Review of the Markets in Financial Instruments Directive

Questionnaire on MiFID/MiFIR 2 by Markus Ferber MEP

The questionnaire takes as its starting point the Commission's proposals for MiFID/MiFIR 2 of 20 October 2011 (COM(2011)0652 and COM(2011)0656).

All interested stakeholders are invited to complete the questionnaire. You are invited to answer the following questions and to provide any detailed comments on specific Articles in the table below. Responses which are not provided in this format may not be reviewed.

Respondents to this questionnaire should be aware that responses may be published.

Please send your answers to econ-secretariat@europarl.europa.eu **by 13 January 2012.**

Deutsches Aktieninstitut, Bundesverband der Deutschen Industrie und Verband deutscher Treasurer welcome the opportunity to respond to the questionaire. Please find below our answers to the questions.

Theme	**Question**	**Answers**
Scope	1) Are the exemptions proposed in Directive Articles 2 and 3 appropriate? Are there ways in which more could be done to exempt corporate end users?	The clarification of the term "ancillary activities" in art. 2 para. 3 MiFID points into the right direction to ensure that non-financial companies will be able to deal on own account in commodity derivates without risking to be covered by the regulatory frame-work of MiFID / MiFIR. Nevertheless, it should be translated into clear legal language that non-financial companies using de-rivatives mainly for hedging purposes are exempted from MiFID / MiFIR in future as well. To avoid uncertainty e.g. for firms that can benefit from the an-cillary activity exemption but that are at the same time market

		makers, members of regulated markets or MTFs, it is also important that the interaction of the exemptions in art. 2 para. 1 lit. d and art. 2 para. 1 lit. i is clarified in particular for commodity derivatives and emission allowances. However, it is still necessary to put straight that corporates trading financial instruments besides commodity derivatives and emission allowances on own account can benefit from the ancillary exemption without any limitation. Furthermore, the term “participants in a regulated market or MTF” in art. 2 para. 1 lit. d (ii) is misleading because it might indicate that every market participant who deals in financial instruments on own account on regulated markets or MTFs is obliged to be authorized under MiFID / MiFIR. To avoid this obvious misunderstanding we would suggest that “to participate” should be replaced by “to be admissible” for trading on regulated markets as defined e.g. in art. 16 of the German stock exchange act. This would ensure that only persons who gained admission to trade directly on regulated markets are excluded from the above mentioned exemption. It should also be ensured that small and mid-sized energy traders which trade commodity derivatives on own account as main business and are therefore not covered by the existing exemptions should be explicitly excluded from MiFID / MiFIR. They are important liquidity providers and do not pose a threat to the stability of financial markets.
	2) Is it appropriate to include emission allowances and structured deposits and have they been included in an appropriate way?	Our answer focuses on emission allowances only. Although emission allowances do share some common features with other classes of financial instruments, such as transferable securities

		(e.g. dematerialised bearer bonds held in a clearing system), they have to be distinguished from such types of financial instrument for several reasons: they do not confer financial claims against the public issuer of such allowances; and they do not represent titles to capital or titles to debentures or constitute forward contracts. Furthermore, the primary purpose of emission allowances is not to serve as an investment product but to price the emissions of carbon dioxide and thereby to improve the cost-effectiveness of climate protection measures. The inclusion of emission allowances in the scope of MiFID / MiFIR will countervail this aim. The efficiency of the emissions' trading price mechanism requires a certain trading volume to reach sufficient market liquidity. The costs to be in line with the MiFID / MiFIR obligations will reduce the trading volume of protection buyers, especially of SMEs. This will decrease liquidity and therefore impair the aim of the emissions trading system to value carbon dioxide emissions by market prices. Costs to comply with the EU emissions trading (EU ETS) Directive are already very high today. According to the KfW/ZEW "CO_2-Barometer" companies with relatively low emissions have to pay considerable costs (ca. 4 %) mainly for complying with ETS monitoring and reporting obligations. As a matter of fact the decreasing allocation of allowances free of charge in the 3rd trading period (2013 – 2020) will result in a huge extra burden for the companies in the future. The recent KfW/ZEW "CO_2-Barometer" (Sept. 2011) shows that as of 2013 the share of installation operators that will have to buy allowances will rise to 63 per cent. The resulting cost burden varies with the size of the

