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European Commission
Directorate-General Internal Market and Services
Unit G3 – Securities Markets
B-1049 Brussels
Belgium

2nd February 2011

Register of Interest Representatives ID # 89854211497-57

Review of the Markets in Financial Instruments Directive (MiFID)
Public Consultation

CFA Institute is pleased to comment on the European Commission's consultation paper on the review of the Markets in Financial Instruments Directive (the "Consultation").

CFA Institute, through its members' experience in international markets and different investment disciplines, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide. CFA Institute promotes fair, open, and transparent global capital markets, and advocates for investors' protection.

We welcome the opportunity to comment on the MiFID review. CFA Institute recently published its own report on the operation of equity markets under MiFID and our comments herein draw from and supplement the findings of that report[1].

We support measures designed to improve the transparency of the markets and the quality and accessibility of trade data, which are critical for the efficiency of the investment decision-making process. We also support measures designed to level the playing field amongst trading venues and market participants alike.

The MiFID review will play a critical role in enhancing the efficient functioning and integrity of the structure of financial markets. We hope that the Commission's proposals serve the interests of investors and help to enable all market participants to earn a fair return. To that end, investors' interests must be paramount in the review process.

Executive Summary

The consultation addresses developments in market structures; improvements to pre- and post-trade transparency in EU equity markets, and new transparency measures in non-equity markets; improvements to market data consolidation; commodity derivative markets; clarifications and extensions to transaction reporting; investor protection and

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[1] See CFA Institute, 2011, *The Structure, Regulation, and Transparency of European Equity Markets under MiFID* (January): http://www.cfapubs.org/toc/ccb/2011/2011/3

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the provision of investment services; convergence of regulatory and supervisory practices; reinforcement of key supervisory powers.

Our main observations are summarised below. We do not comment on commodity derivative markets which are of less relevance to our membership.

- In general, as elucidated in our report *The Structure, Regulation, and Transparency of European Equity Markets under MiFID,* CFA Institute believes that policy measures should support greater transparency and greater consistency in the application of transparency rules within the regulatory framework.

- With regards to market structures, we support the introduction of an "organised trading facility" category to ensure that all organised trading functionality is appropriately captured under the MiFID framework. However, we make the distinction that the definition should only apply to organised trading functionality that cannot be incorporated into the existing trading venue definitions (RM, MTF and SI).

- CFA Institute's position is that all trading venues conducting similar types of business, and all orders of similar types and sizes, should be subject to the same rules.

- We broadly support the Commission's intentions to clarify the criteria relating to systematic internalisers (SIs). For the vast majority of investors, the current calibration of the SI regime offers little utility or choice, such is the narrow focus of the transparency framework. More meaningful quoting obligations, and more widely disseminated quotations, are necessary to better meet investors' needs.

- We broadly support the proposed amendments to the pre-trade and post-trade transparency framework, which (among others) would strengthen the application of the waiver process for pre-trade data and reduce the cost and latency of post-trade data. The proposals would also improve the quality and reliability of post-trade data. Collectively, these amendments would deliver greater clarity and consistency in the application of the transparency framework for equities.

- In general, CFA Institute is supportive of extending transparency requirements under MiFID to financial instruments other than equities. We note that any mandatory transparency regime for non-equity financial instruments would need to be properly calibrated to the specificities of the structures of these markets.

- CFA Institute is firmly of the view that MiFID should be amended to include explicit regulatory provisions requiring the implementation of a consolidated tape for post-trade data. A consolidated tape for equities, in conjunction with implementation of the Approved Publication Arrangements proposals, would help to improve the coverage, quality, consistency, and utility of trade data.

- CFA Institute's preference is to opt for the commercially driven approach to implementing the requirements for a consolidated tape (option C in the Consultation). However, we stress that if such commercially-driven efforts do not meet the prescribed standards or the needs of investors, determinable after an appropriate period of time, then we would firmly support the establishment of a single entity to manage and operate the consolidated tape.

- One of CFA Institute's core values is to promote market integrity. Therefore we strongly support steps to bolster the market abuse regime through extending the scope of transaction reporting in MiFID. In addition to the existing list of securities already under the scope of the current Directive, the proposals would seek to include derivatives, commodity derivatives and depository receipts. With respect to trading venues the proposals seek to include securities trading on MTFs and other organised trading venues.

- We support additional measures to curb market abuse by improving the definition of what constitutes a transaction for reporting purposes, and attaching client and trader identifiers to each transaction. This will allow supervisors to swiftly trace the parties involved in a suspicious transaction. To increase efficiencies in transaction reporting, we support the proposal to direct all reportable transactions to an EU, not Member State, authority. Within this proposal Member State supervisors would have open access to the transaction reporting data collected by the EU authority.

- Protecting the interests of the ultimate investor is another core value of CFA Institute. We recognise a pressing need to raise the standards of professionalism in the investment advice business. 73% of respondents to a CFA Institute member poll believe that retail products are sold on the basis of their fees and not their suitability. We do not believe that the Commission's approach of improving the conduct of business by mandating disclosures on why certain advice was given and how this is applicable to the client's circumstances will be effective. We suspect clients will receive boilerplate statements of suitability, based on tick-box assessments of personal circumstances. Until the European system of adviser remuneration is reformed, customers will continue to buy the sub-optimal products that maximise their adviser's return.

- We completely disagree with the Commission where it concerns measures to curb or abolish the 'execution only' regime. Execution only services provide low cost access to financial instruments for confident investors. By avoiding advisory commissions, through the execution only service, the investor has the potential to earn significantly higher returns. The Commission is concerned that because there are no assessments of appropriateness, 'execution only' investors may harm themselves through their own actions. We believe it is entirely inappropriate for the Commission to intervene on matters of unsolicited, self-informed personal choice. Investors like consumers should be free to make their own choices. Apart from reducing investor welfare, such an intervention will discourage people from educating themselves in investment, because they will be denied the opportunity to practice what they learn.

- With respect to risk management, compliance and looking after the customer's interest, we strongly support proposals to introduce 'Fit and Proper' assessments of all board members of investment firms. The ethical culture of a firm is set by the example by its leaders. If the message from the top is unsympathetic of the client's interest, then such an attitude will proliferate through the firm. We support proposals to elevate the roles of compliance, internal audit and risk management with a direct report to the board. These functions monitor the health of the firm; too often commercial interests obscure their input. Further, we support processes to assure suitability in the placing of the firm's products with its customers. We particularly support the convergent application of conflicts of interest across the EU, with the emphasis that disclosure of conflicts, rather than avoiding conflicts, can only be used as a last resort.

- For the protection of the investor, we strongly believe in the segregation of client and firm assets. However, we do not support the proposed prohibition of the transfer of client title on the posting of collateral. Where the client has entered into a transaction with an intermediary that requires the posting of capital, the intermediary needs some surety that he will have access to that collateral should the client be unable to honour his obligations. At the same time, the firm should not consider posted collateral as its own unencumbered asset. Therefore as a pragmatic solution, we believe that the title of posted collateral should be transferred to an escrow account, which is ring fenced from the activities and liabilities of the investment firm.

- CFA Institute's efforts to promote investors' protection and the harmonisation of the rules across the EU also apply to the situation of tied agents. We support the following proposals: (i) the obligation for Member States to allow tied agents in their country, (ii) the cancellation of the possibility for Member States to allow tied agents to hold clients' financial assets, and (iii) the obligation for the national competent authorities to transmit and publish the identity of tied agents operating from/in their country. For the same reasons, CFA Institute also strongly supports the introduction of a common regulatory framework for telephone and electronic recording across the EU.

- CFA Institute believes that, in the same manner that standardized rules should apply across Europe to ensure a level playing field for all market participants, standardized sanctions should be enforced in case of infringements of these rules. These sanctions must be strong enough to put an end to a breach of the MiFID provisions and to act as a deterrent against those breaches.

- CFA Institute does not support the proposal to give the Commission or Member States the unilateral power to ban certain products, as we believe that the advantages of such bans would be outweighed by the fact that these bans could also adversely jeopardize the functioning of the markets.

We attach our response that addresses the questions of the consultation. Please do not hesitate to contact us should you wish to discuss any of the points raised.

Yours faithfully,

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With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, London and Brussels, CFA Institute is a global, not-for-profit professional association of over 101,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 135 countries, of whom more than 91,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 135 member societies in 58 countries and territories.

CFA Institute develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). CFA Institute is best known for developing and administrating the Chartered Financial Analyst® curriculum and examinations and issuing the CFA Charter.

Our specific comments in response to the consultation's questions are set out below. We have ordered our sections in accordance with the ordering of the Consultation[2].

2. Developments in Market Structures

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

The MiFID provisions currently focus on financial instruments admitted to trading on a regulated market (RM). However, with the rise of multilateral trading facilities (MTFs), spurred by competition under MiFID, some financial instruments are now solely admitted to trading on MTFs.

The Consultation proposes including a specific definition for "admission to trading" of financial instruments under Article 4 of the MiFID framework directive[3]. Per paragraph 2.1 of the Consultation, admission to trading "would be defined as the decision by the operator of a regulated market, MTF, or organised trading facility (see section 2.2 below) to allow a financial instrument to be traded on its systems."

We believe that such a definition is necessary. Including this definition would ensure that all listed financial instruments, irrespective of where they are admitted to trading, are subject to the same regulatory framework.

Including this definition would also provide consistency with the proposed revisions to the Market Abuse Directive (MAD) in which it is envisaged that market integrity rules should apply to financial instruments solely admitted to trading on MTFs, as well as those admitted to trading on RMs.

2. What is your opinion on the introduction of, and suggested requirements for, a broad category of organised trading facility to apply to all organised trading

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[2] Section 1 of the Consultation is an introduction. The questions therefore begin in section 2.

[3] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments (http://eurlex.europa.eu/LexUriServ/Lex-UriServ.do?uri=CELEX:02004L0039-20070921:EN:NOT)

functionalities outside the current range of trading venues recognised by MiFID? Please explain the reasons for your views.

Under section 2.2 of the Consultation, the definition of an organised trading facility "would capture any facility or system operated by an investment firm or market operator that on an organised basis brings together buying and selling interests or orders relating to financial instruments." The Consultation also notes that the definition would exclude those systems that are already regulated as an RM, MTF, or Systematic Internaliser (SI) (the three existing categories of trading venues). It would also exclude pure over-the-counter (OTC) trading.

At present, there are certain types of organised trading functionalities – such as broker crossing networks – that, by virtue of their multilateral and systematised nature, are substantively akin to marketplaces. However, these crossing networks are not bound by the market-oriented rules that apply to other types of trading venues because crossing networks are currently not legally defined as MTFs or SIs. The absence of market-oriented rules for such 'marketplaces' presents an uneven playing field with regards to the regulation of trading venues. This can lead to unequal treatment of orders of similar types and sizes, particularly with respect to the operation of the MiFID transparency requirements. Ultimately, transparency deficiencies harm investors.

