MiFID review: priorities for reviewing the regulation of trading activities

This document was drafted by Eurofi with input from its members. It does not engage in any case the EU Polish Presidency or the Polish financial authorities.

Executive summary

The Markets in Financial Instruments Directive (MiFID) has been in force since November 2007 and is currently under review with the revised text due to be adopted in 2012. Following a public consultation organized at the beginning of 2011 by the EU Commission, the MiFID review proposal is scheduled to be published in October 2011.

Two of the major and most contentious proposals in the EU Commission consultation paper (8 December 2010) are:

- The project to create a new category of venues (Organized Trading Facilities or OTFs) in order to reduce the scope of transactions done away from MiFID regulated venues (ie Regulated Markets, Multilateral Trading Facilities and Systematic Internalisers) and support G20 commitments for the trading of standardized OTC derivatives

- The proposals to extend transparency rules to equity-like and non-equity products.

I. Developments in market structure:

1.1. Present organization of the market and proposals to adjust existing MiFID venue regimes:

The development of alternative trading venues such as Multilateral Trading Facilities (MTFs) and Systematic Internalisers (SIs) alongside existing exchanges (qualified as Regulated Markets or RMs) contributed significantly to making progress towards the objective of introducing more competition in the trading space.

MTFs and SIs, both operated by MiFID regulated investment firms, correspond to different trading needs.

MTFs are multilateral systems which bring together multiple third-party buying and selling interests in financial instruments. MTFs first developed in the cash equity market (particularly for blue chip equities). Cash equity MTFs share many features with RMs, most of them operating a centralized order book model[1]. They may however have organizational requirements differing to a certain extent from those of RMs, due to proportionality principles and the fact that most MTFs do not offer listings. Supervisory treatment may also differ across countries.

The MTF regime has also been adopted by some multilateral bond and derivative electronic trading platforms, developed by investment firms, such as inter-dealer brokers for example. The number of multilateral platforms, which usually address the more standardized part of the market, is expected to grow with the implementation of the non-equity transparency requirements announced in the Dodd-Frank Act and the MiFID review consultation paper and the implementation of G20 commitments regarding the trading of standardized OTC derivatives. Trades are executed electronically on these venues by matching of orders or request for quote (RFQ) / request for stream processes (for asset classes where there is not sufficient liquidity to support continuous trading). The investment firms operating these platforms usually do not act as counterparties in the deals executed on the platforms.

SIs provide bilateral trade execution in which the SI acts as the counterparty to all customer orders and are quote-driven whereas RMs and cash equity MTFs are mainly order-driven[2]. SIs have however had only limited success so far, attributed mainly to the lack of clarity of their definition.

The proposals made by the Commission to solve the issues identified with existing MiFID regimes (MTFs and SIs) are generally accepted by industry players:

- **Improving the alignment of RM and MTF requirements in MiFID.** Stock exchanges are in favour of this proposal considering that since RM and MTF business models are similar they should be regulated and supervised in the same way. Users of these platforms are more cautious pointing out that consistent regulatory treatment of RMs and MTFs should be applied in a proportionate way and be adapted to the different business models developed by MTFs.

- **Clarifying the eligibility criteria of the SI regime and making quote rules more flexible.** Although these proposals are considered to be a step in the right direction, some players believe that the Commission should beforehand reconsider the need for the SI regime and better define its objectives. Others question whether the quoting obligation should be general, rather than only when triggered by dealings below standard market size.

The remaining part of trading, conducted outside MiFID regulated venues (RMs, MTFs and SIs), includes (see table below for futher detail):

- Multi-lateral trades conducted on organized venues which do not come under present MiFID definitions, such as broker crossing systems (BCSs) and some dealer platforms

1. Dark pool MTFs have also developed proposing block equity trading with no pre-trade transparency, benefiting from MiFID transparency waivers for large-in-scale orders. They are designed to accommodate the needs of wholesale participants to be able to execute large orders with limited price impact.
2. SIs have an obligation to publish firm quotes in shares admitted to trading on a RM for which they are SIs, when dealing for sizes up to standard market size

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- Bilateral trades: bilateral exchanges by phone, email or on single dealer platforms. This trading method is mostly used for large equity blocks or products which offer limited liquidity, such as customized and / or structured note and derivative products.

These transactions, which are usually considered as OTC trades[3], are not subject to the trading venue requirements of MiFID, since they are not carried out on MiFID regulated venues, but are subject to post-trade transparency rules for equity trades and the counterparties of these OTC deals are regulated by MiFID as investment firms.

Multi-dealer platforms also usually provide pre-trade data (indicative quotes) and post-trade reporting to the participants of the platform, based on the information produced by the dealers contributing to the platform[4].

Broker crossing systems (BCSs) are automated systems operated by broker dealers to internally match client orders or to match client orders (eg retail, institutional…) and in-house orders[5] at a reference price imported usually from the relevant RM. They can generally be considered as multilateral platforms since they bring together multiple buying and selling interests for order execution. As they aggregate liquidity coming from the different order flows of the investment firm, BCSs can facilitate different types of trading including the trading of child orders of larger parent orders. BCSs operate in a discretionary way (in terms of access and matching of orders) which differentiates them from MTFs.

There are two main types of dealer platforms. Single dealer platforms offer deals with a single dealer (the dealers or banks operating single-dealer platforms provide quotes to their customers on a bilateral basis) and therefore are mostly an electronified version of traditional bilateral OTC trading. **Multi-dealer platforms** are multilateral platforms which offer interaction with several dealers. As mentioned further up in this document, many of the existing multi-dealer platforms have adopted the MTF status.

In terms of trading volumes, OTC is the main trading method employed for bonds and derivatives for which around 80 to 95% of trading is conducted OTC, either by voice or on electronic platforms. The market share of OTC for equity trades is disputed. OTC is considered to represent either 15 to 20% or 40% of total equity trading (including BCSs), depending on the estimates and counting methods employed[6].

1.2. Proposal to create Organised Trading Facilities (OTFs) a new category of alternative trading platforms and a regime for Broker Crossing Systems (BCSs):

The Commission is proposing to create two new regimes to regulate organized venues which are not RMs, MTFs or SIs in order to reduce the scope of transactions done away from MiFID regulated venues and to ensure that trading systems with similar functionalities are subject to similar requirements: OTFs (Organised Trading Facilities) and BCSs (Broker Crossing Systems). At this stage it has not yet been decided whether the BCS regime would be a sub-regime of the OTF one or whether it would be a separate regime.

Operating an OTF would be a new licensable activity under MiFID. OTFs would be subject to a certain number of core regulatory requirements notably in terms of notification and transparency[7]. After reaching an asset-specific threshold the Commission is proposing that OTFs be required to convert to a MTF.

The proposed OTF regime is also intended to support the implementation in the EU of G20 commitments regarding the trading of standardized OTC derivatives contracts on exchanges or electronic trading platforms[8]. OTFs would be one of the electronic platforms on which standardized OTC contracts should trade, where appropriate, in addition to RMs and MTFs.

Based on existing trading venues (see the description of the present organization of the market in the table below), OTFs would include mainly the trading conducted on BCSs, which focus mostly on equity trading (unless a separate regime is created), and derivatives and bond trading happening on different types of dealer platforms that are not MTFs. Many existing multi-dealer platforms have adopted a MTF status as discussed previously, however in the future some of these platforms or new platforms would have the choice to opt either for the MTF or for the OTF regime, depending on their characteristics.