		installation in the scope of the EU ETS Directive. Depending on the CO_2 emissions this burden can easily amount to several million Euros. Overall, increasing transaction costs by expanding MiFID / MiFIR requirements on emission allowances will further hamper the efficiency of the ETS. These additional costs are not accompanied by any benefits especially regarding investor protection. Participants in emission trading are exclusively professional clients. Therefore, there is no reason to protect these investors by the MiFID / MiFIR rules.
	3) Are any further adjustments needed to reflect the inclusion of custody and safekeeping as a core service?	
	4) Is it appropriate to regulate third country access to EU markets and, if so, what principles should be followed and what precedents should inform the approach and why?	
Corporate governance	5) What changes, if any, are needed to the new requirements on corporate governance for investment firms and trading venues in Directive Articles 9 and 48 and for data service providers in Directive Article 65 to ensure that they are proportionate and effective, and why?	
Organisation of markets and trading	6) Is the Organised Trading Facility category appropriately defined and differentiated from other trading venues and from systematic internalisers in the proposal? If not, what changes are needed and why?	The broad definition of "organised trading facilities" might include platforms which are neither relevant for investor protection nor have an effect on financial stability. This applies, inter alia, for electronic platforms like FXall, Currenex or 360T, which solely simplify to arrange tailor-made and therefore non standardised derivative contracts, in particular with regard to maturity and volume, between (corporate) end users (buy-side) and

		financial institutions (sell-side). In addition, as mentioned in our answer to question 7 these electronic platforms are not "trading platforms". Therefore, they should not be covered by the scope of MiFID / MiFIR. The definition of OTF should be restricted to "trading platforms" in the classical meaning. The term "trading" in this sense would require a sufficiently liquid secondary market where investors are actively trading financial instruments.
	7) How should OTC trading be defined? Will the proposals, including the new OTF category, lead to the channelling of trades which are currently OTC onto organised venues and, if so, which type of venue?	**Definition of OTC trading** We are concerned that the new OTF category will also affect derivatives used by non-financial companies, even if they did not cross the clearing threshold and are therefore not covered by the scope of MiFID / MiFIR. This would harm their capability to effectively hedge risks stemming from their operative business with customised OTC derivatives. An adequate definition of OTC trading should allow corporates to agree bilateral derivatives without being covered by MiFID / MiFIR directly or indirectly. Therefore, with regard to derivatives OTC trading should be defined as contrary to the trading of standardised instruments. This definition should also recognize that derivatives used for hedging purposes do not pose a threat to financial stability and should therefore be allowed to be traded OTC as a rule. This functional approach would acknowledge that corporate end-users depend heavily on (over-the-counter) derivatives agreed bilateral because standardised derivatives that are e.g. eligible for trading on exchanges do not meet corporates' needs to effectively hedge risks resulting from their operative business. An effective hedge requires that the terms of the respective derivative contract re-

		flects exactly the characteristics of the underlying business. E.g. a corporate entity managing foreign exchange risks will demand a derivative which accurately matches the respective cross-border business regarding maturity and payment-flows. Only these bespoke derivatives which are necessarily agreed OTC between the corporate and the financial counterparty provide the flexibility needed for the companies that, in contrast, standardised products will not. **Interplay of OTC trading and the new OTF category** OTC derivatives are negotiated between non-financial counterparties and their financial counterparty in two different ways. Especially larger transactions or hedges with a long maturity are normally agreed by phone. For other derivatives (the "day-to-day-business") corporates use electronic platforms which coordinate supply and demand for bespoke derivatives. These platforms include e.g. 360T, Currenex and Fxall. They provide corporates multilateral access to counterparties selected in advance (a selection criterion defined by the corporate is e.g. the creditworthiness) for a deal request so that the end-user avoids to contact every single bank by phone. Besides saving transaction costs these platforms provide further advantages (this holds also true for SMEs): They offer sufficient transparency to the users to enable them to assess the soundness and fairness of the price formation process and to secure processes based on corporate needs (including electronic confirmations within a defined period of time and audit trails of all necessary trading information). Although these platforms offer multilateral access they are in