We support the introduction of an "organised trading facility" category to ensure that all organised trading functionality is appropriately captured under the MiFID framework. However, we make the distinction that the definition should only apply to organised trading functionality that cannot be incorporated into the existing trading venue definitions (RM, MTF and SI). If, for example, an execution venue is organised (such that executions occur within the parameters of a priority algorithm), systematised (such that executions are automated and systematic in nature), and multilateral (such that there are multiple third party buying and selling interests) – then that venue should be regulated as an MTF, in order to provide for a level playing field and to minimise scope for regulatory arbitrage.

Indeed, it would be optimal for few venues to be incorporated into the organised trading facility regime. The existing trading venue categories should be used to the fullest extent possible, with the organised trading facility definition only being used as a 'backstop' where it would not be legally possible (for example, as a result of future innovation) to incorporate a venue under the existing MiFID definitions.

Further, care must be taken so as not to inappropriately capture "pure" OTC trading[4]. Such OTC transactions serve an important role, enabling investors to obtain efficient executions for non-standard types of business. Investment firms conducting OTC transactions are required to adhere to the applicable conduct of business requirements set out under MiFID, as opposed to the market-oriented rules applicable to RMs and MTFs. In

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[4] MiFID characterises OTC transactions as ". . . ad hoc and irregular and are carried out with wholesale counterparties and are part of a business relationship which is itself characterised by dealings above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser". (Recital 53, p. 9). Accordingly, such activity includes non-systematic bilateral trades executed on an ad hoc basis by the investment firm acting in a principal or agency capacity.

the case of such “pure” OTC transactions, this regulatory distinction is appropriate given the different types of business concerned. As the Commission notes, the organised trading facility definition should not, for example, include facilities used simply to execute an order on an external trading venue or to route such an order.

Equally, it is important that the definition of an organised trading facility is sufficiently broad. If the definition is too specific, it may become necessary to create a new regulatory category every time a new type of organised execution venue is created, which would be costly and inefficient.

The suggested requirements applicable to an organised trading facility are set out in section 2.2.1 of the Consultation, points (a) through (h)[5]. CFA Institute believes that these requirements are appropriate, and would in large part help to ensure that any organised trading functionality that cannot be brought under the existing trading venue definitions operates under a similar regulatory framework as those venues.

In short, CFA Institute’s position is that all trading venues conducting similar types of business, and all orders of similar types and sizes, should be subject to the same rules.

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

Please refer to our response to question 2. We have no further comments.

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

[5] The requirements are as follows:
(a) A complete notification and description of the facility or system of the investment firm or market operator to the competent authority including, at least, details of the trades that may be executed using the system, the range of financial instruments it covers, the trading methodology, and the arrangements for post-trade processing;
(b) The competent authority would notify the European Securities and Markets Authority (ESMA), which would maintain a complete list of all such facilities and publish the details of the system on its website together with a unique code identifying the system for use in transaction reports to competent authorities and post-trade transparency reports to the public, where required in the relevant parts of MiFID;
(c) The adoption and publication of clear rules regarding access to the facility or system;
(d) The adoption of clear and effective arrangements for the identification and management of conflicts of interest that may arise from operation of the facility or system;
(e) The adoption of arrangements for the sound management of the technical operations of the facility or system, including the establishment of effective contingency arrangements to cope with risks of systems disruptions;
(f) The monitoring of all trading taking place on the facility or system with a view to identify conduct involving market abuse;
(g) The compliance with instructions from the competent authority to suspend or remove a financial instrument from trading under Article 41(2) of MiFID;
(h) For facilities offering trading in commodity derivative contracts, compliance with reporting obligations.

The current description of “investment services and activities”, as set out under Annex 1, Section A of MiFID, includes the operation of an MTF[6]. Therefore, it would be consistent to include the operation of an organised trading facility within this description.

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

We do not believe that it is appropriate or practicable to specify a threshold for organised trading facilities above which they must convert to an MTF. As we have noted in our response to question 2, if the operation of a trading facility is substantively akin to an MTF, it should be regulated as an MTF, regardless of its size.

We also do not believe that it would be necessary to place an arbitrary cap on activity outside RMs and MTFs. If all organised trading functionality is appropriately captured, such that the existing trading venue definitions are used to the fullest extent possible, with the organised trading facility category only being used as a ‘backstop’, then the need or otherwise for such a cap would likely be redundant.

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

The Committee of European Securities Regulators (CESR, replaced by the European Securities and Markets Authority (ESMA) effective 1 January 2011) has defined crossing systems as “internal electronic matching systems operated by an investment firm that execute client orders against other client orders or house account orders”.[7]

The Consultation notes (section 2.2.2) that the sub-regime for crossing systems would form part of the family of organised trading facilities, and would apply not only to equities but to other financial instruments as well.

We do not believe that such a sub-regime is necessary. As the Consultation rightly points out, “… if orders are entered into a crossing system not only by the operator but also by any third party, this would transform the system into a MTF and the relevant requirements including any pre-trade transparency would apply to the system. Similarly, if a broker executes client orders against its own proprietary capital within a crossing system then this would prima facie trigger the application of the systematic internaliser regime.”

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[6] Investment services and activities include: “(1) Reception and transmission of orders in relation to one or more financial instruments. (2) Execution of orders on behalf of clients. (3) Dealing on own account. (4) Portfolio management. (5) Investment advice. (6) Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis. (7) Placing of financial instruments without a firm commitment basis (8) Operation of Multilateral Trading Facilities.”

[7] Excerpt from definition in footnote 21, p. 27 of CESR’s *Consultation Paper—CESR Technical Advice to the European Commission in the Context of the MiFID Review: Equity Markets* (April 2010).

In other words, if a broker crossing system is engaging in a similar type of business as an MTF or an SI, it should be regulated as such. We firmly support this position.

If, however, a crossing system is a hybrid of these two types of trading venues, to the extent that it is materially neither an MTF nor an SI, then the “organised trading facility” category should apply. We do not see the need for a separate sub-category within this regime.

The Consultation notes that, in addition to the requirements for organised trading facilities (points (a) through (h), noted in footnote 3 above), the sub-regime for crossing systems would specify that a) the operator would add the identifier for its crossing system to post-trade information, and b) the operator would identify in transaction reports whether the transaction was executed on the system. However, these two requirements are already contained within the list of requirements that would be applicable to organised trading facilities (point (b) in footnote 3 above and in section 2.2.1 of the Consultation).

There is one additional requirement within part a) for the sub-regime for crossing systems, namely that operators would be required to make public aggregated information at the end of each day about the number, value and volume of all transactions executed using the system. This information would be useful for investors and supervisors. However, a legal requirement may not be necessary. We anticipate that commercial vendors would likely provide such aggregated information based on the fact that these systems would, in any case, be required to attach an identifier to post-trade reports.

Moreover, as we have noted in question 2, the definition of an organised trading facility should be broad. The creation of specific sub-categories within the organised trading facility regime would likely be inefficient.

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

We support this proposal, as suggested by our response to question 6 and question 2.

If a crossing system engages in multilateral order matching, in which orders can be entered into the system by multiple parties, that system should be regulated as an MTF. Otherwise, order flow would be kept dark that would otherwise be pre-trade transparent under the MTF regime. This would lead to inconsistent application of the MiFID transparency framework amongst orders of similar types and sizes. This would be detrimental for investors.

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

CFA Institute supports greater exchange trading of derivatives. Exchange trading facilitates efficient price discovery through displayed pre-trade quotations and publication of post-trade prices and volumes. Public price transparency underpins investor confidence and helps strengthen liquidity, thus contributing to more resilient markets.

The non-discretionary nature of exchanges and other organised electronic multilateral trading venues ensures fair market access and fair treatment of investors. It is also easier to monitor for potential instances of market abuse when transactions are conducted through such transparent, organised venues.

CFA Institute is therefore supportive of a requirement for all clearing-eligible and sufficiently liquid derivatives to trade exclusively on transparent organised trading venues.

The distinction of "clearing-eligible" and "sufficiently liquid" is important for at least two reasons. Firstly, if a contract cannot be accurately margined, collateralised and marked to market, such that it is not permissible for central counterparty (CCP) clearing, then it follows that the contract must be insufficiently standardised for exchange trading to be practicable. Accordingly, it would be inappropriate to mandate exchange-trading for such clearing-ineligible contracts.

Secondly, it would be commercially unviable for derivatives exchanges to list contracts for which no "sufficiently liquid" market exists, whether through a lack of interest from corporate end users, investors, or speculators. If investors were required to use exchanges to trade such contracts, they may find the costs prohibitive to the extent that they forego hedging their business risks altogether.

Accordingly, we believe that the Commission takes the correct approach in focussing on clearing-eligible and sufficiently liquid derivatives for mandatory on-exchange trading.

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

The Commission proposes to create a specific sub-regime of organised trading facilities for derivatives. In addition to the requirements for all organised trading facilities (set out in footnote 3 above and in section 2.2.1 of the Consultation), this sub-regime would also be subject to the following additional requirements:

a) Provide non-discriminatory access to its facility;
b) Support the application of pre- and post-trade transparency;
c) Report transaction data to trade repositories;
d) Have dedicated systems or facilities in place for execution of trades.

Whist we question whether it is efficient to create multiple sub-categories of organised trading facilities – particularly where these requirements differ very little from existing trading categories such as MTFs – we recognise that the requirements a) through d) are appropriate. Regardless of the exact definition or specification of an organised trading venue, these requirements should apply.

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

The Consultation suggests that ESMA could determine when a clearing-eligible derivative is sufficiently liquid to be traded exclusively on an organised trading venue. The Consultation suggests that this determination could be based, for example, on the frequency of trades in a given derivative and the average size of transactions. These two indicators are reasonable starting points.

In general terms, liquidity is defined and measured in terms of depth (open interest amassed at various price levels); breadth (the number and breadth of market participants); and resiliency (the ability of price levels to withstand market pressure). In addition to depth, two frequently used measures of liquidity include bid-ask spreads and volatility. Narrow bid-ask spreads are typically associated with a large number of market participants (thus increasing the range of pricing points at which users can trade). Low volatility (or variability of price changes) is typically indicative of resilient markets.

As has been suggested by CESR[8], the following additional factors should be taken into consideration: size of the underlying market; size and diversity of market participants; liquidity (in terms of the pool of buying and selling interest, as detailed above); availability of CCP clearing; and contract fungibility (the extent to which one contract fully substitutes another).

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

We are not in a position to offer such specific comments.

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

In our view, the most prominent OTC derivative contracts suitable for trading on an organised trading platform are benchmark index credit default swaps (CDS), certain standardised, large single-name CDS issues, and sovereign CDS. As CESR has noted[9], credit derivatives (particularly index CDS contracts) are the most standardised amongst OTC derivative asset classes and thus best suited to trading on transparent, organised electronic trading venues.