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3. Although they go beyond what is described as OTC in Recital 53 of the MiFID Directive where OTC trades are defined as trades performed on an “ad hoc and irregular bilateral basis and carried out with wholesale counterparties and part of a business relationship which is itself characterized 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. OTC transactions are not specifically and directly regulated by MiFID
4. This information is however not accessible to the wider public and in some cases the data on a given transaction is only disclosed to the participant having executed the transaction and not to the other participants of the platform.
5. Many BCSs offer the possibility to their clients to refuse executing order against in-house orders. But BCSs, unlike SIs, offer no transparency of proprietary trades at present
6. The share of OTC trading is considered by some players to vary depending on whether it takes into account only real price forming liquidity (ie trades with clients) or also reporting events (eg MiFID reporting requirements related to give-up trades). Analyses conducted by AFME on the nature of OTC trading show that approximately only 50% of OTC reporting represented genuine liquidity events, meaning that the real share of OTC would be closer to 15 / 20%. Different percentage figures with a share up to 40% for OTC trading are put forward in other surveys such as the Celent / Goethe Universität study of September 2010.
7. Such as: notification and description of the OTF to the competent authority and to ESMA, post-trade transparency reports to the competent authorities and to the public, the adoption of access rules, rules to manage conflicts of interest and monitor trading activity for market abuse, conduct of business rules, and others
8. The mandatory trading on exchanges or electronic trading platforms of standardized OTC derivative contracts, where appropriate, is proposed in the MiFID review following the G20 commitments. ESMA would be responsible for deciding when a derivative, which is eligible for clearing according to EMIR rules, is sufficiently liquid to be traded exclusively on organized venues (ie RMs, MTFs and OTFs).

The proposal to create a new OTF regime raises many questions and disagreements among market players and the lack of precision and specificity of the present definition of OTFs is widely criticized.

The proposal made for regulating BCSs is relatively well accepted by many players, particularly given their growing significance in the market. Many players are favourable to regulating BCSs separately from MTFs and SIs, given the specific combination of features they offer[9]. Some players however consider that it is not clear why it should be necessary to establish a special sub-regime for BCSs rather than including them in the broad OTF category, since they are one of the main types of facility that the OTF definition would capture. Some are also asking for further clarity on specific requirements that would apply to BCSs, such as those relating to post-trade transparency.

The role that OTFs could play in OTC bonds and derivatives trading is considered to be less clear by many industry players. Many market players suggest that the definition of OTFs should first of all make clear that illiquid or bespoke OTC products, which are mainly traded at present by voice or email, should not be required to trade exclusively on such organized venues and additionally, many point out that instruments that are admitted on a RM, MTF or OTF should not be prohibited from being traded OTC. Some players put forward the need to ensure that sufficient flexibility and proportionality is built into the description of OTFs in order to allow hybrid trading processes (voice or email trading with electronic confirmation) which are widely used for OTC trading of derivatives and bonds[10] including on multi-dealer platforms for example.

The possibility for single dealer platforms to be included in the scope of OTFs is debated, as well as the conditions that may be required. Some players consider that some single dealer platforms may be sufficiently organized and structured to qualify for the OTF regime provided proportionate rules can be applied. Others point out that many of the existing bilateral platforms are at present closer to an efficient version of bilateral OTC trading, than to an organized venue model.

It is also believed by some that **venues should not be segmented based on volume** as inferred by the idea to transform OTFs into MTFs passed a certain threshold, but on functional and operational criteria, as the two systems are fundamentally different and provide choice to clients.

Many players however disagree with the need to introduce a new OTF category in the first place.

Market infrastructures (many RMs and some MTFs) are concerned that the OTF regime, which may have a lighter regulation, could attract trading from existing MiFID regulated market places and further increase fragmentation and level playing field issues. They believe that all venues, including crossing networks, could and should fall under the existing definitions of MTFs and SIs - the former covering multilateral trades and the latter organized bilateral ones - and the remaining part of trades coming under a reviewed definition of OTC.

Other commentators stress that the activity potentially covered by OTFs is already broadly regulated under MiFID since the investment firms operating BCSs and single / multi dealer platforms are MiFID regulated firms and that many multi-dealer platforms have adopted the MTF status.

There is also a strong disagreement on the trading of standardized OTC derivatives on exchanges or electronic platforms being mandatory and uncertainty as to the contracts and transactions that may be concerned by these obligations.

The mandatory requirement is considered by many industry players to be stricter than initial G20 commitments and to open the way to applying an equity model to OTC derivatives trading which is not considered appropriate[11]. Concerns have been expressed mainly by broker dealers that this measure may force excessive standardization in the market beyond what is needed to mitigate systemic risks.

Industry players are also concerned by the lack of precision with regard to the contracts and types of transactions potentially captured by the requirements, pointing out that eligibility for clearing may not be a sufficient criterion and that exemptions for block transactions may be needed. With regard to the venue scope, further investigation into the OTF proposal is needed as mentioned previously. The fact that the criteria retained should be predictable but flexible enough to accommodate possible changes in liquidity and market conditions is also highlighted.

In conclusion, many observers consider that additional assessments of the trading that presently takes place outside RMs, MTFs and SIs and of investor needs, is necessary in order to clarify the need and possible positioning of a new category of OTFs and for defining the possible functionalities that it could cover, as well as defining the measures required for implementing G20 commitments regarding the trading of standardized OTC derivatives.

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9. BCSs combine the matching of client orders (as in MTFs), the possibility to execute orders against house orders (as with SIs) and a discretionary trade execution process which enable an efficient internal aggregation of liquidity
10. The benefits of such hybrid trading methods are widely put forward by industry players using them. Under normal conditions hybrid bilateral trading allows for more precise hedging of business risks reducing systemic risks Some players moreover point out that in troubled markets it is important to be able to revert electronic trading to voice, based on client preference.
11. Due to the variable level of secondary trading and discontinuous liquidity of such instruments, mainly sold to a relatively limited number of professional counterparties spread over a large number of products

II. Extension of transparency requirements to equity-like and non-equity instruments:

The transparency regime in MiFID only applies at present to shares admitted to trading on RMs (including when those shares are traded on a MTF or OTC). The MiFID review proposals of the Commission suggest extending transparency rules to equity-like instruments (eg depositary receipts, ETFs, certificates issued by companies…) and non-equity instruments (like bonds and structured products with a prospectus or admitted to trading on a RM or MTF, derivatives eligible for central clearing) in order to improve price formation, facilitate best execution and improve investor confidence. This should also enable regulators to better monitor risks in the market. Pre and post-trade transparency would be required for all trades whether executed on RMs, MTFs, OTFs or OTC with rules possibly differentiated by asset class and OTC trades would be flagged.

There is a general agreement on the aim to improve transparency in non-equity markets, provided that priorities are defined in terms of products and requirements are appropriately designed and calibrated in order to preserve market liquidity and efficiency.

Market infrastructures are generally favourable to extending pre and post-trade transparency to equity-like and non-equity instruments with appropriate calibration, waivers and thresholds (eg to distinguish between retail and wholesale markets).

Many issues are however pointed out, by investment firms, who consider that the proposals of the Commission go beyond what may be useful for end-users and possibly supervisors. They point out that transparency requirements which may be inappropriately calibrated to the specific characteristics of the different products and asset classes may ultimately have a detrimental effect on market liquidity and efficiency. They therefore suggest that there is a need for the transparency regime to be flexible enough to accommodate different levels of liquidity between equity and non-equity products and fluctuating levels within the same products as market or other changes have an impact.

Regarding pre-trade transparency the product scope to which it should apply is debated as well as the need to disclose prices to the wider public.