		fact no “trading platforms”. Trading by investors on a liquid secondary market does not take place. In general bespoke derivatives are held by corporates up to maturity or will be bilaterally adjusted in case the underlying business or market expectations have changed. Agreeing bilateral derivatives on these platforms should be therefore regarded as pure OTC trading and should be excluded from the scope of MiFID / MiFIR. Unfortunately, the introduction of the broadly defined category „organised trading facility (OTF)“ in MiFID / MiFIR bears the risk that these electronic platforms will be covered by MiFID / MiFIR (see our answer to question 6 above). Some of the operators of these platforms may also aim for the OTF or MTF status in order to expand their business. This would lead to the paradox that non-financial companies are in the focus of MiFID / MiFIR, although they are exempted from the trading obligation according to art. 24 et seq. MiFIR (because they did not cross the clearing threshold as defined in EMIR). This indirect impact of MiFID / MiFIR raises certain problems especially regarding pre- and post-trade transparency requirements (art. 7 et seq. MiFIR) which also include „derivatives admitted to trading or which are traded on an MTF or an OTF” (art. 7 para. 1 and art. 9 para. 1 – see our answer to question 22 below).
	8) How appropriately do the specific requirements related to algorithmic trading, direct electronic access and co-location in Directive Articles 17, 19, 20 and 51 address the risks involved?	

	9) How appropriately do the requirements on resilience, contingency arrangements and business continuity arrangements in Directive Articles 18, 19, 20 and 51 address the risks involved?	
	10) How appropriate are the requirements for investment firms to keep records of all trades on own account as well as for execution of client orders, and why?	
	11) What is your view of the requirement in Title V of the Regulation for specified derivatives to be traded on organised venues and are there any adjustments needed to make the requirement practical to apply?	The transparency issue raised in our answers to questions 7 and 22 is of importance for non-financial companies obliged to central clearing after crossing the clearing threshold under EMIR. They are required to trade eligible derivatives according to art. 24 et seq. MiFIR on regulated markets, MTFs or OTFs. It should be acknowledged that these companies do not conclude derivatives exclusively for trading purposes but first and foremost use these instruments for hedging reasons. This case should be carefully reflected by the definition determining which classes of derivatives should be subject to the trading obligation. The two criteria mentioned so far – "eligibility for clearing" (art. 26 para. 1 lit. a) and "sufficiently liquid" (art. 26 para. 3) – do not take these concerns adequately into consideration. We therefore recommend adding a further criterion which takes into account whether the purpose of the derivative transaction is hedging or not. The proposal could refer to the definition of "hedging" developed by ESMA / the EU-Commission within EMIR.

		This would ensure that derivative transactions which are agreed bilaterally on the respective electronic platforms as mentioned in our answer to question 7 but are not eligible for trading (because they are customized in order to match the individual structure of the underlying business) are exempted from the trading obligation. The problem regarding transparency obligations could be circumvented thereby. The suggested amendment would also not create problems with regard to supervisory requirements and investor protection (see our answer to question 22). We therefore suggest amending art. 26 para. 3 as follows: […] ***(d) the specifics of the derivative (e.g. whether they are bespoke in their design or used for hedging purposes as defined by ESMA / EU-Commission in Regulation [ ] (EMIR)).***
	12) Will SME gain a better access to capital market through the introduction of an MTF SME growth market as foreseen in Article 35 of the Directive?	We agree with the EU-Commission that it is important to improve access to capital markets for SMEs. Nevertheless, for the following reasons we doubt that the proposed SME growth markets (art. 35 MiFID) are not appropriate to reach this goal: - First of all we do not see the benefit of this new market category. Already today there are several trading platforms – classified as MTFs under MiFID – especially designed to provide access to capital in particular for SMEs (Entry Standard in Frankfurt, AIM in London, Alternext in Paris). These platforms are operated under private law which allows adjusting market regulation to the specific needs of SMEs. Since these platforms are well accepted among market par-