We are unable to offer comments on specific derivatives for which mandatory on-exchange trading would be seriously damaging to investors. However, in general, derivative contracts that have low volume, high volatility and generally unpredictable

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[8] *CESR Consultation paper – Standardisation and Exchange Trading of OTC Derivatives* (July 2010). CFA Institute's response can be accessed at http://www.cfainstitute.org/Comment%20Letters/20100816.pdf
[9] Ibid.

prices, such that the clearing system may not be able to adequately and accurately set margin, would be ill-suited to mandatory exchange trading.

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

The Consultation proposes the amendment of Article 4 of the directive to include a definition of automated trading. High frequency trading (HFT) would be considered a sub-category of automated trading. The Consultation notes that automated trading would be defined as trading involving the use of computer algorithms to determine any or all aspects of the execution of a trade such as its timing, quantity and price.

We appreciate the Commission's intentions to define automated trading, which are to ensure that such activity can be subjected to appropriate regulation. This is a reasonable approach. However, the precise definition of automated trading would need careful calibration, and therefore further dialogue between the Commission and industry participants engaged in automated trading should be encouraged.

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

The Commission proposes that HFT firms engaging in trading activity over a (as yet to be specified) quantitative threshold should be authorised as investment firms. This would mean that such firms are subject to the same organisational requirements (such as capital requirements and risk management obligations) and the same regulatory oversight as all other investment firms.

We support this approach. HFT firms often account for a significant proportion of overall trading activity (at least in equity markets); accordingly, such firms should be subject to appropriate and proportionate regulation.

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

In the absence of proper risk controls, CESR has noted[10] that sponsored access arrangements[11] could result in an increased risk of error trades and potential for market abuse. CESR has further noted that credit risk could also arise from the inability of sponsors to monitor their clients' business and their exposures.

We concur with these potential risks. Accordingly, CFA Institute is of the view that sponsoring firms (i.e. firms who allow their systems to be used by other traders) should implement robust risk management procedures and controls and retain adequate oversight

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[10] *CESR Consultation paper – Microstructural Issues of the European Equity Markets* (April 2010). CFA Institute's response can be accessed at http://www.cfainstitute.org/Comment%20Letters/20100430_2.pdf

[11] Arrangements that enable clients of broker/dealers to submit orders directly to trading platforms, thereby by-passing broker/dealers' internal systems. The broker/dealer effectively sponsors the client to use the broker/dealer's exchange membership / ID to route orders directly into the exchange's trading system.

of the activities of their clients utilising sponsored-access arrangements. Such controls are necessary to protect the integrity and efficient functioning of the markets and to prevent the noted risks developing into systemic threats.

Furthermore, robust systems controls facilitate better monitoring of the types of equity market participants utilising sponsored-access arrangements and their level of activity. This information would assist regulators develop a more thorough understanding of the type and size of participants in equity markets.

We also agree that firms engaging in automated trading (such as algorithmic and high frequency trading) should implement robust internal risk management procedures and controls over their algorithms and strategies as part of best practice.

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

Circuit breakers are an effective tool for curbing excessive market instability. Accordingly, they help protect the efficient functioning and robustness of markets. For circuit breakers to be effective in combating market instability, they should be applied consistently across all trading venues. This would provide investors with assurance that, irrespective of where they trade, the same protections are in place.

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

Co-location involves physically locating firms' IT systems in close proximity to the matching engines of exchanges and other market centres. Such physical proximity minimises latency in order submission and connectivity between the trading systems of exchanges and investment firms. Co-location may reduce latency by milliseconds or microseconds, which is often sufficient to enable high frequency traders in particular to profit from those not investing in such services.

CFA Institute believes that co-location is a legitimate commercial arrangement between trading firms and exchanges/market centres. In essence, co-location is akin to any regular commercial service, in that the fee charged for the service is reflective of the benefits offered to subscribing customers.

Provided that the service is made available to all market participants wishing to pay for it, and, importantly, that the service is offered on non-discriminatory commercial terms, we do not see any need for regulatory action.

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

The benefits of smaller tick sizes are more diffuse pricing and potentially narrower bid-offer spreads. Smaller tick sizes increase the number of discrete pricing points at which investors can submit limit orders, thus minimising the propensity for large swings in prices. Accordingly, smaller tick sizes help dampen volatility.

Smaller tick sizes also minimise dealers'/market makers' inventory risk, since they increase the range of pricing points at which positions can be closed out. Lower inventory risk enables market makers to post narrower bid-offer spreads.

However, smaller tick sizes may reduce the depth of liquidity amassed at each pricing point as order flow is dispersed over a greater range of points in the order book. Secondly, reducing tick sizes by ever smaller increments could also disadvantage investors if certain market participants obtain execution priority ('jump the queue') by merely posting infinitesimally smaller increments for only nominal price improvement on those orders. At the limit, such circumstances could discourage investors from posting limit orders to the detriment of liquidity[12] and price discovery.

As CESR has noted[13], the use by trading venues of different tick sizes for the same share raises additional issues. Specifically, it could distort price discovery and create an uneven playing field between trading venues. Accordingly, we fully support harmonisation of tick size regimes across Europe and the establishment of minimum tick sizes. We commend the self-regulatory initiative between certain MTFs and the Federation of European Securities Exchanges (FESE) to align certain tick size regimes and to restrict further tick size reduction. We believe that this initiative is the most appropriate approach to the harmonisation of tick sizes at suitable levels and do not foresee the need for regulatory intervention at this stage.

However, it is sensible for regulators to monitor developments on tick sizes and consider action if self-regulatory initiatives fail to achieve adequate tick size harmonisation at appropriate minimum levels.

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

High frequency trading firms typically enjoy all the advantages and benefits of specialists and market makers, including direct access to exchange servers, yet are not subject to the same costs as other market participants. For example, they are exempt from the capital requirements imposed on broker-dealers and from the obligation to make markets for certain securities. Accordingly, CFA Institute takes the position that, if HFT firms are acting as de facto market makers and receiving all the benefits that market makers receive, then they should be required to make markets and provide liquidity on an ongoing basis.

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

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12 See also CFA Institute's comment letter on sub-penny trading at http://www.cfainstitute.org/Comment%20Letters/20100106.pdf

13 *CESR Consultation paper – Microstructural Issues of the European Equity Markets* (April 2010).

CFA Institute does not support either a minimum resting time for orders, or a limit on the ratio of orders to transactions executed. We believe that these proposals would have negative consequences for displayed markets, and would exacerbate the loss of displayed liquidity to dark venues.

Firstly, an enforced minimum resting time for orders would prohibit investors from rapidly cancelling or amending orders in response to changing market conditions. Consequently, those orders would be exposed to greater risk of gaming or exploitation by more sophisticated trading firms utilising automated or algorithmic trading strategies. Limit orders essentially provide a free trading option to market participants with superior information. A minimum resting time extends that option, thus exposing the submitter of the order to greater risk. This would likely discourage investors (particularly 'uninformed' investors) from submitting displayed limit orders, thereby reducing overall transparency and liquidity, and increasing the 'toxicity' of on-exchange order flow.

Similarly, a limit on the ratio of orders to transactions executed would deter statistical arbitrage strategies, which can account for a significant source of liquidity in displayed markets. Specifically, a cap on the ratio of orders to transactions would restrict the ability of investors engaging in statistical arbitrage to adjust their quotes in response to changes in the fair value of related securities. This would result in pricing inefficiencies across related securities and financial instruments. Consequently, such arbitrage activity would decline, thereby reducing the depth of liquidity available in the market.

In our view, the focus of the Commission's efforts in reforming market structures should be to encourage more, not less, trading on transparent organised trading venues. Moving more of the un-displayed liquidity back on to displayed venues would do much to improve market quality and integrity[14].

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

SIs generally trade in relatively small sizes with either retail or professional customers (or both) and are required to publish quotes only for trades up to 'standard' market size in 'liquid' markets, as defined under MiFID. The limited scope of their quoting obligations means that trading transacted with SIs is somewhat less transparent than trading conducted on RMs and lit MTFs. Furthermore, SI quotes are not widely disseminated or readily accessible; SIs may decide which investors they wish to give access to their quotes. For the vast majority of investors, the current calibration of the SI regime offers little utility or choice, such is the narrow focus of the transparency framework. More meaningful quoting obligations, and more widely disseminated quotations, are necessary to better meet investors' needs.

Accordingly, we broadly support the Commission's intentions to clarify the criteria relating to SIs.

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[14] Further elaboration of these views is set out in CFA Institute, 2011, *The Structure, Regulation, and Transparency of European Equity Markets under MiFID* (January): http://www.cfapubs.org/toc/ccb/2011/2011/3

The proposed clarifications, as set out under section 2.4 of the Consultation, are as follows:

a) Amending the implementing regulation by replacing the 'material commercial relevance' test with clear quantitative thresholds, and clarify the application in substance of the non-discretionary rules and procedures.
b) Clarify that once the conditions are fulfilled, SIs are obliged to register with competent authorities.
c) Require SIs to maintain quotes to both buy and sell.
d) Require SIs to maintain a minimum quote size equivalent to 10% of the standard market size of any liquid share in which they are an SI.
e) Require SIs who make use of the exemption from identifying themselves in post-trade reports to publish trading data monthly instead of quarterly as a condition of using this exemption.

With regards to part a), the materiality criteria pertaining to Article 21(1)(a) of the MiFID Implementing Regulation permits firms a degree of flexibility in assessing whether the activity falls within the definition of 'systematic'. Recital 15 of the Implementing Regulation states that an assessment of material commercial relevance should:

"…take into account the extent to which the activity is conducted or organised separately, the monetary value of the activity, and its comparative significance by reference both to the overall business of the firm and to its overall activity in the market for the share concerned in which the firm operates."

We believe that it would be difficult to further clarify the SI definition by providing quantitative thresholds of significance of the business. Materiality is a broad concept, the assessment of which must be tailored according to the specific circumstances of the firm in question. A quantitative threshold for assessing materiality, whilst providing clarity, would be too narrow. It would also be inflexible to changing business conditions and changes in the levels and types of trading activity over time.

We support proposals b) and e). We respond to proposals c) and d) in question 22.

With regards to e), more frequent and granular data over the activities of SIs would enable investors and regulators to better determine the relevance and value of the SI regime.

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

This question relates to proposals c) and d) above.

At present, SIs are permitted to quote one-sided and in a size of only one share. Accordingly, the quotes published by SIs are often of little use to market participants as they do not give a clear indication of the size of business that SIs are prepared to trade in. The economic value of a trading facility depends upon the extent to which investors can see prices on both sides of the market and be able to accurately gauge the depth of trading interest at those prices. Amendments to the SI regime are necessary for SIs to provide investors with a meaningful alternative to transacting orders on RMs and MTFs.

