Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Response provided by the Royal Bank of Scotland

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.

Introduction

The Royal Bank of Scotland Group welcomes the opportunity to respond to the questionnaire on the review of the Markets in Financial Instruments Directive by Markus Ferber MEP. Our response focuses on those areas of the consultation about which we have the greatest concerns – notably market structure and pre- & post-transparency as they affect the non-equities markets. We have contributed to the various trade association responses[1] to which we are generally aligned. We have not, therefore, provided a response to each of the questionnaire's questions but rather have focused on our core issues.

To summarise, we support MiFID's overarching goal of promoting investor choice and flexibility in how and where they transact, with proportionate levels of investor protection. In extending a regime initially developed for the equities market to other products, it is essential that due consideration is given to differences between markets to avoid unintended consequences such as reduced liquidity, which would only harm end-users. We are concerned that in a number of key areas, the policy objectives being perused could be achieved by better means, without harming the markets, and ultimately the end investor.

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?	
	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	

[1] Association for Financial Markets Europe (AFME); the International Securities and Derivatives Association (ISDA) the British Banking Association (BBA) and the International Capital Markets Association (ICMA)

	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?	We believe that the definition and requirements for Organised Trading Facilities, while providing for some differentiation vis-à-vis other trading venues, requires some fundamental changes to ensure that OTFs will be able to meet the needs of end users and promote competition while satisfying policy makers objectives. **EC Consultation** The concept of an Organised Trading Facility was initially proposed as part of the Commission's public consultation on MiFID in December 2010. At that time, we understood the key intention of the OTF category was to subject all organised trading occurring outside the current range of MiFID venues (i.e. Regulated Markets and Multilateral Trading Facilities) to suitable regulation. It was defined broadly to capture any facility or system operated by an investment firm or a market operator that on an organised basis brings together buying and selling interests or orders relating to financial instruments. This would cover facilities or systems whether bilateral or multilateral and whether discretionary or non-discretionary. It would capture broker crossing systems, and also provide a venue for meeting the G20 commitment for standardized derivatives to trade on exchanges or electronic platforms where appropriate. This broad definition would also address evolving market practices and technological developments, and mitigate harmful regulatory arbitrage. It was intended to be 'future proof', in that the definition could be readily applied to new trading venues that

		may emerge in the future. Both the industry and the Royal Bank of Scotland Group were generally supportive of such a regime, as drafted in the Commission's initial consultation. **Legislative Proposal** We support the clarification in the legislative text allowing OTFs to exercise discretion in respect of who can access the venue and how trades can be executed. Such discretion provides a critical distinction between OTFs and regulated markets and MTFs and is important for fostering the flexibility sought by end users. While reference to discretion is contained in recitals, we feel that its importance should be underscored through appropriate references in the articles themselves. However, we are concerned by the addition of certain new requirements which we believe have the potential to undermine the effectiveness of the OTF regime and the markets more broadly. Notwithstanding the incorporation of discretion, we are concerned by the imposition of the requirement prohibiting OTF operators from making use of their own capital within their OTF. Additionally the definition of a multilateral OTF could be interpreted as mandating that two or more price providers are present on all OTFs. Such restrictions seem inconsistent with the policy-makers original intentions, i.e. to suitably and flexibly regulate all organised trading occurring outside of the current MiFID venues.

		Ban on making use of own capital The Commission deem such a ban as necessary in order to ensure both the OTF operator's neutrality in relation to any transaction taking place [on that OTF] and to ensure that the duties owed to clients thus brought together cannot be compromised by a possibility of the operator inappropriately profiting at their expense. We believe that this restriction overlooks the vital role that investment firms' risk capital plays in facilitating client business and liquidity, particularly in the non-equities (fixed income and derivatives) markets. Non-equities markets vis-à-vis equities are considerably more heterogeneous[2] and numerous, trade much less frequently in far larger sizes, by a much smaller number of market participants and are less liquid (please see appendix 1). We are concerned that prohibiting OTFs from making use of their own capital will reduce the level of liquidity and competition a client experiences in a given OTF. In many markets, the presence of a market maker's proprietary capital – also known as facilitatory capital – is necessary to bridge the gap between client demand (buys and sells). It is commonplace in non-equities and derivatives markets that temporary disconnects exist between client driven supply and demand. In these situations, the operator of the OTF should retain the ability to transparently deploy its own capital within the OTF in order to facilitate the business of its clients. If the operator of the OTF is prohibited from transparently using its own capital in such