Many players consider that the scope of products proposed is too wide and that priority for detailed pre-trade transparency should be given to products which are sufficiently liquid and standardized (ie equity-like instruments, non-equity instruments traded on RMs and MTFs and instruments sold to retail investors). Concerns have also been expressed regarding the need for and possible consequences of public disclosure of pre-trade prices in requests for quotes to the wider public and the co-mingling of indicative and firm prices.

For less liquid and standardized products, many players indeed argue that buy-side actors (who are professionals) already have access to pre-trade pricing from private market solutions (eg information providers) or from the dealers they are in contact with (either bilaterally or on a multilateral platform). Since these products are generally only sold to wholesale clients, they consider that equity-like public pre-trade disclosure may not bring much added value and may actually be less informative in some cases (eg with no indication of credit risk for example).

Regarding post-trade transparency the main issue put forward is that post-trade transparency regimes should be specific to each asset class based on asset class specificities (eg instrument liquidity, issuance size, etc…).

Rules of delayed information should be defined to appropriately protect the parties of a trade (eg with possibilities to delay publication of large trades). The rules defined should also take into account requirements to set up trade repositories for OTC derivatives, which will provide post-trade data on OTC derivative trades.

MAIN TYPES OF VENUES AND TRADING METHODS USED PRESENTLY IN THE EU

	Main types of venue	Trading method	Types of trades	Price formation	Transparency requirements to the public
MiFID regulated venues	**RMs: Regulated markets** (ex: NASDAQ OMX, NYSE Euronext, Deutsche Börse, LSE…)	Multilateral Continuous matching with centralized order book	Equities Listed bonds and derivatives, ETFs…	Continuous matching of participants' bids and offers	Pre trade (real time current orders and quotes)and post trade (trade report for each transaction) for equities admitted on RMs with venue identification
	Lit cash equity MTFs (ex:BATS ChiX, Turquoise, ,…)	Multilateral Continuous matching with centralized order book	Mainly Equities (mainly blue chips)	Continuous matching of participants' bids and offers	Pre and post trade for equities typically with venue identification
	Dark pool MTFs or dark order book operated by MTF or RM sponsored (ex: Chi Delta, Smartpool, Liquidnet…)	Multilateral Matching with non-displayed order book (no pre-trade transparency)	Mainly Block trading of Equities (mainly blue chips)	Price usually built at mid-point of best bid and offer quote of relevant RM	Post trade for equities Usually identification of the MTF or RM operating the dark venue (but not necessarily of the dark venue itself if the RM or MTF operates both lit and dark order books) Large in scale waivers for pre-trade Reference price pre-trade transparency waiver most often
	Multi-dealer MTF platforms (ex : TradX, MarketAxess, Brokertec, Tradeweb, Bloomberg, Bondmatch…)	Multilateral Customer or dealer selecting best bid and offer quotes from several dealers on trading platform most often. Some have an order driven model (eg Bondmatch)	Bonds and Derivatives	RFQ, cross-matching, firm quotes, auctions… with dealers contributing to platform Order book in some cases	No transparency required for non-equities *Trade repositories will offer some aggregated post-trade information for OTC derivatives trades with the implementation of EMIR*
	SIs Systematic Internalisers (ex: Citi, UBS, RBS, …)	Bilateral Systematic execution of client orders on own account	Equities, Bonds Derivatives	Firm bid and/or offer price for liquid shares admitted on RMs, quotes for others up to std market size	Limited pre-trade transparency for equities. All SIs opted for anonymous post-trade for equities (reported as SI)
Other electronic platforms	**BCS or Broker Crossing Systems** (ex: Citi Match, Goldman Sachs Sigma, Crédit Suisse Crossfinder, Bank of America Merrill Lynch MLXN…)	Multilateral and bilateral Internal matching of client orders (which may be sliced) or matching of client orders and house orders (with client permission) Orders entered by operator	Equities	Cross-matching of client orders or matching with house orders	Post-trade transparency for equities trades reported anonymously (reported as OTC with no venue identification) *Trade repositories will offer some aggregated post-trade information for OTC derivatives trades with the implementation of EMIR*
	Non MTF multi-dealer platforms	Multilateral Customer or dealer selecting best bid and offer quotes from several dealers on trading platform	Bonds and Derivatives	RFQ, cross-matching, firm quotes, auctions… with dealers contributing to platform	
	Single dealer platforms	Bilateral Customer dealing with a single dealer on trading platform	Bonds and Derivatives	RFQ, quotes,… with dealers contributing to platform	
Voice or email	**Bilateral OTC**	Bilateral between customer and dealer or between dealers Voice or email	Trading of equities (block trading), bonds and derivatives	Bilateral negotiation with dealer Quotes	

Main document

Context:

The Markets in Financial Instruments Directive (MiFID) has been in force since 1 November 2007 and is currently under review[12] with the revised text due to be adopted in 2012. The European Commission ("Commission") organized in December 2010 a two-month public consultation on possible changes to be made to the directive. The amendments proposed by the Commission aim at tackling weaknesses identified in the application of the original MiFID text, adapting the directive to the evolutions in trading methods and technologies, addressing issues raised by the financial crisis and implementing the G20 commitments to improve transparency and oversight of OTC derivatives[13] and commodity markets. The MiFID review proposal is scheduled to be published in October 2011.

The present document will focus on the amendments related to market structure and trading activities proposed by the Commission in its consultation paper (8 December 2010), which appear to be the most contentious, represent the areas where the stakes are highest for market stakeholders and on which there are disagreements regarding the objectives pursued and the rationale for further regulatory intervention, namely:

- Developments in market structure:
    - The proposal to create a new category of alternative trading platforms - Organised Trading Facilities (OTFs) - and a sub-regime for broker crossing systems (BCSs)
    - Further alignment of requirements for Multilateral Trading Facilities (MTFs) and Regulated Markets (RMs) and clarification of Systematic Internaliser (SI) criteria
    - Mandatory trading on exchanges or electronic trading platforms (ie RMs, MTFs or OTFs) of standardized OTC derivative contracts, where appropriate
- Extension of pre and post-trade transparency requirements to non-equity instruments (including OTC derivative contracts) and equity-like instruments
- Access of third-country participants to the EU and global consistency of trading rules applying to transferable securities.

I. Developments in market structure:

Evolutions in trading functionalities and G20 commitments to encourage the trading of standardized OTC derivatives on organized venues have led the Commission in its Consultation Paper (8 Dec 2010) to propose enlarging the scope of venues regulated by MiFID[14] with the aim of promoting transparency and facilitating supervision of certain trading activities. The Commission is in particular considering that the MiFID framework Directive could be amended to require that all trading in derivatives which are eligible for clearing and sufficiently liquid be traded either on RMs, MTFs or a specific regime of organized trading facilities (OTFs) to be precisely defined by MiFID. A review of existing rules applying to MTFs and SIs has also been proposed in order to solve some level playing field and consistency issues and clarify the positioning and objectives of these venues.

Although the majority of the industry generally agrees with the need to review the definitions and requirements of venues by MiFID, many players consider that the characteristics of products (particularly OTC products) and of existing trading venues and trading methods need to be thoroughly analyzed, taking into account investor needs, in order to evaluate proposals for adjusting existing venue requirements and for creating possible new venue regimes such as the OTF regime proposed by the Commission.

