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	PwC, Central Cluster Financial Services Regulatory **PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see http://www.pwc.com/structure for further details.** **PwC firms help organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with close to 169,000 people who are committed to delivering quality in assurance, tax and advisory services. Tell us what matters to you and find out more by visiting us at http://www.pwc.com/.**

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?	Extending the scope of MiFID regime to encompass spot secondary markets in emission allowances (EUAs) has both advantages and disadvantages. While there are some similarities

		between spot trading EUAs and certain financial instruments, and we understand the arguments put forward by the Commission to support increased supervision of this trading activity and a consistent approach in respect of spot and futures trading, we do not believe that spot trading should be included within the MiFID regime and supervised exclusively by financial markets supervisors. We believe that MiFID should focus on financial instruments' impact – both direct and indirect – on the proper functioning and integrity of the financial markets. EUAs main purpose, though, is to encourage and support reductions in emissions: the regulatory and supervisory regime devised for this market should be fully coherent with this principal role from a broad perspective. For example, recent fraudulent behaviour within this market in Germany did not affect the proper functioning of the financial markets. It did have negative consequences from a VAT perspective, but this obviously should not fall within MiFID scope. It is appropriate that structured deposits should be included within the scope of the regime from an investor protection perspective. There is a possibility that there may be different interpretations of what constitutes 'structured deposits' and therefore the inclusion of a definition may be appropriate within MiFID, given that the PRIPs proposal has not yet been tabled. This definition should be in line with ideas and methodology of the PRIPs initiative.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	In some countries, such as Germany and the UK, custody and safekeeping is already treated as a 'core service' within the national regime. It is important that legislators bear in mind the links between custody and safekeeping and national bankruptcy regimes, as well as the legal aspects of cross-border bankruptcy issues. For example, in Germany, provisions are laid down in the

		German Safe Custody Act (Depotgesetz – DepotG) and the German Bankruptcy Act (Insolvenzordnung – InsV). From this perspective, there will need to be coherence with the upcoming revisions to the Securities Law Directive. Consideration should also be given to potential issues in this regard in relation to third country regimes. The UK regulated the activity of "safeguarding and administering" assets, which is interpreted to include custody services. However, a person is not required to be regulated in the UK unless they provide both safeguarding and administration services, with the anomalous result that a person who engages in one of these activities is not required to be regulated for that activity. We also note that as in Germany, the regulation of custody activities bears an important connection to the national bankruptcy regime and also to the UK Financial Services Authority's detailed rules on dealing with client money and assets.
	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?	From an investor protection perspective, we believe it is appropriate to regulate third country access to EU markets in general. Third country firms offering financial services and investment products in the EU should apply the same standards and be subject to a similar level of supervision as EU firms. However, provided these conditions are fully met and the third country supervisory authorities communicate on an ongoing basis with their EU counterparts, we do not see the need to require firms to open a branch in an EU country when targeting professional and retail clients. In effect, one of the major challenges, currently, to retail investor protection is the growing use of the internet. In Germany, several actions have been taken to define and distinguish

		whether a service, provided via the internet, takes place in Germany or not. To date, from our perspective none of these attempts have succeeded in providing sufficient clarity. This type of concern will not be addressed through requiring the establishment of a branch in the EU: however, investors could be protected, and still retain freedom of choice, if equivalent regulations apply in, and are suitably enforced by, a third country.
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?	The Commission has proposed a broad definition for the new category of organised trading facility (OTF) in order to capture all types of organised execution and trading platforms which do not correspond to the functionalities or regulatory specifications of existing trading venues (regulated markets and multilateral trading facilities). However, considering the issue from various clients' perspectives, we are concerned that the definition currently lacks sufficient clarity in terms of what would be classified as an organised trading facility. Even though MiFID best execution provisions will apply to the platform operator there might be the need to define the respective parameters regarding the proper use of discretion (e.g. regarding the equal treatment of client orders). We are also concerned that the Commission's approach with regards to the use of proprietary capital might not provide a sound basis for the efficient operation of all types of markets, particularly markets where the intervention of market makers and firms using their own capital in back-to-back transactions, is