[2] In terms of outstanding issuance, a company would typically have an extremely large number of identical equity securities outstanding. In contrast the company's fixed income securities are likely to come in a wide variety of flavours, in terms of interest rate type (fixed / floating), maturity dates, ranking in terms of payment priority and any the extent and nature of any security that is attached to the debt.

		circumstances, clients' ability to trade large sizes quickly, at a low cost, when they want, will be significantly diminished. Removing the restriction would also increase competition and enhance client choice. We consider the Commission's objectives of ensuring the OTF's neutrality [and therefore ensuring the duties owed to clients cannot be compromised] could be better met in other ways, without damaging the levels of liquidity the end-client can access, and therefore resulting in a better price. The operator of the OTF could disclose the process whereby it deploys its own capital, so as to facilitate an informed decision by the end user. Further, in order to promote a level playing field and allay policy makers' concerns around the risk that some clients may be disadvantaged, conflicts of interest rules - to which MTFs and RMs are already subject - could also be imposed on OTFs. Client order handling rules could also address concerns over a potential breach of duties owed to clients. **Multilateral or Bilateral?** Liquidity is provided through a number of channels across different markets, including single-dealer platforms (SDPs), multi-dealer platforms (MDPs), inter-dealer platforms (IDBs) and through manual execution channels. It seems unlikely that the new OTF category will accommodate single-dealer platforms, on account of the reference in the definition of OTF to "multiple third-party buying and selling interests". Therefore, it would appear that derivatives required to trade on an OTF (as part of the trading obligation) may not be traded on an SDP.

		SDPs provide significant liquidity to clients across various non-equities markets. SDPs enable end-users to execute trades in a variety of different products (all executed against the capital of the firm operating the SDP) based on their requirements. Additional benefits include enabling client relationships that cover research, advice and straight through processing connections that reduce operational costs and risks. The model is highly competitive. Clients trading on SDP are fully aware that they are trading bi-laterally. Due to the significant level of competition for many of the products being traded (particularly those that are more liquid) clients can also access prices from multiple SDPs (as well as other multilateral venues). Firms are effectively forced to quote competitively. If they did not, they would not attract market share. Any prohibition preventing SDPs from becoming OTFs would be to the client's detriment. Since SDPs present an incremental source of liquidity, banning this, by definition, would reduce customer choice. Clients may also be unable to access the suite of accompanying benefits and functionality offered by single-dealer platforms. **Prohibition on OTFs connecting with one another** We disagree with the proposal preventing an OTF from connecting with another OTF "in a way which enables orders in different OTFs to interact". We understand this stems from the concern that connected OTFs would resemble an MTF, and they should therefore be regulated as such. However, we would argue it is in the best interests of the end-investor that OTFs are able to