Many investment firms point out that sufficient flexibility and proportionality will be needed in the definitions and requirements of OTFs to accommodate existing trading methods and that OTFs should not be structured to capture the trading of illiquid or bespoke OTC products. They are indeed concerned that a "one-size-fits all" approach based on listed equity instrument standards may be forming the basis for defining requirements for the trading of non-equity products, many of which have quite different characteristics in terms of liquidity and customization and are used by different customer groups.

As for market infrastructures, most of firms question the actual need for new venue regimes, considering that all organized trading could possibly fit in with the existing MiFID venue definitions (ie RMs, MTFs and SIs). They are mainly concerned that the OTF regime, which may have a lighter regulation, could attract trading from existing MiFID regulated market places and further increase fragmentation.

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12. As per Article 65 of the MiFID original legislation requesting the European Commission to report to the Council and European Parliament on the possible need for review / amendment of a number of topics in the original legislation
13. http://www.g20.org/Documents/pittsburgh_summit_leaders_statement_250909.pdf
14. The operation of an organised trading facility would become an investment service for which autorisation is required

1.1. Present organization of the market

Facilitating competition in the trading space and increasing market efficiency, while providing market integrity and investor protection were the main objectives of the initial MiFID text. The development of alternative trading venues such as MTFs and SIs alongside existing exchanges (qualified as RMs) contributed significantly to making progress towards this objective.

MTFs and SIs have specific characteristics and correspond to different trading needs.

Originally used mainly by alternative venues executing blue chip equity trades, the MTF regime has also been adopted by some multilateral bond and derivative electronic trading platforms. The number of multilateral platforms is expected to grow with the implementation of the non-equity transparency requirements announced in the Dodd-Frank Act and the MiFID review consultation paper.

MTFs are defined in the MiFID directive as "multilateral systems operated by an investment firm or a market operator which bring together multiple third-party buying and selling interests in financial instruments in the system and in accordance with non-discretionary rules in a way that results in a contract".

- **Most MTFs created so far have mainly focused on cash equity trading** and share many features with RMs. Among the cash equity MTFs operating at present in the EU, 3 of them represent the largest market share (Chi-X Europe, BATS Europe and Turquoise). Most of these MTFs have an order-driven market model and operate a centralized order book model in the same way as RMs[15], which provides non-discretionary[16] and anonymous matching among participants. The main differences between cash equity MTFs and RMs are that MTFs can be operated by investment firms[17], that MTFs do not provide listing and related issuer services[18] and that many lit MTFs allow a certain proportion of non-displayed orders such as large-in-scale orders to interact with the displayed order-book[19]. Cash equity MTFs may also have organizational requirements differing to a certain extent from those of RMs due to proportionality principles and the fact that most MTFs do not offer listings[20]. Supervisory treatment may also differ across countries. MTFs generally state that they have attracted customers by lower fees and the speed of their platforms. Many MTFs also offer pan-European trading of shares which is less common in the case of RMs. Lit MTFs represent around 15 to 30% of equity trading in the EU, depending on the estimates and the time period observed[21].

- Several cash equity MTFs (eg Chi-X Delta, Smartpool…) and a regulated market (Deutsche Börse) **operate a dark order book platform** with no pre-trade transparency benefiting from the transparency waivers of MiFID. For example the large in scale waiver is designed to accommodate the need of wholesale participants to be able to execute large orders with limited price impact. Commonly referred to as "**dark pools**"[22], these MTFs that use the so-called "reference price" pre-trade transparency waiver facilitate the interaction of purely dark liquidity and provide order execution at prices referenced by other systems. Prices used are mainly those of the RMs where the shares are listed[23]. If a matching order is found the transaction takes place by an execution of buying and selling interests in a non-discretionary way and the transaction is published post-trade. They are an alternative to OTC for executing trades with no pre-trade transparency[24]. Dark trading on dark MTFs and crossing networks (see definition below) is estimated to represent less than 7% of total volumes for equities[25].

- With the increasing accessibility and development of electronic trading and matching solutions, many investment firms have implemented electronic trading platforms, executing standardized fixed income, derivative or bond instruments, to position themselves in the market before the rules are finalized[26]. This trend is expected to continue with the upcoming

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15. MTFs offer limit order books because that is the model that best suits the characteristics of the products they trade and the markets they operate within. While most RM trading is now done on electronic limit order books, particularly for cash equities,it also includes trades done in a voice pit (eg at the London Metals Exchange), bilaterally negotiated bespoke trades on a discretionary basis that are subsequently cleared (eg through NYSE Euronext BClear) and large trades in listed products that are executed by voice and subsequently cleared (eg Deutsche Börse's block trade facilities).
16. i.e. with no discretion as to how interests may interact
17. Operating an MTF is an investment service to which MiFID applies
18. This is mainly a matter of business choice and listing opportunities. There are MTFs that operate "junior" listing markets where the issuer requirements are not harmonized on EU level such as NASDAQ OMX First North
19. This practice is also permissible on RMs but is much more prevalent on MTFs
20. Proportionality principles in legislation apply for example to conflicts of interest mitigation, resources to ensure business continuity, contingency arrangements to cope with risks of system disruptions. RMs point out that since the trading functions of RMs and MTFs are equivalent proportionality is not justified and the regulatory and supervisory treatments should be the same
21. Based on different statistics found in surveys such as Celent / Goethe Universität study on MiFID of September 2010, CFA Institute 2011 or estimates provided by Eurofi members
22. For firms managing also a lit platform, this order book is distinct from the main displayed or lit order book.
23. eg mid-point of best bid and offer price or volume weighted average price
24. Other alternatives are RMs benefitting from the same waivers as MTFs and Sis which are not submitted to pre-trade transparency for orders above standard market size
25. Based on the average of statistics found in surveys such as Celent / Goethe Universität study on MiFID of September 2010, CFA Institute 2011 and Financial Times articles
26. The implementation of the Dodd-Frank act has been put back about 6 months to the end of 2011 while the revised MiFID directive will not be adopted until the end of 2012.

Dodd-Frank and MiFID non-equity transparency requirements[27]. The investment firms operating these platforms usually do not act as counterparties in the deals executed on the platform. **Many of these platforms are multi-dealer platforms** where trades are executed electronically by matching of orders or request for quote (RFQ) / request for stream processes (for asset classes where there is not sufficient liquidity to support continuous trading)[28]. In the EU most of these platforms have adopted the MTF status. They aim at providing more efficiency than voice trading, easier access to multiple counterparties and improved use of market and post trade data for their users[29]. Inter Dealer Brokers (IDBs) who traditionally play a key role as intermediaries in disseminating pre-trade information for both listed and OTC instruments and structuring efficient secondary OTC markets are playing a major part in these developments[30]. As a result, an increasing proportion of OTC trades, particularly the more standard bond or derivative trades, are expected to move to these platforms.

SIs are defined as "investment firms which, on an organized, frequent and systematic basis, deal on own account by executing client orders outside a RM or an MTF". Unlike RMs and MTFs, **SIs provide bilateral trade execution in which the SIs act as the counterparty to all customer orders.** Moreover, SIs are quote-driven whereas RMs and MTFs are mainly order-driven. SIs are required to publish at least a firm bid and / or offer price at which they are prepared to buy or sell shares for their own account and trade accordingly by executing bilaterally against the customer. There are 10 SIs[31] at present and their market share is fairly limited.

The remaining part of trading, conducted outside MiFID regulated venues (RMs, MTFs and SIs), includes:

- Multi-lateral trades conducted on organized venues which do not come under present MiFID definitions, such as broker crossing systems (BCSs) and some dealer platforms

- Bilateral trades: bilateral exchanges by phone, email or on single dealer platforms. This trading method is usually used for large equity blocks or products which offer limited liquidity, such as customized and / or structured note and derivative products.

