13 January 2012

Re: Review of the Markets in Financial Instruments Directive Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

Bloomberg L.P. ("Bloomberg") strongly welcomes this initiative of the rapporteur and the ECON committee to actively engage with stakeholders and seek out their views. Bloomberg supports the overall thrust of the MiFID review and provides these comments below in response to the questionnaire.

Q4. 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?

The rapporteur may wish to address the lack of clarity in the meaning of “third country access”.

In considering this question, there should be a clear understanding as to what is meant by “regulating third country access to EU markets,” as these words could mean at least any of the following:

(a) access by third country firms to investment services/activities provided by EU firms

We respectfully suggest that the Commission should not prohibit EU investment firms from providing investment services to entities located in non-EU countries. We understand that this is not the intention, but we suggest that it be clarified that EU firms are permitted to have non-EU entities as clients. Any provision to the contrary would unnecessarily restrict the economies of the European Union as this would limit an EU investment firm’s ability to provide its services outside the European Union and diminish the influence and relevance of EU firms in the world markets.

We note that Article 28(5) of the Regulation provides that a third country trading venue may request access to a CCP established in the European Union only if the Commission has decided that the legal and supervisory framework of the third country ensures that the trading venue complies with legally binding requirements equivalent to the requirements on trading venues under MiFID, MiFIR and the Market Abuse Regulation and that the legal framework of the third country provides for an effective equivalent recognition of requests of trading venues authorised under MiFID to access to CCPs established in that third country. The reason for proposing such a limitation is not clear. If it is reciprocity, then there is no need for the references to MiFID. If, however, there is a concern that allowing access by third country trading venues to an EU CCP could compromise the EU CCP’s soundness, then we do not think that the conditions are appropriate. Even where a firm meets the MiFID, MiFIR and the Market Abuse Regulation standards, these do not address risks created by the firm’s activities on the trading venue for the CCP. If the concern is risk, we think it would be better to state that a CCP should not provide CCP services to a third country trading venue in respect of trades executed on that venue without prior notification to its Home State regulator, together with providing a risk assessment and management profile. This would allow regulatory oversight and intervention tailored to the particular facts and risks.
(b) the direct access of third country firms to EU regulated markets

Third country firms, we believe, should be able to access EU regulated markets, provided that the third country participants satisfy the criteria proposed in Article 55(3) of MiFID.

(c) the provision of services by third country firms to EU firms

If EU investment firms are to take full advantage of the opportunities offered by non-EU markets (such as those in the BRIC countries), an EU firm will inevitably need, directly or indirectly, to use the services of a non-EU firm. Such non-EU firm will not necessarily have an EU presence. We consider that the provisions in Article 36, 37 and 38 of the Regulation are potentially extremely damaging to the EU economy. For example, the legal and supervisory framework in a number of third countries (including both developed and less developed markets) would not be equivalent to the requirements in MiFID and the Capital Adequacy Directive as required by Article 37. Therefore, under the proposal, even eligible counterparties could find themselves excluded from most non-EU markets if, as proposed, they would be precluded from hiring local brokers who did not meet the EU standards. We are not aware of any issues which have raised concerns that would require enactment of any provisions of this kind.

Article 36(4) does provide that persons established in the EU are allowed to receive investment services from an unregistered third country firm “at their own exclusive initiative” even if the legal and supervisory framework of its third country is not equivalent to the requirements of MiFID and the Capital Adequacy Directive, but we respectfully suggest that the concept is both very narrow and ill-defined. Recital 36 of the MiFIR provides that any solicitation or promotion by the third country firm in the EU will automatically mean that its services are not to be deemed as services provided at the own exclusive initiative of the client. Particularly since investment firms do advertise their services, the reality of commercial interaction is such that it may be very difficult to determine whether a service is being provided at the exclusive initiative of an EU customer. In practice, therefore, the Article 36(4) exclusion will be illusory.