Accordingly, we support the proposals to require SIs to maintain two-sided quotes.

With regards to the minimum quote size, we have no reason to consider 10% of the standard market size not to be a reasonable threshold. In general, SIs should quote in sizes that are commensurate with the size of business they are prepared to undertake.

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

Under section 2.5 of the Consultation, the Commission proposes to further align organisational requirements so that RMs and MTFs operating similar businesses of a similar size are subject to equivalent organisational standards and regulatory oversight.

This is appropriate in order to provide for a level playing field between trading venues[15].

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

We believe that such an arrangement would help minimise the risk of abusive or potentially abusive practices going undetected. Cooperation and exchange of information between trading venues over market surveillance issues would help to strengthen the level of investor protection and support market integrity, and also potentially help prevent systemic failures.

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

In general, SMEs are more risky investments than large capitalisation companies. The potential risks SMEs pose for investors include: less capital and so less balance sheet strength compared with large cap companies; fewer products and services and so less diversified revenues; fewer customers and fewer suppliers; typically less management talent in reserve due to company size; and higher potential for fraud and impropriety arising from weaker internal controls compared with large cap companies.

Consequently, if a tailored regime is to be created for SMEs that would exempt them from the same reporting, listing and governance requirements that apply to all other listed firms, that regime should make it very clear to investors that these companies adhere to lower listing and reporting standards, so that investors are not caught unaware that they have invested in a higher-risk company.

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

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[15] Further issues related to the regulatory level playing field between trading venues of similar types and sizes are set out in section 3.3, pp.21-22 of *The Structure, Regulation, and Transparency of European Equity Markets under MiFID,* CFA Institute (January 2011).

We have no further comments.

3. **Pre- and Post-Trade Transparency**

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

Under section 3.1.1 of the Consultation, the Commission suggests the following amendments in respect of the pre-trade transparency framework for equity markets:

a) Implementing acts could be proposed on the specific methods for the application of the waiver rules in order to ensure legal certainty regarding their interpretation;

b) ESMA could be required in the framework directive to monitor the waivers on an ongoing basis and to report annually to the Commission about their use;

c) Competent authorities of Member States could be obliged to notify ESMA and other competent authorities of the intended use of waivers and provide an explanation regarding their functioning. ESMA could then be required to publish an opinion about whether the use of the waiver is consistent with MiFID. If a competent authority proposed to allow the use of the waiver contrary to an ESMA opinion it would be required to publicly justify its reasons for doing so;

d) An actionable indication of interest (i.e. an indication of interest that includes all necessary information to agree on a trade) would be treated as an order and subject to applicable pre-trade transparency requirements and such indication of interest could not be made transparent to direct participants in a trading system without also being made public.

We support these suggested amendments. We note that points b) and c) essentially formalise the procedures that have already been undertaken by CESR prior to its replacement by ESMA. Point d) is appropriate to ensure that all orders of similar types and sizes are subject to the same rules.

Collectively, these amendments would deliver greater clarity and consistency in the application of the pre-trade transparency framework.

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

Please refer to our response to the previous question.

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

Currently, MiFID does not specify how the large-in-scale (LIS) pre-trade transparency waiver should apply to partially filled orders for which the residual portion (the ‘stub’) is below the relevant LIS threshold.

CFA Institute believes that MiFID should be amended to require residual orders that fall below the LIS thresholds to be pre-trade transparent[16]. This is necessary to ensure fair treatment with other similarly sized orders that are required to be displayed.

The purpose of the LIS threshold is to minimise market impact. To the extent that the stub is below the LIS threshold, it is less exposed to market impact risk. As such, there is little economic rationale to exempt the stub from being displayed.

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

Average transaction sizes have fallen on electronic order book markets since the implementation of MiFID. The downward trend is particularly pronounced on dark order book markets, which are typically organised as 'reference price' systems[17]. Our own analysis shows that, for both lit and dark order book markets, average turnover per trade was less than EUR 11,000 by October 2010.

Given the convergence in average trade sizes, the reference price system pre-trade transparency waiver, as currently calibrated, does not provide appropriate regulatory treatment for reference price systems compared with lit order book markets because both types of trading venue are engaging in a similar size of business.

In our view, it is appropriate to establish a minimum size threshold for dark reference price systems that provide for executions at prices inside the quoted spread on the stock's reference market.

A minimum size threshold of this type is necessary first and foremost to provide consistency in the application of transparency rules for similarly sized orders. Secondly, such a threshold is necessary to protect displayed limit orders and the price discovery function they serve. Systems that match orders at the mid-point of the spread provide price improvement; a size restriction is therefore appropriate in return. Thirdly, such a threshold would also help uphold the proportion of trading on transparent venues, which ultimately benefits investors through narrower bid-offer spreads[18].

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

We believe that the existing large-in-scale pre-trade transparency waiver thresholds should be maintained.

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[16] See also *The Structure, Regulation, and Transparency of European Equity Markets under MiFID*, CFA Institute (January 2011).

[17] Further detail is provided in *The Structure, Regulation, and Transparency of European Equity Markets under MiFID*, CFA Institute (January 2011).

[18] CFA Institute (January 2011) finds negative correlation between the average level of transparency in a given market and the average bid-offer spread.

A reduction of the large-in-scale thresholds could have adverse unintended consequences on market transparency. The fall in average order and transaction sizes since the implementation of MiFID has increased the gap between 'large' order sizes and average order sizes. A lowering of these thresholds, however, would necessarily result in a greater proportion of dark transactions—which already account for between approximately 40 percent and 50 percent of all transactions.

Further, as the Consultation notes, there is no conclusive evidence to suggest that the current LIS thresholds are resulting in higher execution costs or further market fragmentation.

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

We firmly support the proposals to shorten the time delays for reporting of trade data[19].

Delays in the publication of trades reduce the usefulness of trade information to investors and exacerbate difficulties in accurately consolidating post-trade data. Further, trades executed via negotiated transactions, such as VWAP trades, may be adversely affected by trade reporting delays as the prices negotiated may be distorted by trades reported outside of the window of calculation for the negotiated price.

With regards to the proposed amendment in the implementing regulation to reduce the deadline for real-time reporting from 3 minutes to 1 minute, we note that, if firms currently use the full 3 minutes permissible, there is a risk that firms would simply substitute 3 minutes for 1 minute. CESR has also noted[20] that in the United States, the Financial Industry Regulatory Authority (FINRA) has proposed to reduce its respective reporting deadline to 30 seconds from trading time. We recommend that the Commission also proposes a 30 second deadline instead of 1 minute. If it is possible to report trades

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[19] Section 3.1.2 of the Consultation states that:

"For real time publication, the Commission services consider it necessary to:
a) Strengthen the framework directive requirements by specifying that post trade information would be published as close to instantaneously as is technically possible;
b) In the implementing regulation:
– Reduce the deadline for reporting in real time from 3 minutes to 1 minute; and
– Require systems not to be designed to publish details in a "batch" but instead to publish the details as soon as they are entered into the system.
For the deferred publication regime of large transactions, the Commission services consider necessary in the implementing regulation to:
a) Shorten the delays permitted so that almost all transactions are published no later than the end of the trading day. Only the very largest trades that occur late in the trading day could be able to be published on the next day but even then before the opening of the following trading day;
b) Shorten the intra-day delay period from 3 hours to 2 hours; and
c) Raise the intra-day transaction size thresholds."

[20] *CESR Technical Advice to the European Commission in the Context of the MiFID Review: Equity Markets – Consultation Paper* (April 2010). CFA Institute's response can be accessed at http://www.cfainstitute.org/Comment%20Letters/20100601.pdf

“as close to instantaneously as technically possible”, then we see no reason why 30 seconds would impose undue difficulty for investment firms.

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

The afore-mentioned instruments are equity-like in economic substance. Therefore we see no reason why these instruments should not be incorporated into the same transparency framework as that pertaining to equities.

We are not able to comment on what further products should be considered, but suggest that traditional UCITS (undertaking for collective investment in transferable securities) would not be suitable. UCITS are open-ended collective investment schemes; as such, they are NAV (net asset value) priced. UCITS shares are created or cancelled by the fund manager upon subscription or redemption requests from investors; accordingly, there is no secondary market for such instruments.

34. Can the transparency requirements be articulated along the same system of thresholds used for equities? If not, how could specific thresholds be defined? Can you provide criteria for the definition of these thresholds for each of the categories of instruments mentioned above?

We consider that the simplest and most effective approach would be to extend the MiFID equity transparency framework to these instruments, subject to review in subsequent periods. As we note above, these instruments are similar in economic substance to equities and therefore it would be appropriate to harmonise the transparency requirements for equities and equity-like financial instruments. The economic substance of an instrument should prevail over its legal form when determining the appropriate regulatory framework.

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

The Consultation notes that the transparency framework only applies to shares admitted to trading on a regulated market (but the rules apply to all trading of those shares whether they subsequently trade on an RM, MTF, or OTC).

In order to provide for a level playing field and keep pace with market developments, it is necessary to extend the transparency requirements to shares that are only admitted to trading on an MTF or organised trading facility.

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

Please refer to our response to question 25. As we have noted above, if SMEs are to be exempt from certain provisions that apply to other listed firms, then investors should receive prompt and prominent disclosures alerting them to the fact that these companies are subject to fewer requirements than others, and so carry a higher risk. Where appropriate, SMEs should list on a market that makes it clear to investors that the company does not adhere to all of the transparency and other reporting and governance requirements of other listed firms.

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

In section 3.4 of the Consultation, it is suggested that pre- and post-trade transparency requirements should be extended to non-equity markets through an amendment to the framework directive.

The transparency requirements would be differentiated by asset class. They would apply to:

a) All bonds and structured products with a prospectus or which are admitted to trading either on a regulated market or MTF; and

b) All derivatives eligible for central clearing according to Article 4 and all derivatives reported to trade repositories according to Article 6(1) of the Commission proposal on OTC derivatives, central counterparties and trade repositories.[21]

The over-arching requirements are specified under section 3.4.1 of the Consultation[22].

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[21] COM(2010) 484.

[22] The requirements would specify that all RMs, MTFs, and organised trading facilities offering trading in non-equity financial instruments would publish their pre-trade information in a continuous manner. Investment firms executing trades OTC would be required to make pre-trade quotes that are reflective of current market value and that are binding below a specific trade size. Similar to the systematic internaliser regime, this would not mean an obligation to quote on a constant basis for every product. Rather, an investment firm that is willing and interested to quote or to receive a request to quote on a specific product which it agrees to meet, would be required to make its quote both in terms of price and volume available to the public, and commit to it below the specified size.