These transactions, which are usually considered as OTC trades[32] are not subject to the trading venue requirements of MiFID, since they are not carried out on MiFID regulated venues, but are subject to post-trade transparency rules for equity trades and the counterparties of these OTC deals are regulated by MiFID as investment firms.

In terms of trading volumes, OTC is the main trading method employed for bonds and derivatives for which around 80 to 95% of trading is conducted OTC, either by voice or on electronic platforms[33].
The market share of OTC for equity trades is disputed. OTC is considered to represent either 15 to 20% or 40% of total equity trading (including BCSs), depending on the estimates and counting methods employed[34]. This share is found to remain generally stable in many statistics, which would imply, if confirmed, that MTFs and SIs have so far not captured much of the OTC flow in the equity market but have rather gained market share vs RMs.

Two main types of platforms are used to execute electronically transactions which are not traded through RMs, MTFs or SIs: Broker crossing systems (BCS) and Dealer platforms.

BCSs and dealer platforms are operated by MiFID regulated investment firms, which means that the execution of client orders on such platforms is subject to MiFID conduct of business rules. The platforms themselves and their operation are however not regulated as trading venues by MiFID (unlike RMs, MTFs and SIs). They are not subject to MiFID public transparency rules at present (apart from post-trade transparency for equity trades). Multi-dealer platforms usually provide pre-trade data (indicative quotes) and post-trade reporting to the participants of the platform, based on the information produced by the dealers contributing to the platform. This information is however not accessible to the wider public and in some cases the data on a given transaction is only disclosed to the participant having executed the transaction and not to the other participants of the platform.

27. Related to the trading of standardized OTC derivatives on exchanges or organized platforms and pre and post-trade transparency requirements for non-equity transactions
28. Whereby participants (who are customers of dealers / banks) to select the best bid and offer from several dealers or banks on the trading platform
29. At present in the US fewer than 5% of interest rate swaps for example are considered to be executed on electronic platforms, according to dealers recently surveyed by the Financial Times (31 May 2011), but this share is expected to increase up to 80% in the coming years with the implementation of the Dodd-Frank requirements,
30. IDBs are key liquidity infrastructure providers. Operating as hubs they are MiFID compliant and regulated intermediaries.
31. Citigroup Global Markets, Crédit Suisse, RBS / ABN Amro, UBS, BNP Paribas, Danske Bank, Goldman Sachs International, Nordea, Knight Capital Europe and Nomura International
32. Although they go beyond what is described as OTC in Recital 53 of the MiFID Directive where OTC trades are defined as trades performed on an "ad hoc and irregular bilateral basis and carried out with wholesale counterparties and part of a business relationship which is itself characterized 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. OTC transactions are not specifically and directly regulated by MiFID
33. Retail trading activity in bonds and derivatives is very limited. Figures based on the average of statistics found in surveys such as Celent / Goethe Universität study on MiFID of September 2010, CFA Institute 2011 and Financial Times articles
34. The share of OTC trading is considered by some players to vary depending on whether it takes into account only real price forming liquidity (ie trades with clients) or also reporting events (eg MiFID reporting requirements related to give-up trades). Analyses conducted by AFME on the nature of OTC trading show that only approximately only 50% of OTC reporting represented genuine liquidity events, meaning that the real share of OTC would be closer to 15 / 20%. Different percentage figures with a share up to 40% for OTC trading are put forward in other surveys such as the Celent / Goethe Universität study on MiFID of September 2010

The MiFID review is expected to determine how the trades executed on BCS and dealer platforms should be classified.

- **Broker crossing systems (BCSs)** are automated systems operated by broker dealers to internally match client orders or to match client orders and house orders[35]. They can generally be considered as multilateral platforms since they bring together multiple buying and selling interests for order execution[36]. BCSs are mainly used for equity block trading as an alternative to dark pools or traditional brokerage and for matching flows.

    - **They are operated by sell-side institutions who, by combining all their different order flows** (eg retail, institutional, in-house orders…some of which are sliced) **have enough internal liquidity to create efficient matching of orders.** Since they facilitate the aggregation of liquidity, they can facilitate different types of trading including the execution of child orders of larger parent orders, which can be executed either against each other or against other order flows (eg retail or own trading book). Orders are entered by the operator of the BCS and crossed at a price usually built at the mid-point of best bid and offer quotes on the relevant RM. This means that they can prove notably to be more cost effective for traders who may save all or part of the bid / ask spread. If client orders are not matched internally they may be routed on to a trading venue for execution.

    - **BCSs have, according to the investment firms that operate them, specific characteristics that differentiate them from MTFs: they operate in a discretionary way** in terms of access (they may be open only to selected participants, usually the clients of the investment firm operating the platform). In addition, **BCSs provide matching of orders which does not necessarily take place according to the pre-defined parameters** of a conventional order book system (within BCSs deals may occur at any point within the bid-ask spread). BCS clients can also specify for example with which type of trading flow they wish to or do not wish to interact with – ie other clients and / or internal bank flow. Although they provide no public pre-trade transparency, BCSs may also differ from dark pools since the execution price may not necessarily be fixed according to a reference, but may be defined on the platform by matching of orders or of quotes.

- **Dealer platforms:** There are two main types of platforms, which execute usually the more standardized OTC bond and derivative transactions:

    - **Single dealer platforms** offer deals with a single dealer (the dealers or banks operating single-dealer platforms provide quotes to their customers on a bilateral basis) and therefore are mostly an electronified version of traditional bilateral OTC trading.

    - **Multi-dealer platforms** are multilateral platforms which offer interaction with several dealers. As mentioned further up in this document, most existing multi-dealer platforms have adopted the MTF status.

1.2. Further alignment of requirements for MTFs and RMs, clarification of SI criteria and review of transparency requirements for equity trades:

Further alignment of MTF and RM requirements:

- Proposals have been made by the EU Commission in the MiFID consultation paper to improve the alignment of RM and MTF requirements in MiFID. The aim is to address potential concerns related to differences in the organizational requirements of RMs and MTFs mentioned previously - leading in practice to a lighter regulatory and supervisory regime for MTFs according to the consultation paper - and a need for better coordination of obligations for operators of RMs and MTFs to monitor trades conducted on their venues.

- Regulated markets are in favour of this proposal arguing that since RM and MTF business models are similar they should be regulated and supervised in the same way (ie organizational requirements aimed at market integrity as well as market surveillance requirements). This would facilitate the fair and orderly functioning of fragmented markets according to them[37]. Some point out that rules for the authorization of new products should also be aligned.

- Users of these platforms agree that consistent regulatory treatment of RMs and MTFs is needed but believe that it should be applied in a proportionate way and be adapted to the different business models developed by MTFs in order to enable sufficient competition to be maintained in the market. One of the main differences put forward is that MTFs concentrate mainly on trading whereas RMs also have issuance, listing or data provision activities.

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35. Many BCSs offer the possibilitiy to their clients to refuse executing orders against in-house orders, but BCSs unlike SIs offer no transparency on proprietary trades at present
36. Although some of them may mainly be operated unilaterally matching internal flows
37. Stock exchanges often point out the negative effects of fragmentation. They consider that fragmentation has brought significant changes to the relationship between stock exchanges and their issuers. Once issuers have decided to be listed in a given venue it may be difficult for them to keep track with the trading activity of their shares due to fragmentation, which also impacts the activity of venues in different ways: impacts on investor and shareholder relations commercial, financial and competitive positioning of the venue, etc…

Clarification of SI criteria:

- The core transparency requirement for SIs is to publish a firm bid and / or offer price[38] in those shares admitted to trading on a RM for which they are SIs and for which there is a liquid market[39]. This is applicable to SIs when dealing for sizes up to standard market size. SIs that only deal in sizes above standard market size are not subject to this provision.