We respectfully suggest that the access of EU firms to non-EU markets should be informed by the following key principles:

- An EU investment firm or credit institution should be free to select any third country firm to provide it with any investment services/activities. Such EU institutions are already regulated and any principle that restricts their ability to select the persons most appropriate to provide them with the services they need would seem excessive and potentially very damaging. We do not think the EU should regulate access to the services of non-EU regulated firms by eligible counterparties and professional investors. To do so would restrict access of EU firms to most dynamically developing markets and put them at a competitive disadvantage against firms outside the EU that could freely access such markets.

- Issues related to protection of EU retail investors (i.e., investors that are not eligible counterparties or professional investors) may be solved by prohibiting third country firms from approaching EU retail customers. Investment services could be provided by third country firms to EU retail investors only if they have not solicited or promoted those services in breach of EU or national laws. The EU could allow third country firms to approach EU retail customers
only with permission and under supervision of an EU investment firm that has the primary
relationship with those customers.

In addition, article 36(5) of the MiFIR might also restrict access of EU investment firms and their
clients to non-EU markets, since it provides that any disputes between a third country firm and an EU
investor shall be settled in accordance with the law of and subject to the jurisdiction of a Member
State. If an EU investor is a participant in an overseas exchange, that exchange could be considered
to be providing services to the EU investor. The exchange’s rules, which will provide for the
settlement of disputes, will by definition be the same as regards applicable law for all participants.
The suggested provision would be incompatible with that commonly accepted practice

Q6. 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 rapporteur may wish to address the lack of clarity in the definition of organised trading
facility (“OTF”) and ensure greater certainty for both the market and regulators.

General

In our view, the OTF category is not appropriately defined because it is not possible, from the
definition, to determine whether or not any particular system would be regarded as an OTF. The
MiFIR Article 2(7) definition defines an OTF only by reference to the concept that:

- it is not a regulated market or MTF;
- but it is a system or facility in which multiple third party buying and selling interests in financial
  instruments are able to interact in a way that results in a contract.

We respectfully suggest that a clear policy decision as to what activity should fall within the
scope of the MiFID must guide the definition of OTF. We believe that the proposed regulation intends
to distinguish between a system that provides an infrastructure for participants to interact with each
other on whatever basis they think appropriate and one in which the operator exercises discretion in
determining how or on what basis orders interact. If this is in fact the intention, then the definition of
OTF should specify that.

While we agree with the intention of the legislation, the definition should make it clear that
trading venues covered by the definition of OTF must include only venues that involve both (i)
operator discretion and (ii) the possibility of interaction between multiple third party buying and selling
interests.

Vague terminology of the MiFIR

Whilst Recital 7 indicates that the OTF definition should be able to “capture all types of
organised executing and arranging of trading which do not correspond to the functionalities or
regulatory specifications of existing venues,” there is no further indication of what is meant by
“organised”. There are only two examples given in Recital 7 of what is and what is not an OTF. A
“broker crossing system” is an OTF. Facilities “where there is no genuine trade execution or
arranging taking place in the system, such as bulletin boards used for advertising, buying and selling
interests” are not an OTF. The words underlined are ambiguous and difficult to apply in practice to the facilities that are widely available today. Bulletin boards are typically electronic and their participants communicate by electronic means with the board and through the board to other participants. The boards provide a means for participants to generate and agree order on tickets between them, whilst the operator of the board remains entirely passive. Would the “arranging” be taking place in the system, if the system comprised both of the bulletin board and the communication arrangements? We would have understood that this is not the case, and the operator is not “organising” any trading at all, but the position is not clear because neither the concept of “organised” nor of “arranging taking place in the system” is underpinned by any deeper discussion or review, either in the MiFID itself or in other published documentation.

Meaning of discretion

The definition of an OTF is very similar to that of a multilateral trading facility; indeed, the principal distinction appears to be that a multilateral trading facility brings together multiple buying and selling interests “in accordance with non-discretionary rules”. Recital 8 of the MiFIR states that the “operator of an organised trading facility should have discretion over how a transaction is to be executed”. We assume, given that the OTF operator will be subject to best execution, suitability and order handling rules, that this means that the operator has to have discretion as to the parties to a transaction and the terms of a transaction on a per transaction basis, as opposed to establishing the operational functionality and making it available to participants for them to decide how to use it.

