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RESPONSE OF THE FEDERATION OF EUROPEAN SECURITIES EXCHANGES (FESE)
EUROPEAN COMMISSION PUBLIC CONSULTATION ON THE REVIEW OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)

I. Introduction

We thank the European Commission for the opportunity to respond to the current Consultation Paper. The Federation of European Securities Exchanges (FESE) represents 46 exchanges in equities, bonds, derivatives and commodities through 21 full members from 30 countries, as well as 7 Corresponding Members from European emerging markets. FESE is a keen defender of the Internal Market and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE represents public Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation. In line with the interests of the broader market, securities admitted to trading on our markets have to comply with stringent initial and ongoing disclosure requirements and accounting and auditing standards imposed by EU laws.

At the end of 2010, FESE members had up to 9,050 companies listed on their markets, of which 8% are foreign companies contributing towards the European integration and providing broad and liquid access to Europe's capital markets. Many of our members also organised specialised secondary market MTFs that allow small and medium sized companies across Europe to access the capital markets; 1,035 companies are listed in these specialised markets/segments in equity, increasing choice for investors and issuers. Through their RM and MTF operations, FESE members are keen to support the European Commission's objective of creating a single market in capital markets. At the same time, as will be explained further below, the objective of integrating secondary trading at the European level does clash with another EU objective; that of maintaining the access to capital markets for vibrant local companies that are vital to economic growth and employment.

II. General Remarks

In addition to our responses to the different questions outlined below, and in an equally constructive spirit, we would like to note the following observations we have about the CP in general that go beyond specific issues:

- Our first observation is that the CP appears to be overly concentrated on trading and not to consider sufficiently the impact that trading has on other aspects of the economy, notably the ability of companies to raise capital and the ability of investors to access safe and varied products. As the operators of RMs and MTFs, our members are acutely aware that trading has a direct impact on **issuers and investors.** Hence we would like to see more of a discussion of issues such as issuers' control over trading in their shares or the structural way in which retail investors have access to capital markets. We leave it to the representatives of these groups to make their cases, but generally extend our support to those who point out that secondary trading in financial instruments should be seen in the full context of its impact on the real economy.

- In terms of process, we welcome the fact that the Commission services have been working on the Review since 2009 in a rather open and inclusive fashion, having organised several stakeholder meetings and launched studies done by 3rd parties. At the same time, we believe **there is relatively little analysis of the facts in the CP itself in some key areas**. For example, a big picture of the trading done in equity markets is missing. If some of these analyses exist but will be included in the Impact Assessment, then it may have been better to include them in the CP itself.

- Moreover, given that the MiFID Review was specifically postponed several times beyond its original date, we would have expected the CP to be more firmly focused on drawing lessons from the implementation of MiFID to date. While the CP is certainly based on such an effort, in various key areas, there is not enough information and analysis (quantitative or legal) **on the actual problems encountered with the implementation of the Directive**. The most notable example of this is the reality of a portion of the equity trading volumes occurring outside the MiFID venues of RM, MTFs and SIs. For the MiFID Review to be successful in addressing this phenomenon, there has to be a detailed legal and business model analysis of what kind of trading happens outside these venues, whether this is in any way due to the lack of clarity of any of the existing definitions of venues, and what changes may need to be introduced to these definitions. In the absence of such an analysis, the proposals put forward in the CP do not benefit from the actual experience accumulated since 2007. We recommend a detailed analysis of any difficulties in the interpretation of the Directive that may have affected its implementation as the justification for the legal changes proposed.

- Another example of an important implementation problem which has not been addressed in the CP is the fact that since 2009, the transparency parameters set by CESR are **in violation of the Directive since they do not include all the trading that happens in the EU** but instead have been based on data only from the RMs. This practical issue is due to technical problems with the transaction reporting regime; as the CESR Protocols stated, it was not possible for CESR to use the transaction regimes for transparency parameter calculations. We believe that **this and similar problems with implementation have to be fully taken into account in the MiFID Review**, which needs to find reliable solutions to these problems.

- It is in everyone's interest for a CP to be open-ended while giving a good indication of the convictions that the Services have based on the existing facts and analysis available to them. In this sense we fear **the CP is not sufficiently inclusive in some areas where certain options have not been considered in full.** For example, in dealing with trading that happens outside MiFID equity venues, the only option with which the CP is occupied seems to be the option of creating a new category, with many unstated assumptions informing this choice (the assumption that these activities cannot be seen as part of the existing venues, and that they are inherently different and justify a lower set of rules than for the existing venues). By contrast, the option of whether the existing definitions could be retained and clarified (based on a different assumption, ie that the activities are the same as those captured by the existing venues today) is not explored explicitly. We fear this will definitely influence the answers the CP attracts, because there will not be much analysis of the changes to the definitions for clarification that might achieve the Commission's stated goal of capturing this activity. In a similar vein, we note that the questions on the consolidation of data (Options A, B, and C) are predominantly based on A and B, giving the impression that there is already a preference for A or B. We doubt that this is the case, and attribute the weight of questions to the fact that the Commission may need more information on A and B than C. However, in analysing the responses, we believe extra care should be made to ensure that all options are taken into account equally.

- In some areas, the **chosen policy focus is too narrow and the CP misses crucial areas that will affect the final market structure.** In particular, with regard to derivatives, we note the CP fails to refer to the need to achieve further standardisation of OTC Derivatives as a way to increase market safety and efficiency. It is particularly intriguing to note that this reference has not been made in the European Commission consultation as it was proposed in the CESR Advice to the European Commission of 13 October 2010, which stated that 'legal, operational and product standardisation (…) can be achieved and would be beneficial for operational efficiency and the reduction of systemic risk. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described below.' We encourage the Commission to take this crucial part of the CESR (now ESMA) advice in the design of the legislative proposal.
- Finally, we are concerned that the **announced timetable** (adoption by end-May 2011) may not leave the Commission Services sufficient time to read, analyse, cross-check, and utilise the information that will be submitted in response to this CP in preparation of the College's adoption. Especially in those areas where the CP's announced line may need to be changed to take account of the input from the CP, the lack of time may act as a constraint and create an inadvertent incentive for keeping the original proposals. We draw your attention to this fact and urge you to take the necessary time to fully test the proposals you have made in the light of all new information.

III. Executive Summary

Below we provide a **selective** summary of our responses to the various sections of the CP.

General Remarks on Market Structure

We believe that the MiFID Review should provide greater clarity than is the case today on key questions of the market structure in all asset classes. Experience with implementation since 2007 shows a lack of consensus on key issues (even issues on which we believe the legal text is clear). The most important benefit of the MiFID Review will be to provide such clarity.

Above all we believe the Review should be based on the following principles with regard to market structure:

- Market structure in any asset class has to be **clear.**
- It has to be based on a **functional** approach (as is the basis of the FSAP and specifically MiFID).
- It has to be **mandatory** in the sense that once a certain activity falls into a certain category, the participant should not have the 'freedom' to get out of that category. This is not to be confused with giving all market participants sufficient **flexibility** and **choice** in the actual trading venues they may choose to do business with or to operate.
- The structure has to make a clear **distinction** between the **activity** (the function) and the **rules** attached to it. Lack of clarity in this point only creates confusion and uneven application.
- For simplicity and fairness, the structure has to have the **minimum number of venue types** necessary to **capture** all the basic trading functionalities, avoiding either of the two extremes of assuming that all functions are the same and assuming that small differences in business preferences constitute a legitimate new activity.

Based on these principles, we find that the existing venue classification of MiFID is sufficient to capture all the major trading functionalities in equities, while in derivatives there might be a need to consider a new category to capture some activities not possible to include in RMs and MTFs.

Equity Market Structure

- **There are some important anomalies in the 'big picture' of how much trading is flowing through each type of regulated venue.** By all public records, a significant amount of trading is taking place in the OTC space, i.e. trades reported as OTC and subject to only OTC rules. The magnitude of this, even at the lowest end estimate of 13% (assuming for example that every OTC trade were to be quadruple counted), contrasts with the MiFID vision of OTC as a 'spill-over' category and as an exception from the pre-trade transparency obligations of the Systematic Internaliser category. The trading in the OTC space seems in particular to be quite important in relative terms when compared with the MTF and SI categories, which are the two main venue types created by MiFID to create competition with RMs and to capture the off-exchange trading. This fact contrasts with the expectations of some market participants who thought that after MiFID most off-exchange trading would happen in the form of MTF or SI trading. The great majority of dark trading (defined as trading that happens without pre-trade transparency) is happening in the OTC space, not in the RM or MTF platforms set up under the MiFID waivers. Finally, the fact that a full accurate picture of the trading is not available is itself an important fact that needs to be included in the MiFID Review as a topic of discussion and reform.
- **The Review should ensure that only those trades originally intended to be OTC are subjected to the OTC freedoms.** In addition to aggregate market share of trades reported as OTC, the Impact Assessment needs to analyse what exactly is being traded on an OTC basis by looking at the trade-by-trade analysis, which is perfectly possible to do with the existing data and which has been done

in a recent independent study by Frankfurt University and Celent. This study concluded that the post-MiFID trading that has been reported as OTC is very different in nature from the OTC envisaged by MiFID Recital 53; that OTC is being used essentially for small size trades that would not face any market impact; that a big part of OTC trades are at sizes that one would normally have expected to see subjected to SI pre-trade transparency rules if they had been bilateral, and subjected to full transparency (and other MTF rules), if they had been multilateral. This suggests that an important amount of trading appears to be escaping the MiFID rules on trading venues for MTF or SIs.

- **The business models of many broker crossing networks could easily be seen today as either an MTF or an SI.** The Impact Assessment needs to consider seriously the fact that MiFID may not have to be revised in any fundamental way to "capture" BCNs, because the fundamental characteristics of these platforms are already captured in the MTF or SI definitions. On the contrary, not treating them as such, when they do the same business as RMs, MTFs or SIs, would mean allowing unfair competition and undermine investor protection and market integrity.
- **The MiFID Review must provide clarity on a number of fundamental principles of the MiFID structure**, namely the fact that the MiFID framework is supposed to be exhaustive; MiFID categories of venues are mandatory and must be enforced consistently; no two competitors should be allowed to do the same business while being subject to different rules; the main division of the market structure is between multilateral and bilateral, and all rules follow from this; multilateral trading cannot be discretionary; multilateral trading cannot allow restrictions for private access; bilateral trading occurs when a broker assumes capital risk and is therefore subject to lighter rules than multilateral trading; and a platform that crosses two orders is multilateral. In line with these views, we make recommendations to improve the definitions of MTF and SI and introduce a new and explicit definition of OTC based on Recital 53.

Derivatives Market Structure

A well-defined, comprehensive and exhaustive market structure is also crucial for derivatives markets. The ultimate goal should be that all market places/trading venues arranging or facilitating trades need to comply with MIFID market rules. Tighter enforcement of the three existing MIFID trade venues categories or small adaptation of how they are defined should allow covering all market places. However, if after thorough analysis of trading activities not captured by the current venue categories (which is not included in the CP), the Commission could demonstrate that some trading activities cannot be covered by the existing categories, then the introduction of a new category of execution venue like OTFs for certain derivatives market business models such as voice-arranged markets could be envisaged. It will also be necessary to understand how such a new category relates to existing execution venues and in which cases a conversion to an existing category would be necessary/justified. In principle, we would support thresholds for conversion to a derivatives MTF, and in such a case we would urge for thresholds that are clearly defined and enforced.

Equity Market Transparency

We support the proposed maintenance of the transparency requirements on equity markets. We agree with the Commission Services that the LIS waiver already has enough flexibility vis-à-vis changing market conditions and should therefore not be weakened. Similarly, we support the proposal to introduce a minimum size for the reference price waiver.

Equity Data Consolidation

We support the proposals to improve the quality, timeliness and availability of OTC post-trade data and the consolidatibility of all data through standards that support existing industry initiatives such as the harmonisation of trade identifiers along lines proposed by CESR. We strongly disagree with any proposal that would take competition out of the equity data area, and therefore firmly oppose the Options A and B in relation to the consolidation of data. Our vision is that of competing but equally good, reliable, reasonably priced consolidated tapes being offered by the industry subject to the same principles of competition as those underpinning the rest of MiFID. These tapes already exist and with the help of selective standards where needed these tapes will be the quickest and most efficient way of meeting investor needs. We caution against the Commission launching a mandatory utility tape – whether it is run by the regulators or a single industry provider – which would be a major waste of precious time and resources for both the regulators and the industry, come at a cost to the taxpayer and complicate the trading environment without solving any of the underlying problems with data.

SMEs

As our members operate RMs and MTFs that admit to trading many smaller companies, we are sensitive to the constraints faced by such companies when accessing capital markets. We also acknowledge that some aspects of the regulation of trading have an impact on SMEs' access to capital, e.g. the question of how data is presented could very easily reduce the visibility of SMEs. However, when these issues are taken globally, we do not believe that there is any major initiative needed in the MiFID Review that would improve the SMEs' access to finance. In particular, we oppose any move to lighten the regulatory requirements for SMEs to come to the markets. We feel that the choice of RM vs. MTF admission already provides sufficient choice for the different sizes of SMEs in Europe.

Non-equity Market Transparency

FESE very much **welcomes** the proposal of requiring pre- and post-trade transparency for all trades **in bond market products**. Based on our experience, we fully believe that properly calibrated pre- and post-trade transparency regimes should apply in the benefit of all market participants, in particular investors.

As for derivatives, **we strongly welcome pre and post-trade transparency as a principle**. The European Commission's proposals are in line with the G20 objectives of providing further transparency to the OTC derivatives markets. Nonetheless, as with bond markets, it is inappropriate to envisage a mere extension of requirements from one market to another. We welcome the suggestion to apply such a transparency regime by type of derivative product/market as we consider that some calibration may need to be performed because products/markets are very different from each other.

Intermediary Rules

We support the continuation of an execution-only service since that will help retain competitive pressure on intermediaries' services to clients and help with the cost and choice faced by investors when accessing capital markets. We think UCITS should be kept in the list of non-complex instruments.

Commodity Derivative Measures

FESE generally welcomes the proposed regime of position reporting. We agree that some forms of market abuse, such as manipulative squeezes, would be more easily identified where regulators have access to position, rather than transaction, reports for appropriate instruments.

Transaction Reporting

FESE members agree with the extension of the transaction reporting regime to all financial instruments admitted to trading or traded on the above platforms, as this extension would ensure that adequate market abuse monitoring rules are applied consistently across financial instruments.

We would support the extension to those OTC derivatives whose value depends on the performance of a financial instrument that is admitted to trading on a RM or on the credit risk of a single issuer of such financial instruments.

For the regulation to be effective, regulators should avoid requiring transaction reporting where position reporting would provide the relevant information. As mentioned above, some forms of market abuse, like manipulative squeezes, would be more easily identified where regulators had access to position rather than transaction reports for appropriate instruments.

Reinforcing Supervisory Powers (Commodity Derivatives)

FESE believes that a well-equipped market surveillance system, together with an adequate position management regime, rather than hard position limits are the most appropriate methods to maintain orderly commodity markets. We consider that position limits are not an effective tool for managing price volatility other than on settlement. In addition, position limits may have the unintended consequences of squeezing markets and could be counterproductive from a market dynamic point of view.

In the particular case of commodities, position limits on hedgers, arbitrageurs, investors and speculators holding positions for the longer term would be ineffective in tackling price volatility, even were it to be proved conclusively that excessive positions, whatever the definition of that might be, leads to 'excessive commodity price volatility.'

2. DEVELOPMENTS IN MARKET STRUCTURES

General Introduction

The structure of a secondary market (i.e. the venue classification) in any asset class is extremely important. It is the basis for every other component of regulation. This is because the market structure determines how the rules attached to each type of trading are supposed to be applied. It answers the questions:

- Who falls into what category?
- What happens once they are in that category?

The CP is proposing a significant change to the MiFID equity market structure through the creation of a new regulatory category. Before we provide our views on this specific proposal, we would like to note a number of concerns we have with the approach taken by the CP on this subject. We are of the view that a number of important factors are currently excluded from the assessment that are critical to the outcome. We do this in a constructive spirit to ensure the ongoing effectiveness of the markets.

EQUITY MARKET STRUCTURE

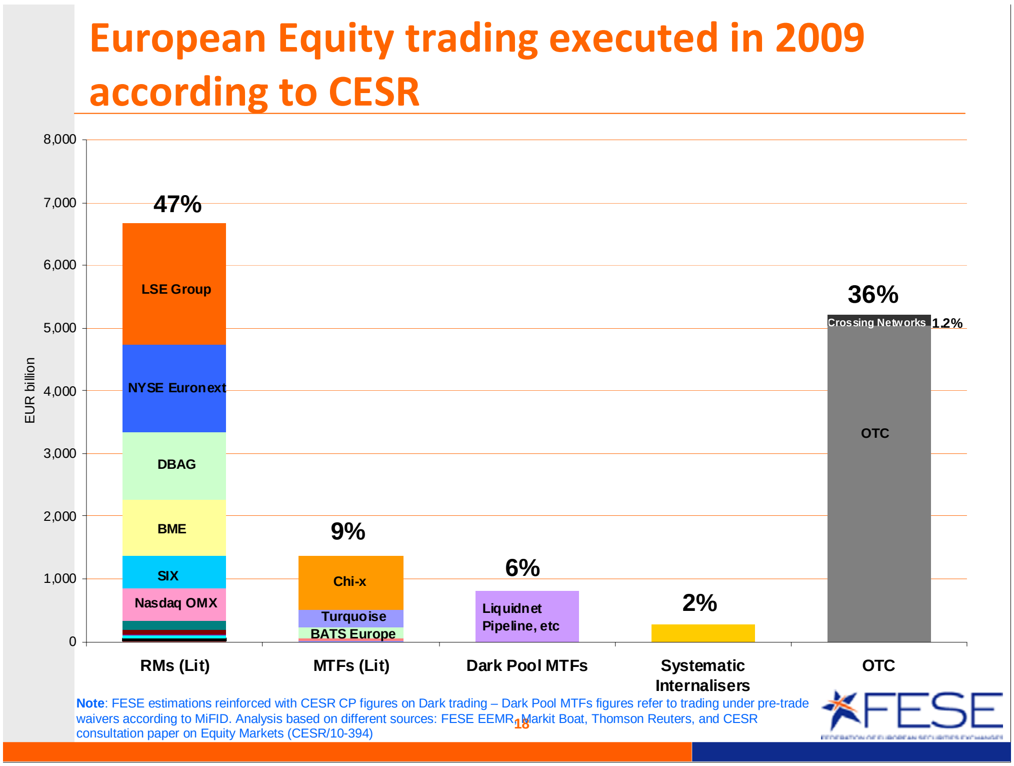
1. WHAT IS THE BIG PICTURE?

