

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?	With reference to the objectives listed in our cover letter, it is appropriate that changes to MiFID article 2 will give regulators oversight of all persons with direct access to organised trading facilities. This is a crisp, objective criterion. Additionally, we suggest that any regulatory requirements for firms without customers, including corporate end users and professional trading firms, be appropriate to their business. Unnecessarily high regulatory burdens would reduce competition, contrary to the objectives of MiFID, and reduce the benefits (stated in our cover letter) that competition and professional trading bring to financial markets.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	

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Theme	Question	Answers
	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?	<p>We suggest that any regulatory requirements for professional trading firms without customers be appropriate to their business. Unnecessarily high regulatory burdens would reduce competition, contrary to the objectives of MiFID, and reduce the benefits that automated professional trading can bring to financial markets.</p> <p>Directive Articles 9.2, 9.3, 9.4(a), and 9.6(b) include language that make it clear that a large and complex business demands more of its management body (which implies that the demands on a small, simpler business should be proportionately limited). Similar language should be added to 9.4(d) and 9.4(e).</p>
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?	
	7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to	

Theme	Question	Answers
	the channelling of trades which are currently OTC onto organised venues and, if so, which type of venue?	
	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?	<p>Directive Article 17.1 establishes requirements for systems and risk controls for investment firms that engage in algorithmic trading. We support requiring that all trades entering the market -- not just those generated by firms engaged in algorithmic trading -- have reasonable mandatory pre-trade risk checks. The Futures Industry Association has produced a set of recommendations regarding best practices for risk controls¹. We believe that specific risk controls would be most effectively determined by trading venues, through a combination of risk controls on their electronic platforms and requirements on their members, to ensure that such risk controls are in place. These requirements would then apply equally to all traders, including any not subject to direct regulatory oversight. The requirements applied to each specific firm should be appropriate for its role in the market and consistent with industry best practices.</p> <p>Directive Article 17.2 creates a requirement for investment firms to describe algorithms to regulators. Regulators would be best served by thorough audit trails that let</p>

¹ FIA Principal Traders Group Recommendations for Risk Controls for Trading Firms, November 2010, available at http://www.futuresindustry.org/downloads/Trading_Best_Practices.pdf

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		<p>them examine the orders and trade executions that algorithms have generated, rather than by attempting to understand specifics of the algorithms themselves. A disclosure requirement could poses practical implementation issues. It could create new risks by burdening regulators with large volumes of detailed information that they are not equipped to process. If the Directive retains a disclosure requirement for algorithms, such disclosures should be brief and manageable for both firms and regulators.</p> <p>Directive Article 17.3 creates a requirement for any algorithmic trading strategy to be in continuous operation and to post firm quotes on an ongoing basis, regardless of market conditions. We believe that imposing new market making requirements such as these would harm competition, increase risk and raise costs for investors without protecting against market failures.</p>

² See for instance Lepone, “The Impact of High Frequency Trading (HFT): International Evidence”, February 2011

³ ESMA: Final Report - Guidelines on systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities, 22 December 2011. Available at <http://www.esma.europa.eu/system/files/2011-456.pdf>

⁴ Recommendations regarding regulatory responses to the market events of May 6, 2010: Summary Report of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues. Available at http://www.cftc.gov/ucm/groups/public/@aboutcftc/documents/file/jacreport_021811.pdf

⁵ FIA Market Access Risk Management Recommendations, April 2010, recommendation 1f, p.10. Available at http://www.futuresindustry.org/downloads/Market_Access-6.pdf

Theme	Question	Answers
		<ul style="list-style-type: none"> • While research shows that algorithmic traders are important sources of liquidity and price discovery during even the most volatile market conditions,² even the largest and most sophisticated market makers selected by exchanges to provide liquidity, and given incentives to do so, are not asked to <i>guarantee</i> that they will post continuous quotes in the market at all times • Risk management best practices dictate extra caution in trading during extreme conditions, and that suspending trading in such conditions is sometimes the prudent course of action. See for instance ESMA's guidelines for automated trading, Guideline 2.2(d).³ • This Article suggests that the only valuable algorithmic strategy is market making (the posting of firm quotes on an ongoing basis). Algorithmic trading (and even HFT) is much broader than market making and includes various other beneficial strategies like various forms of statistical arbitrage that help to dampen volatility and transfer liquidity between products and markets. This diversity of strategies benefits the market ecosystem. • New regulatory quoting obligations could also drive up message traffic with large numbers of "compliance quotes". <p>This provision, if implemented, would only serve to harm</p>

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		<p>the market. The Directive will be improved by removing it altogether. If its purpose is to prevent a “flash crash”, then the circuit breakers already provided for by Directive Article 51.2 are a more appropriate means of achieving it. We refer to recommendations on circuit breakers in the Joint CFTC-SEC Advisory Committee’s recommendations regarding the “flash crash” of May 6, 2010,⁴ and the Futures Industry Association’s price banding approach described in its risk management recommendations.⁵</p> <p>In any event, market maker obligations are not designed or suitable for reducing market volatility. Market maker obligations could not force market makers to “catch a falling knife” or buy in the face of overwhelming selling. Fortunately, policy makers do not need to choose between overall market quality and resiliency against market shocks. Well-designed safeguards like circuit breakers will help ensure resilient, well-functioning markets while preserving the market quality improvements of recent years.</p>
	<p>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?</p>	<p>Directive Article 17.1 establishes resilience, capacity, and business continuity requirements for investment firms that engage in algorithmic trading.</p> <ul style="list-style-type: none"> • These should apply to everyone regardless of whether they use algorithms. • The requirements applied to each specific firm should be appropriate for its role in the market and consistent with industry best practices.