		route orders to other OTFs (under a liquidity sharing agreement). This allows client orders to be executed at more attractive prices. If liquidity sharing agreements are prohibited under MiFID, price differences across different OTFs will be arbitraged out by high frequency trading firms. This would allow HFTs to benefit - as opposed to the end investor.
	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?	By mandating clearing-eligible and sufficiently liquid derivatives to trade on either an RM, MTF or OTF ('the trading obligation') will inevitably result in more transactions occurring on trading venues. If we assume that one of policy makers' goals is to channel still more OTC trades onto regulated venues, then an OTF regime that accommodates the various styles of execution (e.g. request-for-quote, voice brokered, or electronic) will be critical (please see response to question 6). It is important to keep in mind that investors demand, and will continue to demand, appropriate channels by which they can execute bespoke transactions tailored to their needs (i.e. over-the-counter transactions). Investors view OTC and organised markets as complementary – not mutually exclusive. When clients are able to trade standardised products over exchange they will. However, when they demand a tailored solution to suit their needs they will trade OTC. Any attempt to standardise all products so they may be traded on an organised venue will prevent investors from finding a solution that fully suits their needs. This will limit clients' ability to effectively manage their risks, and ultimately impede economic activity in the European Union.
	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?	
	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?	We support requirements for investment banks to keep records of all trades on own account, as well as for execution of client orders.
	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 recognise that this requirement is intended to satisfy the G20 commitment that standardised OTC derivatives be traded on exchanges or electronic platforms, where appropriate. We believe 'appropriate' in this context to mean where demonstrably contributing to systemic stability. Only a relatively small subset of products will initially have the requisite liquidity to be suitable for trading on an trading venue (e.g. whole year G11 Interest Rate Swaps and Foreign Exchange Non-Deliverable Forwards). It will be important that OTFs are constructed to provide sufficient flexibility in how clients execute (including via voice) and therefore this response should be read in conjunction with that of Question 6. OTFs will need to accommodate a number of different execution models and must not be predicated on a limit order book paradigm. OTC derivatives commonly trade on a request-for-quote basis where the client can obtain competitive quotes from a number of dealers without having to disclose its trading interest to the broader market. It will be important to retain these features to allow clients to execute effectively and efficiently. As the liquidity of the instrument will be a key factor in determining those cleared products that are suitable to trade on a

		venue, agreeing on an appropriate definition of liquidity will be critical as liquidity is a recurrent theme in both EMIR and MiFIR. It will be important to allow for adjustments to reflect the transient nature of liquidity and the fact that an instrument's liquidity can change significantly over the lifetime of the contract. This underscores the importance of a properly designed waiver system that has the flexibility to accommodate changes in product liquidity. Finally, we support the exclusion from the trading requirement of non-financial counterparties that are exempted from EMIR's clearing obligation which should help ensure that end users needs are appropriately considered. However, it will be important that the Systemic Internaliser regime is appropriately designed to ensure that end users exempted from trading on a venue are not penalised (see response to question 21).
	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 proposals fit appropriately with EMIR?	We support proposals to remove commercial barriers that are being used to prevent competition in the clearing of financial instruments. Through the removal of discriminatory practices competition in the clearing space is increased, leading to lower costs, increased efficiencies, and increased innovation in the European market for clearing services. We particularly support non-discriminatory treatment in respect of how contracts traded on a venue's platforms are treated in terms of collateral requirements and netting of economically equivalent contracts and cross margining with correlated contracts cleared by the same CCP under Article 28. However, as the EMIR's articles on access to CCPs and access to venues of execution are likely to apply only OTC derivatives, we believe that competition

		would be further enhanced if MiFID articles 28 and 29 were not constrained by the narrower definition in EMIR and instead applied to all financial instruments.
	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?	Any revisions to the existing Article 25 should focus on how a product's complexity affects its level of risk in terms of its expected return (i.e. return volatility). Rather, the Commission's proposal is focused solely on the complexity of a product's structure. We do not object to the proposed exclusion of Structured UCITS from the execution-only regime set out in Article 25.3, provided the definition of "Structured UCITS" does not change from the current draft - i.e. the definition in Article 36 paragraph 1 subparagraph 2 of Commission Regulation 583/2010. Any wider exclusion of derivative-based UCITS would not be appropriate in our opinion.
	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 counterparties, professional clients and retail clients appropriately differentiated?	There is currently no ability to classify a group company based on the financial assets and/or activities of a holding company or subsidiary. We feel that this is necessary. The current approach clearly reflects the legal independence of the group entities in the event of default. However, it does not reflect the commercial reality of the situation that a member of a group can often draw on financial resources, expertise and experience of the holding company and other group members and so can '*punch above its weight*' compared with independent companies conducting the same activities and having the same financial assets. The proposed default classification of local authorities as 'retail' does not recognise that they are very different in size, financial experience and expertise. Particularly, they are very different across member states. A classification regime for these entities that reflects financial size, exposure to, and experience in, the financial markets would be more appropriate.
	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	We acknowledge policy makers' intent to enhance market efficiency/price formation and appreciate the role that market transparency can play in furthering these goals. That said, we do not believe that a compelling case has been made for mandating pre-trade transparency across all non-equities markets. Particularly, there is an absence of any obvious market failure