We believe strongly that as a prerequisite for any change to the MiFID equity structure, the Commission services need to have a solid basis for understanding what has been happening in the EU equity markets since the introduction of MiFID. This is missing from the CP, which does not analyse or consult on a comprehensive 'big picture' of the EU equity markets to see where trading is executed and how it is regulated. There is little acknowledgement of how the evolution of MiFID has fundamentally changed the market structures. From the CP there appears to be limited detail of the depth of the Commission's understanding of the current market structure or gaps which could be filled by stakeholders. Thus the CP appears to propose changing the rules without confronting openly how MiFID has changed market structure in the first place.

To see just how useful such a big picture analysis can be, we refer to the US SEC's Concept Release on Equity Market Structure from January 2010[1]. This CR provided a fully comprehensive picture of where trading happens in the US markets down to the last cent. The aggregate market share of each type of trading venue is useful to understanding how much trading is taking place subject to which type of rules. If the Commission services did not feel they had this information, it may have been useful to put down the partial information that they do have so that it could be the basis of a discussion on what is known, what it means, and whether the MiFID Review should propose additional changes to any type of reporting so that the information collected is sufficient to understanding market structure.

In fact, CESR did provide in its Technical Advice sufficient data to create a composite picture of the whole EU secondary markets trading in equity. Below is a chart that shows the market share captured by each type of trading venue according to CESR:

[1] http://www.sec.gov/rules/concept/2010/34-61358.pdf



We understand that both CESR and the Commission Services remained concerned that a certain amount of over-counting is still occurs in the reported OTC section despite it being nearly 3 years since implementation. As a result of this the picture above may not be fully accurate with regard to the share of OTC. However, even assuming the highest possible degree of over-counting (for example, assuming that every trade is double, triple or quadruple counted), the above figures cited by CESR based on public figures demonstrate **a number of important facts that would be worth including in the Commission Services' assessment of MiFID**:

- **A significant amount of trading is taking place in the OTC space**. The magnitude of this contrasts with the MiFID vision of OTC as a spill-over category and an exception from the pre-trade transparency obligations of the Systematic Internaliser category. Since it was conceived as an exemption from SI rules, the OTC category is exempted from all the major trading venue rules (e.g. pre-trade transparency, non-discretionary order execution, non-discriminatory access, and market surveillance). If the drafters of MiFID had known that this category was going to capture some 13-36% of all trading volumes, the content of the rules may have been different.
- **The trading in the OTC space seems in particular to be quite important in *relative terms* when compared with the MTF and SI categories**, which are the two main venue types created by MiFID to create competition with RMs and to capture the off-exchange trading. This fact contrasts with the expectations of some market participants who thought that after MiFID most off-exchange trading would happen in the form of MTF or SI trading. Again, if the drafters had known that most of the off-exchange trading conducted by brokers would be as OTC as opposed to SIs, the content of the rules would have been different.
- **The great majority of dark trading (defined as trading that happens without pre-trade transparency) is happening in the OTC space**, not in the RM or MTF platforms set up under the MiFID waivers. Again, this means that the overall framework for dark trading provided by MiFID only has a limited value in determining how dark trading is done. If most dark trading happens on an OTC basis, what does that say about the relevance of the RM/MTF waivers?
- Finally, **the fact that a full picture of the trading is not readily available is itself an important revealing fact** that needs to be included in the MiFID Review as a topic of discussion. Precisely the

fact that the public figures on OTC are so unreliable proves the necessity for a discussion on whether the supervisors need better tools to get a comprehensive view of the markets. In fact, this applies not just to aggregate market shares of traded volume, but also more granular data on trading needed for the EU Single Market to function efficiently. CESR has been making all the transparency calculations based on data only from RMs and more recently proposed a number of MTFs to be included. Yet this issue – the lack of data for aggregate market share or for transparency calculations – is not raised in the CP. There is a recognition however that the granularity and accuracy of reported OTC data need to be improved. Precisely what kind of information supervisors should have about the different trading activities needs to be discussed explicitly. That is why the unreliability of current OTC figures is an important fact to discuss.

2. WHAT EXACTLY IS BEING TRADED ON AN OTC BASIS?

Another important piece missing from the CP which we urge the Commission to take into consideration in the Impact Assessment is **an analysis of the trades occurring in the OTC space**. We believe that the MiFID Review must take into account the size and nature of over-the-counter business and explicitly ask whether OTC trading is in line with current MiFID rules and how it might impact MiFID objectives. This is because according to MiFID, OTC is not subjected to any of the trading venue rules. Therefore it is very important that only those trades that should not be subject to trading venue rules are classified as OTC.

As stated above, the aggregate size of OTC is a useful point in this context because it can suggest that it occupies a bigger place in the market than has been presumed by MiFID. However, whether OTC is 5, 10, 15 or 50% of traded volume is of secondary importance when analysing whether ***the trades executed in this space are correctly classified as OTC***. What really matters on this point is ***what kind of trades are executed as OTC***.

In this context, we note how MiFID currently defines OTC trades. Recital 53 reads as follows:

"It is not the intention of this Directive to require the application of pre-trade transparency rules to transactions carried out on an OTC basis, the characteristics of which include that they are ad-hoc and irregular and are carried out with wholesale counterparties and are part of a business relationship which is itself characterised by dealings above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser.[2]

Against this background, we brought some important new evidence to the attention of the Commission services last fall, which we believe to be most relevant to the MiFID Review[3]:

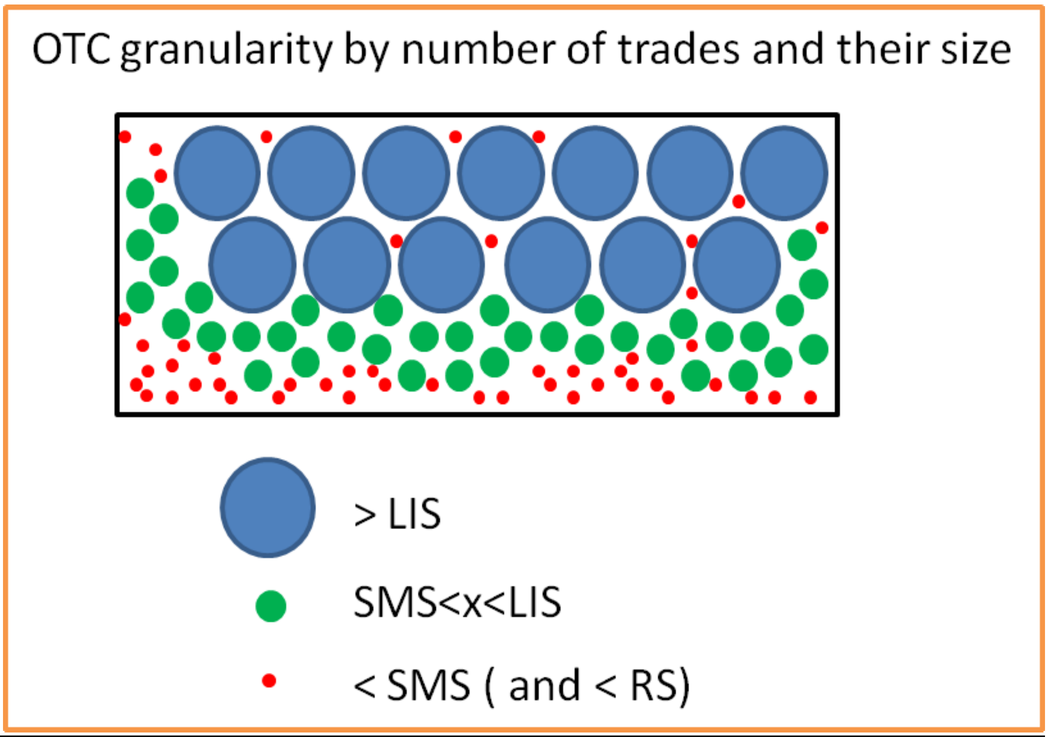
- **The median average of OTC trades is not much higher than public markets.** This means that it is wrong to argue that trade sizes on the public markets have become too small to meet the needs of investors. The median turnover - the turnover value below which 50% of all observations can be found - is quite similar for OTC and public markets, with around 8,000 euro in the OTC market and around 6,000 euro on the primary markets for high liquids.
- **Most OTC trades (73%) executed are too small to face any market impact –** therefore the justification for these trades being executed on an OTC basis cannot be that the investor needs protection from the market impact that they would face in public markets.
- **Recent research data also casts doubt on the assumption that OTC is only with wholesale parties.** A big part of OTC trades are retail size and smaller (39%), with only 13% at the size recognised as LIS, the threshold designed to accommodate the needs of the buy-side. Irrespective of whether all of

[2] European Union (2004), MiFID.
[3] Gomber and Pierron (2010) 'MiFID: Spirit and Reality of a European Financial Markets Directive'

these small OTC trades are with wholesale parties whose large orders have been sliced and diced, or some part of it comes from retail investors, the data shows that **only a very small part of the trades executed within the OTC segment would have faced market impact if executed in public markets.**

- **Specifically, if executed in an MTF set-up, most OTC trades (87%) would have to be pre-trade transparent** (and all of them would have been subject to rules ensuring discriminatory access to the platform, non-discretionary order execution, and venue surveillance).
- **If executed in a SI set-up, most OTC trades (48%) would have to be pre-trade transparent** (and all of them would have been subject to non-discriminatory access to the platform, non-discretionary execution, quote disclosure, anonymous post-trade transparency and quarterly reports with venue identification).

Summarising this research data[4] on OTC (the share of number of trades below SMS is 48%, between SMS and LIS is 39%, and above LIS is 13%) and looking at this visually, we have created the picture below:



But, what does it mean in terms of regulatory treatment?

- <u>**If the platform is doing multilateral trading**, then:</u>
    -  (largest bubble) would not be escaping any MTF pre-trade transparency, but would be escaping all other MTF rules (e.g. access, execution system, surveillance).
    -  (medium bubble) and (smallest bubble) would have escaped all the MTF rules, including not only pre-trade transparency, but also access, execution system, and surveillance.

[4] Gomber and Pierron (2010) 'MiFID: Spirit and Reality of a European Financial Markets Directive', page 21.

- **<u>If the platform is doing bilateral trading on a systematic basis</u>**<u>, then:</u>
  - o (largest bubble) and (medium bubble) would be legitimately treated as OTC as defined in MiFID.
  - o But (smallest bubble) would be escaping all SI rules, including not only pre-trade transparency but other rules (access, execution system, etc.)

The above stated facts lead us to believe that:

- The post-MiFID trading that has been reported as OTC is very different in nature from the OTC envisaged by MiFID Recital 53.
- Essentially the trades being reported as OTC are small size trades that would not face any market impact and have sizes which one would normally have expected to see subjected to SI pre-trade transparency rules because they are below the SMS (as well as being below the retail size).
- This has the consequence that an important amount of trading reported as OTC appears to be escaping the MiFID rules on trading venues for MTF or SIs.
- **To address this, the Review should ensure that only those trades originally intended to be OTC are subjected to the OTC freedoms.**

3. ARE THE NEW TRADING PLATFORMS REALLY SO UNIQUE?

Separate from an analysis of OTC as a whole, we believe the MiFID Review also needs to be based on a sound analysis of the **business models of the so-called broker crossing networks** - broker dealer crossing networks, or BDCNs – which are currently treated as OTC in terms of regulation and which have emerged in the last few years as brokers have invested in automation and created trading platforms. Except for a few recent cases, the majority of these platforms are operated under the general broker license of the operating broker as part of their normal banking business. As a consequence, they are not subject to any of the MiFID trading venue rules (for RMs, MTFs or SIs). As with OTC in general, this is based on the assumption that they constitute nothing other than what is described in Recital 53.

The CP briefly acknowledges that there is trading happening outside MiFID venues and – without analysing how much and what kind of business is done in this way - immediately concludes that this is due to new developments and technology implying that this could not have been foreseen or captured by MIFID: “In order to address evolving market practices and technological developments, and mitigate harmful regulatory arbitrage, a broad definition in MiFID could be introduced to suitably regulate all organised trading occurring outside the current range of MiFID venues.”

In doing this, the CP is leaving out some very important questions about the business models of these entities and how they compare with the MiFID rules. For example, **<u>the CP does not ask whether</u>** any trading happening outside MiFID venues today is in line with MiFID and **may have been captured by MiFID in any way** (through clearer rules or tighter enforcement). Furthermore, the CP appears to assume that, going forward, **any trading happening outside MiFID venues today should continue to be treated as different from the trading happening on the 3 main MiFID venues** and be exempted from the trading venue rules.

In taking this approach, the CP also seems **<u>to reject the main recommendations of the ECON Committee Report</u>** ‘Regulation of trading in financial instruments – “dark pools” etc’ on equity market structure, OTC and broker crossing networks. The entire equity portion of the CP presumes the creation of a new BCN category, a category that was firmly rejected by the European Parliament (which voted on these issues on 14th December 2010, several days after the consultation was published). There is a clash between the CP proposal and the Parliament's views.

We fully recognise that an analysis of the business models of every BCN would have been beyond the scope of this CP. However, on such a crucial question of proper regulation and fair competition, it is necessary to analyse the most common characteristics of BCNs and compare these with the MiFID definitions of MTFs and SIs.

Evidence from the study stated above shows the following facts about BDCNs:

- Given that functional regulation is a key concept of MiFID (and much of EU financial regulation); the regulatory classification of BDCNs should be firmly based on a **functional approach (i.e. same business, same rules).**
- As BDCNs are providing multilateral matching of client orders against each other or dealing on their own account by executing client orders (or a combination of both), **the study concludes that they should be classified either as MTFs or SIs and should fulfil the same regulatory obligations of these MiFID trading venues in terms of transparency, access, and venue surveillance**.
- The study also finds that the implementation of a **threshold approach for BDCNs** (below which they would be considered as OTC) would put other MiFID compliant trading venues (e.g. smaller MTFs, which have to fulfil the full range of requirements) at a significant competitive disadvantage.
- The study also finds that the threshold approach would undermine the policy rationale of well-regulated and supervised liquidity pools in Europe, would be easy to circumvent, and would create uncertainty for the operators of the venues.
- If OTC and BDCNs continue to increase their market share, the European equity market could shift from an order-driven market to a quote-driven one
- The development of BDCNs creates second class investors. While MiFID has imposed non-discretionary access rules to the various regulated venues, BDCNs are allowed to provide access to selected customers across the various market participant types (traditional buy side, other sell side, hedge funds, etc.). Retail clients do not normally have access to these types of venues and if they do choice is limited. Therefore, access to this liquidity pool is not set on a fair basis.[5]

Accordingly, there are a number of important conclusions to be drawn about BDCNs for the purpose of the Impact Assessment:

- A significantly large number of the BDCNs –if not all- could easily be seen today as either an MTF or an SI.
- MiFID does not need to be revised in any fundamental way to "capture" BCNs, because the fundamental characteristics of these platforms are already captured in the MTF or SI definitions.
- By contrast, not treating them as such, when they do the same business as RMs, MTFs or SIs, means perpetuating unfair competition.
- Even more importantly, it means that certain trading activities are not being subjected to the rules specifically designed for them, which undermines investor protection and market integrity.

[5] Gomber and Pierron (2010) 'MiFID: Spirit and Reality of a European Financial Markets Directive'

4. DOES EVERYONE HAVE THE SAME UNDERSTANDING OF THE MIFID FRAMEWORK?

As we have stated above, we believe that the MiFID equity venue classification is sufficiently exhaustive to capture most types of BDCN activity, which should fall under either the MTF or SI categories. Therefore MiFID does not need to be revised in any fundamental way to "capture" BDCNs.

However, this does not mean that the MiFID Review should not clarify the existing venue classification. In fact, the most obvious benefit of the Review is for the Commission to set out clearly what experience has been had over the last 3 years in terms of the enforcement of the various venue categories and what needs to be clarified.

It is a fact that there is a lack of consensus in the market on how the MiFID venue classification should be applied. The CP briefly alludes to some aspects of the MTF and SI definitions that may need to be clarified, which we find a good start but incomplete. The MiFID Review needs to go deeper into this question and identify all the key points that are currently ambiguous or misunderstood but which cannot continue without being clarified. In the nearly 2-year long debate that has ensued over the subject, we have come across a number of important issues over which divergences seem to exist. These divergences exist even though in a number of cases the legal text is very clear in our opinion. However, there seems to be different views and we believe that the MiFID Review has the opportunity to clarify these issues:

- Is the MiFID framework supposed to be exhaustive or partial?
- Are the MiFID categories mandatory or voluntary?
- Can there be two, or more, competitors undertaking the same business but subject to different rules?
- What are the main divisions of the market structure?
- Can multilateral trading be discretionary?
- Can multilateral trading allow private access?
- What exactly constitutes bilateral trading?
- Is a platform that crosses two orders multilateral, bilateral, or neither?

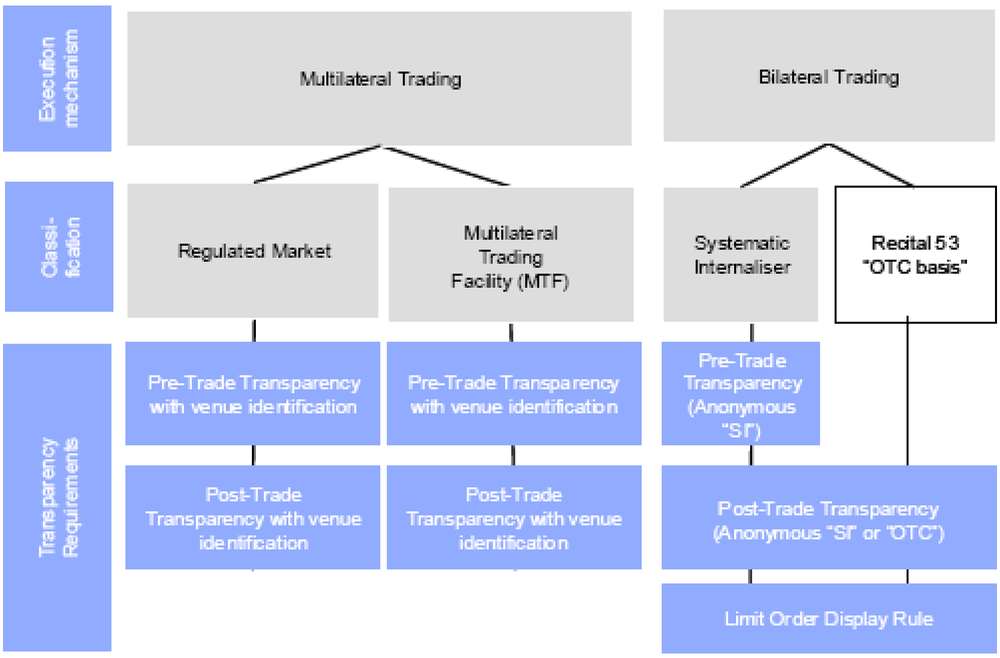
Our views on these questions are as follows:

- **Is the MiFID framework supposed to be exhaustive or partial?** We firmly believe that the intention of MiFID is to capture all types of trading on RMs, MTFs, or SIs. The only kind of trading that does not fit into these three categories is defined clearly in Recital 53. Please see the Frankfurt University/Celent study for a more detailed legal analysis of OTC as defined in Recital 53.
- **Are the MiFID trading venue categories mandatory or voluntary?** As stated at the beginning, a market structure is there to attach a set of rules to a set of activities. We believe that any trading structure only makes sense if it is mandatory and well enforced in a consistent way. Market participants will not have the self-interest to be classified in a certain way. This should not be confused, as is often done, with whether market participants have the freedom to choose their business models or whether legislation is allowing for enough space for innovation. MiFID gives brokers and market operators plenty of freedom to set up their business models in ways that best serve their users and markets. But what it does not, and should not, do is leave it to a market participant to decide to be subject to MiFID rules or not. Within this framework, there is still flexibility: for example, a broker can decide to run an MTF or an SI, or be a part owner in one, or as an intermediary use any RM, MTF or SI, or execute trades on an OTC basis. But in each of these cases, the activity that takes place in that regulatory space has to be

matched with the rules designed for that activity. Otherwise there is no meaning in having a market structure.