- The fact that only a limited number of investment firms operate as SIs[40] (to date only 10) is mainly attributed by the Commission to the lack of clarity in their definition. Proposals are being made by the Commission to clarify the eligibility criteria (clear quantitative threshold, non-discretionary rules and procedures) and to modify quote rules – requiring SIs to maintain quotes to both buy and sell and a minimum quote size equivalent to 10% of the standard market size of any liquid share in which they are SI.

- Industry players generally agree that the SI regime should be reviewed[41] and that more objective criteria for determining when a firm is a SI should be determined. Many players also point out that rules and definitions should clarify the positioning of SIs vis a vis the new trading regimes envisaged – eg OTFs see below - and should recognize in particular the differences between SIs and crossing systems (the latter being discretionary and also operating a crossing system, whereas SIs are the counterparties for all trades).

- Some players however consider that the Commission should beforehand reconsider the need for such a regime and define more clearly its objectives. Some also question whether the quoting obligation should be general, rather than only when triggered by dealings below standard market size.

Review of transparency requirements and waivers for equity trades:

- As mentioned above, the development of electronic trading has facilitated the generation of dark liquidity and the use of dark orders to minimize market impact costs. Many regulators are concerned that the growth of dark pools may affect at some point the quality of price discovery in lit markets.

- In this context measures are proposed in the MiFID review consultation to ensure in particular that waivers are applied consistently and coherently and to give ESMA a role in monitoring their use.

1.3. Proposal to create OTFs (Organised Trading Facilities) a new category of alternative trading platforms and a regime for crossing networks:

One of the main objectives of the MiFID review, as described by the EU Commission, is to take evolving market practices and technological developments into account in order "to suitably regulate all organized trading occurring outside the current range of MiFID regulated venues".

Proposals made by the Commission:

The Commission is proposing to create two new regimes to regulate organized venues which are not RMs, MTFs or SIs in order to reduce the scope of transactions done away from MiFID regulated venues and to ensure that trading systems with similar functionalities are subject to similar requirements: OTFs (Organised Trading Facilities) and BCSs (Broker Crossing Systems). At this stage it has not yet been decided whether the BCS regime would be a sub-regime of the OTF one or whether it would be a separate regime. The proposed OTF regime is also intended to support the implementation of the G20 commitments related to the trading of standardized OTC derivative contracts on exchanges or electronic trading platforms. **There is disagreement on this proposal among market players.** Exchanges in particular question why such trading activity cannot fall under MTF or SI trading activity and why a new trading venue category may be required.

Organised Trading Facilities (OTFs):

- The OTF regime proposed by the Commission would cover "facilities and systems both bilateral and multilateral and discretionary and non-discretionary bringing together on an organized basis buying and selling interests or orders relating to financial instruments excluding those already regulated". Examples of such OTFs given by the Commission are broker crossing systems and inter-dealer broker systems. Only bilateral OTC trades executed by voice or email would be excluded from this definition given by the Commission, meaning that OTFs could possibly cover multi-dealer and single dealer platforms described above, as well as BCSs. Many existing multi-dealer platforms have adopted a MTF status as discussed previously, however in the future some of these platforms or new platforms would have the choice to opt either for the MTF or for the OTF regime, depending on their characteristics.

- Operating an OTF would be a new licensable activity under MiFID. OTFs would be subject to a certain number of core requirements such as: notification and description of the OTF to

38. A firm quote is a price quote on a security, made by a dealer or market maker, that guarantees a bid or ask price up to the amount quoted. This differs from an indicative quote wherein the price and quantity of a bid or ask quote are not firmly posted.
39. In the case of shares for which there is not a liquid market, SIs shall disclose quotes to their clients on request.
40. SIs do not have the choice whether or not to be registered as SIs. Where a firm enters into an activity that falls within the SI definition, it has to register as an SI, whether or not it considers the quote publication regime appropriate.
41. SIs are not believed to have had a negative impact on the market, but rather to have had only a limited success and marginal impact so far which could be enhanced with an improved regime

the competent authority and to ESMA (range of financial instruments and trades, trading methodology, etc…), post-trade transparency reports to the competent authorities and to the public, the adoption and publication of access rules, rules to manage conflicts of interest and monitor trading activity for market abuse, conduct of business rules, and others.

- After reaching an asset-specific threshold the Commission is proposing that OTFs be required to convert to a MTF.

- A certain number of sub-regimes could be created within the OTF category with further relevant requirements if appropriate.

Broker crossing systems (BCSs):

- The Commission is proposing to create a specific regime for crossing systems which may be a subset of OTFs or a separate regime. The new regime would be "proportionate and take into account the hybrid nature of the business" and include in particular requirements for post-trade identification of the operator of the platform and indication of whether the transaction was executed on the system.

- If orders are entered into the crossing system by a third-party then the Commission is proposing that this would transform the system into a MTF and if the broker executes client orders against its own proprietary capital then this could trigger the application of the SI regime.

Summary of views expressed by industry players and further assessments required:

While there is general agreement among industry players that the regulation of venues in MiFID needs to be reviewed, **the OTF regime proposal of the Commission raises many questions and the lack of clarity, precision and specificity of the proposed OTF definition is criticized.**

The OTF regime is meant to capture all organized trading happening outside existing MiFID regulated venues. Based on existing venues (see the description of the present organization of the market in the table above), this would include mainly the trading on BCSs, which focus mostly on equity trading, and derivatives and bond trading happening on different types of dealer platforms that are not MTFs,.

The proposal made for regulating BCSs is relatively well accepted by many players, particularly given their growing significance in the market. Many players are favourable to regulating BCSs separately from MTFs and SIs, given the specific combination of features they offer[42]. BCSs indeed combine the matching of client orders (as in MTFs), the possibility to execute orders against house orders (as with SIs) and a discretionary trade execution process which enable an efficient internal aggregation of liquidity and make them different from MTFs. Some players however consider that it is not clear why it should be necessary to establish a special sub-regime for BCSs rather than including them in the broad OTF category, since they are one of the main types of facility that the OTF definition would capture. Some are also asking for further clarity on specific requirements, such as those relating to post-trade transparency.

The role that OTFs could play in OTC bonds and derivatives trading is considered to be less clear by many industry players:

- Many market players suggest that the definition of OTFs should first of all make clear that illiquid or bespoke OTC products, which are mainly traded at present on an OTC basis by voice or email, should not be required to trade exclusively on such organized venues[43]. Otherwise this may hinder the trading of such products which may have economic consequences for the participants using these products eg for specific hedging purposes. Additionally, many point out that instruments that are admitted to trading on a RM, MTF or OTF should not be prohibited from being traded OTC.

- Some players put forward the need to ensure that sufficient flexibility and proportionality is built into the description of OTFs in order to allow hybrid trading processes (voice or email trading with electronic confirmation), which are widely used for OTC trading of derivatives and bonds[44] including on multi-dealer platforms for example. Some players moreover point out that in troubled markets it is important to be able to revert electronic trading to voice, based on client preference.

- **The possibility for single dealer platforms to be included in the scope of OTFs is debated, as well as the conditions that may be required:**

  - Some commentators consider that some single dealer platforms may be sufficiently organized and structured to qualify for the OTF regime provided proportionate rules can be applied.