The Consultation also notes that "the implementing measures for pre-trade requirements applicable to regulated markets, MTFs, and organised trading facilities (as per section 2.2.3 above) would provide for a real-time and continuous updating of available and actionable trading interest. Depending on the nature of the system and asset class, these would specify the range and depth of binding commitments to buy and sell the instruments above. As for implementing measures outlining quoting requirements for investment firms acting OTC, the Commission services consider that these would specify that quoted prices could not significantly deviate from pre-trade information available for comparable or identical instruments on regulated markets, MTFs or organised trading facilities as per section 2.2.3 above, as well as specify the size-threshold per asset-class under which quotes would be binding. This could represent a commonly accepted value of trades in each asset-class beneath which the risk associated with the trade can easily be laid off in the market, and is likely to be undertaken by or on behalf of retail investors."

Post-trade transparency requirements would a) provide data on transactions in terms of price, volume, time of trade, and the main reference characteristics of the traded instrument rather than aggregate data; b) be properly calibrated to the class of financial instruments (bond, structured product, etc), the type of instrument (option, swap, etc), as well as the underlying variable; c) be predicated on a system of thresholds and delays, based on transaction size.

In general, CFA Institute is supportive of extending transparency requirements under MiFID to financial instruments other than equities.

Support for transparency in non-equity markets is evidenced by the results of a survey of CFA Institute members, in which just over half of respondents—between 54 percent and 59 percent—indicated it would be valuable to extend pre- and post-trade transparency requirements under MiFID to transactions in instruments other than shares[23]. Amongst the instruments listed, the highest majority opinion, 59 percent, related to corporate bonds.

We note that any mandatory transparency regime for non-equity financial instruments would need to be properly calibrated to the specificities of the structures of these markets.

The Commission's over-arching approach appears reasonable. However, we are not able to comment on the specifics of these proposals, and defer to those who are active participants in these markets.

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

Please see our response to question 37, we have no further comments.

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

Please see our response to question 37, we have no further comments.

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

Please see our response to question 37, we have no further comments.

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

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[23] The results are taken from the report *Market Microstructure: The Impact of Fragmentation under the Markets in Financial Instruments Directive*, CFA Institute (2009), available at http://www.cfapubs.org/toc/ccb/2009/2009/13

Please see our response to question 37, we have no further comments.

42. Could further identification and flagging of OTC trades be useful? Please explain the reasons.

Investors would benefit from more granular and accurate information about the level and type of trading activity that is broadly classified as OTC.

OTC trading accounts for a significant proportion of overall trading. As such, greater granularity of trade data – for example, through the use of flagging and specific identifiers for the different types of OTC transactions – would improve transparency and enable investors to better gauge the level and nature of trading activity in a given instrument. Such information would be useful when determining where to transact an order.

4. Data Consolidation

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

Under Section 4.1 of the Consultation, the Commission proposes to amend the framework directive to require firms to publish trade reports through Approved Publication Arrangements (APAs), which would be required to operate according to prescribed standards and be subject to regulatory approval.[24] The Commission also proposes to amend the implementing regulation to provide greater detail and clarity over the content and format of trade reports. The implementing regulation would also be amended to clarify which investment firm is responsible for reporting certain types of OTC transactions.

CFA Institute fully supports these proposals. The APA requirements and data publication standards would likely significantly improve the accuracy, consistency and reliability of post-trade data. Moreover, implementation of the APA proposals would subsequently facilitate meaningful consolidation of post-trade data. These proposals are necessary to improve trade data transparency for investors.

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

We believe that the criteria (noted in the footnote below) applicable for APAs are appropriate.

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

We support these proposals. Please refer to our response to question 43.

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

In principle and where practicable, we are supportive of implementing consistent standards over data quality and integrity across all types of asset classes as a means to improve the transparency and reliability of information for investors.

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[24] An APA could be an RM, MTF, organised trading facility, or another organisation, such as a data vendor. It would be required to meet the following criteria:
- Guarantee a high level of data security;
- Demonstrate that it can efficiently and consistently disseminate trade data in a way that ensures fast access to the data on a non-discriminatory basis at a reasonable cost;
– Effectively identify erroneous trade reports by undertaking appropriate checks to ensure that relevant fields are completed in trade reports and obvious errors are identified;
– Maintain adequate resources and contingency arrangements; and
– Manage conflicts of interest appropriately and submit regular and timely reports to the relevant competent authority.

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

Under section 4.2 of the Consultation, it is noted that the cost of trade data in Europe is significantly higher than in the United States.[25] The Commission therefore proposes to require (i) unbundling of pre- and post-trade data; (ii) data to be made available free of charge after 15 minutes; (iii) defining what constitutes "reasonable cost" for the selling or dissemination of data.

Firstly, we support (i) unbundling data. The practice of tying the purchase of pre- or post-trade data to the purchase of the other is potentially discriminatory and limits consumer choice. Such unbundling provides greater flexibility for investors, not all of whom require both pre-trade and post-trade data. Separating these offerings would also provide greater product transparency, which should place downward pressure on costs as vendors compete on more transparent terms. Unbundling these services should go some way toward making consolidated data available on a "non-discriminatory basis at reasonable cost".

Regarding (ii), we agree that post-trade data should be made available free of charge after 15 minutes. This practice is already adopted by many RMs and MTFs. Investors paying for market data are primarily concerned with obtaining real-time data feeds. The commercial value of market data therefore declines as time elapses. After 15 minutes have elapsed since trade execution, there is little commercial value in post-trade data and hence such data should be made freely available to investors.

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

It would be sufficient to disaggregate data into pre-trade and post-trade data information.

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

At present, trade data must be made available "on a non-discriminatory basis at reasonable cost". Whilst it may be desirable to refine this provision, we caution that it would be inappropriate to impose fixed fees on the industry.

Accordingly, we recommend that the Commission first monitor amendments (i) and (ii) to determine what impact they have in driving down costs. If data costs remain significantly higher than comparable costs in the United States, further considerations would be appropriate.

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

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[25] Footnote 94 of the Consultation states that "Due to the relatively large number of entities publishing trade data and the cost charged by some entities for that data, the total cost for constructing a complete real time consolidated tape has been estimated at about €500 per screen per month. In comparison the cost for the similar product in the US is around €70."

Presently, there is no formal trade transparency framework for non-equity markets. Consideration of these proposals for such markets would, therefore, be more relevant after a transparency framework has been calibrated, implemented and assessed.

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

CFA Institute is firmly of the view that MiFID should be amended to include explicit regulatory provisions requiring the implementation of a consolidated tape for post-trade data.

CFA Institute has consistently called for a European consolidated tape under MiFID[26]. Indeed, 65 percent of CFA Institute members responding to a survey in July 2009 expressed support for a mandatory consolidated tape[27]. Investors need access to a complete and clear picture of market prices and trading interest to facilitate the investment decision making process and to assist the accomplishment and measurement of best execution. A consolidated tape fulfils these needs.

Further, as the Consultation notes in section 4.3, a consolidated tape would help mitigate the effects of a fragmented market structure. It would help to link competing markets, thereby generating positive network externalities.

A consolidated tape, in conjunction with implementation of the APA proposals, would help to improve the coverage, quality, consistency, and utility of trade data.

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

The Consultation puts forward the following three options to establish the mandatory consolidated tape:

(A) Establish a not-for-profit public utility, appointed by legal act, to operate the consolidated tape. This option is similar to the model in the United States. Trading venues and APAs would be required to make their data freely available to the consolidated tape operator, which would then consolidate the information and make it publicly available at reasonable cost. Revenue from the provision of consolidated data by the single entity would be paid back to trading venues and APAs according to a prescribed formula.

(B) Appoint a single commercial entity to manage and run the consolidated tape following a public tender process. The appointment would be for a limited period of time after which the mandate would be subject to another public tender. Two

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[26] See *The Structure, Regulation, and Transparency of European Equity Markets under MiFID* (January 2011), and *Market Microstructure: The Impact of Fragmentation under the Markets in Financial Instruments Directive* (December 2009).

[27] Excluding 'no opinion' responses, 82% of those surveyed supported creation of a European consolidated tape under MiFID.

sub-approaches are suggested for revenues. (i) Trading venues and APAs would make their data available to the single consolidated tape entity on a reasonable commercial basis; the single entity would then make the consolidated stream available to the market also on a reasonable commercial basis. (ii) Along the lines of option A, trading venues and APAs would make the data available to the single entity for free, and would then receive a proportional share of the revenue generated by the single entity for selling the consolidated data to the market.

(C) Prescribe in MiFID the conditions that must be met for the provision of a consolidated tape and then allow competing commercial providers to provide the consolidated tape if they meet those conditions. Within a defined timeframe, these providers would need to be approved by competent authorities and start to operate. They would be required to acquire the data and make it available to the market in a consolidated format at reasonable cost.

CFA Institute's preference is to opt for the commercially driven approach. Given the Commission's proposals regarding the APA regime (which sets specific standards for data quality, consistency and consolidation), we believe it would first be sensible to see whether industry-led solutions built on the APA regime are successful in delivering a mandatory consolidated tape that is cost-effective, accurate, complete, and reliable. Moreover, the commercially driven approach would likely be the quickest and most efficient to implement, given existing resources and technological expertise amongst commercial vendors.

However, we note that, to date, commercial consolidated data offerings have fallen short of investors needs. We therefore stress that if such commercially-driven efforts do not meet the prescribed standards, determinable after an appropriate period of time, then we would firmly support the establishment of a single entity to manage and operate the consolidated tape.

Accordingly, our preference would be for option C. If unsuccessful, our next preference would be for option B (provided that the mandate would be only for a pre-specified time period so as not to entrench a monopoly), and ultimately option A if necessary.

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

Please refer to our response to question 52. We have no further comments.

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

We are not in a position to comment on the commercial aspects of options A and B.

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

We are not in a position to comment on the relative appropriateness of the revenue distribution arrangements under Option B.

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

Each of the factors listed in the question are relevant considerations. As we have noted in our response to question 52, resources and technological expertise are key factors when determining who should operate the consolidated tape.

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

As we have noted in our response to question 52, our preference for option C is due, in large part, to the fact that it would be the quickest and most efficient option to implement.

We are not best placed to comment on specific implementation timeframes, but stress that investors need this information as soon as is practicably possible.

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

The Consultation notes that mandatory consolidation of pre-trade data is not a priority at this stage, for various reasons. CFA Institute accepts that current priority should be afforded to the consolidation of post-trade data. However, we support the creation of a consolidated quotation system of pre-trade data in subsequent periods.

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

We are unable to comment on the specificities of a consolidated tape for non-equity markets. However, in principle, CFA Institute supports the provision of consolidated data wherever practicable on the basis that it aggregates liquidity across markets and thus provides investors with a clear and complete picture of prices and trading interest across the trading network.

5. **Measures Specific to Commodity Derivative Markets**

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

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

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

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

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

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

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

We do not comment on questions 60 through 66 in relation to commodity derivatives markets.