- **Can there be two, or more, competitors undertaking the same business but subject to different rules?** No, we believe that two competitors doing the same activity should be regulated in the same way. This is important not only for fair competition but also for investor protection, legal clarity and market integrity.
- **What are the main divisions of the market structure?** The MiFID framework makes a big distinction between multilateral trading (RMs and MTFs) and bilateral trading (SI and OTC). Based on this distinction, a different set of rules are applied. This structure rightly recognises that when brokers run an inventory of shares on their own account (bilateral trading), this exposes them to risk and therefore they should not be subject to the same rules as RMs and MTFs, although their trading should be subject to sufficient safeguards on pre-trade trade transparency, access, order execution and conflicts of interest. By contrast, anyone deemed to be bringing together multiple buying and selling interests should be doing this in an environment regulated as either a RM or MTF. This is in recognition of the fact that this activity raises risks for the public interest which require proper regulation such as pre-trade transparency for equity markets, non-discretionary order execution, non-discriminatory access, and market surveillance. Given this significance of this division, the definitions of multilateral and bilateral have to be very clear and coherent.

Please see the Frankfurt University and Celent study for more detail:



Source: Chair of e-Finance, Goethe University, Celent

- **Can multilateral trading be discretionary?** No, multilateral trading should not be discretionary according to our reading of MiFID. This is one of the biggest misunderstandings about MiFID which we believe the MiFID review should clear up. It has been suggested by many participants over the last 2 years that because the reference to non-discretionary trading is mentioned in the definition of an MTF, it should follow that a multilateral trading platform that chooses to be discretionary should not be considered an MTF. Specifically, some BCNs have been viewed as

OTC because they are not doing non-discretionary trading. However, in our view, this is circular logic that defies clear the intention of MiFID:

  - The reference to non-discretionary trading is mentioned both in the definition of an MTF and that of a RM. However, no one would suggest that an exchange could cease to be a RM by deciding not to have non-discretionary trading. The same is true for MTFs.
  - In addition to being included in the definitions of RMs and MTFs, non-discretionary trading is clearly stated in the articles describing how RMs and MTF should behave. Article 14 Para 1 clearly states that an MTF should have a non-discretionary trading system. Therefore it is clear that MiFID meant non-discretionary trading as a requirement to be imposed on MTFs, and not as condition of the business model for a platform to qualify as an MTF. It follows that a platform that otherwise fulfils the definition of an MTF – i.e. bringing together multiple buying and selling interests – should not be allowed to fall outside the definition of an MTF by establishing a discretionary execution system. ***If that were the case, we would have the absurd situation whereby a market participant is allowed to get out of MTF obligations by not following one of the key MTF obligations in the first place.***

- **Can multilateral trading allow private access?** According to MiFID, MTFs have to provide non-discriminatory access to all market participants. The reason is that when a multilateral liquidity pools is created – in the legal form of a RM or MTF - fair treatment of investors and the principle of efficiency demand that the largest number of buyers and sellers are brought together. While a RM does not even have the right to limit access (e.g. to buy-side only), an MTF can, provided it is based on objective, non-discriminatory and transparent criteria. One of the objections we have heard most often to the suggestion that a multilateral BDCN should be an MTF is the claim that this would force the BCN to open its doors to non-clients, and that this would supposedly violate one of the most basic capitalistic principles, i.e. that a bank should be able to decide with whom to do business. The implied logic is that if a BDCN is doing multilateral business, it should not be forced to become an MTF and apply the access rules for MTFs. Again, this is a very big misunderstanding that needs to be corrected by the MiFID Review. In our reading of MiFID, a platform is classified as doing multilateral trading, and from that point on, it has to follow either RM or MTF rules. A broker who finds the MTF rules for access too cumbersome would continue to have the freedom not to do multilateral trading and instead continue to do bilateral trading (in which case as a SI as well s/he will have some obligations about how to treat the clients but will have more flexibility than as an MTF). If however a broker is doing multilateral trading, s/he should not have the freedom to ignore the MiFID rules on fair access to multilateral trading platforms. This is needed both for fair competition and for fair treatment of investors and for the efficiency of the markets. Otherwise, we would have two-tiered or multi-tiered markets with pockets of investors cut off from each other.
- **What exactly constitutes bilateral trading?** As simple as it sounds, the distinction between multilateral and bilateral trading has apparently not been sufficiently clear in MiFID, with the result that some BDCNs have claimed to be operating in the OTC space, whereas they should have been considered as an MTF. (In addition, they assert that within the bilateral space, they should not be considered as doing SI because they are not systematic etc – a claim also difficult to agree with in the case of any BDCN which by definition has a systematic nature). Here we believe the MiFID Review could be helpful by clarifying that bilateral is when the broker assumes risk. This is the intention of MiFID, and the reason why SI rules are lighter than MTF ones.
- **Is a platform that crosses two orders multilateral, bilateral, or neither?** One of the confusions is whether crossing two client orders should be considered as multilateral or bilateral. We would argue that any trade on a RM or MTF (unless orders are filled partially) involve 2 client orders to make a transaction. This does not make these platforms bilateral. What matters for the multilateral/bilateral distinction is whether the broker is assuming risk (bilateral). Otherwise,

any system that brings together multiple buying and selling interests, even if all transactions are concluded based on crossing of two client orders, should be considered an MTF.

The opinions we express in response to the questions below will be informed by the preceding analysis. We strongly advise the Commission Services to incorporate these issues in the Impact Assessment.

2.1 Defining admission to trading

(1) What is your opinion on the suggested definition of admission to trading? Please explain the reasons for your views.

FESE does not believe that this definition is sufficient.

There is an 18-month delay RMs must undergo before they can admit a security that has been listed on another RM. However, MTFs can admit that same security immediately after it has been listed on a RM. The discrepancy on equal treatment should be removed as part of the MiFID Review.

Also, based on the experience during the latest financial crisis and the changes in rules in certain markets and/or venues we believe that the Regulatory Authority of the country of the initial listing, the Operator of the market where the instrument was initially listed and most importantly the issuer should be informed regarding admission of an instrument in another venue by the venue Operator. This would assist in the harmonisation on rules related to market surveillance (e.g. short selling arrangements, trade halt due to non-compliance to information provision to the market such as quarterly results, significant news etc). If that is not the case regulatory arbitrage conditions may emerge at the detriment of the orderly functioning of the market.

2.2 Organised Trading Facilities

(2) What is your opinion on the introduction of, and suggested requirements for, a broad category of organised trading facility to apply to all organised trading functionalities outside the current range of trading venues recognised by MiFID? Please explain the reasons for your views.

We assume that the question here only relates to OTFs in equity markets and include our remarks only in the context of this asset class here. Please see the Derivatives section 2.2.3 on our views on the market structure of that asset class. Both sets of views are based on the same set of principles highlighted in the Executive Summary but reflect different conclusions resulting from the specificities of these markets.

As is consistent with the analysis we have included above, we agree that a significant amount of equity trading is currently escaping MiFID rules. The following is a summary of how we see the problem and how we believe the MiFID Review should address this problem:

- The Impact Assessment needs to give a clear 'big picture' of how much trading is flowing through each type of regulated venue. The best publicly available information indicates that:
  - A significant amount of trading (somewhere between approximately 10% and 40%) is taking place in the OTC space. The magnitude of this, even at the lowest end, contrasts with the MiFID vision of OTC as a spill-over category and an exception from the pre-trade transparency obligations of the Systematic Internaliser category.
  - The trading in the OTC space seems in particular to be quite important in relative terms when compared with the MTF and SI categories, which are the two main venue types created by MiFID to create competition with RMs and to capture the off-exchange trading.

This fact contrasts with the expectations of some market participants who thought that after MiFID most off-exchange trading would happen in the form of MTF or SI trading.

- The great majority of dark trading (defined as trading that happens without pre-trade transparency) is happening in the OTC space, not in the RM or MTF platforms set up under the MiFID waivers.
- Finally, the fact that a full accurate picture of the trading is not available is itself an important fact that needs to be included in the MiFID Review as a topic of discussion and reform.

- The Impact Assessment needs to analyse what exactly is being traded on an OTC basis. A recent independent study concluded that the post-MiFID trading that has been reported as OTC is very different in nature from the OTC envisaged by MiFID Recital 53; that OTC is being used essentially for small size trades that would not face any market impact and sizes which one would normally have expected to see subjected to SI pre-trade transparency rules because they are below the SMS (as well as below the retail size). This has the consequence that an important amount of trading appears to be escaping the MiFID rules on trading venues for MTF or SIs. To address this, the Review should ensure that only those trades originally intended to be OTC are subjected to the OTC freedoms.

- Separate from an analysis of OTC as a whole, the MiFID review also needs to be based on a sound analysis of the business models of the so-called broker crossing networks, the majority of which, except for a few recent cases, are operated under the general broker license of the operating broker as part of the normal banking business. The study cited above found that a big number of the BDCNs –if not all- could easily be seen today as either an MTF or an SI. As a consequence, the Impact Assessment needs to consider seriously the fact that MiFID may not have to be revised in any fundamental way to “capture” BDCNs, because the fundamental characteristics of these platforms are already captured in the MTF or SI definitions. On the contrary, not treating them as such, when they do the same business as RMs, MTFs or SIs would mean allowing unfair competition and undermine investor protection and market integrity.

- Finally, the public debate over the last two years over the application of MiFID in terms of BDCNs has revealed that - despite being rather clear in the legal text – a number of fundamental principles of the MiFID structure do not command a full consensus in the market. These principles are too important over which to allow any divergences of view or room for interpretation. This debate shows that the European Commission needs to use the MiFID Review to clarify for once and for all the intentions of MiFID on the fundamental questions of market structure, namely the fact that:
    - The MiFID framework is supposed to be exhaustive.
    - MiFID categories of venues are mandatory and must be enforced consistently.
    - No two competitors should be allowed to do the same business while being subject to different rules.
    - The main division of the market structure is between multilateral and bilateral, and all rules follow from this.
    - Multilateral trading cannot be discretionary.
    - Multilateral trading cannot allow restrictions for private access.
    - Bilateral trading occurs when a broker assumes capital risk and is therefore subject to lighter rules than multilateral trading.
    - A platform that crosses two orders is multilateral.

While we welcome a debate on any of these issues, we strongly recommend that the MiFID Review bring clarity to all the points above.

As a consequence of the previous analysis, we believe that all multilateral business should happen subject to RM or MTF rules. We also believe that the MiFID definitions of MTFs and SIs – with minor clarifications – are broad enough to capture all possible types of business models that deal with multilateral and bilateral trading. .Consistent with our view that all multilateral business should happen subject to RM or MTF rules, and notwithstanding our view that the MiFID definitions of both MTFs and SIs are broad enough to capture all possible types of business models that deal with multilateral and bilateral trading, the only potential area in which an OTF category could have a role would be in the bilateral space. However, we firmly re-state that we see no multilateral trading functionality that could necessitate an OTF definition and that all multilateral trading should happen under RM or MTF rules.

In the views of our members, practically, the amendments needed are:

- The consistent and accurate enforcement of the MTF definition should be facilitated by removing the reference to 'non-discretionary execution' from the definition, while leaving it in Article 14 Para 1, to clarify that it is an obligation imposed on all platforms that are considered to be an MTF.
- Similarly, the reference to 'non-discretionary execution' should be removed from the definition of RM while leaving it as an obligation.
- A clear definition of OTC should be included in the main body of MiFID, building on the elements that define this activity in Recital 53. It should be clarified that no trades below a minimum size (e.g. the SMS as currently used in the Recital) and no multilateral trades should be executed on an OTC basis.
- There should be a definition of 'bringing together multiple buying and selling interests' to clarify what constitutes multilateral trading.
- The SI definition should be amended to state clearly what is 'bilateral trading'.

In other words, in equity markets, we prefer to see a revision of the MTF and SI regime, so that the definitions for each of these categories may be strengthened to capture the OTC activity which is outside MiFID venue regulation today, and the introduction of an OTC definition, to ensure that only those trades intended as OTC are executed in this space. When these steps are taken, there will not be a need for an OTF category as proposed.

By contrast, the establishment of an equity OTF is not only an unnecessary complication, but would see the intended functional approach of MiFID diminished, i.e. **'same business, same rules'**. It would appear that the Commission is not investigating whether the trading currently taking place outside the MiFID trading venues could move into these venues before determining if a new category is needed. This CP does not appear to ask whether any trading happening outside MiFID venues today is in line with MiFID and may have been captured by MiFID in any way (through clearer rules or tighter enforcement); and furthermore, assumes that, going forward, any trading happening outside MiFID venues today should continue to be treated as different from the trading happening on MiFID venues and be exempted from the trading venue rules.

MiFID is (rightly) based on the functional approach, i.e. it looks at the trading activity carried out (rather than which institution carries it out), identifies the public interest in this activity, and then matches a set of rules to the activity. These rules are then applicable to all institutions that choose to pursue this activity.

As a result, the RM/MTF categories apply a number of very important rules, which must be applied whenever the activity is multilateral trading, i.e. bringing together of multiple buying and selling interests:

- Pre-trade and post-trade transparency
- Non-discretionary order execution

- Open, fair/Non-discriminatory access to the platform
- Market surveillance by the operator
- The entirety of these rules are needed, not just a part, to regulate multilateral trading.

(3) What is your opinion on the proposed definition of an organised trading facility? What should be included and excluded?

See answer to Question 2.

We believe that the focus of the Review should be on improving the MTF and SI definitions.

(4) What is your opinion about creating a separate investment service for operating an organised trading facility? Do you consider that such an operator could passport the facility?

If the Commission were to consider that a separate venue should be defined in order to cover the OTF function, then it would be based on the assumption that this is a new service/facility with differentiations in the rules and operational procedures to be followed by the participants. Therefore, it would exist as a separate service and needs passporting. In this case the lighter application of any rules and requirements applicable to RMs and MTFs constitutes preferential treatment and an unlevel playing field.

See answer to question 2.

(5) What is your opinion about converting all alternative organised trading facilities to MTFs after reaching a specific threshold? How should this threshold be calculated, e.g. assessing the volume of trading per facility/venue compared with the global volume of trading per asset class/financial instrument? Should the activity outside RMs and MTFs be capped globally? Please explain the reasons for your views.

As we believe that a new category for equity markets is not needed, we also do not support any threshold. We believe it is the activity, not the business volume, which should determine the regulatory category. If a platform is doing multilateral trading and it is below the threshold, then it will be unfair that it is not subject to MTF rules already – and it will be bad for market quality since all the MTF protections will have been switched off due to the size of the platform.

Conversely, if the platform is not doing multilateral trading and crosses the threshold, it will be unfair to the platform to be subjected to MTF rules.

Basically, a threshold approach defies the main logic of MiFID, which is the functional approach. The rules applying to RMs and MTF are not subject to any threshold right now, and this is the way it should remain. This is because all of the following rules (pre-trade and post-trade transparency; non-discretionary order execution; open, fair/non-discriminatory access to the platform; market surveillance by the operator) are needed as a package for market quality ***even if the platform is 'small'.*** For example, even a small platform can be the subject of market abuse. Moreover, even smaller platforms, when put together in the aggregate, can be quite significant and therefore could undermine price discovery if they do not provide transparency like RMs and MTFs do. Similarly, we do not see the logic in allowing a smaller platform to use 'discretion' in the execution of orders but require a larger one to ensure non-discretion.

The current MTF package is a quality label and guarantees that multilateral trading is happening subject to the necessary rules. It should be imposed on those doing multilateral trading, no matter what size, and should not be switched on or off based on the success of the platform.

In this section, we have limited ourselves to equities, and provide our views on derivatives market structure separately. However, since this question seems to be the best place to answer this question in relation to derivatives, we would like to state our view here. For derivatives, there should be clear-cut and enforceable thresholds (defined per asset class and products within asset class based on the respective global volume) above which the OTF would have to be converted to MTF in the view of the need to have a level playing field among trading venues.

2.2.2 Crossing Systems (Equity Markets)

(6) What is your opinion on the introduction of, and suggested requirements for, a new sub-regime for crossing networks? Please explain the reasons for your views.

We also call into question the need for a BCN category to capture BCNs:

- Given that functional regulation is a key concept of MiFID (and much of EU financial regulation); the regulatory classification of BDCNs should be firmly based on a **functional approach (i.e. same business, same rules).**
- As BDCNs are providing a multilateral matching of client orders against each other or dealing on their own account by executing client orders (or a combination of both), **the Frankfurt University / Celent Study (cited above) concludes that they should be classified either as MTFs or SIs and should fulfil the same regulatory obligations these MiFID trading venues in terms of transparency, access, and venue surveillance**.
- The study also finds that the implementation of a **threshold approach for BDCNs** (below which they would be considered as OTC) would put other MiFID trading venues (e.g. smaller MTFs, which have to fulfil the full range of requirements) at a significant competitive disadvantage.
- The study also finds that the threshold approach would undermine the policy rationale of well-regulated and supervised liquidity pools in Europe, would be easy to circumvent, and would create uncertainty for the operators of the venues.
- If OTC and BDCNs continue to increase their market share, the European equity market could shift from an order-driven market to a quote-driven one
- The development of BDCNs creates a two tier structure for investors. While MiFID has imposed non-discretionary access rules to the various regulated venues, BDCNs are allowed to provide access to selected customers across the various market participant types (traditional buy side, other sell side, hedge funds, etc.). Therefore, access to liquidity pool is not set on a fair basis,[6]

Accordingly, there are a number of important conclusions to be drawn about BCNs for the purpose of the Impact Assessment:

- A significantly large number of the BDCNs –if not all- could easily be classified today as either an MTF or an SI.
- MiFID does not need to be revised in any fundamental way to “capture” BCNs, because the fundamental characteristics of these platforms are already captured in the MTF or SI definitions.
- By contrast, not treating them as such, when they do the same business as an RMs, MTFs or SIs, means perpetuating unfair competition.