		necessary to provide essential liquidity.
	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?	There is no definition of 'OTC' or 'OTC trading' proposed currently within MiFID, nor in EU legislation more widely. This is a concept which one might think is well-understood, but in practice may not be so straightforward. By asking these questions together, we assume that a direct link is being made between OTC activity and 'dark' trading and orders, but we think this may be an over-simplistic approach. While there are no definitions of 'OTC trading', there are definitions, or at least descriptions, of 'OTC derivatives', but these can differ. For example, IOSCO describes OTC derivatives as contracts "*transacted directly between two contracting parties without the interposing of an exchange or other intermediary*" (IOSCO, Report on Trading of OTC Derivatives, February 2011). In its glossary of terms, the CFTC in the US defines OTC activity in futures (rather than swaps) as: "*Over-the-Counter (OTC)**:** The trading of commodities, contracts, or other instruments not listed on any exchange. OTC transactions can occur electronically or over the telephone*". In EMIR, the definition of OTC derivatives included in the Council's General Approach of October 2011 states: "*over the counter (OTC) derivatives' means derivative contracts whose execution does not take place on a regulated market as defined by Article 4 (1) point 14 of Directive 2004/39/EC or on a third country market considered as equivalent to a regulated market according to Article 19 (6) of Directive 2004/39/EC*". These discrepancies suggest that it might be useful to define OTC trading for the purposes of the revisions to MiFID. It is not yet clear whether the above definition will be retained in the adopted EMIR text. If it is retained, it might raise questions

		in relation to the revision of MiFID because it does not refer to MTFs or OTFs (which are defined separately). In relation to the second question, it is not clear that the proposals, as currently tabled, will automatically lead to channelling OTC trades, in derivatives or other instruments, onto 'lit' venues. There are reasons for investment firms and their clients to want to keep some trades and orders in the dark, some of which are justifiable (e.g. preserving the ability to execute large trades without causing market disruption or price volatility). The effective calibration of the pre-trade transparency regime, around different markets/instruments, is more likely to ensure improved levels of transparency.
	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?	In relation to algorithmic trading, the Commission's proposals closely reflect the recent ESMA guidance on systems and controls for highly automated trading in the context of the current MiFID regime in many respects. It should be noted that 'algorithmic' and 'automated' trading are not synonymous. We believe these different types of trading need to be properly defined, and considered separately to achieve appropriate regulation. Clearly, other issues will require further clarification in implementing measures before the full impact can be thoroughly assessed by firms - for example, the definition of 'disorderly market' (Article 17) and 'disorderly trading conditions' (Article 51). Automated risk controls can only effectively and efficiently manage clearly pre-defined risk scenarios. A final point of detail: Article 51(6) states that regulated markets should make available information on the order book to the competent authority on request or '*give the competent authority*

		access to the order book so that it is able to monitor trading'. The latter implies real-time, remote access by supervisors to the order book: it is worth noting that this raises significant issues around data security in terms of data transfer to regulators, would be very costly for market operators, and would take a significant amount of time to implement.
	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?	It is worth noting that both the corporate governance requirements considered under Question 5 above, and requirements relating to resilience, contingency arrangements and business continuity are incremental for existing market operators but will constitute a step-change for many data service providers who have not been subjected to a regulatory regime up to this point. Proportionality issues will need to be considered in the implementing measures.
	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?	We suggest that the requirements should better reflect the IOSCO recommendations on targeting, incentives and mandates (as discussed in its report of February 2011).
	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?	The introduction of an MTF SME growth market requirement in Article 35 will not, in our view, ensure better access for SMEs to capital markets, particularly not on a cross border basis. The underlying objective of MiFID is to ensure market integrity and investor protection. This proposal in no way addresses the potential inconsistency between the need to reduce accounting, information and reporting burdens on SMEs (as targeted through other Commission initiatives), while ensuring adequate levels of investor protection through appropriate levels of transparency.
	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?	Article 24(3), point 1 states that clients need to be informed whether 'advice is provided on an independent basis and whether it is based on a broad or a more restricted analysis of the market', which suggests that there is a possibility that advice can still be independent even if based on a 'more restricted analysis'. Furthermore it remains unclear whether the duty to inform about the basis of the analysis of the market generally refers to "investment advice" or only to "investment advice on an independent basis". Market participants will need an early understanding of the starting point in relation to 'inducements' to be prohibited in terms of portfolio management and independent advice. The problems surrounding 'inducements' were subject to fierce debate in the run up to the introduction of the MiFID regime in 2007 and the transposition of the rules in a number of countries did not always follow the guidelines provided in the relevant CESR protocol, leading to significant differences in requirements at the national level. National disparities have increased in the intervening period, not least in response to the financial crisis. However, our experience in different countries in the EU suggests this may be an area where the focus needs to