6. Transaction Reporting

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

We support the proposal; many of the points noted in this Consultation with respect the proposed amendments to the Market Abuse Directive (MAD) were supported by us in our response to the Commission's consultation on the revision of the MAD[28]. In the main our reasoning is that the original MAD predated MiFID and hence had to be updated to serve today's financial markets. The proposed amendments to MAD will require extensions to the transaction reporting requirements under MiFID to be fully effective.

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

We support the proposal, for the reasons stated in our answer to question 67.

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

We support the proposal, for the reasons stated in our answer to question 67.

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

We support the proposal, for the reasons stated in our answer to question 67.

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

We support the proposal of extending transaction reporting to all correlated instruments and to all commodity derivatives to support the market abuse regime.

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

We support the proposal, for the reasons stated in our answer to question 67.

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[28] http://www.cfainstitute.org/learning/products/publications/commentletters/Pages/07232010_45513.aspx#

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

We support the proposal, for the reasons stated in our answer to question 67.

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

We support the proposal, for the reasons stated in our answer to question 67.

75. What is your opinion on the suggested specification of what constitutes a transaction for reporting purposes? Please explain the reasons for your views.

We agree with the Commission that national differences in transaction reporting requirements create inefficiencies, confusion and opportunities for market abuse. As a first step in resolving these issues, an EU definition of what defines a transaction is necessary. We believe the Commission's proposal of "a transaction refers to any agreement concluded with a counterparty to buy or sell one or more financial instruments" is adequate when set within article 5 of the implementing regulation 1287/2006.

76. How do you consider that the use of client identifiers may best be further harmonised? Please explain the reasons for your views.

We understand that South Africa is the leader in using client identifiers to track the initiators of trades. This measure was brought in to control market abuse and we are led to believe that it has been very effective. Under the South African system, each customer has a unique identification code; this enables the exchange and regulator to rapidly trace the counterparties in a suspicious transaction. Therefore we support the introduction of client identifiers; our recommendation is that each client should have his own unique EU identification code, to facilitate this process.

77. What is your opinion on the introduction of an obligation to transmit required details of orders when not subject to a reporting obligation? Please explain the reasons for your views.

The current system of trade reporting is not consistent, which is detrimental to the interests of investors. Statistics on the volume of trading activity at the various trading venues are inaccurate, some trades suffering from multiple reporting and quite possibly some are not reported at all. To promote order to the trade reporting system we see it is necessary to enhance the current reporting obligations. Hence we support the requirement to transmit the required details of orders to the receiving investment firm, by agents who are not executing these transactions.

78. What is your opinion on the introduction of a separate trader ID? Please explain the reasons for your views.

Instituting a requirement for a separate trader ID completes the audit trail between the end parties in a transaction. Hence, we support the proposal as a method of strengthening the market abuse regime.

79. What is your opinion on introducing implementing acts on a common European transaction reporting format and content? Please explain the reasons for your views.

We support the proposal because we support the above measures to bolster the effectiveness of the EU market abuse regime.

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

We support this proposal as it aligns the pan-European nature of the financial markets with a pan-European supervisory system. The efficiencies are self-evident; those charged with reporting transactions will only have to report to one entity.

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

This proposal removes loop holes in the transaction reporting process by identifying and clarifying the rules and obligations for those charged with transaction reporting.

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

We are not sure that the proposal is consistent with the desire for all transactions to be reported to a single EU authority. We do not want to see duplication in the reporting framework, but we do believe that transaction reporting should be centralised through an EU authority, not fragmented over the Member States. Our interpretation of the EMIR proposals indicates that transaction reporting would be directed to the Member State authority and not to a centralised EU authority.

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

We support the proposal as it harmonizes reporting rules and obligations across all transaction reporting entities.

7. Investor Protection and Provision of Investment Services

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

Yes, we agree that there should be further limitations placed on the current optional exemptions granted to Member States. Broadly, these exemptions refer firms that do not hold client funds, do not provide advice, and only transmit orders to authorised firms. Our suggestion is to introduce additional controlling criteria on maximum transaction size and maximum volume of business over in a 3-month period. For example, optional exemptions could only apply to firms or persons whose transaction size is less than 5,000 Euros or less the 250,000 Euros of 'consideration' business in a rolling 3-month period.

We agree that Member States should be obliged to apply requirements on exempted entities that are analogous to the MiFID conduct of business rules. The reasoning behind our support for these proposals is the incidence of articles in the media highlighting alternative investment schemes which direct the reader to an agent of the product[29]. In the footnoted example, there was no evidence to suggest that one of the two agents was under any regulatory control, even though the scheme represented a material investment. Hence, restricting exemption by transaction size and volume of business would bring these types of investment schemes within the scope of the Directive.

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

We entirely agree that retail investors should experience the same level of regulatory protection wherever they purchase investment products. We define as an investment product as anything other than simple interest earning savings account. Further we also believe that savings products currently marketed under the Insurance Mediation Directive (IMD) ought to brought under to the scope of MiFID to ensure homogeneity 'suitability' of standards.

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

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[29] An example http://www.dailymail.co.uk/property/article-1341415/Floridas-looking-brighter-The-outlook-improving-Sunshine-State-investors-cash-U-S-housing-scheme.html

There is clearly a conflict of interest where a firm is selling its own securities to a customer. In the circumstance where the issuing firm is a credit institution or an investment firm, which provides investment advice, insurance or low risk services such as a deposit taking to the customer the conflicts become more subtle for two reasons. First, with the existence of a business relationship the customer will place the issuer in a position of trust. Second, the issuer has privileged access to the client. Therefore, while the sale of the issuer's securities may be unsolicited, the issuer can exert a strong influence on the customer:

- by having the ability to inform the customer of the pending sale,
- through the existence of the business relationship with the customer, and
- through the customer's awareness of the issuer's brand (which has little to do with the merits of the investment).

The customer could respond purely on the good faith he has in the business and not on a considered analysis of the investment. It is worth noting that much of the business model of retail banking is geared to the cross-selling of financial and investment products to depositors. Hence, we believe that where the issuer is an agent of the customer, MiFID rules should apply. We support extending the definition[30] of the service of execution of orders to include direct sale of own securities.

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

We do not support either Option A (further restrictions on the existing 'execution only' provision) or B (the abolition of 'execution only' provision) in the Consultation's proposals. Fundamentally, where it comes to services purchased purely on the initiative of the client, we do not see any need to regulate further. The client must take responsibility for his or her own self-motivated actions. This is a freedom of choice issue where the individual must be able to make his or her own consumer choices. Such a proposal is not far short of regulating consumer actions on buying luxury items or playing roulette, purely on the basis that they cannot afford the financial risk in making those choices. Further, such an intervention will discourage some retail investors from educating themselves, as they will not have the opportunity to practice what they have learnt.

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

[30] Article 4(5) of Directive 2004/39/EC

We believe there is no need for further regulation for the reason that clients ought to be able to exercise their own choices on whether they decide to use ancillary lending facilities as part of an execution only transaction. However, these transactions can represent a systemic risk, therefore we support the intervention of supervisors to make sure that investment firms have adequate capital and that clients have posted adequate margin or collateral to support these transactions.

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

The introduction of UCITS with hedge fund features, "NewCITS", raises the issue of whether investors need further protection from investing in these products. Our belief is that if the investor is using an execution only service, it is their choice as to whether they decide to invest in these products or not. Therefore, we do not agree with the proposal to restrict the availability of UCITS to users of execution only services.

90. Do you consider that, in the light of the intrinsic complexity of investment services, the "execution-only" regime should be abolished? Please explain the reasons for your views.

No, we do not agree for the reasons stated in our answer to question 87.

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

CFA Institute, conducted a poll of its membership involved the management, marketing and sales of retail investment products[31]. We asked whether, in their opinion, these products were sold on the basis of their fees or their suitability: 73% said they were sold on the basis of their fees.

We appreciate that the Commission seeks to improve the level of advice given to customers to resolve the suitability issue, but we do not think that this approach is workable. The crux of the issue concerns the form of remuneration that the salesman or financial adviser receives; commission-based compensation for financial advice is fundamentally conflicted.

At the end of 2012, as part of its retail distribution review, the United Kingdom government will require that all financial advice is paid by fee, rather than by commission. This is a bold step as clients are conditioned to being charged 5% commission on a £5,000 portfolio solution, but are resistant to paying £250 for advice to obtain the

[31] http://www.cfainstitute.org/about/press/release/Pages/04212009_16370.aspx

same result. We support the UK government's policy and recommend it to the Commission for consideration.

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

As a matter of best practice we agree that intermediaries should specify in writing the reasoning behind their recommendations on the basis of the client's profile. For the majority of investors, the development of the client profile is often not much more than a box ticking exercise.

CFA Institute requires its members who are engaged in an advisory relationship to make inquiries—either actively through an interview or passively through completion of a standardised form—about the client's investment experience, risk and return objectives, and financial constraints prior to making any investment recommendations, and before taking any investment action. They also must reassess and update this information regularly. They also must determine whether an investment is suitable to the client's financial condition and consistent with the client's objectives, mandates and constraints. Finally, they must act with loyalty, prudence and care and by putting the client's interests ahead of their own.

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

We believe that a customer should be informed by their intermediary 'without delay' if there is a material change in the risk/return characteristics of a financial instrument. This would include a sharp change in value, both upwards and downwards, in the absence of news.

A material change in the expected risk and return of one instrument that affects the balance of the portfolio should lead to management action, including alerting the client of the situation and informing him of the options available to return the portfolio to its desired performance characteristics.

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

We agree for the reasons stated above in question 92 that the client's portfolio should be monitored to ensure the continuing suitability of the investments versus the client's needs. In the context of incorporating a change in the client's circumstances into the design of the client's portfolio, we would see this as best practice and a service that should be offered to the client through an annual reassessment of the client's profile. We cannot justify making this service an obligation unless the intermediary is compensated for its provision, through a retainer or separate consulting fee.

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

The answer to this question is dependent on the expectations that the customer has on the intermediary. If the portfolio is discretionary, then the client has delegated the choice of investments to the intermediary, and needs only to know how the portfolio is performing against pre-agreed criteria. Where the intermediary is acting as an adviser to the client and the client is making the investment choices then best practice would require that the intermediary 'fully' informs the client of the risk/return characteristics of the instrument. We would add that suitability of the asset in relation to the existing portfolio, not just the client risk/return profile should also be a consideration.

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

Yes, we support the proposal for the delivery of independent quarterly valuations of complex products to clients. We believe that an independent third party is the best source of price information on these products in the absence of a liquid quote.

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

Yes, we support this proposal. Clients would benefit from knowing how the value of these securities evolves in relation to other assets. This will inform their current and future investment choices. Public disclosure of such information would benefit all consumers of these products.

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

Yes, we support this proposal for the reasons stated in our answer to question 93.