	transparency requirements and why?	and there is already a significant amount of pre-trade information and competitiveness present. We are particularly concerned over the potential for unintended consequences in terms of illiquidity and higher costs to end users that could arise under a poorly designed and calibrated regime. Moreover, it will be important to consider pre-trade transparency requirements in a global context to promote competition and avoid regulatory arbitrage. **Trading Venues** Any non-equities pre-trade transparency regime will need to have the flexibility to enable market participants, and in particular corporate end users, to continue to transact efficiently and effectively, with minimal market impact. We are concerned that the non-equities transparency regime is predicated on an equities order book model (e.g. reference to continuous quoting under Article 7) which is not suited to wholesale-focused markets. These markets are characterized by larger trade sizes and a far more numerous and heterogeneous array of instruments, with varying degrees of liquidity (please see appendix I). For continuous quoting to work for non-equities, while still providing price discovery, the quotes would need to be indicative and applicable only to liquid instruments. The concept of flexibility is underpinned in MiFID Recital 1: “The transparency requirements should be calibrated [..] for different types of trading, including quote driven systems”. In this regard, it may be helpful to include a similar reference in the Article 7. While we appreciate the Commission’s intent to avoid a “one size fits all approach”, we are concerned that administering a waiver system could pose significant challenges due to the sheer volume and diversity of instruments (compared to equities) that

		would require assessment3. Recognising the amount of pre-trade transparency that currently exists across many of the asset classes, we would recommend a more targeted approach, which for example explicitly recognises the role and transparency provided through existing request-for-quote systems, which play an important role in fostering price discovery. **Systematic Internalisation** We have particular concerns regarding the design and practicality of the Systematic Internaliser regime for non-equities which we believe is untenable both from a client and operational perspective as it is neither suited to the asset classes to which it is directed nor to the clients and how they trade. It is important that the SI regime recognises the critical role that investment firms, which deploy their capital, play in providing market liquidity by assuming risk to accommodate wholesale client needs. We are concerned that various aspects of the regime as drafted have the potential to decrease the attractiveness of providing market liquidity to the detriment of clients. This is particularly acute in fixed income and derivatives markets on account of the vast numbers of different instruments and differing levels of liquidity. Under the SI regime, firms would be required to: 1. provide firm quotes when prompted for a quote by a client (if indeed the SI does wish to quote); 2. make all firm quotes available to all clients and available to the public below a certain size; and

[3] IOSCO- plain vanilla interest rate swaps includes over 100,000 variants that can be traded on a daily basis

		3. enter into transactions with any other client to whom the quote is made available below a certain size 4. comply with best execution obligations and for quotes to “reflect prevailing market conditions in relation to prices at which transactions are concluded for the same or similar instruments on RMs, MTFs or OTFs”. As one of only twelve financial institutions currently registered as a Systematic Internaliser, we feel it is important to remember, at the outset, what the intention of the Systematic Internalisation regime for equities actually was under MiFID 1. The main goal of the regime was to achieve a fair deal for the small scale, retail investor who wanted to trade equities. From a firm’s perspective, such a regime made sense in many ways. It was fully automated, therefore reducing the need for traders to physically place the order into the market, and it was a useful method of executing smaller trades in the most liquid instruments. However, the Commission have taken a model that was principally designed for retail flow in the equities market, and applied it to non-equities. There are many differences between equities and non-equities that make such an approach unworkable. The average trade size in non-equities is much larger than in the equities markets, while non-equities markets are generally less liquid than equities. Lower levels of liquidity in non-equities markets (caused by bid-offer mismatch) mean that the role of dealers as liquidity providers is absolutely vital. We are concerned that should the Systematic Internaliser regime for non-equities be implemented as currently drafted, it has the potential to decrease the attractiveness of providing market liquidity, which will ultimately be to the detriment of the end client. This, for the