		be on more the outcomes from the investor protection perspective, rather than introducing identical means. According to recital 52 of the MiFID Directive, limited, non-monetary benefits, such as product training, may be received from a third party by an investment firm when providing independent advice. Article 24(5), however, makes no mention of this possibility. This inconsistency needs to be addressed.
	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?	Best execution is a valuable and laudable principle (similar to the principle of 'acting honestly') and should be retained as such. However, the practicalities of the associated regime are challenging. One notable deficiency in the current MiFID regime was the lack of information on which investment firms (or their clients) could make a comparison of execution quality between venues. This will be rectified by the requirement now imposed on execution venues to provide regular information in this regard. However, in terms of costs, better prices offered by alternative execution venues can be totally negated by the cost of clearing and settlement associated with the trades, particularly if undertaken on a cross-border basis. The costs of accessing alternative execution venues can negate the benefits of lower prices achieved by changing venues for a substantial period. So the answers are not obvious. That said, a requirement on execution venues to assess the quality of their service and disclose information to market participants and end users is a step in the right direction.

		One particular area of concern, however, with the Commission's proposal arises in Article 27(5), second subparagraph, where the Commission states that '*Member States shall require investment firms to summarise and make public on an annual basis, for each class of financial instruments, the top five execution venues where they executed client orders in the preceding year*'. This implies an obligation on investment firms to execute orders on more than five execution venues for each class of financial instrument. The cost of multiple connections for small investment firms is prohibitive, and the business rationale supporting multiple venue access is dependent on the type of financial instrument involved. However, even with shares, this type of requirement would only be practical (for larger investment firms) for very liquid shares which are traded on multiple venues.
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	Under MiFID II, the protections to eligible counterparties, professional clients and retail clients are appropriately differentiated. Some information and reporting requirements will now be applied to firms dealing with eligible counterparties. The overarching high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading should apply irrespective of client categorization.
	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?	
	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?	
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	From technical view it could be ineffective to implement pre-trade transparency mechanisms within OTFs with very small volume as the cost would rise disproportionately.
	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)?	The provisions will clearly lead to substantial redefinition of data standards and formats for the information that will be required. One particular issue that in our view could be a risk to the CTP regime is the absence of any commercial incentives for a company to become a Consolidated Tape Provider. It should also be borne in mind that technical implementation can only start after the final definition is published.
	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?	Real-time reporting requirements have a significant impact on technology. The reduction of the allowed delay to one minute will require performance improvements generating costs.
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?	Key interactions with legislation currently being negotiated or upcoming include: EMIR, MAD, Securities Law Directive; CSD, PRIPs (and IMD) There are also some points of detail to be considered with regulations in other sectors. For example, Article 9(4) of MiFID II stipulates that ESMA should develop draft regulatory standards specifying certain notions in relation to the management body. Article 87(4), last paragraph of the CRD IV proposal published on 20 July 2011 (COM (2011) 453 final) sets out a similar requirement for the European Banking Authority (EBA). However, ESMA is required to submit its proposed RTS to the Commission by 31 December 2014: EBA, on the other hand, has to submit its draft RTS by 31 December 2015. The difference in timing can create uncertainty for firms: also it would be advisable that steps are taken to ensure the compatibility of the two sets of RTS.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	Clearly, one of the major jurisdictions outside the EU which should be borne in mind appropriately is the US, particularly the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and ancillary supervisory activities. The Dodd-Frank Act is as well as MiFID II/MiFIR twofold and seeks to foster investor protection as well as market integrity and will have major impacts on all globally active market participants (banks, trading venues, central counterparties). For example, with regards to the OTC derivatives regime, commodities trading, and trade repositories, the Dodd-Frank Act has an immediate impact on the global financial market system and economy and society as a whole. To avoid, wherever possible, or mitigate differences

		between the US rules and up-coming MiFID II/MiFIR regime might be helpful to all market participants.
	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**	
Article ... : Pre- and post trade transparency	Data formats are mentioned several times. From a practical perspective, it must be borne in mind that technical revisions to comply with any new requirements can only commence once the requirements themselves have been published.	
Article 4 MiFID/Art. 2 MiFIR	Definitions The Commission is proposing to include some definitions in MiFIR (Art 2) and some in the new MiFID Directive (Art 4). We understand that the rationale for this approach may be to benefit from the greater harmonisation possible through a Regulation as opposed to a Directive. However, in a number of cases in terms of definitions which the Commission is proposing to include in MiFIR, this approach may not be the more appropriate as it will not necessarily ensure consistent transposition into national law. We would like to suggest that all definitions should be included in the Directive. Careful review by the Commission and ESMA of transposition measures could ensure that transposition is harmonised as much as possible.	
Article ... :		
Detailed comments on specific articles of the draft Regulation		
Article number	**Comments**	
Article ... :		
Article ... :		