**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.**

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| Name of the person/ organisation responding to the questionnaire | **RBC Capital Markets – Stuart Baden Powell, Head of European Electronic Trading Strategy.** |

| **Theme** | **Question** | **Answers** |
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| 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? | |

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| | 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? | |
| 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? | Yes, however it could be more robust. We remain concerned about dark trading, in particular internalisation engines from brokers and broker-dealers. The term Broker Crossing Network (BCN) has been created to imply the benefits of internal matching of trade on an agency basis. BCN is not a category offered in the MiFID and seems to have been created to set an agenda to suit investment bank internalization engines not suitably covered within the MiFID text. Crucially the term "broker crossing" gives the implication that this is passive non invasive client order to client order matching. This is not the case. BCN's contain bank proprietary flow. The term "broker" is related to pure agency crossing. We strongly suggest if the BCN terminology is to be formally adopted by ESMA and the EC it should be changed to reflect the reality of the situation, |

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| | | this should be a "BDCN" or "Dealer Crossing Network". Investment banks who operate BDCN's will seek to retain proprietary trading within the engines as it provides significant benefits to the investment bank – the benefits to the end client however are mixed. The OTF category should remain free of proprietary trading. We are also concerned over the use of dark trading in executing small order sizes. Dark trading was justified on the grounds it reduces market impact and enables the trading of large blocks of shares and can be particularly helpful in small and mid cap lines of stock. Only Liquidnet operates under the "large in scale" waiver. All other European dark pools of note (MTF, SI, OTC) have very small trade sizes and are not functional to the preferred use of dark trading. The opportunities present for market participants to work off small child order size trades in dark pools are profound. Market impact on each child order can be perceived to be higher than large block trades. Some years ago it was suggested that a minimum order size be used in dark trading, many would argue that Minimum Accepted Quantities ("MAQ's") can be offered by choice to the end users. However, if a buy side firm deploys an MAQ its fill rate will lower versus expectation. Whilst this was acceptable some years ago, the expectation of crossing rates in the dark has increased. If a dark pool has greater than 5-10% matching rate, very rarely is it truly dark. With so many small dark orders sub MAQ's buy side traders feel they are missing liquidity in the dark if a mandatory size was installed in dark venues. The question to ask is should small size orders, often blind IOC order types even be allowed to execute in the dark? Who does it really benefit? It |

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| | | is critical that the transparency of operations of dark OTC and any future OTF venues are revealed by investment banks. Buy side traders have to balance the "need to get done" versus concerns of negative selection and adverse costs. They can only do that with a micro level understanding of bank and broker dark routing practices.<br><br>We would urge MEP Ferber to look into the number of internationalisation engines that will be caught by the OTF category as our expectations are that the majority of investment banks would have several OTF books in operation. Whilst the OTF category will capture much OTC trading it will lead to a fragmentation of dark pools as each bank will have to declare OTF's within its operations, which in turn may reduce crossing opportunities for buy side traders. If MEP Ferber supports the provision of opportunities for investment banks to continue to operate capital based dark pools, the creation of a tightly regulated and defined BDCN could be an option.<br><br>Much discussion has taken place about the definitions of agency principal, client versus prop and riskless principal trading. We would like to see a very clear regulatory split between these types of capital and the OTF regime. Essentially, control should be passed away from the bank to the regulator to ensure that the buy side are comfortable with the interactions they will receive in any future OTF. We would expect riskless principal to be pushed by banks to be included within the OTF category as well as swaps due to extensive commercial interests. It may be pertinent for the |