		reasons outlined above, is particularly acute in fixed income and derivatives markets on account of the vast numbers of different instruments and differing levels of liquidity. We disagree with proposals to require SIs (for non-equities) to publish firm (or transactable) quotes to clients when the quoted size is at or below a size specific to the instrument (the threshold) in a manner which is easily accessible to other market participants on a reasonable commercial basis. Indeed, in its extreme, such a regime would destroy the request-for-quote model in favour of a central limit order book approach. This is because the request-for-quote model can only exist if dealers can price transactions to reflect client specific considerations, notably counterparty credit risk, or the risk that a party to a transaction will fail to fulfil its obligations. Counterparty credit risk is particularly relevant to derivative transactions which are not cleared by a central counterparty. Different clients (counterparties) carry different levels of counterparty credit risk. Firms are likely to offer better pricing to clients that clear through a central counterparty (all other things being equal) than to those that do not. If the SI regime forces firms to quote the same price to all clients, firms will be forced to quote prices based upon the lowest common (or most risky) denominator. In other words, firms will implement defensive pricing strategies in order to protect themselves, which would create a widening of spreads, and ultimately more expensive execution for the client. Besides counterparty credit risk, there are a number of other factors that firms need to take into consideration when making pricing decisions, including:

		• Investor credit rating • Settlement risk/final settlement of the transaction • Whether the transaction is clearable or not • Wholesale v retail (conduct of business obligations placed on us as the liquidity provider) • Competitive nature of the client • Size of the order • Portfolio impacts (Credit Valuation Adjustment etc) • Choice of channel through which we quote (including connectivity costs, brokerage, latency etc.) The Commission's objective of ensuring that SIs provide all their clients with fair quotes and that no client is discriminated against, could be better fulfilled by introducing a "non-discriminatory quoting policy". This means that transactable quotes must be made available to clients on an objective basis measured against clear criteria, such as those set out above. Obliging Systematic Internalisers to provide any client with access to the same quote as made to another client is not an appropriate solution. As explained, there are counterparty risks and concerns that have to be taken into account in pricing. For these reasons, the expectation that Systematic Internalisers "should not be allowed to discriminate within categories of clients [professional or retail]" is unworkable as it is inconsistent with sound business practices (please see Recital 17 of the Regulation). We are also concerned by the absence of any reference to waivers in relation to disclosure of quotes under the SI regime for non-equities. We believe a more targeted approach is required, which takes into account the broad spectrum of assets

		and liquidity profiles in the non-equities markets. Therefore, the obligations to disclose quotes should only apply to liquid instruments. Appropriate waivers should be in place (as intended for the OTF pre-trade transparency requirements). Indeed, the SI regime for equities makes reference to the liquidity of instruments. Under the equities SI regime, the requirement to publish firms' quotes only applies to those shares, depositary receipts, exchange-traded funds, certificates, and other similar financial instruments admitted to trading on a regulated market or traded on an MTF or OTF 'for which there is a liquid market'. For those instruments where there is not a liquid market, Systematic Internalisers shall disclose quotes to their clients on request. However, there is no requirement that this quote, if firm, has to go out to all other clients. Finally, the requirement for quotes to reflect prices at which transactions are concluded for the same or similar instruments is problematic on a number of fronts. Firstly it does not consider counterparty credit risk as discussed above. In addition, it does not recognise the challenge of reference pricing for less liquid/illiquid instruments. **Operational concerns** We are concerned by the significant operational challenges such a regime would present. For example: • What mechanism would enable firms to communicate to all clients that they are offering firm prices in a specific instrument below a standard market size? • How long do prices advertised to all clients stay 'live' for?