  - Others point out that many of the existing bilateral platforms are at present closer to an efficient version of bilateral OTC trading (ie an electronic way for a dealer to interact with its clients), rather than to an organized venue model.

It is also believed by some that **venues should not be segmented based on volume** as inferred by the idea to transform OTFs into MTFs passed a certain threshold, but on functional and operational criteria, as the two systems are fundamentally different and provide choice to

42. Unless if they engage only in an active proprietary market making model
43. Many players also point out that such products should not be disincentivised from trading by the capital treatment under Basel
44. The benefits of such hybrid trading methods are widely put forward by industry players using them. Under normal conditions hybrid bilateral trading allows for more precise hedging of business risks reducing systemic risks and under disruptive market conditions (illiquid markets), it can act as a pressure release valve facilitating the orderly removal of risk from the financial system.

clients. For example, crossing systems offer the clients the ability to interact with closely monitored liquidity in an environment where crossing rules ensure that the minimum of new high and lows are created, to ensure best possible execution, increasing efficiency for investors using them by lowering market impact and execution costs. By contrast, an MTF is by definition open to all participants on a non-discriminatory basis and is not able to offer the same degree of tailoring to individual client preference.

Many players however disagree with the need to introduce a new OTF category in the first place:

- Market infrastructures (many RMs and some MTFs) are concerned that the OTF regime, which may have a lighter regulation, could attract trading from existing MiFID regulated market places and further increase fragmentation and level playing field issues. They believe that all venues, including crossing networks, could and should fall under the existing definitions of MTFs and SIs - the former covering multilateral trades and the latter organized bilateral ones - and the remaining part of trades coming under a reviewed definition of OTC.

- Other commentators stress that the activity potentially covered by OTFs is already broadly regulated under MiFID since the investment firms operating BCSs and single / multi dealer platforms are MiFID regulated firms and that most multi-dealer platforms have adopted the MTF status.

Further assessments required:

- **Most observers consider that the wide and rather unspecific definition of OTFs proposed in the consultation paper should be clarified so that it corresponds to specific trading functions in the market[45].**

- This implies that further assessment of the trading that currently takes place outside RMs, MTFs and SIs is necessary in order to refine the OTF definition and better evaluate the need for a new category of OTFs and for defining the possible functionalities that it could cover. This involves in particular:

  • Identifying the criteria that define "organized trading"

  • Evaluating the nature and scale of the trading activity in equities, bonds and derivatives that currently takes place outside RMs, MTFs and SIs and that can and should be qualified as "organized", the types of platforms used and their main characteristics.

  • Identifying the main criteria that differentiate these trades and the platforms used (RM, MTF and SI) on one hand and bilateral OTC trades and information services on the other hand: eg multilateral or bilateral nature of trades, non discretionary or discretionary trading and access, frequency of trades, functionalities of the platforms used (such as method for order input and confirmation, execution of trades on the platform, etc….)

  • Evaluating the share of this activity which could potentially be covered by existing venue definitions (ie RMs, MTFs, SIs)

  • Measuring the size of the remaining market that could be qualitifed as bilateral OTC trading and reviewing the characteristics and definition of these trades.

1.4. Mandatory trading on organized trading venues of standardized OTC products, where appropriate

Proposals made by the Commission:

- The mandatory trading on exchanges or electronic trading platforms of standardized OTC derivative contracts, where "appropriate", is proposed in the MiFID review in accordance with G20 Pittsburgh Summit Commitments (Sept 2009). ESMA would be responsible for deciding when a derivative, which is eligible for clearing according to EMIR rules, is sufficiently liquid to be traded exclusively on organized venues (ie RMs, MTFs and OTFs). This recommendation would be based on the frequency of trades or the average size of transactions for example. The aim of the Commission is to increase price transparency of OTC derivatives, facilitate the offsetting of transactions, enhance liquidity and reduce trading costs. Products often mentioned as being suitable for more multilateral trading are credit derivatives, equity options, fixed income options, certain interest rate derivatives and some foreign exchange products…

Summary of views expressed by industry players

- **The objectives and rationale of such a measure are questioned by some industry players, particularly the fact of making this requirement "mandatory".** This is considered to be stricter than the initial G20 commitment which provides for an "assessment of appropriateness" of the implementation of this requirement. In addition, many are concerned that this may open the way to applying an equity model to OTC derivatives trading which they consider to be inappropriate given the characteristics of these products[46].

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45. Even if many players agree with the Commission that MiFID should not be prescriptive about where trades must be executed in order to provide flexibility and choice for investors
46. Characteristics such as: variable level of secondary trading, discontinuous liquidity, products mainly sold to a relatively limited number of professional counterparties spread over a large number of products

- **Some industry players have also expressed concerns with regard to the implementation scope of the proposed measures** (what would be considered as "appropriate"?) and point out that criteria should be predictable and flexible enough to accommodate possible changes in liquidity and market conditions:

  - Products: Eligibility for clearing does not mean that a product can be traded meaningfully on an organized venue, therefore specific criteria should be defined for identifying products which can be traded multilaterally on an organized venue.

  - Platforms: Many OTC derivatives already trade on a variety of electronic platforms today (such as the multi or single dealer platforms described above). As suggested earlier in this document, these types of platforms should be further assessed in the context of the evaluation of the OTF regime in order to verify whether they satisfy G20 guidelines and to determine how they should be classified according to MiFID.

  - Transactions: Specific provisions, such as exemptions for large block transactions, may be necessary for trades above-standard market size which may require private negotiation. Many players indeed believe there should be sufficient flexibility to accommodate for counterparties who wish to execute bilaterally provided certain rules are respected.

- **Concerns are also expressed, mainly by broker dealers, that this measure may force excessive standardization in the market,** beyond what is necessary to mitigate systemic risks and may reduce hedging options for corporate clients with specific needs. Indeed greater standardization of legal documents and processing of OTC derivatives is desirable but product standardization may go against the interests of end users in some cases, according to arguments put forward by some industry players.

- In addition, further global consistency may be needed in the rules applying to the trading of OTC derivatives which are not eligible for trading on organized platforms (eg rules for posting collateral in order to avoid regulatory arbitrage), as recently suggested by Tim Geithner.

II. Extension of transparency requirements to non-equity instruments:

Proposals made by the Commission:

- The transparency regime in MiFID only applies at present to shares admitted to trading on RMs (including when those shares are traded on a MTF or OTC). The MiFID review proposals of the Commission suggest extending transparency rules to equity-like instruments currently outside the scope of MiFID transparency requirements (such as depositary receipts, ETFs and certificates issued by companies) and non-equity instruments (like bonds and structured products with a prospectus or admitted to trading on a RM or MTF and derivatives eligible for central clearing) in order to improve price formation and facilitate best execution.

- This should also enable regulators to better monitor risks in the market. This would involve pre and post-trade transparency requirements for all trades whether executed on RMs, MTFs, OTFs or OTC with pre-trade and post-trade transparency rules differentiated by asset class[47] with OTC trades being flagged.

Summary of views expressed by industry players:

- There is a general agreement on the aim to improve transparency in non-equity markets.

- Market infrastructures are generally favourable to extending pre and post-trade transparency to equity-like and non-equity instruments with appropriate calibration, possible waivers and thresholds eg to distinguish between retail and wholesale markets. Extending transparency to OTC markets in a proportionate way would limit transfers of trading to less transparent markets according to them. An appropriate transparent price formation mechanism is also seen by some as a way to facilitate central clearing of OTC derivatives.