Therefore one reason why a bulletin board may not be an OTF, regardless of whether “arranging takes place in the system” (see the above discussion), is that the operator of the bulletin board will have no discretion over how any particular transaction is to be executed. In a bulletin board the market participants control whether, when and on what basis they transact.

The concept of discretion will need to be defined with substantial clarity to address user-directed actions or instructions to ensure such actions or instructions do not constitute discretion on the part of the operator. In addition, there needs to be clarity as to whether the operator of an OTF is also receiving and transmitting and/or executing orders. We assume that the idea that the operator must have discretion would mean that the operator of an OTF is also carrying out one or both of these activities, but this should be clarified.

Q8. 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?

Algorithmic trading

The rapporteur may wish to address the issue of Directive’s equating algorithmic trading to high frequency trading.

The definition of “algorithmic trading” is proposed as “trading in financial instruments where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, the price or quantity of the order or how to manage the order after its submission, with limited or no human intervention. This definition does not include any system that is only used for the purpose of routing orders to one or more trading venues or for the confirmation of
orders”. We believe that the proposed definition of algorithmic trading is too wide for the intended purpose. Our understanding is that the policy concern is that there are "potential threats for the orderly functioning of markets arising from algorithmic and high frequency trading”. We think it is important not to assume that the use of algorithms automatically equates either to high frequency trading or to the risks of abusive behaviour that have been identified with high frequency trading.

We assume from the last sentence that algorithmic trading would not include situations where an order is submitted to an order-routing system which then uses an algorithm to decide how best to divide up an order into different parts (for example, so as to achieve best execution for the order as a whole). This is not clear, however. We do not think that systems which have only these features raise any of the risks that are of regulatory concern.

We do not think that article 17(3) addresses the risks which have been identified, nor do we think it is appropriate to impose what is essentially a market-making obligation on all investment firms that may use algorithms as part of their trading technology. For example, an investment management firm could employ an algorithmic trading strategy on behalf of its clients, but this should not mean (and it would not be in the interests of its clients) that the management firm would thereby be required essentially to use its clients’ money to post firm quotes at competitive prices on a continuous basis. We believe that this provision confuses the provision of liquidity with the market risks that can be presented by certain algorithmic trading strategies if the systems and controls are not adequate to ensure that the trading strategy is appropriate and controlled. We also think that dealers and others trading as principal should be permitted to do so without also assuming market-making duties to the market at large: the liquidity provided by dealers and others acting as principal is too important to compromise by imposing additional duties. A decision as to whether to become a market maker should be left up to the individual market participant and should not be imposed by governmental fiat.

Q9 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?

We support such requirements to the extent they are applicable or relevant to the market. We would like to point out, however, that not all requirements are appropriate for all markets and asset classes and the Directive should reflect it.

Q13. 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?

Article 30 of MiFIR provides that: “where the value of any financial instrument is calculated by reference to a benchmark,” a person with proprietary rights to the benchmark shall ensure that central counterparties (“CCPs”) and trading venues are permitted, for the purpose of trading and clearing, non-discriminatory access to relevant licenses, price and data feeds and information on the composition, methodology and pricing of the benchmark. We think that while trading venues and CCPs certainly need the level of a benchmark, the composition and methods of calculation of a benchmark are not necessary for a CCP or trading venue to carry out their activities. The producer of a benchmark, however, will have extended significant resources to produce and maintain the benchmark and might be significantly harmed by a disclosure of its proprietary information. It is not enough to impose confidentiality obligations: once disclosed, as matter of fact the information is no
Q15. **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?**

In our view, proposed Article 24 of the Directive is not necessary to protect investors. MiFID already imposes a number of requirements, including acting in the best interest of the client. Not all third party payments are problematic. A blanket prohibition on third party payments could actually harm investors. We think that the real question is whether such payments produce conflicts of interests that cannot be managed. In our view the combination of the existing MiFID conflicts requirements and inducements regime has worked well and protected investors.