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[6] Gomber and Pierron (2010) ‘MiFID: Spirit and Reality of a European Financial Markets Directive’

- Even more importantly, it means that certain trading activities are not being subjected to the rules specifically designed for them, which undermines investor protection and market integrity.

Rather than create a new sub-regime, we would urge the Commission to investigate what kind of activities are undertaken in the OTC space today and to clarify the existing regulatory framework to ensure that these activities are properly captured in the existing framework.

(7) What is your opinion on the suggested clarification that if a crossing system is executing its own proprietary share orders against client orders in the system then it would prima facie be treated as being a systematic internaliser and that if more than one firm is able to enter orders into a system it would be prima facie be treated as a MTF? Please explain the reasons for your views.

The further definitions are helpful and, accompanied by further detail and full implementation by prudential regulators across all jurisdictions, should help to identify business models which should be covered by existing regimes.

However, we think that these clarifications are not sufficient. We need other changes to the SI and MTFs definition to remove possible ambiguities:

Practically, the amendments needed to enforce this are:

- The consistent and accurate enforcement of the MTF definition should be facilitated by removing the reference to 'non-discretionary execution' from the definition, while leaving it in Article 14 Para 1, to clarify that it is an obligation imposed on all platforms that are considered to be an MTF.
- Similarly, the reference to 'non-discretionary execution' should be removed from the definition of RM while leaving it as an obligation.
- A clear definition of OTC should be included in the main body of MiFID, building on the elements that define this activity in Recital 53. It should be clarified that no trades below a minimum size (e.g. the SMS as currently used in the Recital) should be executed on an OTC basis.
- There should be a definition of 'bringing together multiple buying and selling interests' to clarify what constitutes multilateral trading.
- The SI definition should be amended to state clearly what is bilateral trading and to remove ambiguity on what is 'systematic internalisation'.

2.2.3 Trading of standardised OTC derivatives on exchanges or electronic trading platforms where appropriate

General Introduction

FESE welcomes the European Commission's proposal to implement the mandate of the G20 leaders' statement agreed on 25th September 2009 which resulted from the problems identified during the financial crisis in OTC derivatives markets. FESE believes that legislative proposals should aim at improving transparency in the OTC derivatives markets, mitigating systemic risk and protecting against market abuse in these markets.

As with equities, we believe that the same type of business should be subject to the same rules and that market structures should not be any more complex than is necessary to capture the main trading functionalities.

A well-defined, comprehensive and exhaustive market structure is also crucial for derivatives markets. The ultimate goal should be that all market places/trading venues arranging or facilitating trades need to comply with MIFID market rules. Tighter enforcement of the three existing MIFID trade venues categories or small adaptation of how they are defined should allow covering all market places. However, if after thorough analysis of trading activities not captured by the current venue categories (which is not included in the CP), the Commission could demonstrate that some trading activities cannot be covered by the existing categories, then the introduction of a new category of execution venue like OTFs for certain derivatives market business models such as voice-arranged markets could be envisaged. It will also be necessary to understand how such a new category relates to existing execution venues and in which cases a conversion to an existing category would be necessary/justified. In principle, we would support thresholds for conversion to a derivatives MTF and in such a case we would urge for thresholds that are clearly defined and enforced.

Whether or not regulators see a need for an additional category for derivatives instruments such as the proposed OTF, we support the G20 recommendations and would like to highlight that regulated markets should be used as role models and benchmark in order to ensure a safe an efficient market. These regulated market principles include pre and post-trade transparency requirements, fair/open access, market abuse monitoring, rules on conflict of interest as well as a clear authorisation process.

We believe that venues subject to those requirements would provide investors with a wide range of benefits such as for example:

- **Confirmation rates** - Exchange traded derivatives achieve confirmation rates of virtually 100% in real time, with registration and central clearing occurring simultaneously. Although confirmation rates for certain standardised OTC derivatives have improved somewhat, on-exchange processing should be regarded as the best practice model for the industry, where coverage and confirmation rates remain well in advance of OTC processing, greatly reducing the risk of error and ensuring certainty of execution and performance. In areas where clearing of OTC derivatives has been accepted, the availability of trading and clearing would add further efficiency to the total execution process.
- **Liquidity and Price Discovery** - Exchange trading will enhance liquidity. For benchmark exchange products such as NYSE Liffe's Euribor Future Eurex's Bund Future or NASDAQ OMX equity index futures, up to half the liquidity of the contract is provided by specialist proprietary trading firms, a source of liquidity not available in OTC markets where inter-bank business predominates. This helps **to ensure tight bid offer spreads** and deep liquidity. In contrast with OTC markets, this **price discovery and transparency is available to all market users**, and there is no need to access it via brokers or other intermediaries.
- **Market confidence in crisis period** - Enhanced liquidity has important risk management benefits, **ensuring that markets remain tradable during crisis situations**, particularly if market participants default and positions need to be unwound. Indeed, liquidity confidence in a crisis situation is an essential pre-requisite of safe central clearing, and exchange-traded markets increase the confidence with which products can be cleared and risk managed.
- **Benefits to users** - The increased liquidity created by moving these contracts on to exchanges will benefit users, particularly buy-side participants.

Please see our general remarks in relation to derivatives market structure.

Lack of reference to standardisation

We note as well that the consultation fails to refer to the need to achieve further standardisation of OTC Derivatives as a way to increase market safety and efficiency. It is particularly intriguing to note that this reference has not been made in the European Commission consultation as it was proposed in the CESR advice to the European Commission of 13 October 2010 which stated that '*legal, operational and* *product standardisation (…) can be achieved and would be beneficial for operational efficiency and the reduction of systemic risk. This should be achieved through the development of carefully defined industry targets, with arrangements to monitor the achievement of the targets, according to the scope and processes described below.'*

In general, the standardisation approach being implemented to allow clearing of OTC derivatives is an excellent starting point to prepare contracts for exchange trading. In some cases, it may be advantageous to ensure that this standardisation occurs in a manner that increases the liquidity in certain expiries or terms.

More specifically, the definition of standardisation could be focused on three main pillars:

- **Contract terms** (including standard dates, nominal coupon levels etc),
- **Legal process** (supporting documentation),
- **Operational process** (i.e. STP).

Exchange traded derivatives generally use standardised 'lot sizes' per contract, allowing users to tailor transaction sizes by trading the required number of contracts. For instance, Eurex's Bund Future has a lot size of €100,000 (of a notional bund) and NYSE Liffe's Euribor Future has a lot size of €1,000,000 (of a notional deposit). Market users can easily tailor deal size by trading multiples of these contracts.

(8) What is your opinion of the introduction of a requirement that all clearing eligible and sufficiently liquid derivatives should trade exclusively on RMs, MTFs, or organised trading facilities satisfying the conditions above? Please explain the reasons for your views.

FESE members believe it is adequate to introduce such a requirement for all clearing eligible and sufficiently liquid derivatives.

Clearing eligible contracts present a number of characteristics that make them almost automatically suitable for trading on RMs and MTFs: standardisation, general size of the underlying market, liquidity, the ability to value and settle contracts (e.g. through application of reliable, robust and transparent reference prices), the number and diversity of potential participants allied to customer demand and the need for the quality of deliverable[7]. The extent of standardisation, a key factor for trading on RMs and MTFs, has recently increased for certain derivatives products such as for a number of single names, driven by the move to central clearing for such instruments. In the energy markets in particular it has been noticeable that certain contracts that have begun as "cleared" only contracts have migrated into exchange-traded products after a period of time.

With regard to **liquidity**, it should be noted that up to half the liquidity of the derivatives contracts traded on RMs is provided by specialist proprietary trading firms, a source of liquidity not available in OTC markets where inter-bank business predominates. This helps to ensure tight bid-offer spreads and deep liquidity and would provide additional benefits to the OTC derivatives contracts, should these contracts be traded on RMs or MTFs. However, we see the question as not whether liquidity should be seen as a pre-requisite for trading on RMs and MTFs but whether the migration of certain contracts to exchanges would increase liquidity further and decrease risk further, particularly in crisis situations. Increased transparency associated with exchange trading is likely to increase liquidity for all standardised products or products that can be standardised.

[7] This could be the basket of bonds deliverable from which the cheapest to deliver gives the basis for pricing the exchange-traded bond derivative, while for a commodity derivative such as a copper future it could be acceptable producers, brands and chemical purity of the metal.

In summary, the introduction of a requirement that all clearing eligible derivatives should trade exclusively on regulated venues seems to be appropriate. With regard to the liquidity requirement, although laudable, it is not absolutely crucial for a product to be traded on regulated venues as it would be precisely the fact that the product is traded on these venues that would increase its liquidity.

(9) Are the above conditions for an organised trading facility appropriate? Please explain the reasons for your views.

The conditions for all types of trading facilities should be similar if all categories of venues provide the same functions. We agree that the requirements that RMs and MTFs are currently subject to are appropriate to ensure a safe and efficient derivatives market:

- pre and post-trade transparency
- non-discriminatory execution
- fair and open access
- market abuse monitoring
- rules on conflict of interest

As a general observation, if OTFs for derivatives are finally considered by regulators the conditions for authorisation and operation of OTFs should be guided by G20 recommendations to improve transparency and integrity in OTC derivatives markets, or in non-equity markets in general.

(10) Which criteria could determine whether a derivative is sufficiently liquid to be required to be traded on such systems? Please explain the reasons for your views.

Although we cannot provide an exact figure or liquidity target, we believe there are several measures that can be used a good indicator of liquidity such as the following:

- **Replacement cost of a position**. The level of the replacement costs would vary depending on the derivative product as well as the desired size/economic exposure.
- **Transaction parameters**: bid/offer size, their narrowness through how much of a trading session relative to the stated minimum price increment/tick, the 'depth' of market in terms of levels and volumes thereof of prices below best bid/above current best offer, the consistency of those parameters in time and during more volatile (3SD+) market events, the number and diversity of active players by business model, 'consistency' of market tone, price volatility variance, forwardness of all in terms of expressed forwardness of market prices, variety of fungible, equivalent and related prices in matrix.

In addition and similar to what is proposed in the context of the European Commission legislative proposal on OTC derivatives, central counterparties and trade repositories[8], top down and bottom up approaches including ESMA would be useful in this task, as ESMA will have a complete overview of markets through the date of transaction reports and trade repositories.

(11) Which market features could additionally be taken into account in order to achieve benefits in terms of better transparency, competition, market oversight, and price formation? Please be specific whether this could consider for instance, a high rate of concentration of dealers in a specific financial instruments, a clear need from buy side institutions for further transparency, or on demonstrable obstacles to effective oversight in a derivative trading OTC, etc.

[8] See http://ec.europa.eu/internal_market/financial-markets/docs/derivatives/20100915_proposal_en.pdf

The following market features could be taken into account:

- Lack of full standardisation (i.e. two completely similar derivative contracts with expiration dates differing by a short period of time like one day).
- Need for buy-side institutions to upgrade their systems.
- Potential increased participation likely resulting from higher rates of centralised trading, as a result. The concentration in specific financial instruments will decrease.
- Potential for trading to produce pricing measures to be used for risk management purposes at CCP level.

(12) Are there existing OTC derivatives that could be required to be traded on RMs, MTFs or organised trading facilities? If yes, please justify. Are there some OTC derivatives for which mandatory trading on a RM, MTF, or organised trading facility would be seriously damaging to investors or market participants? Please explain the reasons for your views.

Although exchange trading of certain OTC derivatives products might not be achieved immediately as the industry is still working towards the removal of certain barriers related to restructuring events, many standardised benchmarks contracts are already suitable for trading on RMs and MTFs, such as:

- **Short term interest rate**: there are certain interest rates types that have achieved a high degree of standardisation and that could be further standardised e.g. on specific dates.
- **Bond, credit and stock index products** (.CDS index products, IMM dates).
- **Foreign exchange derivatives**

We believe there are certain products that are not suitable for trading on RMs or MTFs. However, in order to achieve the G20 recommendations, transactions on these products could be at least facilitated by other central infrastructures like CCP Clearing or warehousing by Trade Repositories. This would in turn also cater to the improvement of the MiFID transparency requirements.

2.3 Automated trading and related issues

(13) Is the definition of automated and high frequency trading provided above appropriate?

Proposed definition: *Automated trading, also known as algorithmic trading, can be defined as the use of computer programs to enter trading orders where the computer algorithmic decides on aspects of execution of the order such as timing, quantity and price of the order.*

A specific type of automated or algorithmic trading is known as high frequency trading (HFT). HFT is typically not a strategy in itself but the use of very sophisticated technology to implement traditional trading strategies.

We support the proposed definition as it acknowledges that HFT is not a business strategy, but a technology which can encompass a variety of strategies.

High-frequency trading allows actors with the capacity and commercial incentive to interact in markets within extremely fast timescales. This potential, certainly on RMs and MTFs, is transparent and usually available to any participant with the technological capacity who chooses to utilise this type of business model. This is a product of technological advance and is not hugely dissimilar to the historical concept of market makers being located on the floor of an exchange in open outcry to enable them to be close to information dissemination and be able to react in real time to market opportunities and movements.

There is also a misperception that high-frequency traders are speculators who move markets to extremes. In fact, the vast majority of high-frequency trading involves looking for very small arbitrage opportunities, as between futures and cash markets or between the prices of exchange traded funds and their net asset values. These actions do not create volatile markets; they close gaps across markets and increase market efficiency. Indeed, in a different era, if market makers had computers with today's computing power, their activity would have produced similar results.

However, it must be acknowledged that high frequency trading can have both positive and negative impacts, for example:

- In new trading venues when a HFT firm is both a shareholder and liquidity provider, it can have a positive commercial impact on the venue;
- On existing venues institutional investors may be driven away or reduce their activity in traditional flow due to concerns that they are being negatively impacted by HFT participants.
- In their quest to find trading profits, competition among high-frequency traders also serves to tighten bid-offer spreads, reducing transactions costs for all market participants, both institutional and retail
- Rather than harming long-term investors, high-frequency trading reduces spreads, provides price discovery, increases liquidity and makes the market a fairer place to do business.
- Technology has dramatically improved the efficiency of our trading markets. Rather than putting the individual investor at a disadvantage, high-frequency trading cuts costs significantly for everyone.
- Individual investors are the ultimate beneficiaries when their pension funds and mutual funds can transact large volumes of trades anonymously with great speed and at lower cost.

(14) What is your opinion of the suggestion that all high frequency traders over a specified minimum quantitative threshold would be required to be authorised?

FESE believes that any exact thresholds for this would need to be subject to analysis and agreement between the all of the actors involved. All HFT should be required to be authorized, irrespective of their size, since they all have the same potential to impact systemic risk.

However, it may be difficult for regulators to obtain and monitor the data necessary for a threshold approach to function well.

(15) What is your opinion of the suggestions to require specific risk controls to be put in place by firms engaged in automated trading or by firms who allow their systems to be used by other traders?

We believe this is a precondition to any firms who are providing sponsored access; that they should have robust or additional controls on this activity to ensure errors or misuse are detected and prevented and that the rules of an RM or MTF are adhered to prior to the activity being sent to the venue for execution.

Furthermore, trading firms should already have in place measures to mitigate risk and measures designed to minimise erroneous trading activity, such as "fat finger syndrome".

(16) What is your opinion of the suggestion for risk controls (such as circuit breakers) to be put in place by trading venues?

A large portion of existing RMs and MTFs already have such risk controls in place (such as circuit breakers and stress testing. Please read below the table summarising the current risk controls in place in some trading venues:

Name of trading venue(s)	Type of trading venues		Circuit Breakers		Stress Testing	
	RM	MTF	RM	MTF	RM	MTF
Athens Stock Exchange (ATHEX-ASE) operated by Athens Exchange S.A	Yes	Yes	YES	No	Yes	No
Bolsas y Mercados Españoles	Yes	Yes	Yes	Yes	Yes	Yes
Börse Berlin Equiduct	Yes	Yes	Yes	Yes	Yes	Yes
Bulgarian Stock Exchange	Yes	-	No	-	No	-
Budapest Stock Exchange	Yes	-	Yes	-	No	-
Cyprus Stock Exchange	Yes	Yes	No	No	No	No
Deustche Boerse: ▪ **Frankfurter Wertpapierbörse** ▪ **Eurex Deutschland**	Yes	Yes	Yes	Yes	Yes	Yes
Irish Stock Exchange	Yes	Yes	Yes	Yes	Yes	Yes
Istanbul Stock Exchange	Yes	-	Yes	-	Yes	-
Istanbul SE: Automated Trading System (OTASS) [in the Bonds and Bills Market]	Yes	-	No	-	No	-
Ljubljana Stock Exchange –Trading on Xetra® System (Xetra® backend Vienna)	Yes	-	Yes	-	No	-
Luxembourg Stock Exchange **Euro MTF**	Yes	Yes	Yes	Yes	Yes	Yes
Malta Stock Exchange	Yes	-	Yes	-	No	-
NASDAQ OMX: ▪ **NASDAQ OMX Nordic** ▪ **First North**	Yes	Yes	Yes	Yes	Yes	Yes
NYSE Euronext	Yes	Yes	Yes	Yes	Yes	Yes
Oslo Børs: Oslo Axess, Oslo ABM, Oslo Connect	Yes	Yes	Yes	No	No	No
SIX Swiss Exchange	Yes	-	Yes	-	No	-
Warsaw Stock Exchange	Yes	-	Yes	-	No	-
Wiener Boerse: **Xetra Vienna**	Yes	Yes	Yes	Yes	No	No

In the context of the May 6th 'flash crash' these measures help to ensure that the likelihood of a similar occurrence happening in Europe is very unlikely, a point largely agreed upon by the industry.

(17) What is your opinion about co-location facilities needing to be offered on a non-discriminatory basis?

Most RMs and MTFs which offer co-location services already provide a transparent and non-discriminatory service which is available to any member wishing to use it and have the commercial business case to do so.

(18) Is it necessary that minimum tick sizes are prescribed? Please explain why.

FESE, LIBA (now AFME) and the MTFs co-operated during 2009 to agree a harmonised tick-size approach to be used in most equity markets across Europe. On 30th June 2009 an implementation timescale was agreed to deliver this harmonised service. Currently the co-operative agreement amongst the venues is proving successful and further revisions are being investigated in a co-operative manner. Therefore, we currently believe that this issue should be left to market forces.

However, if the agreement does not prove adequate in the future, appropriate principles about equity tick sizes may need to be regulated.