- Many industry players, mainly broker dealers, however consider that the proposals of the Commission go beyond what may be useful for end-users and possibly supervisors, particularly regarding disclosure of pre-trade data to the wide public. They point out that transparency requirements which may be inappropriately calibrated to the specific characteristics of the different products and asset classes may ultimately have a detrimental effect on market liquidity and efficiency.

47. In terms of overarching requirements the framework directive would specify that all regulated markets, MTFs and OTFs offering trading in the following non-equity instruments [considered to be the more liquid and frequently traded market segments per asset class] (bonds and structured products with a prospectus or admitted to trading either on a RM or MTF; all derivatives eligible for central clearing and all derivatives reported to trade repositories) would publish their pre-trade information in a continuous manner. As for investment firms executing trades OTC, the framework directive would require that their pre-trade quotes reflect current market value and are binding below a specific trade size.

They therefore suggest that there is a need for the transparency regime to be flexible enough to accommodate different levels of liquidity between equity and non-equity products and fluctuating levels within the same products as market or other changes have an impact.

Pre-trade transparency:

- Many consider that the scope of products concerned is too wide and that priority for detailed pre-trade transparency should be given to products which are sufficiently liquid and standardized. Pre-trade transparency is indeed considered to be more important for order-driven markets. Transparency could therefore be partially or gradually extended first to equity-like instruments, non-equity instruments traded on RMs and MTFs and instruments sold to retail investors. This could also avoid the risk of data overflow and of publishing poor quality data due to the variety of products covered.

- Concerns have been expressed regarding the disclosure of pre-trade prices in request for quotes to the wider public, which may not be useful or could be risky for retail clients for certain types of product. The issue of co-mingling indicative and firm prices, with proposals to put a binding threshold in place for publishing firm prices was also pointed out. Some players consider more generally that transaction reporting, even consolidated, should be reserved to regulators rather than disclosed to the general public.

- For less liquid and standardized products, many players argue that buy-side actors already have access to pre-trade pricing from private market solutions (eg information providers) or from the dealers they are in contact with on multi-dealer platforms for example, even if this data is not accessible to the wider public. Since these products are generally only sold to wholesale clients, they consider that equity-like public pre-trade disclosure may not bring much added value and may actually be less informative in some cases (eg with no indication of credit risk for example).

- Proportionality should therefore be envisaged particularly for pre-trade requirements (through thresholds, waivers and frequency and delay rules) in order to take into account different client needs (eg retail versus wholesale), product characteristics and to avoid unnecessary cost increases and liquidity reductions. Rules should also be sufficiently flexible to help accommodate possible future evolutions in the functioning of the markets.

- A detailed segmentation of instruments based on liquidity and standardization criteria and the type of investors targeted would help to prioritize transparency requirements in this perspective.

Post-trade transparency:

- Regarding post-trade transparency the general feeling is that post-trade transparency regimes should be specific to each asset class based on asset class specificities (eg instrument liquidity, issuance size, etc…)[48]. Rules of delayed information should be defined to appropriately protect the parties of a trade (eg with possibilities to delay publication of large trades). The rules defined should also take into account requirements to set up trade repositories for OTC derivatives, which will provide post-trade data on OTC derivative trades.

- Two additional issues have been pointed out by some players regarding transparency requirements:

  - For transparency requirements to deliver the objectives pursued by policy makers, standardization of data reporting is critical. Moreover transparency requirements need to be very clear, prescriptive and not principle-based

  - Global consistency among regulators at international level is needed in view of financial markets globalization.

III. Access of third-country participants to the EU and global consistency of rules

3.1. Access of third-country participants to the EU:

Access of third country firms in the EU is not harmonized at present under MiFID and is left to the discretion of Member States. It is subject to general obligations under European Community law and relevant international obligations. To date third country firms must be subject to a regulatory regime which is at least equivalent to that required by MiFID. The Commission can ask the Council for a mandate for pursuing negotiations with third countries in order to obtain, in those countries, comparable competitive opportunities for EU firms (and limit or suspend authorization of third-country firms where third countries do not extend the same treatment to EU firms as is provided to their domestic firms).

The proposal is made in the MiFID review consultation to introduce a unified third country regime based on the principle of exemptive relief for investment firms and market operators based in jurisdictions with equivalent regulatory regimes to the EU. The objective is to develop at an EU level a workable regime for the access of third country investment firms and market operators to EU financial markets in

48. For instance some fixed income instrument markets in small currency areas may need special treatment

order to create a real level playing field for all financial services actors operating in the EU territory.

Implementing measures would define the precise criteria and parameters which a third country regime must fulfill in order to be considered equivalent and the process through which the assessment of equivalence would be made.

The industry is at present divided on this approach. Those who support it believe that it would facilitate access by EU players to non-EU providers of products and services and access of non-EU issuers to EU listing. Some among them are concerned by the level of equivalence in regulation which may be required (possibly verified through a "strict" equivalence test[49]) and the level of detail in which this evaluation may go, while others supporting the regime believe that a harmonized approach to equivalence at EU level is needed.

Opponents consider that such rules already exist at Member State level and that EU level rules would be complex to implement and risk having adverse impacts on EU firms undertaking business abroad.

Some observers consider that a possible option could be to develop such a regime only for professional clients and eligible counterparties in a first stage provided there is reciprocity from third-countries and that a unified EU regime is workable and does not impose stricter obligations than those that exist at present for such clients (eg not requiring strict equivalence of regulations but rather a general recognition of home state rules, the observance of minimum standards of conduct of business and authorization rules in the host country).

Others on the contrary believe that such a regime, if implemented, would be better aimed at retail clients in order to enhance investor protection.

3.2. Global consistency of trading rules:

The second concern widely expressed relates to the level of consistency of the rules being defined in the EU, US and in Asia[50] particularly regarding OTC derivatives, which may undermine the ability of EU firms to do international business if inappropriately defined.

The extra-territorial application of the Dodd-Frank Act (DFA) is an area of concern particularly for OTC derivatives. Regarding the territorial scope of the DFA provisions, the Dodd-Franck Act stipulates that provisions relating to swaps "shall not apply to activities outside the US unless those activities… have a direct and significant connection with activities in, or effect on, commerce in the US or contravene CFTC anti-evasion rules". The provision applicable to security-based swaps is slightly different. Although the rules interpreting and implementing these extra-territoriality provisions are not yet finalized, there is a risk that their interpretation may be wide with for example EU-based dealers selling derivatives on EU instruments to a US-based counterparty having to comply with the Dodd-Frank Act (as well as EU regulation).

This has led the EU Commissioner M. Barnier to call for identical rules in the US and the EU to cover derivatives trading although the focus has so far been mainly on post-trading with core areas mentioned including scope and conditions for clearing, collateral and capital requirements and mutual recognition of the two jurisdictions' central counterparties and trade repositories.

49. The problems associated with the endorsement regime under the Credit Rating Agency Regulation where ESMA has taken a strict equivalence view are often pointed out. It is in effect considered to stop firms using ratings issued outside of Europe unless the country's regime is « approved » by the EU.

50. Concern has also been recently expressed by T. Geithner regarding the level playing field of derivatives rules with Asia although the comments made so far relate mainly to clearing obligations for standardized OTC contracts and obligations for non-cleared trades. A particular area of concern is collateral for uncleared derivatives contracts. In the US the banking regulations have proposed a regulation under the Dodd-Franck Act that would require US banks to demand collateral from counterparties to uncleared derivatives contracts wherever the business is done, which may not comport with requirements in many Asian jurisdictions for example.