		ticipants we do not see the need for a new platform category. - We doubt that many market operators will shoulder the administrative burden and switch their MTF status by registering as SME growth market. In addition, the SME growth market status is lacking flexibility compared with the current private-law-segments as it requires that the majority of issuers should be SMEs up to a market capitalisation of 100 million Euros. Presumably only new MTFs would eventually register as SME growth markets, but adding new MTFs would result in more fragmentation of liquidity for SMEs. - It is also not comprehensible that the EU-Commission expands the scope of other regulations, especially the revised market abuse regulation, on MTFs and excludes at the same time SME growth markets from some of these rules. The regulation "light" of SME growth markets therefore would increase the pressure on market operators to become a SME growth market although this alternative is considered as optional. Therefore, existing platforms which trade shares especially from SMEs and which are registered as MTFs under MiFID should not be discriminated by the regulation. Overall, we oppose the concept of SME growth markets because it ignores existing market concepts and, thus, is redundant at best.
	13) Are the provisions on non-discriminatory access to market infrastructure and to benchmarks in Title VI sufficient to provide for effective competition between providers? If not, what else is needed and why? Do the proposals fit	

	appropriately with EMIR?	
	14) What is your view of the powers to impose position limits, alternative arrangements with equivalent effect or manage positions in relation to commodity derivatives or the underlying commodity? Are there any changes which could make the requirements easier to apply or less onerous in practice? Are there alternative approaches to protecting producers and consumers which could be considered as well or instead?	**Position limits of market operators** Mandatory position limits set by market operators are not justified (art. 59 MiFIR). Already today market operators apply such limits from case to case in order to secure the efficiency of markets. As the proposed obligation is very detailed it would limit the discretion and flexibility of market operators to react appropriately to certain market conditions. Therefore, art. 59 MiFID should be deleted. **Reporting positions in commodity derivatives in real time** Art. 60 MiFID requires operators of regulated markets, MTFs and OTFs to report publicly the aggregate positions held for the different financial instruments traded on their platforms. Furthermore, operators are obliged to report to the competent authorities the positions of a single participant on request. Therefore, members and participants have to report details of their positions in real time (art. 60 para. 2). Reporting real time is very costly for corporates without any additional benefit. Already EMIR requires market participants to report their derivative transactions to trade repositories, therefore the introduction of the real time reporting duty is superfluous. Double reporting should be avoided as stated in recital 29 MiFIR. Furthermore, we do not understand the reporting requirement for practical reasons. Market operators should have the re-

		quested information available because the respective positions were traded on their platforms. In addition, a continuous reporting is not justified for occasionally inquiries of the competent authorities. For these reasons art. 60 para. 2 should be deleted.
Investor protection	15) Are the new requirements in Directive Article 24 on independent advice and on portfolio management sufficient to protect investors from conflicts of interest in the provision of such services?	
	16) How appropriate is the proposal in Directive Article 25 on which products are complex and which are non-complex products, and why?	
	17) What if any changes are needed to the scope of the best execution requirements in Directive Article 27 or to the supporting requirements on execution quality to ensure that best execution is achieved for clients without undue cost?	
	18) Are the protections available to eligible counterparties, professional clients and retail clients appropriately differentiated?	
	19) Are any adjustments needed to the powers in the Regulation on product intervention to ensure appropriate protection of investors and market integrity without unduly damaging financial markets?	
Transparency	20) Are any adjustments needed to the pre-trade transparency requirements for shares, depositary receipts, ETFs, certifi-	

	cates and similar in Regulation Articles 3, 4 and 13 to make them workable in practice? If so what changes are needed and why?	
	21) Are any changes needed to the pre-trade transparency requirements in Regulation Articles 7, 8, 17 for all organised trading venues for bonds, structured products, emission allowances and derivatives to ensure they are appropriate to the different instruments? Which instruments are the highest priority for the introduction of pre-trade transparency requirements and why?	
	22) Are the pre-trade transparency requirements in Regulation Articles 7, 8 and 17 for trading venues for bonds, structured products, emission allowances and derivatives appropriate? How can there be appropriate calibration for each instrument? Will these proposals ensure the correct level of transparency?	Our answer refers to both pre- and post-trading transparency with regard to OTC trading only. As mentioned in our answer to question 7 non-financial end users apply bespoke derivatives predominantly to mitigate risks of their operative business. It was also pointed out that corporates will be covered by the transparency requirements if the electronic platforms they already use will adopt the MTF or OTF status. The transparency requirements will have a negative impact on the corporate hedging strategy for the following reasons: - Making public an order book („prices and the depth of trading interests at those prices for orders or quotes advertised through their systems“ – art. 7 para. 1) including bespoke derivatives with individual agreed characteristics regarding maturity and volume is useless. Applying such an “order book concept” for these derivatives would comprise one or-