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| | | comfort of the buy side that both swaps and riskless principal should remain out of the OTF guidelines. MEP Ferber should be aware of attempts to shift parts of capital back into the OTF through the use of macro phrases such as "where there is no change in asset class" that will open the door for previously discussed types of business to enter the OTF. It is also important to note that definitions of types of participants as well as types of flow could be excluded such as High Frequency Trading ("HFT") for example. It is also critical for MEP Ferber to know that much HFT business could enter the OTF as client business due to the extensive services that many investment banks offer to HFT firms. These should not be allowed into OTF's and this should be addressed specifically. Electronic Liquidity Provider programs where blind IOC orders are sent out of a OTC/OTF dark book to an HFT such as Getco (GES) should also be prohibited from OTF's. Price Improvement in an OTF is questionable and is open to discussion. If this is allowed, much attention must be paid to the arbitrage opportunities that exist on the print and execution itself, as this will remain in the bank firewall for a period of time before printing. If an OTF was created along with a BDCN, there may be clear distinctions between the two that may assist the buy side in becoming more at ease to "trust" banks and brokers. At present, it is our perception that very few banks are truly trusted with the order handling that exists in both the dark and indeed the lit. The creation of a pure agency non HFT client OTF along the lines discussed above if conducted with a Broker Dealer CN would provide choice to the buyside whilst also allowing legislative protection for |

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| | | them. |
| | 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? | Yes, it should assist with moving client orders as being classified from OTC to OTF. However clearly the issue is in relation to the capital/proprietary trading. The OTF category is likely to lead to extensive fragmentation of dark liquidity. |
| | 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? | Article 17.3 has been much critiqued across the industry. Institutional client algorithms are different in operation to those deployed by HFT firms or in fact investment banks operating services for HFT firms (it is very important for MEP Ferber to remember that some investment banks have extensive for-profit operations that cater for HFT firms). It is our belief that 17.3 was targeted at HFT firms however it may have inadvertently captured buy side algorithmic trading use and could be re-worded. Many HFT firms claim to operate market making techniques – yet this is merely self-descriptive, not formal and crucially quite different in mathematical operation to the terms of “market making” that most would be familiar with. Some firms have started to take on Designated Market Maker (“DMM”) roles despite the latency feeds for the DMM being slower than the standard feeds for non DMM’s. Questions should be asked around why HFT firms are doing this, as profit margins on the existing set up are slight compared to HFT’s non DMM/obligated conditions – many have noted to us that this could well be an integrity/PR play. If HFT do in fact operate as “market makers” they should be obligated to do so. However we hold extensive concerns that commercially provided market making obligations can be manipulated to |

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| | | provide not only profit making opportunities but also integrity/PR boosting positioning (please recall that many large HFT firms have significant ownership stakes in Chi-X and BATS and BATS was created by the HFT firm, Tradebot). “Light touch” market making obligations could easily be deployed by MTF firms owned by HFT firms providing a “false integrity” to the end user yet providing multiple opportunities to owner firms at the expense of the end investor. We would stress the need for 17.3 to go into significantly more detail and seek to standardize a set of highly strengthened market making conditions across MTF and primary market venues. Institutional investors are highly concerned over the integrity of the European equity secondary market and much more needs to be done, so that the seemingly countless loopholes are closed.<br><br>On article 17.4 – investment banks will request that investment banks providing direct electronic access to a venue should NOT be responsible for any breaches of the Market Abuse Directive. This is not productive in certain circumstances. Much has been made of the challenges of tracking HFT flow to inquire if some trading activities are contrary to the MAD. The MAD is to be amended to take into account those HFT techniques that ESMA is aware of, often in consultation with investment banks who have HFT clients and operate HFT themselves for their own book. However tracking of HFT is not just about speed, quotes to trade ratios, or mathematics behind the trade output – many HFT firms will have their own direct access to trading venues regulated as broker-dealers. Some will only use investment banking firms for |

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| | | access and perhaps rely on prime brokerage for short selling and post trade services. HFT firms may also use their own access though as well as investment bank's provided access, with trades executing in the investment bank name not the HFT name; this is a simple way to help cover HFT trading strategies due to minor differences in speed and strategies inter alia. The net result of this is that any breaches of the MAD are increasingly difficult to track. Investment Banks providing access to HFT firms should be responsible for the trading activities of HFT clients and hold strong integrity checks for those firms. Those checks should be continually monitored by the firms competent authority to ensure compliance and adjustments in relation to new techniques and regulations. Transparency from investment banks with HFT clients is critical to the protection of market integrity.<br><br>Article 51 concerns message to trade ratios. We have published in the public domain concern over high message to trade ratios. HFT use this technique as an aggressive method for profit capture either in straight arbitrage formats or potentially in seeking to bait institutional order flow. Recent academic research from the University of Mississippi has shown that "quote stuffing" (in this case defined as excessive message traffic) leads to an increase in volatility as well as a widening of the effective spread. Caps on message to trade ratios could be a good idea in order to assist in stabilizing market conditions and reduce costs of buy side participants and pension funds. The biggest question would be where to set the right level in order to avoid penalizing more appropriate operations that are acting |

