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European Commission public consultation

Review of the Markets in Financial Instruments Directive (MiFID)

Euroclear / Xtrakter Response

Euroclear is pleased to be given the opportunity to offer its views on the European Commission consultation on the revision of the Markets in Financial Instruments Directive (MiFID), applied since November 2007.

This response is provided on behalf of the Euroclear group[1] and Xtrakter Limited, a Euroclear group company and a leading provider of capital markets data, operational risk management, trade matching and regulatory reporting services to the global securities market. It has an established track record in providing innovative, secure and reliable systems for the financial services sector. Under the Markets in Financial Instruments directive (MiFID), Xtrakter is an Approved Reporting Mechanism (ARM) to the FSA (UK), AMF (France) & AFM (Netherlands). Xtrakter additionally provides Primary Dealers with an onward reporting facility to the National Bank of Belgium (NBB) in accordance with the NBB and Securities Regulation Fund requirements. Xtrakter was established in 1985 and is part of the Euroclear group of companies since April 2009. It has 300 clients located globally, processes in excess of 3m transactions daily and has registered offices in the United Kingdom.

Euroclear is registered on the European Commission's register of interest representatives - ID number 88290282308-75.

[1] Euroclear group comprises the international central securities depository Euroclear Bank, based in Brussels, as well as the national central securities depositories (CSDs) Euroclear Belgium, Euroclear France, Euroclear Nederland, Euroclear UK & Ireland and NCSD, the CSD for Finland and Sweden, as well as London-based Xtrakter and EMXCO.

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KEY POINTS

Euroclear has contributed to the CESR consulations in view of the preparation of their Technical Advices (CESR/10-799 Non-equity Markets Transparency and CESR/10-808 Transaction reporting) to the Commission and would would like to concur with their conclusions.

(i) Definitions

The Euroclear group is agnostic about many of the proposals relating to trading structures, but we have concerns about the lack of precision in some of the proposed definitions of new trading venues which are intended to capture dark pools and high-frequency trading. Some parts of the group could run the risk of indirectly being included in new venue classifications and/or being obliged to comply with onerous client protection measures which are targeted at the trading venues and investment firms. We assume the MiFID review and the new classifications, such as Organised Trading Facility (OTF), is not intended to cover

- Trade matching and regulatory reporting systems, and
- Order routing systems,

both of which do not affect or faciltate price formation nor trade execution.

(ii) Transparency regimes

Our key concerns with this review relate mostly to changes or enhancements to the post-trade transparency regimes and specifically to their extension to non-equity markets. The key messages which we made to the CESR consultation (CESR/10-510) earlier this year are still valid and worth re-emphasising:

1. Any new transparency regime needs to be proportionate and based on a sound economic analysis of the effects of such a regime.
2. Different instruments have different liquidity profiles and will warrant different regulatory approaches to pre-and post-trade transparency. A further differentiation between instruments with a substantial retail market and those which are purely wholesale is also recommended.
3. If regulators want to deliver greater transparency to the markets, they should, where possible, leverage on existing solutions.

Euroclear is of the opinion that the current transaction reporting requirements suffice to enable supervisors to monitor the activities of investment firms, to ensure compliance with MiFID and to monitor for abuses under the Market Abuse Directive (MAD). Although further clarification is desirable on the extend of the suggested modifications to the transaction reporting obligations, we would express caution for an eventual extension of these requirements to firms that receive and transmit or otherwise handle orders but which are not executing transactions, since this is likely to lead to double reporting.

(iii) Access Rights

Euroclear wants to highlight its long-standing concern on the implementation of certain articles of MiFID related to access to clearing and settlement facilities. We believe that there are regulatory and other barriers which hinder the delivery of the full benefits of access and interoperability across trading, clearing and settlement

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layers. More specifically MiFID article 34 §2 and 46 could be regarded as part of these regulatory barriers, potentially resulting in level playing field issues.

The aim of MiFID articles 34, 35 and 46 (together with the Access and Interoperability Guideline of the Code of Conduct) was to increase competition both at CCP and CSD level, and to provide investment firms with a choice of settlement location. Euroclear has experienced some difficulties in exercising its access rights which we believe are related to the way MiFID is implemented in some Member States.

Under MiFID Article 46(2) the competent authority of a regulated market cannot oppose the use of a settlement system in another Member State unless this is "demonstrably necessary in order to maintain the orderly functioning of that regulated market". This provision also refers to Article 34(2) of MiFID, under which Member States must require that regulated markets offer their participants the right to designate the settlement system, subject to (i) links/arrangements which are necessary for the efficient and economic settlement of the transaction in question; and (ii) agreement of the responsible authority for the supervision of the regulated market that the technical conditions for settlement are such as to allow "the smooth and orderly functioning of financial markets". In addition, the competent authority's assessment must take into account the oversight/supervision of the settlement system already exercised by the authorities with competence for this system (a form of mutual recognition).