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		<ul style="list-style-type: none"> For proprietary trading firms, the principal business continuity considerations are those relating to internal risk management and the integrity of the post-trade process. For instance, such firms need to know their investment holdings and need to ensure that their trades are settled, but may not need to maintain trading connections to every market in all circumstances. <p>Directive Article 51.2 (with 19.4 and 20.4) calls for</p> <ul style="list-style-type: none"> temporary trading halts which allow traders to pause, regroup, and resume orderly trading organised venues to reject orders which are clearly erroneous or exceed pre-determined thresholds. <p>We support the implementation of risk controls and other safeguards that prevent market malfunctions while preserving the many market quality gains from automation and competition. Market failures can be mitigated by well-designed safeguards like circuit breakers and predictable rules for erroneous trades. Experience, including the 06 May 2010 U.S. “flash crash”, shows that these measures are appropriate to support resiliency and safety of financial markets.</p> <p>Directive Article 51.3, together with delegated acts described in 51.7(c), calls for the Commission to constrain venues’ leeway to manage capacity and ensure orderly markets.</p> <ul style="list-style-type: none"> We agree that responsible messaging policies are desirable. However, inappropriately limiting the

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		<p>ratio of orders to transactions could harm market quality and raise costs for investors as the ability to readily adjust orders based on current information enables traders to quote tighter and deeper markets. Trading venues should establish responsible messaging policies.</p> <ul style="list-style-type: none"> • In mandating a minimum tick size, it is important to get tick increments right based on price, volume, spreads, etc. as one tick size does not fit all instruments. We believe that European trading venues are managing this issue responsibly now.
	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?	<p>Because the obligation to trade derivatives on an organised platforms (Article 24) can be satisfied by trading on an OTF, it is possible that this will become the venue type of choice for exchange-traded standardised derivatives. It would be a stronger fulfillment of the G20 mandate to see most standardised OTC derivatives migrate to trading on venues with non-discretionary execution.</p>
	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?	
	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	<p>We are broadly supportive of measures, such as those in Regulation Articles 28, 29, and 30, that will benefit the markets by promoting fair competition, encouraging innovation, and lowering costs for investors.</p>

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	proposals fit appropriately with EMIR?	Conditions under which access may be denied should be carefully defined so as not to be open to subjective interpretation. Also, the time frames could be accelerated. There is the risk that unclear rules will give incumbents grounds for long delays in granting access.
	14) What is your view of the powers to impose position limits, alternative arrangements with equivalent effect or manage positions in relation to commodity derivatives or the underlying commodity? Are there any changes which could make the requirements easier to apply or less onerous in practice? Are there alternative approaches to protecting producers and consumers which could be considered as well or instead?	
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	
	18) Are the protections available to eligible	

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	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?	We are broadly in favour of pre-trade transparency, as that provides for a level playing field and encourages competition among traders to provide better prices for investors.
	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?	

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	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)?	
	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?	

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	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	
Detailed comments on specific articles of the draft Directive		
Article number	Comments	
Article 51.3 and 51.7(c)		We believe that minimum tick sizes should be set and clearly communicated by each trading venue, but we do not see cause for mandate by a regulator. In the USA, where tick sizes are mandated by the regulator (generally constrained to one penny, except for stocks under one dollar), analysis ⁶ shows that in some symbols the mandated penny increment leads to an artificially wide bid-ask spread and increased off-exchange trading activity. In fact, as we understand it, a significant

⁶ Comment letter of Allston Trading, LLC, Hudson River Trading LLC, Quantlab Financial, LLC and RGM Advisors, LLC dated April 23, 2010, available at <http://www.sec.gov/comments/s7-02-10/s70210-155.pdf>

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		<p>percentage of dark pool and internalisation volume in the USA is concentrated in highly active, low-priced stocks that are artificially constrained by the penny increment. When the spread is artificially wide, it becomes easier for market participants to engage in quote matching strategies off- exchange. A reform that encourages trading to take place away from those public markets would run counter to the goal of encouraging more trading of securities to take place on organised trading venues.</p> <p>If tick sizes are prescribed by legislation, we do not believe they should be set simply according to price level, because price alone is an insufficient determinant of a stock's spread. Volume and volatility characteristics should also be considered. We believe that the market will find the best ongoing solution to the dynamic problem of setting tick sizes, and note that shortly after the application of MiFID, trading venues and market participants worked to harmonise tick sizes without intervention from regulators. We believe this structure has been effective.</p>
Article ... :		
Article ... :		
Detailed comments on specific articles of the draft Regulation		
Article number	Comments	

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Theme	Question	Answers
Article ... :		
Article ... :		
Article ... :		