		der as a rule, namely that from the non-financial company requesting a bespoke transaction on the respective electronic platform. Besides the administrative burden for the platform operator to create an open order book the information provided would have no value for end-users. On the contrary: Especially in narrow markets, e.g. for rare metals or exotic currencies, the transparency obligation might bear the risk that other market participants would be able to conclude from the order the identity of the non-financial company representing the quote / deal. Consequently, the hedging strategy of the respective corporate becomes visible for everyone (e.g. competitors) which can not be intended by the legislator. Problems with confidentially occur also with regard to post-trade-transparency if volumes and prices were published. Furthermore, the transparency requirements will impact prices negatively especially regarding derivatives with volumes above market average or an illiquid underlying (e.g. certain currencies or maturities). Increasing prices would raise the hedging costs for corporates, including follow-up orders if the requested amount is split. This would harm the efficiency of corporate risk management with the consequence that otherwise reasonable hedges would not be concluded. - In addition, bespoke derivatives are not traded on secondary markets where retail or institutional investors are involved. Hence, transparency obligations for bespoke derivatives can not be justified with the investor protection argument. Furthermore, non-financial companies participating in derivative transactions are by and large considered as professional

		clients and therefore do not need the same degree of protection. - There is also no justification for transparency requirements in MiFID / MiFIR for supervisory reasons. The forthcoming regulation on derivatives (EMIR) already provides for the obligation for market participants to report derivative transactions to trade repositories. An additional reporting requirement is therefore redundant. For these reasons we suggest to restrict the pre- and post-trade-transparency obligations of art. 7 and 9 MiFIR to counterparties which are subject to the trading obligation in art. 24 et seq. This would exempt non-financial companies with a stock of derivatives not exceeding the clearing threshold defined in EMIR and would also take into account recital 12 MiFIR which explicitly outlines that OTC-derivatives are not covered by the transparency regime: "Therefore only those financial instruments traded purely OTC which are deemed particularly illiquid or are bespoke in their design would be out-side the scope of the transparency obligations." Articles 7 para. 1 and 9 para. 1 regarding pre- and post-transparency on regulated markets, MTFs and OTFs should be amended as follows:

		E.g.: Art. 7 para. 1: Regulated markets and investment firms and market operators operating an MTF or an OTF based on the trading system operated shall make public prices and the depth of trading interests at those prices for orders or quotes advertised through their systems for bonds and structured finance products admitted to trading on a regulated market or for which a prospectus has been published, emission allowances and for derivatives ***which are subject to the trading obligation as referred to in Art. 24.*** […] The aforementioned exemption should also cover transparency requirements for systematic internalisers (art. 17 and 20). Given that the EU-Commission has announced to widen the scope of the definition for systematic internaliser we assume that many financial counterparties of corporates will be covered by these provisions when MiFIR / MiFID will be adopted. Therefore, the problems regarding transparency mentioned above are also relevant with regard to systematic internaliser. In addition, SIs are required to quote the same price for an instrument in question for all clients. This obligation hinders SIs to differentiate prices taking into account the counterparty risk which is essential in derivative transactions. We fear that this requirement will raise prices also for derivatives agreed with corporates of high creditworthiness.
	23) Are the envisaged waivers from pre-trade transparency requirements for trading venues appropriate and why?	

	24) What is your view on the data service provider provisions (Articles 61 - 68 in MiFID), Consolidated Tape Provider (CTPs), Approved Reporting Mechanism (ARMs), Authorised Publication Authorities (APAs)?	
	25) What changes if any are needed to the post-trade transparency requirements by trading venues and investment firms to ensure that market participants can access timely, reliable information at reasonable cost, and that competent authorities receive the right data?	Regarding transparency issues please refer to our answer to question 22.
Horizontal issues	26) How could better use be made of the European Supervisory Authorities, including the Joint Committee, in developing and implementing MiFID/MiFIR 2?	
	27) Are any changes needed to the proposal to ensure that competent authorities can supervise the requirements effectively, efficiently and proportionately?	
	28) What are the key interactions with other EU financial services legislation that need to be considered in developing MiFID/MiFIR 2?	MiFID / MiFIR should be in particular aligned with the corporates' exemptions stated in EMIR. This applies especially for the trading obligation (see our answer to question 11) and the rules concerning pre- and post-trade-transparency (see our answer to question 22). In addition, the draft regulation expands competences of supervisory authorities significantly. These new competences can have serious repercussions on risk mitigation strategies of non-financial companies. Therefore, we fear that the exemptions