These articles imply that it is the supervisory authority of the Member State on whose territory the regulated market/MTF is located that needs to agree on the assignment of a settlement system in another Member State. We are not convinced that this is the most adequate way to ensure freedom of choice of the settlement location. It would be better if the supervisory authority of the Member State on whose territory the settlement system is located assesses whether the addition of settlement transactions from a regulated market/MTF from another Member State still allows the smooth and orderly functioning of the settlement system.

(iv) Consistency with other Legislation

The issue of Access rights described above is, of course, directly related to the future supervisory structures for (I)CSDs which are being considered in relation to the CSD Regulation. It is our view that in the interest of consistency and coherence (specifically in terms of specific provisions such as those relating to access), the European Commission should take a holistic view across all legislative initiatives affecting post-trade market infrastructures which are being progressed, such as EMIR, the MiFID review and, later this year, also the CSD legislation.

This holistic view is also vital in relation to the suggestion in the Consultation that provision of custody and collateral services might eventually be qualified as 'investment services'. This could potentially lead to the extension of the definition of 'investment firms' to include CSDs, and as such to include them in the field of application of MiFID. We believe that such extension would unduly increase the burden on CSDs without providing a commensurate benefit for their clients, given the activity types they perform do not constitute investment services. Note that CSDs will shortly become subject to the CSD Regulation. It is important that the correct rules are located in the correct piece of legislation and that duplication of regulation should be avoided.

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SPECIFIC COMMENTS

Section 2 DEVELOPMENT OF MARKET STRUCTURES

Q1. What is your opinion on the suggested definition of admission to trading? Please explain the reasons for your views.

Regulatory authorities need to be clear in their definition of the securities which are considered under the directive.

It is appreciated that the instrument considered by MiFID are those admitted on a regulated market and the Commission considers it appropriate to expand this to Multi-lateral Trading Facilities (MTFs) and Organised Trading Facilities (OTFs). We would think it is critically important to articulate more precise venue criteria, and a clearer definition of OTFs specifically (see also Q 2) to avoid expanding the instruments coverage considerably beyond what this review aims to achieve.

Q2. What is your opinion on the introduction of, and suggested requirements for, a broad category of organised trading facility to apply to all organised trading functionalities outside the current range of trading venues recognised by MiFID? Please explain the reasons for your views.

Euroclear appreciates the need to implement a new venue type OTF. We believe greater precision is required in the definition of organised trading facilities (OTFs) to avoid blurring the borders between trading venues (regulated markets, MTFs or OTFs) and other post-trade facilities for transaction/trade reporting, matching or order routing.

We would strongly urge that clear criteria are established to ensure that numerous post-trade reporting mechanisms services are not unintentionally captured as a result of this.

Xtrakter is of the view that the definition of OTF needs to be tightened to ensure that it does not capture genuine OTC business, which the consultation paper indicates should be excluded by definition.

For example, Xtrakter has a database of 600,000 instruments. A large proportion of these are unlisted small MTF issuance that would not ordinarily be classified as MIFID eligible. If the TRAX trade matching and regulatory reporting system were classified as an OTF (or even upgraded to an MTF), then would all these instruments instantly become MIFID eligible securities? We do not believe that this was the intention of the authorities nor in the best interest of the market as a whole.

Looking at the criteria within the consultation it is also unclear whether Approved Publication Arrangement (APA) regimes might also fall into the OTF venue type, depending on the systems/market facilities they provide. We strongly urge the Commission to detail the OTF criteria, to avoid potential confusion as to the types of market facilitators that are captured by such a regime.

Q3. What is your opinion on the proposed definition of an organised trading facility? What should be included and excluded?

The establishment of the venue type OTF appears to be designed to capture dark pools and high-frequency trading facilities and to ensure appropriate oversight from a regulatory perspective. We believe that the criteria need to be quite specific to ensure purely these types of system venues are captured by the amended directive. The language currently used in the current paper could also cover services, such as

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pure order routing and matching services, which are quite different from the trading facilities intended to be captured.

Section 3 PRE- AND POST-TRADE TRANSPARENCY

Q32. What is your opinion about the suggestions for reducing delays in the publication of trade data? Please explain the reasons for your views.

Activity in the equity markets is dominated by efficient automated environments and therefore publication as close to real-time as possible is standard practice. The benefit therefore of the allowance for a maximum delay reduction to a minute appears questionable.

Q37. What is your opinion on the suggested modification to the MiFID framework directive in terms of scope of instruments and content of overarching transparency requirements? Please explain the reasons for your views.

We understand the regulators believe the markets overall will benefit from greater transparency, but this transparency should be delivered in a way which has no negative or unintended consequences for the markets.