Q17. **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?**

MiFID Article 27(2) Member States requires each execution venue to make available to the public, without any charges, data relating to the quality of execution of transactions on that venue on at least an annual basis. Periodic reports shall include details about price, speed of execution and likelihood of execution for individual financial instruments. We think that in order to prevent execution venues from selecting criteria to make their execution look the best, the regulators should develop a unified set of execution data to be reported by each execution venue. However we consider that there should first be further work done to identify whether there is any evidence that such reports are necessary at all. We believe that market participants are already able to identify the trading venue providing the best execution for their orders and will use a trading venue that best suits their needs.

We would like to point out that there is a mismatch between the Directive’s best execution requirements and best practice in the industry, which is to measure execution costs, including the indirect cost of a trade’s effect on subsequent pricing in the market, and try to understand how they can be improved. The onus on venues to measure execution quality is displaced – it is the investment firms themselves that need to prove best execution and they should have some requirement or at the very minimum an expectation to measure the quality of their executions (using transaction cost analysis), understand and try to improve them, and be in a position to provide their clients with a report on the quality of the execution on clients’ trades.

Q20. **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?**

There are significant differences between and among instruments and different trading venues so that there is no "one size fits all" concept of pre-trade transparency that can be applied. The need for expansion of the pre-trade transparency requirements beyond the current scope has to be carefully considered. For example, what exactly is it that an operator of an OTF that is a broker-crossing system would have to provide? Waivers from the pre-trade transparency requirement may be appropriate in certain situations, including but not limited to a waiver for large orders. The concept needs to be tested against the reality of the new wide range of trading venues that will be introduced.
through the OTF regime and against the wider range of instruments envisaged to see how practicable and useful it would be and the nature of the waivers that would enable the particular market to function efficiently.

Q21. **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?**

Please see our response to Q20.

Q22. **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?**

Please see our response to Q20.

Q23. **Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?**

Please see our response to Q20.

Q24. **What is your view on the data service provider provisions (articles 61-68 in MiFID), consolidated tape provider, approved reporting mechanism, authorised publication authorities?**

While Articles 61-5 and 67 set out the requirement and scope for authorisation, the procedures for granting, refusing and withdrawing authorisation, requirements for the management body of a data reporting services provider and conditions for consolidated tape providers (CTPs), it is not clear what the obligations of market participants are with respect to CTPs and therefore why any organization would need to seek authorization. It is clear from Article 19, for example, that post-trade data must be made available through an APA and from Article 23 that transaction reports must be made directly or through a regulated market, MTF, OTF or ARM. It is not clear by which participants and under which circumstances (if any) it would be either necessary or advantageous to use a CTP. The consolidation of data is already being carried out by many market participants as well as vendors and it is critical that they continue to have access to the constituent data from the RMs, MTFs and APAs on a non-discriminatory basis and at a reasonable cost.

Q25. **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?**

For the market to be able to produce a truly accurate consolidated tape of record it would be...
necessary for all market participants to use synchronized clocks. Without them, it simply would not be possible for different consolidators of the data to be consistent in the order in which they represent historical trades. For market participants to be able to access timely, reliable information at a reasonable cost they need to be able to access consolidated data using a single license and without having to contract with each RM, MTF and APA separately with each having its own terms and restrictions, with the result that the restrictions on the terms and use of the consolidated data is the sum of the terms and restrictions of all of the venues included.

Q29. Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?

Trading in financial instruments particularly derivatives, is a global business. The United States is finalizing a new swap trading regime that provides for mandatory trading of certain cleared swaps on a regulated markets and swap execution facilities. We think that harmonization is absolutely essential for efficient functioning of global markets.

We appreciate the opportunity to submit these comments. If you should have any questions, please contact the undersigned at ccotzias@bloomberg.net

Respectfully submitted,

Constantin COTZIAS
Bloomberg L.P.