		• How will an SI communicate to its clients that a price advertised is no longer live (i.e. the client cannot hit it). The only method of achieving this would be to stream live prices. However, the decision as to whether prices are streamed to clients is currently – and should remain – driven by the client himself. Many corporate clients do not want prices streamed, firstly because of the significant physical expense involved in establishing the stream, and secondly because they prefer simple methods of trading and interacting with us (for instance, over the phone).
	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?	See response to Q 21
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	Please see our response to question 21. In light of the large number of instruments (and thus waivers required) and the degree of heterogeneity we believe a more-targeted approach to pre-trade transparency is required for non-equities as opposed to the blanket approach proposed in the Commission's legislative proposal. It will be especially important that when creating the framework of waivers, it adequately considers the request-for-quote model. Liquidity is not a constant. Volatility and liquidity can change dramatically over a relatively short period of time. We consider it necessary to have in place some sort of mechanism to recalibrate, or allow for adjustments to waivers during periods of market stress. Under the legislative proposal, a Competent Authority must notify ESMA six months before a waiver is

		intended to take effect. We have significant concerns around this timeframe. It is considerably too long when one considers how volatile market conditions can be. A suitable alternative would be to allow national Competent Authorities to adjust, or implement new waivers as and when they see fit, albeit under a guiding set of principles established by ESMA – and accompanied by a mechanism that subjects any changes to appropriate ex-post scrutiny to ensure they were made in the spirit of the guiding principles.
	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?	We support the development of a post-trade transparency regime for non-equities and derivatives, providing it is sensitive to the nature of the market with reporting delays and volume masking calibrated in line with transaction size and liquidity. It should at all times be borne in mind that increased transparency does not equate to enhanced liquidity per se. Post-trade [public] transparency, without an appropriate system of delays in place has the potential to significantly reduce liquidity. Clients' ability to trade large sizes quickly, at a low cost, when they want, could be significantly diminished. The framework of delays should reflect the operation of the market and allow market participants sufficient time to manage their positions prior to a disclosure being made. Without such delays in place, dealers would be unwilling to take significant positions (institutional flow) onto their book, as there is a danger they will be on-risk when forced to disclose. In this scenario, the dealer risks the market moving against him before he has unwound his risk. If this were to happen, the reality is that the

		dealer would be unwilling to take large positions onto his book going forward. Ultimately, the price clients execute at would suffer. It is therefore essential that careful consideration is given to establishing appropriate reporting delays for different size trades and different asset classes. This will then help ensure that the impact of public post-trade transparency is not such as to discourage the provision of liquidity to end users. Furthermore, liquidity is not a constant. Volatility and liquidity can change dramatically over a relatively short period of time. We consider it necessary to have in place some sort of mechanism to recalibrate, or allow for adjustments to delays during periods of market stress. We believe that the CESR (now ESMA) report on post-trade transparency for non-equities and derivatives published in 2010 (see here), which calls for an appropriately calibrated system by asset class or sub-asset class, should be a good basis from which to form a European post-trade transparency regime. We advocate full disclosure to regulators, and have no reservations with providing Competent Authorities with as much post-trade data as they require.
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?	

Appendix I

The equity market consists of a comparatively small number of companies, usually with a very large number of a single class of shares outstanding, which have an indefinite life and are issued very infrequently. This is in contrast to the fixed income (bonds) market where even a single company could have many hundreds of fixed income instruments outstanding, with maturities varying from a few days to many years, with very frequent new issuance.

Looking at these features in turn:

Indefinite life vs. defined maturity securities – a hold to maturity investment policy can only apply to a security that has a maturity, so by definition all equities are ultimately tradable, unlike the fixed income markets where many investors would intend to hold their investment until the securities redeem. This means that many fixed income securities are unlikely to ever be traded. Therefore by their nature, equities should be intrinsically more liquid. Liquidity in any particular fixed-income securities would typically decline over time as more of the bonds end up with hold-to-maturity investors.

