to ESMA for the consideration of waiver applications in MiFIR Article 8(3). Regulators should appreciate that investment firms and investors are operating in a commercial environment. It is proposed that ESMA will have 3 months to decide a waiver application. This is far too long. Despite being supportive of the pre-trade transparency model for MTFs and OTFs, there are

		significant flaws in the proposals for SIs and these should be addressed by the Parliament. There is a risk that requiring firm, tradable prices to be available to all clients of an SI (as outlined in MiFIR Article 17) will actually have a negative effect on transparency. By making a Request for Quote available to all clients in an SI, it is impossible for investment firms to take account of counter-party risk. This could lead to two unintended outcomes: i. SIs could be forced to alter all prices to reflect the "lowest common denominator" client in terms of credit rating, relationship length or any other measure used to determine risk. This would result in the price of products increasing significantly for all clients of an SI; or ii. Access to SIs is restricted to only the most highly rated clients. This would be bad for small and mid-sized clients as access would be detrimentally affected. It would make access particularly difficult for new market entrants, or clients who wished to move their business from one SI to another. **Derivatives** We believe that the proposals for pre-trade transparency for derivatives are inappropriate and could result in detrimental unintended consequences. There are already many methods for price discovery in the derivatives market which currently function well. It is our fear that implementing the pre-trade proposals outlined in MiFID/R without amendment could result in smaller notional prices being offered by dealers which could lead to more derivatives being traded like futures. Smaller sized, standardised contracts could leave investors less able to appropriately hedge risk as they would be forced to settle for an imperfect combination of small, standardised contracts rather than a bespoke product. There is also a risk that more frequently traded contracts could erode concern for the underlying.
	22) Are the pre-trade transparency	See answer to Question 21

	requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?	
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	As per our response to Question 20 above, Nomura appreciates the important role of transparency in equity markets. We would also reiterate that it is widely recognised that too much transparency eventually begins to damage markets and investors. As the specifics of how the waiver regime will be applied have now moved to Level 2, we are unable to comment further at this stage.
	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)?	Nomura generally supports the establishment of these service providers. However, we remain unsure that a competitive environment would be capable of delivering a Consolidated Tape that is consistent from multiple providers. We still believe that a single official tape of record provided by a private bidder would be preferable, despite concerns over a monopolistic environment. Nomura is particularly supportive of the APA regime. The UK market has benefited from the enhanced implementation of MiFID I by the FSA in creating a Trade Data Monitor (TDM) regime. The APA regime is an extension of this.
	25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that	Nomura does not believe that any changes are needed to the requirements. However, it is crucial that the European authorities tackle the idea of a "reasonable cost". Costs should be set by a central pricing authority to ensure that they remain accessible and

	market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?	"reasonable".
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?	The European Supervisory Authorities (ESAs) are a valuable source of advice for European Union policymakers, providing both technical expertise and market insight. They can be effectively deployed in providing detailed definitions at Level 2, enabling policymakers at Level 1 of the process to focus on agreeing matters of principle and the broad direction of legislation. The Commission's intentions, given the degree of detail deferred to Level 2 in its proposals on MiFID II and MiFIR, seem to be to use the ESAs in this way. Providing that the final text agreed at Level 1 provides sufficient direction and intent, we believe that this is a constructive use of the ESAs. Where possible, we would encourage Members of the European Parliament to make use of the expert advice on MiFID-related issues already published by the ESAs, particularly by the European Securities and Markets Authority (ESMA) and its predecessor the Committee of European Securities Regulators (CESR). CESR's technical advice of the review of MiFID, issued to the Commission in a series of papers in 2010, is a good example of the kind of detailed analysis that should be utilised by policymakers at Level 1. We would also recommend that European policymakers make further use of joint industry working groups such as the one which was convened in 2010 on post-trade transparency in Equities. Nomura was a member of this group and found that it effectively brought together industry and policymakers to yield a common output.

	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	Nomura considers that some changes could be made to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately. These include: • Clarification of Member State responsibility for third country firms registered with ESMA to approach eligible counterparties in the EU • Clarification of Member State responsibilities for branches of third country firms • Clarification of Article 71 on powers to be made available to competent authorities. Specifically, clarification would be helpful with regard to obligations under MIFID II that telephone and data traffic records may be relevant, and with regard to circumstances in which demands for information on positions would be justified • Clarification of the operation of Article 72 as regards remedies available to competent authorities, particularly with regard to how this article is meant to interact with existing national legal frameworks • Clarification of appropriate triggers for use of the remedies, and notions of comity where remedies utilised by one Member State may conflict with interest of another
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	In developing MiFID/MiFIR consideration should be given to the Market Infrastructure Regulation (EMIR), particularly with regard to the definition of "OTC" and the measures which apply to those products falling into that category. It is a cause for confusion and possibly distorting effects that the clearing obligation under EMIR would apply to MTFs (as defined under MiFID) but not to regulated markets due to the differing definitions of "OTC". In addition, both dossiers contain provisions on CCP access. These should be aligned as closely as possible.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need	Whilst Nomura International does not actively have branches or subsidiaries in regions outside the EU, by virtue of our client base, we often fall subject to external rules, particularly in the USA.

	to be borne in mind and why?	In developing MiFID and MiFIR, the provisions included in the Dodd-Frank Act should be borne in mind. For instance, Title VII of the Dodd-Frank Act establishes a new framework for regulatory and supervisory oversight of the OTC derivatives market. The pending regulation of OTC derivatives in Japan, contained in the Financial Instruments and Exchange Act, should also be monitored by EU legislators.
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	The proposed provisions regarding administrative sanctions, publication of sanctions, rules breaches, effective application of sanctions, reporting of breaches and submitting sanction information to ESMA seem generally to encourage effective and dissuasive disciplinary action. Given the upper limits of monetary sanction against legal persons and against natural persons, it is not clear that disciplinary sanction would in all cases be proportionate. Much depends upon the guidelines to be issued to member states by ESMA in this area.
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	Level 1 measures should clearly articulate the intent of legislation, providing a framework for detailed provisions to be set at Level 2 on how these measures should be applied in practice. Furthermore where policy will have a 'transformative' effect on the market (for example, making some business models unviable), these should be discussed and agreed at Level 1 to ensure that there is an appropriate degree of political accountability. Level 2 measures should define the detailed technical standards and calibration of the Level 1 rules. The ESAs tasked with defining Level 2 rules (or assisting the Commission in doing so) have the technical expertise to ensure that the rules are both rigorous and implementable. However, this process must stay strictly within the parameters defined by Level 1.

		With this in mind, we generally believe that the balance between Level 1 and Level 2 in MiFID/R is appropriate. However, there is scope to review the Level 1 text so that it more clearly articulates the objectives of policymakers. This will assist policymakers at Level 2 by setting clear parameters and reducing the potential for ambiguity. Furthermore, a lack of clarity from policymakers in the Level 1 text can create market uncertainty. This will only increase as the policy process moves forward. We fear that this uncertainty could have a significant effect on the functioning of markets after the legislation is finalised but before the publication of the Level 2 rules.
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