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

The question raises the concern on whether 'eligible counterparties', whose business is the financial markets, have adequate access to information concerning complex products and other financial instruments. It would appear that these instruments fall outside the scope of the Transparency Directive; therefore there is no obligation on the behalf of the issuer to inform the investor on the underlying performance of the financial instrument or to communicate material changes in the underlying performance to the investor. Hence, we agree with the Commission's proposal.

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

To some investors these are material considerations in the construction of their portfolios. We believe that the market has responded to the needs of these investors by producing and labelling financial instruments that serve their needs. Therefore, we do not feel it is necessary to impose obligations in this area as the market is adequately serving investors with these interests.

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

We would not support the removal of the possibility to provide summary disclosure concerning inducements. In our response to CESR's consultation on inducements – good and poor practices[32], we call for clear, accurate and understandable disclosure in summary form. We believe that all information that affects the risk and return characteristics of the service or product are of interest to the client, particularly negative cash flows, not associated with proper fees[33].

We share the Commission's concern that some summary disclosures have morphed into detailed disclosures. Such detailed information can be presented in such a fashion as discourage potential clients from reading the content. We hope supervisors will monitor these disclosures and provide advice to compliance departments on the need to present concise information.

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

No, we believe that summary and detailed disclosures presented to the client before the acquisition of the product or service is adequate, providing such disclosures are clear, accurate and understandable. We would strongly support the obligation to provide notice of changes in inducements, so as the client has the option to respond to changes ahead of their implementation. Consideration should be given for arbitration on the fairness of

[32] http://www.cfainstitute.org/learning/products/publications/commentletters/Pages/12212009_17661.aspx

[33] Proper fees – Article 26 of MiFID implementing Directive ("Level 2 Directive"), section c, proper fees.

such proposals where the client is effectively tied into the product or service and it thus unable to respond without incurring a financial penalty.

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

In principle we believe there is little 'justifiable' scope for inducements, beyond fees or commissions paid by the client of person acting on their behalf (Art. 26 (a))[34] and proper fees (Art. 26 (c)). The text in Article 26 (b)[35] leaves too much discretion on what is clear disclosure (part 1) and whether the payment is designed to enhance the quality of service to the client (part 2). Therefore, we would support the deletion of Article 26 (b) from the Level 2 Directive, to restrict the definition and use of inducements.

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

We support the current classification regime, based on its simplicity and clarity.

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

- **a. Introduce, for eligible counterparties, the high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading when informing the client;**
- **b. Introduce some limitations in the eligible counterparties regime. Limitations may refer to entities covered (such as non-financial undertakings and/or certain financial institutions) or financial instruments traded (such as asset backed securities and nonstandard OTC derivatives); and/or**
- **c. Clarify the list of eligible counterparties and professional clients per se in order to exclude local public authorities/municipalities? Please explain the reasons for your views.**

In response to a), b) and c):

a) Yes, we agree this is appropriate for eligible counterparties. We believe that the markets work most efficiently, where there is an explicit condition of trust and integrity.

b) We are not in favour of introducing limitations in the eligible counterparties regime with respect to the description of financial institution or type of financial instrument. We do believe that the eligible counterparty must demonstrate to the intermediary that it has competent staff that are able to deal in complex financial instruments, before they can deal in these instruments. Therefore, we would

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[34] Ibid

[35] Ibid

prefer to see the burden of competency to lie with the eligible counterparty. This type of system would reduce the potential for asymmetric litigation.

c) We would hope the local public authorities/municipalities, who manage substantial funds and periodically require access to large loans have people with the necessary skill to competently discharge their duties. However, the Icelandic banking crisis that adversely affected a number of local authorities demonstrated a lack of investment knowledge and due-diligence on behalf of those who invested. Therefore as discussed in part 'b' above, we feel it is beholden on the Local Authority to prove that it has competency to deal in both simple and complex instruments.

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

Yes, we agree the knowledge and experience presumption should be retained. For similar reasons outlined above, professional clients should be responsible for their own actions. Again, we propose that the professional client must make some attestation to the intermediary that they are competent to deal and invest in the financial instruments that are offered by the intermediary, before they can deal with the intermediary in those instruments.

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

We strongly support the proposal to introduce a principle of civil liability applicable to investment firms covering: information requirements, suitability and appropriateness test, reporting requirements, best execution and client order handling. We believe that applying this proposal across the EU will reduce regulatory arbitrage and improve internal processes at investment firms to protect against reputational damage.

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

We support coverage in all of the areas above, particularly with reference to suitability and appropriateness, for the reasons and example stated in our answer to question 91. However unless there are changes in the Directive we feel that it will be difficult to pursue claims for damages on the grounds to the intermediary failed to deliver best execution.

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

The types of execution quality data that are of value to investors include on speed of execution, the execution price of market orders within the bid/ask spread, the effective spread and the effective to quoted spread. Investors will find this information useful for discovering best execution. We would add that depth (volume of shares) at the bid/ask price and the size of trades are other important indicators in discovering the quality of the markets.

Certain exchanges and data vendors currently supply much of this information[36]. Additionally, a number of vendors provide TCA (Transaction Cost Analysis) tools to help measure best execution. Such tools are valuable given the multi-faceted nature of the best execution definition.

Provided that information on execution quality is readily available to investors and at reasonable cost, it may not be necessary to impose a mandatory obligation on execution venues to supply this information. However, it would be sensible for the Commission to monitor the availability of such information and consider taking action if there is a deficit of information available, particularly with respect to the information available from dark venues vis-à-vis their lit counterparts.

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

CFA Institute's position on execution policies is that investment managers should have to disclose details of how client transactions are handled and how commission benefits are used. This would benefit investors by helping them prior to investing to determine whether an investment manager has a trade execution policy that benefits its clients. Such disclosures should include a) a description of the execution and commission arrangements available to the investment manager and estimates of the cost of individual products and services under each, and b) an analysis of estimated client benefits of each alternative.

Investment managers should have to disclose to clients an analysis of how the clients benefited from the execution and commission arrangements of the investment manager. Investors would benefit from such disclosures by helping them determine whether their investment manager or its trade execution policy provides benefits to them. Such analyses would include a) a description of trading activity performed on behalf of that client's portfolio and the costs associated with those trades, including an itemization of the components of those costs, and b) an analysis of the costs and benefits of the arrangement agreed upon between the client and the investment manager.

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

In principle where a firm is putting capital at risk, it is doing so to make a return. Therefore, when a firm is the counterparty to the client's order, it is in the belief that some financial advantage will accrue to the firm participating in the transaction. Hence,

[36] One such example is LiquidMetrix – see http://www.liquidmetrix.com/LiquidMetrix/Battlemap.

it is difficult to logically and fairly apply the MiFID requirements to the firm dealing on its account. We strongly support the view that persons charged with dealing on account are not in a position to give advice to the client, as there is plainly a conflict of interest.

The problem becomes more complex where a dealing firm publishes research. The business model of research firms depends on corporate fees, commissions and trading profits, hence there is a vested interest to stimulate trading through the publication of research. Though the proprietary dealers and market makers have no way been in a position to offer advice to the firm's clients, there is an explicit link between the publication of research (advice) and earning returns from the dealing account.

Whilst we support the proposal to modify the rules to give greater clarity that exemption is only applicable to people '...who do not provide any investment services or activities other than dealing on own account unless they are market making...', we do not believe the proposal resolves the problem, as by nature the 'duel capacity' firm is inherently conflicted.

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

A matched trade is a clear example of where the dealer is acting as agent, and compensated with a commission. The dealer's interest is to complete the transaction at a price agreeable to both parties. The use of the dealer's capital is incidental, its application is to facilitate the trade and not seek a return by acting as principle.

Therefore we do not support the proposal that these trades should be considered as dealing on own account, nor should this affect the treatment of such trading under the capital adequacy directive. Where a firm is acting as principle, which can occur with systematic internalisers, then the firm should be subject to the appropriate level of capital as prescribed under Capital Adequacy Directive.

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

We strongly agree with the proposals, we believe it is critical to the culture of the firm that the senior executives and non-executives demonstrate integrity, and sound ethical principles to all those who report to them. To effectively supervise the firm's business and to develop strategy all board members need to be sufficiently experienced in the activities of the firm. The financial crisis was a vivid demonstration of where these conditions were absent; hence, all members of the board need to demonstrate their ability to pass 'fit and proper' tests. Therefore, we see an ongoing role for supervisors to assess directors for their ability to pass 'fit and proper' tests.

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

We support the proposals to elevate the status of compliance, risk management and internal audit through a direct report to the board. By raising the status of these functions, we believe that these issues will be given the consideration they deserve, as the board will become directly accountable for decisions concerning, compliance, risk and internal audit.

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

We agree with the proposals, particularly in regard to assessment of the product with the needs of the client. We think these proposals would support better investment outcomes for clients, as there is a higher probability that clients will acquire products that serve their needs and not just the interests of the product providers, distributors and related staff.

116. Do you consider that this would imply modifying the general organisational requirements, the duties of the compliance function, the management of risks, the role of governing body members, the reporting to senior management and possibly to supervisors?

Yes, we do to the extent that the proposals formalise what should be best practice. A formal assessment of a new product in relation to its suitability for specific customer profiles would engage the compliance department. They would have duty to make sure that these products are only sold to customers whose investment profiles were compatible with the risk return characteristics of these products – the suitability test.

Such a structure would encourage organisational requirements for risk management, product stress-testing and product performance. It would follow that the staff managing client funds or marketing these products to clients must have demonstrated the necessary expertise (through training and experience) to perform these functions. This would include a sound understanding of portfolio diversification in the case where the staff manages funds on behalf of the client. The compliance department would lead the role of monitoring and enforcing all these procedures, and would report its performance in executing this function directly to the board.

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

We support the proposal; article 5 of the implementing directive (2006/73/EC) – General organisational requirements - does not specify the need to formalise and retain documents concerning the definition and implementation of their investment strategies in managing clients' portfolios. We would expect that such procedures would already be in general use at investment firms. Therefore codifying this as a requirement in the recast Directive should not impose a cost, for what should already be industry practice.

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

We agree with the proposal, please refer to the member poll cited in our answer to question 91, conflicts of interest at least in the distribution of retail investment products are still manifest and preventing clients receiving the best investment outcomes. Therefore, we agree that implementing measures are required to promote the uniform application of the principles on conflicts of interest.

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

We do not support this proposal. Where a client has entered into a contractual arrangement that requires the posting of collateral, the investment firm needs some assurance of control over the collateral. At the same time, the investment firm should not consider the collateral as its own unencumbered asset. Therefore, we disagree on the prohibition of title transfer.

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

We do not support this proposal for the reasons stated above.

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

Yes, we do. Our proposal is when a client enters into a relationship that requires the posting of collateral, title of the securities should be transferred to an escrow account of the investment firm (ring fenced from the activities and liabilities of the firm). This affords protection to the client and providing some surety to the investment firm, should the client be unable to meet his obligations.