(19) What is your opinion of the suggestion that high frequency traders might be required to provide liquidity on an ongoing basis where they actively trade in a financial instrument under similar conditions as apply to market makers? Under what conditions should this be required?

As defined in the CP, HFT is a subset of algorithmic trading. As such the activity is not wholly market maker driven and therefore it may not be wholly appropriate to mandate obligations on HFT traders.

Market Making regimes tend to offer the market makers enhanced tariffs or access in return for them undertaking the obligations; if these were to apply to HFT it may result in unintended consequences. The Commission should conduct a further assessment of the business undertaken by HFT in order to determine their business model before mandating obligations or defining minimum order resting times applicable solely to this business type. Market makers are different kinds of participants and both are beneficial to liquidity. Mandating ongoing liquidity provisions would hurt activity whereas incentives would be the better route. These incentives are already in place by many exchanges in the form of fee discounts.

An intermediate solution may be privileged with "liquidity providers" contracts including requirements that HFT firms will have to meet in exchange for the benefits they receive from their activity.

(20) What is your opinion about requiring orders to rest on the order book for a minimum period of time? How should the minimum period be prescribed? What is your opinion of the alternative, namely of introducing requirements to limit the ratio of orders to transactions executed by any given participant? What would be the impact on market efficiency of such a requirement?

See response to question 19. Furthermore, minimum resting time will increase the risk exposure of HFTs, and therefore will result either in a shift to dark trading (risk avoidance strategy) or in an increase in spreads (risk mitigation strategy).

2.3 Systematic Internalisers

(21) What is your opinion about clarifying the criteria for determining when a firm is a SI? If you are in favour of quantitative thresholds, how could these be articulated? Please explain the reasons for your views.

Lack of clarification in the definitions of any of the alternative venues competing with RMs - i.e. MTF or SI – could be one of the reasons why the current level of equity OTC is high (about 36% according to CESR). As was originally intended by MiFID, all functionally identical trading should be regulated in the same way to ensure the same protection for investors and a level playing field ('same business, same rules').

As we have previously stated in our response to the previous CESR MiFID consultation (CESR 10-394) the revision of the SI regime might be one of the options for capturing some of the OTC activity which is escaping MiFID venue regulation today. Therefore this question needs to be assessed in the broader context of the other changes made to the venue framework. Whatever is done, the principle should be that the venue structure ensures price formation and 'same business, same rules'.

Also previously stated, the overall functional approach of MiFID must be safeguarded. MiFID makes a useful distinction between bilateral and multilateral trading which must be retained. Multilateral trading should in principle be regulated as RM or an MTF (e.g. if bilateral platforms link to one another, this should be considered de facto as multilateral).

All bilateral trading should be adequately captured and regulated within the MiFID framework. This could be done for instance by widening the SI definition in which case the obligations on SIs would be modified (though not necessarily radically) to bring them in line with the new definition. The SI regime occupies only 2% of the market, whereas OTC is a total of 36%. There is definitely merit in looking at whether the SI regime is comprehensive. Finally, OTC would also be defined to create more clarity; OTC would be essentially for larger trades.

To capture all systematic, frequent, organised bilateral trading in the SI regime, as intended by MiFID, it would be useful to delete the 'materially commercial' criteria and the reference to 'non-discretionary' in the SI definition (Level 2). Moreover, all SIs should be subjected to tightened pre-trade transparency rules (e.g. a higher SMS structure for all shares.) This is because in certain instances, these could allow an OTC platform which otherwise does the same business as an SI not to be considered as an SI regime. The other two criteria stated in 21(1) (b) (personnel or automated technical systems) and (c) (regular or continuous basis) are fully sufficient to define an SI.

Another possible difficulty in the proper application of the existing categories is that some current OTC platforms may be combining multilateral and bilateral business models, which makes their classification difficult. It would be useful to consider how EU regulation can achieve an outcome whereby multilateral and bilateral trading would be separated more clearly and each would be submitted to proper classification. Certainly, combining these two businesses should not allow the operation of a venue to escape the rules of either type of venue.

(22) What is your opinion about requiring SIs to publish two sided quotes and about establishing a minimum quote size? Please explain the reasons for your views.

In general, we have the impression that the pre-trade transparency provided by SIs is not sufficient. Therefore, we support:

- SIs to maintain quotes in a size that reflects the business they are prepared to undertake;
- The rules to maintain the price improvement restriction (since this would be bad for the price formation process overall);
- SIs to identify themselves in real time (and not just on an quarterly basis) and
- SIs to also to make the information public as to where they publish post-trade information.

All these changes/decisions would be an important contribution to improving pre- and post-trade data and overall transparency.

2.5 Further alignment and reinforcement of organisational and market surveillance requirements for MTFs and RMs as well as organised trading facilities

(23) What is your opinion of the suggestions to further align organisational requirements for RMs and MTFs? Please explain the reasons for your views.

FESE supports the elimination of all potential comparative disadvantages faced by RMs vis-à-vis MTFs. We see merit in the proposal to apply the same organisational requirements to RMs and MTFs. MTFs have the same rights as RMs, therefore they should also have the same obligations. For this reason, we fully agree with the proposal that MTFs be adequately equipped to manage the risks to which they are exposed, to implement appropriate arrangements and systems to identify all significant risks to its operation and to put in place effective measures to mitigate risks. We believe that, at present, enforcement with regard to MTFs is not as strict as it is for RMs. Thus, measures in order to reduce discretion of competent authorities will help to ensure that rules apply equally across RMs and MTFs as well as across different jurisdictions.

Another concern refers to the differentiation MiFID makes between RMs and MTFs in the authorisation of new products. Currently, RMs wishing to trade an instrument admitted to trading on another RM must wait 18 months before being authorised to trading it. The same rule does not apply to MTFs and we urge the Commission to address this situation.

(24) What is your opinion of the suggestion to require RMs, MTFs and organised trading facilities trading the same financial instruments to cooperate in an immediate manner on market surveillance, including informing one another on trade disruptions, suspensions and conduct involving market abuse?

In principle, the concept of greater co-operation would provide enhanced stability to the markets and increase the potential that abuses would be identified and appropriate action taken. However, as fragmentation is now so widespread and the organisations in question are in direct competition with each other, it is challenging to ascertain how this concept could work in practise without a “lead” entity and strict and transparent engagement criteria. It would appear sensible that the “home market” or “listing venue” take the lead in this respect; clearing the work in conjunction with the relevant prudential regulator. As an example of co-operation the majority of RMs who are members of FESE already have in place a formal methodology to enable us to communicate with the relevant experts on trading on disruptions or halts.

Therefore, regarding trade suspensions related to stock events (M&A), a greater coordination of national regulators could be required. An alternative would consist in the automated flagging and suspension of trades in an instrument, by the venues on which the instrument is listed. In the case of cross-borders market abuse, ESMA should be given greater monitoring and enforcement powers.

2.6 SME Markets

(25) What is your opinion of the suggestion to introduce a new definition of SME market and a tailored regime for SME markets under the framework of RMs and MTFs? What would be the potential benefits of creating such a regime?

We do not believe there is any need for introducing special regulation on SMEs access to capital markets and we do not believe that this is an issue that should be addressed within the MiFID Review.

If SMEs face difficulties in accessing capital markets, then this is due to a number of factors:

a) the difficult business environment following the financial markets crisis
b) it has become more difficult to find appropriate investors
c) lack of visibility vis-à-vis investors. T

We believe that these issues will not be resolved through lighter regulation.

Smaller companies are a critical part of the EU economy as they are significant engines for employment growth, and important for innovation and competition. Due largely to EU legislation, the cost of going public and being a publicly quoted company has increased enormously, in terms of the cost of compliance, management cost and public scrutiny. Small listed companies remain very nationally bound for investment and therefore do not benefit from EU passports. There are relatively few EU networks, initiatives or supports which reduce the impenetrability of the EU markets for small listed companies and allow them to go across borders. Small listed companies struggle to get brokers and analysts coverage beyond their national border and therefore investment remains national.

From a market perspective, smaller companies are essentially a different asset class to deeply liquid and frequently traded stocks. They should be looked at in this way from a market infrastructure, investment, support and regulatory perspective and should not be retro-fitted into structures, rules and networks for which they are fundamentally ill suited. For this reason, we believe that focussing primarily on regulatory initiatives runs the risk of missing the greater issue. In our view, the solution cannot be found by introducing a new SME market definition and tailored regulatory regime in MiFID, or indeed, by regulation alone. We believe there is a role for the EU institutions to play beyond regulation, by setting a pan-European strategy with a clear vision for the smaller listed company segment, taking into consideration the key areas of enterprise, finance and macroeconomic policy. There is also a clear need to create a community for the small listed company sector as an asset class and delivering to the needs of this community in terms of origination and the required infrastructure supports.

We acknowledge and fully support the on-going work of DG Internal Market and DG Enterprise (i.e. SME Finance Forum), going forward we believe it would also be useful for the Commission to hold a workshop for EU SMEs, investors in these companies and other market participants (e.g. analysts) with a view to exploring how best to address the multiple challenges faced by this important sector.

(26) Do you consider that the criteria suggested for differentiating the SME markets (i.e. thresholds, market capitalisation) are adequate and sufficient?

Please see response to 25. We do not think these proposals are justified. In addition, we would like to address an important issue that, in our view, should be taken into consideration.

To assess the SME Markets in more detail we believe the first step to take should be to analyse the effect MiFID has had on the market structure and in turn access to capital for SMEs.

RMs **fully supported the introduction of competition** based on the fact that it would be on a level playing field. However, this situation, in our view does not offer that, it has allowed **unfair competition from brokers**; they have effectively been given a free rein to compete whilst applying **no trading venue rules.**

FESE members believe that **the regulatory framework must make room for different needs**, which often emanate from different sizes. For this reason, we have **a positive view of all primary market MTFs**, and insist that they must be retained as a separate avenue for smaller companies to access capital markets, in addition to and distinct from the RM avenue. FESE members serve smaller companies through both types of platforms.

Capital markets **are important for raising capital for SMEs** and in our view this facility has to **remain viable**. Currently, SMEs raise capital either through the main RMs or through the dedicated growth market MTFs as set up by the RMs - this **choice** should most certainly be **retained**.

When assessing the existing **regulatory burdens we believe that they must be kept to the minimum** needed for investor protection and market integrity.

The existing framework in our view is robust and fully supports the requirements of SMEs. RMs have in addition created a platform which has lighter regulation and requirements for SMEs and in our view a change of requirements is not going to solve the main issue because we believe that changing the requirements to list would not have a huge impact on costs as it will always cost a certain amount for a company to come to the market and for the RM to maintain that listing. Changes to the requirements do not necessarily mean that less work is required in order to accept a listing or apply to list. More importantly, listing on a RM provides them with a certain 'quality label' as all instruments are EU instruments.

Finally, we are also concerned about the **lack of visibility an SME** has under the new trading structures, we believe that following MiFID there is a risk that the visibility has decreased in two ways:

First, it is clear in RMs that an investor viewing for example blue chip stocks will also consider other stocks listed on that market (i.e. SMEs) as potential investments. However, now that trading of blue chips is being done on other trading platforms we are concerned that there is a large scope of investors who may not consider going to the RM to view what else is available; as a result SME shares are not being viewed and considered as an investment option as much as they were previously.

In addition, in terms of RM selling data, if they were obliged to provide specific data i.e. data on individual companies and not the whole package, again, this would significantly decrease the visibility of SMEs and as a result reduce their chances in being viewed as a potential investment. Steps should be taken to generate more interest in SMEs as a pan-European investment class, and any actions that might reduce their visibility should be avoided.

Overall, we believe that the bigger issue here is to review and consider the impact of the trading structure on the economy, and we do not see any need to introduce additional requirements to 'reduce' the regularity burden on SMEs.

3. PRE- AND POST-TRADE TRANSPARENCY

3.1 Equity Markets

3.1.1 Pre-trade transparency

(27) What is your opinion of the suggested changes to the framework directive to ensure that waivers are applied more consistently?

As a general principle, the rationale behind the four waivers available for RMs/MTFs is that of the necessary protection of large-in-scale orders from adverse market impact whilst safeguarding price discovery. Any deviation from pre-trade transparency disclosure must be well justified to protect price formation and avoid distortions to the level playing field. There have been difficulties in the application of the waivers, these problems are twofold. Firstly, they are caused by the way pre-trade transparency waivers were designed. Secondly, they are caused by the way pre-trade transparency waivers were interpreted and enforced across the EU. Going forward, after a recast of the pre-trade transparency waivers, we would encourage the move towards a rule-based approach in order to provide greater clarity to market participants and to ensure that rules are applied in the same way across the EU.

In principle, we agree with all the changes proposed.

(28) What is your opinion about providing that actionable indications of interest would be treated as orders and required to be pre-trade transparent? Please explain the reasons for your views.

We agree with the proposal. This appears a sensible step forward. However, the suggestion that "such indication of interest could not be made transparent to direct participants in a trading system without also being made public" may result in practical impediments. Rather, if an IOI is made transparent to all members of a trading system rather than a selective group, it would have the effect of making the IOI public knowledge which could limit or, indeed prohibit its use. The standard waivers and thresholds should also apply to IOIs.

(29) What is your opinion about the treatment of order stubs? Should they not benefit from the large in scale waiver? Please explain the reasons for your views.

FESE believes that the LIS waiver should not apply to stubs, and that it should be clearer that the waiver threshold only applies to the initial orders, and not to any residual orders that have been partially executed. Thus the remaining stubs would have to be disclosed in the order book or cancelled. This is consistent with the principle that only large orders should be protected against market movements.

(30) What is your opinion about prohibiting embedding of fees in prices in the price reference waiver? What is your opinion about subjecting the use of the waiver to a minimum order size? If so, please explain why and how the size should be calculated.

We support the Commission Services' proposal to ban embedding fees into prices. 'Quarter-Spread-Matching" models and the like undermine the original rationale of the Reference Price Waiver, which were meant to restrict the amount of dark trading.

We fully agree that the reference price waiver should only be available above a minimum size. This is consistent with the original intention of the Directive and with the principle that all order should contribute to price formation unless they are large enough to face market impact.

Gross prices should be used for the calculation of the reference price so as not to disadvantage some trading venues, and to limit detrimental practices such as payment for order flow for instance.

(31) What is your opinion about keeping the large in scale waiver thresholds in their current format? Please explain the reasons for your views.

Our main principle is that orders that are not large should contribute to price discovery. We need to ensure that only those orders that truly need protection from market impact are kept dark, while all other orders contribute to price formation. We believe that the current calibration for LIS orders is appropriate and we encourage the Commission to maintain the LIS threshold as it is.

We are aware that the Commission will receive feedback from some parties to the effect that the changes in the market conditions over the last few years should trigger a revised LIS table, with lower thresholds. We disagree with this, essentially because we find that the table is already based on parameters that change with liquidity conditions, and therefore large orders in any company will be protected at lower thresholds if market conditions change dramatically.

We therefore support the Commission's pro-transparency approach and agree with the proposal.

3.1.2 Post trade transparency

(32) What is your opinion about the suggestions for reducing delays in the publication of trade data? Please explain the reasons for your views.

We agree with the suggestions and support simplifying the table and deleting intra-day delays

3.2 Equity-like instruments

(33) What is your opinion about extending transparency requirements to depositary receipts, exchange traded funds and certificates issued by companies? Are there any further products (e.g. UCITS) which could be considered? Please explain the reasons for your views.

We are of the view that it would be appropriate to apply the MiFID transparency requirements to financial instruments such as depository receipts, exchange traded funds and certificates issued by companies on the condition that they actually trade on-exchange like shares. This condition is important so as to avoid inadvertently applying transparency requirements to financial instruments, such as collective investment undertakings, that facilitate investments via subscriptions and redemptions, rather than by on-exchange trades. The definitions of the various financial instruments being brought within the scope of the equity transparency requirements will need to be drafted carefully to achieve this. For example, the definition of 'Exchange Traded Funds' for these purposes should, in our view, clearly exclude collective investment undertakings which are admitted to trading on a RM but which do not actually trade in the secondary market and which instead facilitate investments via subscriptions and redemptions.

We believe that it would be appropriate to initially extend the transparency requirements to the financial instruments outlined above and then over time further expand the range of instruments where a clear market rationale for doing so exists.

(34) Can the transparency requirements be articulated along the same system of thresholds used for equities? If not, how could specific thresholds be defined? Can you provide criteria for the definition

of these thresholds for each of the categories of instruments mentioned above?

A system of threshold could be applied, but will have to be adapted to the characteristics of the instruments at stake.

3.3 Trade transparency regime for shares traded only on MTFs or organized trading facilities

(35) What is your opinion about reinforcing and harmonising the trade transparency requirements for shares traded only on MTFs or organised trading facilities? Please explain the reasons for your views.

Whilst we broadly support transparency for shares traded only on MTFs, some Members believe that mandatory transparency for such shares similar to that for shares admitted to trading on RMs would be beneficial whilst others believe a separate regime would be preferable. It is important to take into consideration that SMEs have a choice offered by RMs in terms of listing on an RM or MTF and subsequently a choice in terms of transparency. If any such transparency rules were introduced, it would be important to distinguish between EEA instruments and non-EEA instruments as some FESE Members have non-EEA instruments included for but not admitted to trading, leading to the situation that the issuer located in a non-EEA jurisdiction cannot be held responsible for disclosure obligations arising from listing requirements.

(36) What is your opinion about introducing a calibrated approach for SME markets? What should be the specific conditions attached to SME markets?

See response to question 35. Whilst there may be a reasonable rationale to utilise a calibrated approach, any such assessment should ensure that any relaxation of the obligations within the calibrated approach does not result in opportunities to inhibit transparency and therefore allow business to be opaque to the detriment of the wider market.

SMEs should not benefit from a lighter regime regarding trading, so as to ensure an even level of investor protection; however, a lighter regime could be applied to SMEs regarding listing.

3.4 Non equity markets

3.4.1 Pre-trade transparency

3.4.2 Post-trade transparency

(37) What is your opinion on the suggested modification to the MiFID framework directive in terms of scope of instruments and content of overarching transparency requirements? Please explain the reasons for your views.

We agree that there is a need to regulate transparency for bond markets in the context of the MiFID Review and therefore we agree with European Commission’s proposal of requiring pre- and post-trade transparency for <u>all</u> trades in bond market products, whether executed on RMs, MTFs, organised trading facilities or OTC.

In addition, we fully believe that the transparency requirements should apply to all bonds with a prospectus or which are admitted to trading either on a RM or MTF. However, we would like this to be extended to all bonds <u>not</u> admitted to trading either on a RM or MTF. Currently, the majority of bonds are admitted to trading on a RM, even though the majority are not traded on exchange, but OTC. The fact that bonds tend to be admitted to trading on a RM brings with it many advantages for the investors, because these bonds are issued with initial and ongoing issuer disclosure requirements and are subject to other important investor protections such as conduct of business rules. However, if trading in bonds becomes subject to transparency obligations, and this is only required for bonds admitted to trading on a RM, this might act as a disincentive for admission to trading on a RM and in the end reduce transparency of all kinds. Thus, it is important to introduce transparency also for instruments not admitted to trading on MiFID regulated venues.