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| | | on behalf of institutional investors. This should be discussed as should the possibility of a mandatory “up-time”. It was raised in the US over a year ago that orders should be required to remain available for execution, i.e. “up” for a period of at least 50 milliseconds before any amendments or cancellations can be made. MEP Ferber should look into this area in more detail for a possible solution. |
| | 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? | It is important that firms keep these records but do so in sufficient detail and be provided on recall and request by end clients. |
| | 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 Article 35 of the Directive? | We are supportive of SME’s gaining improved access to capital. We have heard one MEP from the ECON on public record state that HFT should be applied to SME’s. We would highly question this as a distinct possible downside to this proposal. The impact of HFT on market integrity has been open to debate, the quality of research contains a high degree of variance and we are concerned that European bodies are |

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| | | short of the required suitable research from those without vested commercial interests in HFT firms. Indeed, recent research has shown the HFT does increase volatility and not dampen it as some HFT and investment banking supporting HFT firms would suggest. We would also raise concern over the quality and robustness of the UK Office of Science Foresight work into HFT and Computer Based Trading – which at present, the working paper is not suitable for sound policy use. If HFT do increase volatility (particularly short run and intraday) the creation of the SME MTF would expose small firms to potentially excessive volatility movement in their share price, pulling it away from fundamental valuations – this could have very real concerns on the financial stability of the SME in question which may not have the balance sheet to absorb excessive volatility in equity stock holder capital. This area must be reviewed before continuing with the SME MTF proposals. |
| | 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 | |

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| | 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? | With regard to equities we support improved best execution requirements. We would prefer if the best execution requirements were more detailed; particular attention should be paid to orders at the point they enter the brokers firewall not necessarily just what venue the SOR sends the order to. |
| | 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? | If the reference price waiver for dark pools stays in operation it should be referenced against a fixed price from an agreed EBBO. By creating a situation where a venue may choose between an EBBO or the NBBO for a mid point match an arbitrage opportunity exists. Furthermore, data feed speed on |

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| | | the update of the midpoint along with possible decimal place differences also provides opportunities for the type of trading that causes a significant erosion of confidence in the equity market structures. Opportunities for high quality dark interaction are important for the buy side, much dark liquidity is not high quality at present and it increases the market impact as a result rather than decreasing it. |
| | 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? | |
| | 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)? | |

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| | 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? | |
| 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? | |

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| **Detailed comments on specific articles of the draft Directive** | |
| **Article number** | **Comments** |
| Article ... : | There are plans afoot to bring IRS and some CDS products onto the exchange for the purposes of transparency and CCP clearance, this is in light of the Lehman Brothers difficulties. Whilst we support this move MEP Ferber must be aware that HFT firms have expressed a large interest in targeting IRS and CDS products for trading once on exchange. If HFT practices increase volatility as the latest research is proving, MEP Ferber must raise the possibility of increased volatility in CDS products. Does the market want or need increased short term and intraday (recall that a flash crash may occur at the end of the trading day and not rectify itself before the close) volatility in sovereign, in particular European sovereign state CDS spreads that causes movements away from the fundamental value. This could lead to potentially disastrous consequences for sovereign states, the EU and wider. It is a fat tail event but something that is extremely important to think about and take pro-active action to mitigate against. |
| Article ... : | |
| Article ... : | |
| **Detailed comments on specific articles of the draft Regulation** | |
| **Article number** | **Comments** |
| Article ... : | |
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