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

Yes, we agree with the proposal. All clients should be aware of the risks involved where an investment firm makes use of their financial instruments, or makes use of financial instruments that the client has posted as collateral.

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

We believe that the text in article 18 of Directive 2006/73/EC – Depositing client funds - adequately covers the due-diligence requirements of investment firms. We feel that putting diversification requirements on investment firms will cause complications in the event of a failure at a bank, credit institution or money market fund. If one of these organisations fails, who has lost money, all clients or just some clients? This is a matter of prudential supervisors to ensure that financial institutions receiving deposits operate in a conservative manner to protect the value of the client's funds, see subsection 2(a) of article 18.

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

While we are sympathetic to the thrust of the proposals, we feel the measures suggested are not compatible with the creative and multi-permutational processes of the underwriting and placing business. Almost always, the counterparties in underwriting and placing are institutional investors, who as experts will be aware of the Commission's concerns. These investors always have the choice not to participate in the offering, if they do not like the terms.

8. Further Convergence of the Regulatory Framework and of Supervisory Practices

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

CFA Institute supports the harmonization of the access to financial markets across EU Member States, as it serves the interests of investors. Therefore, we agree with the Commission's proposal to abolish the discretion for Member States to allow tied agents to operate in their country, making it compulsory for Member States to allow tied agents.

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

Currently, Member States may allow tied agents registered in their territory to handle clients' assets on behalf and under the full responsibility of the investment firm for which they are acting within their territory or, in the case of a cross-border operation, in the territory of a Member State which allows a tied agent to handle clients' money. CFA Institute supports the Commission's proposal not to allow tied agents to hold clients' financial assets in the future, the rationale being that tied agents themselves are not authorized persons, and therefore cannot provide investors with a sufficient level of protection.

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

It is our understanding that, in order to ensure the appropriate and consistent supervision of tied agents across the EU, MiFID foresees that tied agents providing services across border are treated as a branch of the investment firm that they represent in the host Member State, when this investment firm has one or several branches in this host Member State[37]. It would not apply when this investment firm has no branch in the host Member State. It is also our understanding that the Commission proposes to cover this loophole by proposing that tied agents be treated as a branch, independently of whether or not the investment firm operates a branch in the host Member State. We agree with this proposal, as it would enhance the level of investor protection.

CFA Institute strongly believes that investors should have access to sufficient information to be able to assess the risks they are taking. This includes being able to verify if the persons or firms they are dealing with really are tied agents. Therefore, we support the Commission's proposal to foresee (i) the obligation (instead of the option) for the home competent authority of the investment firm appointing tied agents to transmit the identity of tied agents to the host competent authority, and (ii) the obligation (instead of the option) for the host competent authority to publish this information.

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

[37] Article 32 of Directive 2004/39/EC

CFA Institute has no comments in this regard.

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

CFA Institute has long held the view that, within a single jurisdiction, all market participants engaged in similar activities should be held to the same standards and adhere to the same rules, regardless of the domicile, size, business, or exchange listing of a firm. Consequently, we support the introduction of a common regulatory framework for telephone and electronic recording across the EU, which would also enhance the level of investor protection.

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

For the reasons explained above, CFA Institute supports minimum recording requirements for conversations and communications involving (i) the receipt of client orders; (ii) the transmission of orders to entities not subject to the MiFID recording requirement; (iii) the conclusion of a transaction when executing a client order; (iv) the conclusion of a transaction when dealing on own account.

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

CFA Institute has no comments in this regard.

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

CFA Institute has no comments in this regard.

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

Beyond the general MiFID principle that investment firms are subject to home country authorization, supervision and enforcement, Article 4 of the MiFID Implementing Directive 2006/73/EC allows Member States to impose additional requirements at national level in "exceptional cases to address specific risks to investor protection or to market integrity that are not adequately addressed by MiFID…"[38]. Only France, Ireland and the UK have

[38] "and provided that one of the following conditions is met: (a) the specific risks addressed by the requirements are of particular importance in the circumstances of the market structure of that Member State; (b) the

used this possibility so far, which, in the Commission's view, might be due to the difficulty to fulfill the conditions of Article 4, or to the sufficiently stringent requirements under MiFID.

While the possibility of imposing additional requirements at national level could be considered to increase the level of investor protection, we consider that it has the disadvantage of introducing different requirements across the EU, in contradiction with the objective of a single rulebook across Europe. We also believe that standardized rules across the EU have the additional advantages of (i) being simpler for market participants to understand and apply, and (ii) facilitating the monitoring of their implementation by the competent authorities. The fact that national regulators have made limited use of this possibility also puts in question its relevance and usefulness. As a conclusion, CFA Institute agrees with the Commission's proposal to delete Article 4 of the MiFID Implementing Directive.

We also support the introduction of an ongoing obligation for Member States to notify to the Commission any addition or modification in the text of the national provisions in the field covered by MiFID, instead of only the first adoption of these national provisions. This is necessary to ensure an overview at EU level of how MiFID is translated at national level.

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

CFA Institute believes that, in the same manner as standardized rules should apply all across Europe to ensure a level playing field for all markets participants, standardized sanctions should be enforced in case of infringements of these rules. In addition to being detrimental to investor protection, the absence of standardized sanctions in the EU as well as discrepancies in their application creates the risk of regulatory arbitrage. This should therefore be swiftly addressed.

CFA Institute therefore agrees that, while the sanctioning authority rests with national regulators, the existing provisions on administrative sanctions should be specified, and supports the Commission's proposal that:

- appropriate administrative measures should have at least the effect of putting an end to a breach of the provisions of the national measures implementing MiFID and/or eliminating its effect, and should at least include: injunctions to put an end to an infringement, temporary prohibition of an activity, suspension or replacement of members of the management or supervisory bodies or of the bodies as such, and the possibility of issuing public notices on the website of competent authorities;
- appropriate administrative sanctions should mean decisions which have the effect of acting as a deterrent against the breach of the provisions of the national

requirement addresses risks or issues that emerge or become evident after the date of application of this Directive and that are not otherwise regulated by or under Community measures".

measures implementing MiFID, in particular administrative fines and periodic penalty payments;

- a sufficient minimum amount for administrative fines would be established and, where a maximum level of sanctions is provided for in legislation, it would be sufficiently high to guarantee deterrence.

CFA Institute would recommend the Commission and Member States to consider the "enforceable undertakings" used by the Australian Securities and Investments Commission[39], the Dubai International Financial Centre and others, as their most flexible and effective remedies to improve and enforce compliance with law. Enforceable undertakings are administrative settlements that can be accepted as an alternative to court action or certain other administrative sanctions, and which have the advantages of (i) producing a swift result that compensates persons who have suffered loss or damage as a result of the contravention of the law, (ii) restricting the activities of the entity in breach of the law and compelling it to implement improved compliance arrangements, (iii) being a cost-effective alternative to litigation. All this would improve investor protection.

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

We have no further comments beyond those cited in the previous question.

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

The reporting of violations of MiFID rules by market professionals is the frontline resource in the fight for an effective implementation of a harmonized single rulebook at EU level, which would enhance investor protection. As experts in the markets who are exposed to the daily flow of business, they are better placed than supervisors to detect compliance issues. Hence, we support the introduction of whistle-blowing programs to create incentives to report or tip off infringements to the competent authorities and to protect persons who provide such information – including more lenient sanctioning of the person involved in the violation.

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

CFA Institute agrees with the Commission's proposal that the competent authority be obliged to publish (at least on its website) every measure/sanction imposed for

[39] http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/EU_guide.pdf/$file/EU_guide.pdf

infringement of MiFID provisions. This would indeed contribute to the enhancement of investor protection, because:

- this would increase the awareness of investors towards a market participant in breach of MiFID provisions and as such not providing the highest level of investor protection, and would allow them to make an informed decision on whether they should conduct business with this market participant;
- the publication of an infringement to MiFID provisions could significantly damage the reputation of a market participant and would therefore act as a deterrent, which would limit the number and/or extent of the violations and as a result ensure a higher level of investor protection.

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

CFA Institute does not have comments in regards to questions 138, 139 and 140

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

No comment.

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

No comment.

141.

We note question 141 is left blank in the Consultation. It has been left in our response for consistency with the ordering of the questions in the Consultation.

9. Reinforcement of Supervisory Powers in Key Areas

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

While CFA Institute appreciates the desire of the Commission to protect the investor and the orderly functioning, integrity and stability of the financial markets, it does not support its proposal to give an unilateral power to the Commission or the Member States to ban the provision of certain investment services and the carrying out of investment activities in certain financial instruments. We believe that the advantage of such bans would be outweighed by the fact that these bans (or the possibility of such bans, which would be reflected in the markets) could also adversely disrupt the functioning of the markets and therefore become part of the problem.

143. For example, could trading in OTC derivatives which competent authorities determine should be cleared on systemic risk grounds, but which no CCP offers to clear, be banned pending a CCP offering clearing in the instrument? Please explain the reasons for your views.

For the reasons stated above, CFA Institute does not support this proposal.

144. Are there other specific products which could face greater regulatory scrutiny? Please explain the reasons for your views.

CFA Institute does not have comments in regards to question 144.

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

CFA Institute does not believe that hard position limits are an appropriate or effective tool for managing derivative positions.

Hard position limits are somewhat blunt because they do not take account of the complexities and interconnectedness between various financial instruments and their underlying instruments. Accordingly, hard position limits can potentially distort price discovery across interconnected instruments and markets.

Furthermore, hard position limits would be difficult to calculate across both exchange and OTC markets because exchange markets tend to use multilateral netting, whereas OTC markets are bilateral and, as such, positions are calculated gross. Additionally, hard position limits would be difficult to calibrate; some customers may use the derivative to hedge an underlying exposure, whereas other customers may be seeking to hedge exposures to other correlated instruments.

Any use of position limits would at least need to be calibrated to take into account the ratio of the position to total market size or open interest.

Moreover, a better approach to position limits would be to focus on exposures. Such an exposure management regime would, for example, be based on the size of the derivative's delta (i.e. the sensitivity of the derivative price to changes in the price of the underlying), and also the price impact per trade. In the case of the former, a very large delta would trigger large margin calls for very small movements in prices.

Accordingly, CFA Institute favours an exposure management approach over the imposition of position limits.

146. What is your opinion of using position limits as an efficient tool for some or all types of derivative contracts in view of any or all of the following objectives: (i) to combat market manipulation; (ii) to reduce systemic risk; (iii) to prevent disorderly markets and developments detrimental to investors; (iv) to safeguard the stability and delivery and settlement arrangements of physical commodity markets. Please explain the reasons for your views.

Please refer to our response to question 145. We have no further comments.

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

Please refer to our response to question 145. We have no further comments.

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

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

Please refer to our response to question 145. We have no further comments.

2nd February 2011.