Contrary to claims that 'transparency kills liquidity', we have evidence on how transparency boosts liquidity, as the case of the Danish market where the pre- and post-trade transparency regime was developed in cooperation with market participants and it has brought positive results to market efficiency. Similarly, in Iceland there is an order-driven market in place with equity-like (pre- and post-trade) transparency that has had positive results. Similarly, mandated transparency in Italy has been beneficial. Moreover, the US experience also shows the positive effects of transparency[9]. Equally, it is essential that transparency requirements in secondary trading are applied consistently (in both concept and practice) across the full range of trading venues, including OTC trading.

As far as derivatives as concerned, we strongly welcome pre-trade transparency as a principle. The European Commission's proposals are generally in line with the G20 objectives of providing further transparency to the OTC derivatives markets. Nonetheless, it is important to note that derivatives markets have several characteristics that make them very different to equity or fixed income markets. In this context, we welcome the suggestion to apply such a transparency regime by type of derivative product/market as we consider that some calibration may need to be performed because products/markets are very different between each other. Hence, some exemptions may need to be made in the regime.

(38) What is your opinion about the precise pre-trade information that RMs, MTFs and organised trading facilities as per section 2.2.3 above would have to publish on non-equity instruments traded on their system? Please be specific in terms of asset-class and nature of the trading system (e.g. order or quote driven).

First of all, pre- and post-trade transparency plays distinct and complementary roles in supporting price formation in both equities and bonds. Post-trade transparency alone is not enough. Although the price formation process is different in bond markets, the presence of publicly available pre-trade prices is essential to a fair price formation for bonds as well.

We believe that pre-trade transparency would help not only retail investors but professional investors to achieve best execution in fixed income securities. Investors would benefit both from better prices and a proper implementation of the best execution requirements, for which a certain level of pre-trade transparency is necessary.

It is known that bond trading is mainly executed on an OTC basis via electronic platforms or via telephone brokerage platforms. It is estimated that about 95% of bond trading is OTC out of which telephone brokerage represents the larger part of the OTC market, and only 5% is executed on either RMs or MTFs.

In the current OTC trading environment, the pre-trade transparency that is provided is not effective. In a bilateral OTC market (mainly telephonic), there are significant limitations on the effectiveness of pre-

[9] SEC speech discussion: "An overview of the bond market transparency" by Chester S. Spatt
http://edgar.sec.gov/news/speech/spch010606css.htm

trade transparency. Currently, dealer quotes are available through facilities such as Bloomberg. However, these indicative levels are variable depending on individual client relationships, transaction sizes and other circumstances: In the case of a client telephone call to initiate an immediate transaction, the opportunity to publish any meaningful pre-trade information is limited or non-existent. By contrast, electronic order-driven markets currently offer full pre-trade transparency. Retail investors are usually not able to assess the pricing quality of bonds offered by their intermediary. Since the most relevant factor for best execution for retail investors is the total determination (i.e. price and costs), the lack of access to data for retail investors significantly undermines the application of the best execution rule to bonds.

If the bond issue has been sold mainly in the primary market to retail investors (follow the Prospectus Directive and MiFID definitions of a retail investor), we believe that full pre-trade transparency must be mandatory. However, we believe that appropriate waivers from the pre-trade transparency requirements should apply to trading in wholesale debt securities, as is the case for equities.

We agree with the implementation of a consistent pre-trade transparency regime applicable to all bonds in all trading venues including OTC. CP 3.4.1 envisages investment firms being required to make public quotes in terms of price and volume which are binding below a specific trade size. In our opinion, an equivalent pre-trade transparency regime should be applicable to RMs and MTFs. In other words, orders below a specified size should be displayed in full, whereas orders above a minimum size should be subject to client direction in terms of display of size and price. Hence, we are in favour of including a pre-trade transparency waiver regime.

There is broad recognition that the European markets for corporate and asset-backed bonds do not fully meet investor requirements in respect of liquidity and cost. These inadequacies result from a reliance on dealer capital which is currently inadequate to fully support market needs. Currently, several initiatives are under way to introduce electronic order-driven trading alternatives to these relatively illiquid markets. There is a general acceptance that, if successful, electronic order-driven trading will bring significant improvements in liquidity and transaction costs as well as facilitating the introduction of Central Counterparty (CCP) services in the European bond markets.

In our view, an imposition of pre-trade transparency requirements on orders in excess of minimum retail size may have a detrimental effect on these desirable market developments. By their nature, the corporate debt and asset-backed bond markets have limited liquidity, in that transactions are spread over a substantial universe of bond issues. The existence of large orders in specific bonds may have a significant effect on market pricing of those bonds, quite disproportionate to the effect of similar transparency in the equity markets. As a result, institutional investors display marked reluctance to participate in trading venues which mandate full display of orders. In our opinion, a blanket pre-trade transparency requirement for large orders would place RMs and MTFs at severe disadvantage to OTC bilateral trading. Put simply, an institutional investor would, in all likelihood, pick up the phone and conclude a bilateral OTC transaction rather than publish a fully disclosed order on RM or MTF.

It is important to keep the level playing field and to elaborate a pre-trade transparency regime that is comparable across asset classes. A pre-trade regime is needed for all different instruments but the content should be adapted to the nature of the specific instruments. Given the experience of equity markets, however, special attention should be given to avoiding any loopholes that would undermine the overall transparency regime. We could propose to the Commission to look at the already defined deferred publication thresholds and delays for equities included in Table 4 of level 2 of MiFID and propose something similar for the fixed income area. Nonetheless, we believe that further assessment is needed before any conclusions are made and therefore we encourage the Commission and ESMA to work on these calibrations in due time.

As far as derivatives are concerned and as mentioned above, we strongly welcome pre-trade transparency as a principle. The European Commission's proposals are generally in line with the G20 objectives of providing further transparency to the OTC derivatives markets. . Nonetheless, it is important to note that derivatives markets have several characteristics that make them very different to equity or fixed income markets. In this context, we welcome the suggestion to apply such a transparency regime by type of derivative product/market as we consider that some calibration may need to be performed because products/markets are very different between each other. Hence, some exemptions may need to be made in the regime.

(39) What is your opinion about applying requirements to investment firms executing trades OTC to ensure that their quotes are accessible to a large number of investors, reflect a price which is not too far from market value for comparable or identical instrument traded on organised venues, and are binding below a certain transaction size? Please indicate what transaction size would be appropriate for the various asset classes.

With regard to bond markets, we fully support European Commission's proposal to ask investment firms executing trades OTC to ensure transparency. This would prevent an unlevel playing field, would incentivise the trading on organised platforms, and would definitively improve the transparency of the markets which would benefit investors. However, as described above, we are in favour of including a pre-trade transparency waiver regime in trading in wholesale debt securities.

With regard to derivatives and in line with the objective of increasing transparency in OTC derivatives markets, we agree with the suggestion of applying requirements to investment firms executing trades OTC as described above. The appropriate transaction size would need to be calibrated based on several parameters.

(40) In view of calibrating the exact post-trade transparency obligations for each asset class and type, what is your opinion of the suggested parameters, namely that the regime be transaction-based, and predicated on a set of thresholds by transaction size? Please explain the reasons for your views.

There are a number of ways to implement a post-trade transparency regime and there is no overall support for a single option. We urge the commission to conduct a further assessment in this area to identify the most beneficial solution to enhance the Bonds markets.

A regime could be solely based on transaction size or a mixture of transaction size and liquidity. However we fear that it would have to be properly calibrated for the different instruments according to all different jurisdictions as bonds are not, in reality, all the same and cannot be treated as such. For example, Government Bonds have different characteristic and liquidity than, say, a Corporate or Municipal Bond. We support full post-trade transparency (trade price and size) for all executed trades. However, for large blocks (above retail size) deferred publication (i.e. end of day) should be the rule.

By contrast, an outstanding issue size based regime could be used - to adapt the reporting obligation to the liquidity constraint - for all type of bonds. This information is easily accessible and if it takes into account the differences of a bond depending on the jurisdiction (i.e. currency, amount issued, etc), a system of thresholds could be worked out. This is especially important in markets where there is already evidence that transparency is actually working well (e.g. Denmark or Iceland)

Nonetheless, we believe that further assessment is needed before any conclusions are made and therefore we encourage the Commission and ESMA to work on these calibrations.

As far as derivatives are concerned and as mentioned above, we strongly welcome post-trade transparency as a principle. The European Commission's proposals are in line with the G20 objectives of providing further transparency to the OTC derivatives markets. Post-trade transparency is essential to guarantee best execution. Nonetheless, because of the specificities of derivatives markets, it is difficult to suggest a mere extension of requirements in one market to another. We welcome the suggestion to apply such a transparency regime by type of derivative product/market as we consider that some calibration may need to be performed because products/markets are very different between each other. Hence, some exemptions may need to be made in the regime. As an example of the particularities of derivatives markets, we refer to the case of physical trades for which it takes days just to organise the transportation element of the trade. The 15 minutes delay proposed for the data to be made available for free after the trade takes place is an equity market standard which results in an unrealistic period for many illiquid Commodity OTC markets.

Post-trade transparency arrangements should provide for the publication of trade specific data (derivative contract, price, volume, without identifying the counterparties) rather than merely aggregate data.

(41) What is your opinion about factoring in another measure besides transaction size to account for liquidity? What is your opinion about whether a specific additional factor (e.g. issuance size, frequency of trading) could be considered for determining when the regime or a threshold applies? Please justify.

We are of the opinion that simplicity and uniformity are key. Please see above.

With regard to derivatives, we believe that a good measure of liquidity could be the replacement cost of a position. The level of the replacement costs would vary depending on the derivative product as well as the desired size/economic exposure.

4. DATA CONSOLIDATION

4.1 Improving the quality of raw data and ensuring it is provided in a consistent format

(43) What is your opinion of the suggestions regarding reporting to be through approved publication arrangements (APAs)? Please explain the reasons for your views.

We welcome the proposed Approved Publication Arrangement (APA) framework. It would address the lack of availability, timeliness and quality of OTC data, which is the real problem of consolidatibility. We believe that APAs would actually:

- Boost the trade reporting activity and appear as the pre-consolidator for OTC post-trade data.
- Make data available in a structured and standardized way.
- Offer the chance to introduce minimum requirements regarding data quality while keeping the number of accreditation processes at a reasonable size.

(44) What is your opinion of the criteria identified for an APA to be approved by competent authorities? Please explain the reasons for your views.

We support these criteria. However, we think that competent authorities should have a harmonised approach across Europe with standardised criteria at the EU level. Similarly, we believe that an APA could be authorised by ESMA, too.

(45) What is your opinion of the suggestions for improving the quality and format of post trade reports? Please explain the reasons for your views.

Data from RMs is already of the best quality and is easy to consolidate. Only small improvements are needed to further increase the consolidatibility of RM data, and FESE's work on identifiers is aimed at that. However, no matter what actions are taken by RMs (or MTFs) to improve the consolidatibility of their data, OTC data needs to improve in terms of not only availability and timeliness but also, most importantly, in terms of quality. A "bundling" by consolidation of good and poor quality market data would result in a data consolidation product that would have no practical value or use to anyone. In order to provide a meaningful consolidated view, it is of essence that clear and detailed reporting requirements for OTC data are introduced and supported on a pan-EU Level. This will reduce uncertainty amongst investment firms regarding their reporting duties, thus avoiding over- or under-reporting and improve the reliability of OTC post-trade data. Overall, the introduction of the Approved Publication Arrangements (APAs) regime will play an important role in the achievement of this objective.

With regard to timeliness, reduced reporting times for OTC trades would help to align the information value between organised trading venues and OTC. Otherwise, OTC data of longer reporting times would be consolidated with real-time data made available by RMS and MTFs (in milliseconds after the trade takes place) and would again result in a "bundling" of varying data qualities.

(46) What is your opinion about applying these suggestions to non-equity markets? Please explain the reasons for your views.

If mandatory transparency requirements are justified for any other asset classes, the specificities of these asset classes have to be taken into account. However, the same general principle applies to all asset classes that any kind of consolidation should be left to market forces. In addition, due to their specificities, we do not believe the suggestions are suitable for derivative markets.

4.2 Reducing the cost of post trade data for investors

(47) What is your opinion of the suggestions for reducing the cost of trade data? Please explain the reasons for your views.

There has been a lot of misunderstanding and confusion about the cost of data and the contribution of various parties to the cost of consolidation. Moreover, costs have further come down as well thanks to concrete steps taken by the exchange industry. In particular, the provision of separate post-trade data products by FESE members as well as the overall availability of 15-minutes delayed data free of charge support data consolidation with regard to cost efficiency. Exchanges have already taken a proactive action with regard to the cost of data, by both unbundling and offering free data after 15 minutes.

In July 2010, FESE members trading equities committed to offering 15-minute delayed data free of exchange fees for all end-users. At that point, most FESE members were already providing such a service. However, we believed that it would be useful to formalise this practice and widen it to cover all FESE equity exchanges. As of today, all FESE members trading equities have either already fulfilled this commitment or are in the process of doing so shortly.

In addition, FESE members committed to offering a real-time post-trade data product separate from pre-trade data at substantially reduced cost in order to facilitate a cost-effective availability of real-time post-trade data only. The introduction of a post-trade data product by FESE members has reduced the cost of data by almost 60% (from 357 EUR to 146 EUR). The introduction of such a product by all FESE members produces further cost savings for investors. Therefore we are pleased to report that all FESE members have either already introduced or launched plans to introduce separate post-trade products.

Please see detailed table below:

	Level 1		Last Trade	
FESE membership	**Local**	**Euro**	**Local**	**Euro**
Athens SE		7		1
BME		12.5		2.5
Borse Stuttgart		5		4.5
Bratislava SE		0		0
Bucharest SE		10		7
Bulgaria SE		0		0
CEESEG - Budapest		20		6.4
CEESEG - Ljubljana		10		7
CEESEG - Prague		10		7
CEESEG - Vienna		30		13
Cyprus SE		1		0.6
Deutsche Börse		56		15
Irish SE		15		8
Luxembourg SE		32		30
NASDAQ OMX (Nordic)		29		15
NASDAQ OMX (Baltic)		14		-
NYSE Euronext		59		16
Oslo Bors	280 NOK	35	70 NOK	8.75
SIX Swiss Exchange	15 CHF	11.6	5 CHF	3.9
TOTAL		**357.1**		**145.7**
				-59%
Source: FESE members				

N.B. Two FESE members (Malta SE and Warsaw SE) will be added into this table once they have completed their pos-trade data product. The post-trade product of NASDAQ OMX Nordic includes Baltic.

Nonetheless, given the small share occupied by exchanges in the overall cost of data (8% to 15%, with a downward trend, according to an independent research study[10]), bringing overall costs down will require a collaborative effort on the part of everyone. There is also a need to recognise that costs will not disappear by setting up a utility (please see section on consolidation).

(48) In your view, how far data would need to be disaggregated? Please explain the reasons for your views.

Disaggregation down to instrument level as suggested by CESR would increase the administrative burden on all market participants exponentially. Moreover, as explained in the SME section, this would significantly reduce the visibility of SMEs.

(49) In your view, what would constitute a "reasonable" cost for the selling or dissemination of data? Please provide the rationale/criteria for such a cost.

Regarding cost, we believe the following:

- The debate regarding cost has had too narrow a focus. An accurate view of the total cost borne by a typical customer will show that, collectively, RMs' exchange user fees represent 8% to 15% of overall data costs and the balance represented by intermediaries (vendors, communications) – which does not seem out of proportion when comparing the value represented by the data vs. the value of delivery.
- Exchanges have all individually and collectively been taking significant actions to reduce the costs of data and improve the quality of their offerings, and have many other actions underway. RMs offer various price options in their product offerings already, e.g. retail pricing or snapshot pricing for wholesale customers, resulting in very reduced fees (- 60%) addressed to non-professional as well as professional investors.
- RMs remain fully committed to offering post-trade prices at a reasonable cost, but believe they should continue to be able to charge fees to account for the intrinsic value and quality of the information they produce. They should not be subjected to price regulation for the market data they produce, just as intermediaries who deliver data which they derive from RMs data are not subject to price regulation. RMs data create value for the entire market (price formation) and it would violate all basic principles of competition to deny RMs to be compensated for the value they create.
- Post-trade data, like other services provided in the European trading landscape, should continue to be subject to competition and be made available according to their intrinsic value. RMs are exposed to full competition in all areas of their business – and have considerably lowered their transaction fees (as documented by the Oxera study[11]), further reducing their share of the costs borne by clients. Competition will force these trends to continue in all areas of services provided by exchanges and others.

Based on the reasons above, FESE members do not see the need of defining the "reasonable" cost term for market data fees as the competitive framework would offer a competitive cost, in line with the spirit of MiFID. Hence, in all asset classes, we strongly reject the idea of defining what is a reasonable commercial cost.

[10] Download study from http://www.atradia.com/

[11] The Oxera study conducted for the European Commission shows that exchanges' fees account for only 3% of the total cost of trading, and that these costs have come down by 33% over 2 years.

(50) What is your opinion about applying any of these suggestions to non-equity markets? Please explain the reasons for your views.

If any kind of transparency is justified in non-equity markets, then certain general principles may apply to the data produced in these asset classes. In particular, the overall principle that any kind of consolidation should be left to market forces applies to all asset classes. Similarly, in all asset classes, we strongly reject the idea of defining what is a reasonable commercial cost.

In addition, characteristics of different markets will have to be taken into account when considering if any standards are needed for data publication and dissemination and if so what kind. As an example, the 15 minute-delay proposed for the equity data to be made available for free after the trade takes place is an equity market standard which makes sense in that area. However, such a standard would result in an unrealistic period for many illiquid Commodity OTC markets. For certain physical trades, it takes days just to organise the transportation element of the trade. Hence all possible data standards under consideration would have to be carefully reviewed to ensure they are adapted to the non-equity markets and should be avoided when they are not.

4.3 A European Consolidated tape

(51) What is your opinion of the suggestion for the introduction of a European Consolidated Tape for post-trade transparency? Please explain the reasons for your views, including the advantages and disadvantages you see in introducing a consolidated tape.

Already today 'European Consolidated Tapes' exist in Europe. Various vendors already produce such tapes, and new initiatives have been announced in order to improve existing solutions.

We are aware that certain market participants currently are not satisfied with the available tapes However, this is mainly due to the fact that there is a bundling of good and bad quality market data as outlined above. Once the quality issue regarding OTC data is resolved, a more meaningful consolidation should be possible. Moreover, we feel that 'the time that the industry has had to offer solutions' has sometimes been seen in an unrealistic light. Given that fragmentation of trading is a phenomenon created by MiFID, we are rather encouraged by the amount of progress that has already been made by the industry in creating and improving consolidated tapes that meet market needs since the introduction of MiFID.