Homogeneity of securities – In terms of outstanding issuance, a company would typically have an extremely large number of identical equity securities outstanding. In contrast the company’s fixed income securities are likely to come in a wide variety of flavours, in terms of:

- interest rate type (fixed / floating);
- maturity dates;
- ranking in terms of payment priority; and
- extent and nature of any collateral that is attached to the debt.

So, even though the market value of the debt may be considerably larger than that of the equities, this can by no means be taken to imply that these fixed income securities would be liquid – something that is likely to vary from security to security. These differences are perhaps near their extreme for the securitisation markets where the debts are linked to a particular set of assets, which are by definition unique, with the originating company often playing only a minor part in the overall credit profile of the security and where some tranches of the debt can be very small.

Value of trades – Equity markets, generally, consist of a large number of relatively low value securities. Equity trades are also typically very small compared to those in the fixed income markets. This then feeds an illusion of liquidity in the equity space – admittedly there are a high number of trades but the value, particularly compared to the total outstanding value of those securities, is likely to be very small. This is in contrast to the fixed income markets where a single issue may be largely held by a small number of investors, meaning the liquidity requirements of fixed-income investors is likely to be very much more concentrated i.e. infrequent trades of positions which account for a comparatively large proportion of the outstanding securities - a situation in which equity market makers have historically been afforded special dispensation to delay post-trade transparency reporting.

Fundamental Risk and Transparency

Equities are, by their nature, higher risk securities than fixed-income instruments. This greater uncertainty over the potential risks and returns is likely to result in a far greater diversity of opinion (both at a single point in time and over a period as events unfold) among current and potential investors. This brings with it, a greater likelihood of regular trading. Once again the vanilla securitisation markets (and therefore those that have the most direct bearing on the availability of credit to the wider economy) are perhaps at the opposite extreme, having (in the case of the senior most tranches) usually been structured to limit (as far as reasonably possible) the risks to a set of fundamental economic and collateral based risks – bringing a greater degree of predictability, slower changes to credit risk profiles over time and therefore often very limited diversity of opinion over future prospects for the security.

The Market

Ability to borrow stock in the equity markets has traditionally allowed market makers to temporarily short-sell stocks and therefore meet customer orders without necessarily carrying the inventory, which is possible only if short positions can be easily covered. This in turn relies on trades being small compared to the “tradable free-float” of the security.

The Wider Value of Secondary Market Trading

As explained above we expect the current MIFID/MIFIR proposals with respect to pre-trade transparency to have an adverse impact on the liquidity of asset-backed securities in the secondary market due to the nature of the asset class and inherent illiquidity thereof. This will in turn have an adverse impact on the primary issuance of Asset Backed Securities (ABS) and, in the case of Retail Mortgage Backed Securities (RMBS), the ability of banks and other financial institutions to provide mortgages and other consumer lending. The following gives some background as to why secondary market trading is important to investors in primary issuance.

Investors need a degree of flexibility in their portfolios to enable them to manage future events. For example, in straight forward investment funds these events could take the form of unexpected fund redemptions. Whereas for investors with much longer investment horizons, such as pension funds or insurance funds, there will always be uncertainties regarding the future size and timing of the liabilities these funds are required to meet, in addition to the ever present advantage of being able to adjust the investment strategy to take advantage of changes to potential returns or to protect their investors from increases in risks associated with their investments.

Investors' ability to invest in longer-term securities is therefore reliant on their ability to make adjustments to meet any such changes in circumstances, which will at least partly rely on the opportunity to sell investments in the secondary market. ***As a result, any changes that adversely impact secondary market liquidity run the risk of also reducing the availability of funding via those channels (typically also increasing the cost) and therefore propagating this adverse effect into the sectors of the real economy that are directly or indirectly dependent on funding through these markets.***