		foreseen in the European Market Infrastructure Regulation (EMIR) will be countervailed by these competences as well: - Product intervention: ESMA and competent national authorities are allowed to temporarily (art. 31 MiFIR) or permanently (art. 32 MiFIR) prohibit or restrict certain financial instruments and activities in cases of significant investor protection concerns or a serious threat to the orderly functioning and integrity of financial markets. - Position management: ESMA is allowed to request information from any person regarding its derivative exposure, to require steps to reduce the position and to limit the ability from entering into a commodity derivative (art. 35 MiFIR). - Competences of competent authorities: According to art. 72 MiFID competent authorities will be equipped with similar instruments regarding the above mentioned position management of ESMA (request information, call for reducing exposures and limit commodity positions). As these supervisory powers are far-reaching and the circumstances triggering the measures are defined vaguely and lack the required legal certainty we fear that the sole possibility of applying these instruments could deter non-financial companies from mitigating their operative risks by the use of derivatives. To ensure consistency with EMIR, derivatives of non-financial companies which are not obliged to be cleared should be exempted from the above mentioned supervisory measures. This would be in line with the widely shared view that the derivatives of corpo-

		rates are used to a large extent for hedging purposes and therefore bear no systemic risks. For this reason we suggest the following amendments in art. 31 para. 1 lit. b and art. 32 para. 2 lit. e: ***[…] Derivative transactions of non-financial counterparties which are not subject to the clearing obligation as defined in Art. 5 para. 1 of Regulation […] (EMIR) shall be exempted from the prohibition or restriction.*** These derivatives should also be exempted from the measures referred to in art. 35 and 72.
	29) Which, if any, interactions with similar requirements in major jurisdictions outside the EU need to be borne in mind and why?	
	30) Is the sanctions regime foreseen in Articles 73-78 of the Directive effective, proportionate and dissuasive?	
	31) Is there an appropriate balance between Level 1 and Level 2 measures within MIFID/MIFIR 2?	

Detailed comments on specific articles of the draft Directive

Article number	**Comments**

Annex 1, Section C (6):	Although Annex 1, Section C (7) states that derivative contracts related to commodities which are physically settled are exempted from MiFID / MiFIR under certain circumstances we are concerned that Annex 1, Section C (6) will derogate this exemption. The definition in Annex 1, Section C (6) comprises all physically settled commodity derivatives which were traded on regulated markets, MTFs and OTFs. As laid down in our answer to question 6 we assume that the definition of an OTF is likely to be very broad and will cover electronic platforms used by non-financials to improve efficiency of OTC trading. We are therefore concerned that commodity derivative transactions used by non-financials to hedge their operational risks which are settled physically and arranged on the respective electronic platforms will be defined as financial instruments in future. This would disregard the fact that the use of physically settled forward products is essential for non-financial firms. Their inclusion into MiFID / MiFIR would effectively extend the scope to purely commercial activities (i.e. gas/power contracts including physical delivery) which do not display the characteristics of traditional derivatives trading. It would also reduce substantially the scope of the ancillary activity exemption as this type of trading typically represents the main trading activity of commodity firms. As such, it is essential that physically settled contracts remain outside the scope of the directive. We therefore strongly support a better specification of the MiFID-definitions to exclude all products with future delivery that are physically settled. This is the approach used in the US under the Dodd-Frank Act, and as such any departure from this approach in the EU would create regulatory inconsistency. Therefore, we propose that the "commercial purpose test" of Annex 1, Section C (7) should be inserted in Annex 1, Section C (6) regarding physically settled forwards traded over regulated markets, MTFs and OTFs. This would appropriately distinct commercial activities from the definition of financial instruments.
Article ... :	
Article ... :	