Additionally, FESE members made a number of operational commitments to further improve the easy consolidability of market data. Furthermore, FESE Members will provide post-trade data separated from pre-trade data at lower costs. Thus, a Tape of Record for post-trade data at lower cost will be possible in due course which should address market participants' requirements.

We are convinced that the industry can deliver a Tape of Record in a better and more cost and resource efficient way than any Central Consolidator..

(52) If a post-trade consolidated tape was to be introduced which option (A, B or C) do you consider most appropriate regarding how a consolidated tape should be operated and who should operate it? Please explain the reasons for your view.

Competition, which is critical to European markets, requires a delicate balance which can be upset by unnecessary regulation. FESE members firmly support the industry-led consolidation of equity market data, Option C.

We consider both A and B anathema to the pro-competition spirit of the EU and a complete contradiction with the rest of the FSAP.

RMs' data is of excellent quality, widely available, easily consolidatable with other data, and provided to users at a cost even lower than their intrinsic value. Taking into account the fundamental features of European markets, a competitive framework is the right approach for Europe and will be enabled by applying focus on the true source of post-trade transparency problems, i.e. the quality, availability and consistency of OTC data and the inadequate standardisation of data more generally.

Specific benefits of Option C are:

- Efficient and competitive
- Allows innovation and adaption to different users' needs
- Wastes no public resources
- Wastes no time (can be built on existing initiatives)
- Allows quick adaptations over time without being frozen in time
- Allows meeting diverse needs while meeting the same core set of needs from the market

(53) If you prefer option A please outline which entity you believe would be best placed to operate the consolidated tape (e.g. public authority, new entity or an industry body).

We oppose Option A as a mandatory consolidated tape (MCT) will not solve the main problems faced by market participants and supervisors, and create new problems for the following reasons:

- A MCT means that RMs (and indeed any other trading venues) are not able to compete on the basis of quality because their prices are treated as equal value components of the proposed CT.
- A MCT will be expensive to build and operate and will likely require a complex revenue allocation model for the participating markets.
- Potential MCT revenues could be one reason why certain trading venues with no or little price formation of their own are in favour of a MCT, as it would allow them to earn revenue from market data and would elevate their prices to the same level of value as the prices of the price-forming venues.
- Most critically, MCT revenues will spoil the information value of the tape as they have in the US because they create economic incentives to conduct trades solely for the sake of that market data revenue.
- Finally, a US-style MCT would introduce additional problems to Europe. In addition to taking away the competition, it is more than likely that it will also change the market microstructure due to gaming for data revenues, a serious and inevitable problem with a central system that has kept the US authorities busy. This is a significant problem with largely unpredictable consequences for the micro and macrostructure of European markets. Gaming would likely become a fixture of the market and, instead of venues competing on the basis of their execution quality; they would compete in terms of their gaming. This is not a good outcome for Europe.

(54) On Options A and B, what would be the conditions to make sure that such an entity would be commercially viable? In order to make operating a European consolidated tape commercially viable and thus attaining the regulatory goal of improving quality and supply of post-trade data, should market participants be obliged to acquire data from the European single entity?

Option A and B will put an unnecessary burden on public resources for the set-up as well as for the operation on an ongoing basis, as we sincerely doubt that it will be self-sustainable. We are convinced that a mandatory consumption of the Consolidated Tape would be necessary in order to recover the costs at least. This, however, would put an unnecessary additional cost burden onto the financial industry itself.

(55) On Option B, which of the two sub-options discussed for revenue distribution for the data appears more appropriate and would ensure that the single entity described would be commercially viable?

We oppose option B as much as Option A, for all the same reasons as Option A. In particular, no formula can replace market efficiency in valuing market data. It would lead to a major distortion of the markets.

In addition, Option B will have the additional disadvantage of rotating the Central Consolidator role which will add an unduly burden on financial market participants as they would be forced to change and adapt to a completely new infrastructure on a more or less regular basis.

(56) Are there any additional factors that need to be taken into account in deciding who should operate the consolidated tape (e.g. latency, expertise, independence, experience, competition)?

FESE strongly supports a decentralised consolidation as described in Option C. However, if the Commission were to continue to support Option A or B, despite the objective concerns, we have outlined, we believe that the European consolidated tape would have to be run by a European entity, neutral and at no-cost for the tax payers. It would also have to stay away from price regulation.

(57) Which timeframe do you envisage as appropriate for establishing a consolidated tape under each of the three options described?

FESE is convinced that once the data availability and data quality issues regarding OTC data have been solved, already existing consolidation solutions will be able to provide the required consolidated view, e.g. “Tape of Record”. Several industry-driven solutions already exist or are currently on their way.

Regarding a Centralized Consolidated Tape, we are convinced that such a development would take several years to be implemented. Just as an example, the US CT took approximately 8 years to be built.

(58) Do you have any views on a consolidated tape for pre-trade transparency data?

FESE appreciates the Commission’s view that pre-trade transparency should not be the focus of mandatory data consolidation.

MiFID, unlike RegNMS, does not require a CT due to the fact that MiFID has a different Best Execution rule as well as having no Trade-Through rule. Market participants in Europe thus are not forced to consume all market data in order to comply with the regulation. In Europe market participants choose those markets’ data on which they are trading, thus working with a “customised” view. This is the most resource efficient way to deal with pre-trade data, as all data comes at a cost. Usually, 90% of a market data feed is consumed by pre-trade data, and only the rest constitutes trades. In case a Mandatory Consolidated Tape were to be introduced, additional and costly line resources would become necessary. It is important that pre-trade data is made available to those who want to consume it, but market participants should have the choice to consume it in a customised way, tailored to their specific needs.

Furthermore, due to the evolution in technology, latency plays an even bigger role in the trading process. Introducing a Central Consolidated Tape would significantly add to data latency, making it unusable for trading purposes. Last but not least, a Central Consolidated Tape would be a political question as well, since depending on the location of the tape, it would favour one or some markets versus others.

(59) What is your opinion about the introduction of a consolidated tape for non-equity trades? Please explain the reasons for your views.

If mandatory transparency were to be introduced for non-equity instruments, any consolidation of the mandated data would have to take into account the specificities of these markets. What will not change is the principle that consolidation should be left market forces, or the fact that prices should not be regulated

In addition, due to their specificities, we do not believe that a consolidated tape of any kind is suitable for derivatives markets.

5. MEASURES SPECIFIC TO COMMODITY DERIVATIVE MARKETS

5.1 Specific requirements for commodity derivative exchanges

(60) What is your opinion about requiring organised trading venues which admit commodity derivatives to trading to make available to regulators (in detail) and the public (in aggregate) harmonised position information by type of regulated entity? Please explain the reasons for your views.

FESE generally welcomes the proposed regime of position reporting. We agree that some forms of market abuse, like manipulative squeezes, would be more easily identified for most commodity types where regulators have access to **position rather than transaction reports** for appropriate instruments. We note that for listed energy and commodity derivatives, particularly those requiring delivery of the underlying, the accepted method of monitoring for market abuse such as corners and squeezes by regulators like the CFTC is through position reporting.

Some calibration may need to be performed depending on the type of the derivative instrument, as they are very different between each other.

Although a harmonised regime *per type of commodity derivative* may be adequate, we do not believe that a harmonised position reporting regime *for all commodity derivatives* would be effective in view of how different commodity markets are between each other. Any benefits of harmonised reporting can be outweighed by the complexities of trying to have a single reporting mechanism which works for all Exchanges. The system currently in place in certain jurisdictions works well as it is tailored to the specific nature and requirements of the different commodity exchanges. In case the Commission sees specific needs for this in certain markets or for certain commodities, this should be carefully analysed and explained before any measure is considered.

With regard to the responsibility for reporting, we believe it should be the trading venue or the CCP to report positions on CCP-cleared transactions and the firm for non-CCP-cleared transactions.

In addition, it will be important to ensure that the position reporting regime does not overlap with similar transparency regimes like the ones foreseen to be undertaken through trade repositories in the context of the European Commission's proposal on OTC derivatives, central counterparties and trade repositories.

(61) What is your opinion about the categorisation of traders by type of regulated entity? Could the different categories of traders be defined in another way (e.g. by trading activity based on the definition of hedge accounting under international accounting standards, other)? Please explain the reasons for your views.

In line with developments in other markets and in particular in the US, some FESE members are using the following categorisation:

(a) Producer/Merchant/Processor/User
(b) Swap Dealer
(c) Money Manager
(d) Other Reportables

In order to ensure global consistency, we would support the use of a similar system across the globe. However, we note that the use of such a categorisation for regulators may be limited, as current categories group very different types of regulated entities' positions.

(62) What is your opinion about extending the disclosure of harmonised position information by type of regulated entity to all OTC commodity derivatives? Please explain the reasons for your views.

See answer to question 61.

(63) What is your opinion about requiring organised commodity derivative trading venues to design contracts in a way that ensures convergence between futures and spot prices? What is your opinion about other possible requirements for such venues, including introducing limits to how much prices can vary in given timeframe? Please explain the reasons for your views.

Designing contracts in a way that ensures convergence between futures and spot prices seems like a laudable objective although due to the way markets function might be difficult to achieve.

Although concerns about the lack of convergence between futures and sport prices have been noted in agricultural markets in the US, we do not see this as an issue for many European commodity markets such as power and carbon markets. In addition, in markets where products are physically delivered, the spot price is not formed in any multilateral trading system but rather by bilateral trading between entities and which are therefore not transparent. The market therefore relies on futures prices as a benchmark for trading activity in the underlying markets (with the application of premiums and discounts, as necessary, to reflect any difference in quality or location, for example, in relation to the contract standard of the futures contract compared with the goods which are the subject of specific spot physical contracts).

We are glad to note that the current MiFID regime takes these particularities into account in article 37.2 of the Commission's Regulation (EC) no 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC. We support the retention of these provisions.

5.2 MiFID exemptions for commodity firms

(64) What is your opinion on the three suggested modifications to the exemptions? Please explain the reasons for your views.

5.3. Definition of other derivative financial instrument

(65) What is your opinion about removing the criterion of whether the contract is cleared by a CCP or subject to margining from the definition of other derivative financial instrument in the framework directive and implementing regulation? Please explain the reasons for your views.

5.4. Emission allowances

(66) What is your opinion on whether to classify emission allowances as financial instruments? Please explain the reasons for your views.

6. TRANSACTION REPORTING

6.1. Scope

Important: Before we answer the questions that have been posed, we note the absence of an issue on transaction reporting, i.e. the fact that it is currently not usable for CESR/ESMA's equity transparency calculations. We think the Review should make the necessary changes so that these reports can be used for this purpose.

(67) What is your opinion on the extension of the transaction reporting regime to transactions in all financial instruments that are admitted to trading or traded on the above platforms and systems? Please explain the reasons for your views.

FESE members agree with the extension of the transaction reporting regime to all financial instruments admitted to trading or traded on the above platforms as this extension would ensure that adequate market abuse monitoring rules are applied consistently across financial instruments. This would avoid regulatory loopholes by which market participants could perform abusive practices in instruments not covered by transaction reporting.

(68) What is your opinion on the extension of the transaction reporting regime to transactions in all financial instruments the value of which correlates with the value of financial instruments that are admitted to trading or traded on the above platforms and systems? Please explain the reasons for your views.

We would not only support the extension to those OTC derivatives whose value depends on the performance of a financial instrument that is admitted to trading on a RM or on the credit risk of a single issuer of such financial instruments. We would also support the extension to those OTC derivatives that have contributed an increase in systemic risk or are likely to do it in the future. Hence, we would support the inclusion of instruments like all credit derivatives, asset backed securities, collateralised debt obligations and the like.

(69) What is your opinion on the extension of the transaction reporting regime to transactions in depositary receipts that are related to financial instruments that are admitted to trading or traded on the above platforms and systems? Please explain the reasons for your views.

We agree with the extension to depositary receipts as they represent an alternative way to buy securities and could be subject to the same abuses as securities.

(70) What is your opinion on the extension of the transaction reporting regime to transactions in all commodity derivatives? Please explain the reasons for your views.

For the regulation to be effective, regulators should avoid requiring transaction reporting for futures instruments where position reporting would provide the relevant information should not be repeated.

As mentioned above, some forms of market abuse, like manipulative squeezes, would be more easily identified where regulators had access to position rather than transaction reports for appropriate instruments. Position reporting is very valuable in order to improve risk transparency and ensure adequate systemic risk management capabilities.

We note that for listed energy and commodity derivatives, particularly those requiring delivery of the underlying, the accepted method of monitoring for market abuse such as corners and squeezes by regulators such as the CFTC is through position reporting.

Position reporting of commodity derivatives is recommended as a replacement for transaction reporting.

(71) Do you consider that the extension of transaction reporting to all correlated instruments and to all commodity derivatives captures all relevant OTC trading? Please explain the reasons for your views.

See answer to question 70. Additionally all correlated instruments such, as CFDs or equity linked structured products, should be subject to the transparency requirements.

(72) What is your opinion of an obligation for RMs, MTFs and other alternative trading venues to report the transactions of non-authorised members or participants under MiFID? Please explain the reasons for your views.

(73) What is your opinion on the introduction of an obligation to store order data? Please explain the reasons for your views.

FESE does not object to a requirement for the storage of order data for a period of five years. We interpret this proposal is to store order data for all orders including unexecuted orders. It would be advisable to include a transitional period to allow all trading venues to make any required systems changes in order to comply with this requirement. RMs already store order data.

(74) What is your opinion on requiring greater harmonisation of the storage of order data? Please explain the reasons for your views.

Whilst there may be a desire to harmonise data storage it must be remembered that the sheer volume of order data created on a daily basis from myriad sources is significant. Where it is currently stored may facilitate efficient storage mechanisms but result in delayed restoration process as it may be in off-site silos and not held in real time. Any initiatives to harmonise data should take all these considerations into account to ensure that the perceived benefits are not grossly outweighed by the cost on implementation.

6.2 Content Reporting

(75) What is your opinion on the suggested specification of what constitutes a transaction for reporting purposes? Please explain the reasons for your views.
(76) How do you consider that the use of client identifiers may best be further harmonised? Please explain the reasons for your views.
(77) What is your opinion on the introduction of an obligation to transmit required details of orders when not subject to a reporting obligation? Please explain the reasons for your views.
(78) What is your opinion on the introduction of a separate trader ID? Please explain the reasons for your views.
(79) What is your opinion on introducing implementing acts on a common European transaction reporting format and content? Please explain the reasons for your views.

We welcome initiatives which provide for greater clarity of the activity undertaken in the market. It is certainly beneficial to clarify who has the obligation, in what form and the method of transmission to report to ensure transaction reporting is not duplicated through the intermediary chain. However, if the aim of the Commission it to enable regulators to have full and consistent oversight of the activity there are a number of additional factors which should be considered. For example trader identification and counterparty identification: a trader may have identity A on one execution platform and identity B on another execution platform and an investor counterparty may have a similarly different identifiers through the intermediary chain and across jurisdictions. These differences would continue to prevent regulators from assessing activity in a consistent manner. Further detailed assessment in this area would be necessary before any constructive conclusion could be reached.

6.3. Reporting channels

(80) What is your opinion on the possibility of transaction reporting directly to a reporting mechanism at EU level? Please explain the reasons for your views.

(81) What is your opinion on clarifying that third parties reporting on behalf of investment firms need to be approved by the supervisor as an Approved Reporting Mechanism? Please explain the reasons for your views.

(82) What is your opinion on waiving the MiFID reporting obligation on an investment firm which has already reported an OTC contract to a trade repository or competent authority under EMIR? Please explain the reasons for your views.

We believe that regulators should ensure that no legal obligation leads to double reporting. Hence we agree with the need to waive the MiFID reporting obligation on an investment firm which has already reported an OTC contract to a trade repository or competent authority under EMIR, as long as the information reported to the trade repository or the competent authority is consistent with that reported through transaction reporting, as described in Annex I, table 1 of Commission Regulation (EC) No 1287/2006 implementing Directive 2004/39/EC. This would ensure that similar activities are subject to similar regulatory treatment and would allow European regulators to have a complete overview of transactions executed in the European Union.

(83) What is your opinion on requiring trade repositories under EMIR to be approved as an ARM under MiFID? Please explain the reasons for your views.

If, as explained in the response to question 82, trade repositories are to be used to report information consistent with that reported through transaction reporting, we suggest that trade repositories are required to be approved as an ARM. A failure to do this would create an unlevel playing field between ARMs and Trade Repositories, which would be executing the same type of business.

7. INVESTOR PROTECTION AND PROVISION OF INVESTMENT SERVICES

7.1 Scope of the Directive

7.1.1 Optional exemptions for some investment service providers

(84) What is your opinion about limiting the optional exemptions under Article 3 of MiFID? What is your opinion about obliging Member States to apply to the exempted entities requirements analogous to the MiFID conduct of business rules for the provision of investment advice and fit and proper criteria? Please explain the reasons for your views.

We agree

7.1.2 Application of MiFID to structured deposits

(85) What is your opinion on extending MiFID to cover the sale of structured deposits by credit institutions? Do you consider that other categories of products could be covered? Please explain the reasons for your views

We agree.

7.1.3 Direct sales by investment firms and credit institutions

(86) What is your opinion about applying MiFID rules to credit institutions and investment firms when, in the issuance phase, they sell financial instruments they issue, even when advice is not provided? What is your opinion on whether, to this end, the definition of the service of execution of orders would include direct sales of financial instruments by banks and investment firms? Please explain the reasons for your views.

We do not have an opinion.

7.2 Conduct of business obligations

7.2.1 "Execution only" services

(87) What is your opinion of the suggested modifications of certain categories of instruments (notably shares, money market instruments, bonds and securitised debt), in the context of so-called "execution only" services? Please explain the reasons for your views.

(88) What is your opinion about the exclusion of the provision of "execution-only" services when the ancillary service of granting credits or loans to the client (Annex I, section B (2) of MiFID) is also provided? Please explain the reasons for your views.

(89) Do you consider that all or some UCITS could be excluded from the list of non-complex financial instruments? In the case of a partial exclusion of certain UCITS, what criteria could be adopted to identify more complex UCITS within the overall population of UCITS? Please explain the reasons for your views.

(90) Do you consider that, in the light of the intrinsic complexity of investment services, the

"execution-only" regime should be abolished? Please explain the reasons for your views.

We have no views on 87 and 88.

On 89, we oppose UCITS being excluded from the list of non-complex instruments. This would harm investors by reducing their choice and increase the cost of investing in capital markets. UCITS is a very good, well-regulated brand which fully deserves being in this list.

On question 90, we strongly oppose such an abolition.

We believe that "execution only" services should remain a choice for investors who are well informed about the products they purchase and willing to accept the associated risks. In return they are able to benefit for reduced transaction fees without any associated fees for advice. Therefore we do not agree with the abolition of "execution only" services. If this were abolished, investors would have less choice and face higher costs. Investment firms' advice needs the competitive pressure from execution-only so that investors are not trapped into having to purchase advice or suitability.

7.2.2 Investment advice

(91) What is your opinion of the suggestion that intermediaries providing investment advice should: 1) inform the client, prior to the provision of the service, about the basis on which advice is provided; 2) in the case of advice based on a fair analysis of the market, consider a sufficiently large number of financial instruments from different providers?
Please explain the reasons for your views.

(92) What is your opinion about obliging intermediaries to provide advice to specify in writing to the client the underlying reasons for the advice provided, including the explanation on how the advice meets the client's profile? Please explain the reasons for your views.

(93) What is your opinion about obliging intermediaries to inform the clients about any relevant modifications in the situation of the financial instruments pertaining to them? Please explain the reasons for your views.

(94) What is your opinion about introducing an obligation for intermediaries providing advice to keep the situation of clients and financial instruments under review in order to confirm the continued suitability of the investments? Do you consider this obligation be limited to longer term investments? Do you consider this could be applied to all situations where advice has been provided or could the intermediary maintain the possibility not to offer this additional service? Please explain the reasons for your views.

We agree with all the proposals. We support all actions to strengthen investor protection and choice.

7.2.3 Informing clients on complex products

(95) What is your opinion about obliging intermediaries to provide clients, prior to the transaction, with a risk/gain and valuation profile of the instrument in different market conditions? Please explain the reasons for your views.

(96) What is your opinion about obliging intermediaries also to provide clients with independent quarterly valuations of such complex products? In that case, what criteria should be adopted to ensure the independence and the integrity of the valuations?

(97) What is your opinion about obliging intermediaries also to provide clients with quarterly reporting on the evolution of the underlying assets of structured finance products? Please explain the reasons for your views.

(98) What is your opinion about introducing an obligation to inform clients about any material modification in the situation of the financial instruments held by firms on their behalf? Please explain the reasons for your views

(99) What is your opinion about applying the information and reporting requirements concerning complex products and material modifications in the situation of financial instruments also to the relationship with eligible counterparties? Please explain the reasons for your views.

(100) What is your opinion of, in the case of products adopting ethical or socially oriented investment criteria, obliging investment firms to inform clients thereof?

We agree. We believe that mandating obligations on the intermediary to provide data such as risk/gain and valuation profiles for the thousands of product on the market would be a virtually impossible task. It would be even harder for organisations offering execution only on-line brokerage services. Such information should only be made mandatory when investment advice is given. An alternative approach could be to mandate the issuer of products to produce such profiles within the Key Investor Information documentation. This can then be provider to the end investor buy the intermediary or financial advisor.

7.2.4 Inducements

(101) What is your opinion of the removal of the possibility to provide a summary disclosure concerning inducements? Please explain the reasons for your views.

(102) Do you consider that additional ex-post disclosure of inducements could be required when ex-ante disclosure has been limited to information methods of calculating inducements? Please explain the reasons for your views.

(103) What is your opinion about banning inducements in the case of portfolio management and in the case of advice provided on an independent basis due to the specific nature of these services? Alternatively, what is your opinion about banning them in the case of all investment services? Please explain the reasons for your views.

We disagree with question 101.

We agree with 102 and 103.

7.2.4 Provision of services to non-retail clients and classification of clients

(104) What is your opinion about retaining the current client classification regime in its general approach involving three categories of clients (eligible counterparties, professional and retail clients)? Please explain the reasons for your views.

(105) What are your suggestions for modification in the following areas:

a) **Introduce, for eligible counterparties, the high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading when informing the client;**

b) Introduce some limitations in the eligible counterparties regime. Limitations may refer to entities covered (such as non-financial undertakings and/or certain financial institutions) or financial instruments traded (such as asset backed securities and nonstandard OTC derivatives); and/or

c) Clarify the list of eligible counterparties and professional clients per se in order to exclude local public authorities/municipalities?

Please explain the reasons for your views.

We agree with retaining the existing classification. We agree with (a), (b), and (c).

(106) Do you consider that the current presumption covering the professional clients' knowledge and experience, for the purpose of the appropriateness and suitability test, could be retained? Please explain the reasons for your views.

No, given the events of the financial crisis this presumption should not hold.

7.2.6 Liability of firms providing services

(107) What is your opinion on introducing a principle of civil liability applicable to investment firms? Please explain the reasons for your views.

(108) What is your opinion of the following list of areas to be covered: information and reporting to clients, suitability and appropriateness test, best execution, client order handling? Please explain the reasons for your views.

We believe it would be beneficial to investor protection.

7.2.7 Execution quality and best execution

(109) What is your opinion about requesting execution venues to publish data on execution quality concerning financial instruments they trade? What kind of information would be useful for firms executing client orders in order to facilitate compliance with best execution obligations? Please explain the reasons for your views.

(110) What is your opinion of the requirements concerning the content of execution policies and usability of information given to clients should be strengthened? Please explain the reasons for your views.

We would welcome the provision of greater transparent and quantifiable data on execution quality which would be beneficial and allow investors to assess how their executions are handled.

In general best execution policies should be subject to greater monitoring by regulators as there may be reasons why the interest of the investor may not always be the most important factor assessed during the creation of such policies. At a minimum the definition and criteria should be more precise to reduce the opportunity for “interpretation” which in turn would strengthen the obligations. The criteria “any other factors which impacts execution quality” should be removed as it is ambiguous therefore allowing subjective assessments to be made and making it difficult to prove effective best execution had been performed. Additionally phrasing such as “order execution on a domestic exchange” in countries with several venues makes it impossible for an investor to determine best execution or where an order will be executed. This ambiguity diminishes regulatory ability to enforce best execution and investor’s ability to assess best execution. A clear and unambiguous definition would strengthen assessment and enforcement such as: Price, Time & Quantity.

However, limiting obligations to publish data to trading venues will not necessarily provide a complete overview. Trading firms themselves currently have the obligation to provide best execution to their clients and this obligation should remain and not be mandated or transferred to execution venues. Clearly the policies utilised by each firm could differ widely and may or not capture information from all venues in which similar securities are traded. This could have the result of providing only a limited view when calculating best execution. Furthermore it is unclear if the provisions and definitions relating to best execution are sufficiently clear and implemented across the EU. Greater transparency of the regimes, calculations and a benchmarking of activity would be beneficial to end investors.

7.2.8 Dealing on own account and execution of client orders

(111) What is your opinion on modifying the exemption regime in order to clarify that firms dealing on own account with clients are fully subject to MiFID requirements? Please explain the reasons for your views.

(112) What is your opinion on treating matched principal trades both as execution of client orders and as dealing on own account? Do you agree that this should not affect the treatment of such trading under the Capital Adequacy Directive? How should such trading be treated for the purposes of the systematic internaliser regime? Please explain the reasons for your views.

We agree with 111. We agree with treating matched principle trades on own account and execution of orders. This trading should fall under the SI regime, because it is trading a clients order against own book.

7.3 Authorisation and organisational requirements

7.3.1 Fit and proper criteria

(113) What is your opinion on possible MiFID modifications leading to the further strengthening of the fit and proper criteria, the role of directors and the role of supervisors? Please explain the reasons for your view.

We agree.

7.3.2 Compliance, risk management and internal audit functions

(114) What is your opinion on possible MiFID modifications leading to the reinforcing of the requirements attached to the compliance, the risk management and the internal audit function? Please explain the reasons for your view.

7.3.3 Organisational requirements for the launch of products, operations and services

(115) Do you consider that organisational requirements in the implementing directive could be further detailed in order to specifically cover and address the launch of new products, operations and services? Please explain the reasons for your views.

(116) Do you consider that this would imply modifying the general organisational requirements, the

duties of the compliance function, the management of risks, the role of governing body members, the reporting to senior management and possibly to supervisors?

7.3.4 Specific organisational requirements for the provision of the service of portfolio management

(117) Do you consider that specific organisational requirements could address the provision of the service of portfolio management? Please explain the reasons for your views.

7.3.5 Conflicts of interest and sales process

(118) Do you consider that implementing measures are required for a more uniform application of the principles on conflicts of interest?

Yes, this is an area that needs to be regulated more strictly.

7.3.5 Segregation of client assets

(119) What is your opinion of the prohibition of title transfer collateral arrangements involving retail clients' assets? Please explain the reasons for your views.

(120) What is your opinion about Member States be granted the option to extend the prohibition above to the relationship between investment firms and their non retail clients? Please explain the reasons for your views.

Title transfer collateral arrangements should be allowed in each case, when dealing with retail clients as well as with professional clients. Such traditional and developed legal means of security provision should not be prohibited in general, but rather issues that arose should be analysed in a broader notion. It might be sufficient already to increase operational standards. An alternative would be pledge constructs. However, national pledging laws across Europe are not harmonised. Therefore a pledge construct is difficult to be used for a cross European business solution.

(121) Do you consider that specific requirements could be introduced to protect retail clients in the case of securities financing transaction involving their financial instruments? Please explain the reasons for your views.

(122) Do you consider that information requirements concerning the use of client financial instruments could be extended to any category of clients?

(123) What is your opinion about the need to specify due diligence obligations in the choice of entities for the deposit of client funds?

We agree with 121 and 122.

7.3.6 Underwriting and placing

(124) Do you consider that some aspects of the provision of underwriting and placing could be specified in the implementing legislation? Do you consider that the areas mentioned above (conflicts of interest, general organisational requirements, requirements concerning the allotment process) are the appropriate ones? Please explain the reasons for your views.

8. FURTHER CONVERGENCE OF THE REGULATORY FRAMEWORK AND SUPERVISORY PRACTICES

8.1 Options and discretions

8.1.1 Tied agents

(125) What is your opinion of Member States retaining the option not to allow the use of tied agents?

(126) What is your opinion in relation to the prohibition for tied agents to handle clients' assets?

(127) What is your opinion of the suggested clarifications and improvements of the requirements concerning the provision of services in other Member States through tied agents?

(128) Do you consider that the tied agents regime require any major regulatory modifications? Please explain the reasons for your views.

8.1.2 Telephone and electronic recording

(129) Do you consider that a common regulatory framework for telephone and electronic recording, which should comply with EU data protection legal provisions, could be introduced at EU level? Please explain the reasons for your views.

(130) If it is introduced do you consider that it could cover at least the services of reception and transmission of orders, execution of orders and dealing on own account? Please explain the reasons for your views.

(131) Do you consider that the obligation could apply to all forms of telephone conversation and electronic communications? Please explain the reasons for your views.

(132) Do you consider that the relevant records could be kept at least for 3 years? Please explain the reasons for your views.

8.1.3 Additional requirements on investment firms in exceptional cases

(133) What is your opinion on the abolition of Article 4 of the MiFID implementing directive and the introduction of an on-going obligation for Member States to communicate to the Commission any addition or modification in national provisions in the field covered by MiFID? Please explain the reasons for your views.

We agree.

8.2 Supervisory powers and sanctions

8.2.1 Powers of competent authorities

8.2.2 Sanctions (definition, amounts, publication)

(134) Do you consider that appropriate administrative measures should have at least the effect of putting an end to a breach of the provisions of the national measures implementing MiFID and/or eliminating its effect? How the deterrent effect of administrative fines and periodic penalty payments can be enhanced? Please explain the reasons for your views.

(135) What is your opinion on the deterrent effects of effective, proportionate and dissuasive criminal sanctions for the most serious infringements? Please explain the reasons for your views.

(136) What are the benefits of the possible introduction of whistleblowing programs? Please explain the reasons for your views.

(137) Do you think that the competent authorities should be obliged to disclose to the public every measure or sanction that would be imposed for infringement of the provisions adopted in the implementation of MiFID? Please explain the reasons for your views.

8.3 Access of third country firms to EU markets

(138) In your opinion, is it necessary to introduce a third country regime in MiFID based on the principle of exemptive relief for equivalent jurisdictions? What is your opinion on the suggested equivalence mechanism?

Yes. Securities and derivatives trading is a global business and should continue to be facilitated both for EU firms and RMs undertaking this business in 3rd Countries, and 3rd Country and RMs firms undertaking this business in the EU. Exemptive relief is but one mechanism: access to and from a 3rd Country should be based on reciprocity and be tailored on a case-by-case basis.

Most importantly, there has to be a level playing field between RMs on the one hand and broker-dealers when accessing US (or other international) capital markets.

Equivalence of 3rd Country jurisdictions could be assessed according to well established international standards such as IOSCO's "Objectives and Principles of Securities Regulation" (IOSCO, June 2010), and particularly:

- Annex A: "Principles Relating to the Regulator",
- Annex D: "Principles for Cooperation in Regulation", and
- Annex I: "Principles for Secondary Markets".

These Principles include:

- (A) - clear responsibilities, adequate powers and proper resources, independence, management of systemic risk and mitigation of conflicts of interest;
- (D) - the ability to share information with domestic and foreign counterparts; and
- (I) - authorisation and ongoing regulatory oversight and supervision, and the promotion of transparency of trading.

The Commission, in its assessment of the equivalence of Third Country regimes, could also base itself, where appropriate, on the relevant IMF Financial Sector Assessment Programme report(s).

Maintaining stability in the global financial system is also a key objective. In this respect, equivalent mechanisms such as the 2008 Memorandum of Understanding on cross-border financial stability between the relevant EU competent authorities, as extended to the non-EU EEA Countries in June 2010, must also be capable of being extended to Third Countries as well. ESMA and the ESRB could play a role here as well.

(139) In your opinion, which conditions and parameters in terms of applicable regulation and enforcement in a third country should inform the assessment of equivalence? Please be specific.

Please see the answer to Question 138 above on the regulatory equivalence test. In terms of an equivalence test for enforcement, we suggest that IOSCO Principle C "Principles for the Enforcement of Securities Regulation" could be used. These advance that the regulator should have comprehensive powers of inspection, investigation, surveillance and enforcement. One might add aspects of the Commission's Communication on "Reinforcing sanctioning regimes in the financial services sector" (COM 2010/716), so that these powers also include the power to prosecute offenders under civil and/or criminal law, with a range of appropriate sanctions against the offending individual(s) and the firm, through a "tariff", including financial penalties, imprisonment, and banning orders. This should be underpinned by clear evidence that the Third Country regime "works", for instance, through monitoring the number of cases, and their publicity.

(140) What is your opinion concerning the access to investment firms and market operators only for non-retail business?

We agree that, in the initial phase, this access should be circumscribed to, according to the MiFID definitions, to experienced counterparties and inter-professional business. This too has to be subject to the principle of equal treatment between RMs/MTFs and broker-dealers.

9. REINFORCEMENT OF SUPERVISORY POWERS IN KEY AREAS

9.1 Ban on specific activities, products or practices

(142) What is your opinion on the possibility to ban products, practices or operations that raise significant investor protection concerns, generate market disorder or create systemic risk? Please explain the reasons for your views

We agree with this possibility.

(143) For example, could trading in OTC derivatives which competent authorities determine should be cleared on systemic risk grounds, but which no CCP offers to clear, be banned pending a CCP offering clearing in the instrument? Please explain the reasons for your views.
(144) are there other specific products which could face greater regulatory scrutiny? Please explain the reasons for your views.

We welcome such a proposal as a last resort option which should only be used where the justification on grounds of systemic risk is clearly set out. Even if the powers to ban trading exist, they should be employed only in the most extreme of circumstances to make the framework for the new supervisory authorities credible, within the EU and with international partners.

We note that as suggested by the European Commission in its proposal for a Regulation on OTC Derivatives, central counterparties and trade repositories, CCPs should play a key role in the eligibility process, both in the bottom-up approach, by initiating the process of deciding to clear certain contracts, as well as in the top-down approach, in which CCPs would need to be consulted. We consider that the decision on which products are centrally clearable should be left to clearing houses and any such decision by an individual clearing house should not result in an automatic mandate for all clearing houses to clear such form of product. The role of ESMA in the eligibility of the clearing obligation would be useful in this sense.

If no CCP is willing to accept the risk of those products, that would be a clear indication for a regulator to investigate and potentially ban or restrain such a product.

9.2. Stronger oversight of positions in derivatives, including commodity derivatives

(145) If regulators are given harmonised and effective powers to intervene during the life of any derivative contract in the MiFID framework directive do you consider that they could be given the powers to adopt hard position limits for some or all types of derivative contracts whether they are traded on exchange or OTC? Please explain the reasons for your views.

RMs are well equipped with market surveillance systems and subject to regimes of position management as an effective way to monitor positions. Hence we do not see the need to give regulators powers to adopt hard position limits for commodity derivatives. Position limits could run the risk of damaging commodity market in the form of squeezes. The application of position limits by regulators has been proposed in other jurisdictions like the US for other products with limited success. In addition, the US position limits are targeted to specific types of commodity derivatives contracts rather than across the board. Different studies have demonstrated that markets where position limits exist are not less volatile than those where they do not exist.

(146) What is your opinion of using position limits as an efficient tool for some or all types of

derivative contracts in view of any or all of the following objectives: (i) to combat market manipulation; (ii) to reduce systemic risk; (iii) to prevent disorderly markets and developments detrimental to investors; (iv) to safeguard the stability and delivery and settlement arrangements of physical commodity markets. Please explain the reasons for your views.

As mentioned above, FESE believes that a well-equipped market surveillance system, together with an adequate position management regime rather than hard position limits, are the most appropriate methods to maintain orderly commodity markets. We consider that position limits are not an effective tool for managing price volatility other than on settlement. In addition, position limits may have the unintended consequences of squeezing markets and could be counterproductive from a market dynamic point of view.

In the particular case of commodities, position limits on hedgers, arbitrageurs, investors and speculators holding positions for the longer term would be ineffectual in tackling price volatility, even were it to be proved conclusively that excessive positions, whatever the definition of that might be, leads to 'excessive commodity price volatility.' High, or low, commodity prices are not necessarily volatile, or excessively volatile, prices and generally they represent a reaction to an analysis of information on future supply and demand.

Position limits set by regulators have shown some results in certain jurisdictions like the US because of the hedging exemptions that exist in those markets.

(147) Are there some types of derivatives or market conditions which are more prone to market manipulation and/or disorderly markets? If yes, please justify and provide evidence to support your argument.

We are not aware of any types of derivatives or market conditions which are more prone to market manipulation and/or disorderly markets.

(148) How could the above position limits be applied by regulators:

a) **To certain categories of market participants (e.g. some or all types of financial participants or investment vehicles)?**
b) **To some types of activities (e.g. hedging versus non-hedging)?**
c) **(c) To the aggregate open interest/notional amount of a market?**

See answer to question 145.

- END -