Euroclear would like to re-emphasise the points it raised in its response[2] to CESR in its consultation on non-equity markets transparency (CESR/10-510). Any new transparency regime needs to be proportionate and based on a sound economic analysis of the effects of such a regime. Different instruments have different liquidity profiles and will warrant different regulatory approaches to pre-and post-trade transparency. Non-equity markets and equity markets have specific characteristics and as such require a completely different approach to ensure Europe continues to provide efficient competitive capital markets.

A further differentiation between instruments with a substantial retail market and those which are purely wholesale is also recommended This is in the interest of regulators, issuers, trader communities and end-investors alike. Unrealistic requirements will potentially damage liquidity and the ability to obtain competitive prices.

Q39. 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.

We would emphasise that the CESR feedback from its consultation[3] on MiFID found no need for pre-trade transparency in respect of the OTC markets. Feedback from our industry participants concurs with the CESR recommendations in this regard.

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[2] Our Response dd. 4 June 2010 can be found on www.euroclear.com – link

[3] CESR Technical Advice to the European Commission in the Context of the MiFID Review: Non-equity Markets Transparency (Ref.: CESR/10-799)

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Q40. 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.

Euroclear agrees that the post-trade transparency obligations must be calibrated by instrument type to avoid damaging the respective market.

Xtrakter has provided the European Commission with trading data for 2009 which highlights the level of trading activity within various segments of the capital market. The information highlights the importance of an appropriately calibrated approach. For instance, instruments such as structured products and asset backed securities are extremely illiquid. If regulatory authorities were to impose post-trade transparency for such instruments, an appropriate delay (e.g., until the end of settlement cycle, i.e. T+3) would need to be considered for such instruments to avoid damaging liquidity.

Q41. What is your opinion about factoring in another measure besides transaction size to account for liquidity? What is your opinion about whether a specific additional factor (e.g. issuance size, frequency of trading) could be considered for determining when the regime or a threshold applies? Please justify.

We believe that issuance size is largely irrelevant in judging the liquidity of an instrument in the secondary markets and calibration based on this metric will add complexity to the reporting process with no added value gained by the regulator.

The data provided to the European Commission highlights that numerous instruments trade infrequently and similarly even those that appear to trade on a frequent basis for a period can soon become in-active. It is therefore difficult to consider how an approach could be considered from both a transaction size and frequency basis when attempting to establish liquidity thresholds or measures.

Section 4. DATA CONSOLIDATION

Q43. What is your opinion of the suggestions regarding reporting to be through approved publication arrangements (APAs)? Please explain the reasons for your views.

We believe that reporting through APAs is the logical route for trades not executed on an exchange or on an RM or MTF without APA status. It would ensure that the burden of responsibility for the correct collection and dissemination of the data is borne by a third party rather than the regulator.

Q44. What is your opinion of the criteria identified for an APA to be approved by competent authorities? Please explain the reasons for your views.

The APA conditions outlined generally appear appropriate**,.** However, the text indicates that a harminised approach across asset classes is desirable; this would mean that this APA regime would also cover non-equity markets. As a consequence, some conditions might need to be reconsidered since they may not be suitable for all markets. For instance, the identification of erroneous trades by undertaking checks to spot errors (e.g. in prices) may be less obvious in illiquid non-equity markets than in the liquid equity markets (also see Q46).

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Q45. What is your opinion of the suggestions for improving the quality and format of post trade reports? Please explain the reasons for your views.

Euroclear agrees that the standardisation of trade reports would aid the timely and accurate dissemination of clear and comparable trade reports in all markets. Improving the regulatory hurdles for APA designation will help to ensure the quality and integrity of trade reporting data is maintained.

Q46. What is your opinion about applying these suggestions to non-equity markets? Please explain the reasons for your views.
As mentioned earlier in this response, the diversity of instruments in non-equity markets and the desire to retain liquidity in these instruments give rise to specific challenges. We endorse the calibrated approach as proposed by CESR, but have no specific views to offer on the exact calibrations.

As mentioned above in Q44, the lack of homogeneity also affects the ability of operators to identify erroneous trades in illiquid markets. A complete accurate assessment of market prices in non-equity markets will not be practicable in all instances. Therefore, the requirement to identify erroneous trade reports should not apply across non-equity and equity markets.

While discussions with regulatory authorities show they believe a harmonised approach of APA regimes across asset classes is a sensible , we believe this must be fitting and proportionate to the markets they intend to cover,

Q51. What is your opinion of the suggestion for the introduction of a European Consolidated Tape for post-trade transparency?

In line with our views that post-trade transparency regimes should be differentiated by instrument type and developed by leveraging on existing solutions, we also believe that solutions for a European Consolidated Tape should be developed by building on market-led solutions offered by competing commercial providers.

Section 6. TRANSACTION REPORTING

Q67. 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.

Euroclear would reiterate the concern that the criteria around the OTF must be tightened to ensure OTC bi-lateral activity is not considered as discussed earlier within OTF section (cf. Q1). If a post-trade system such as Xtrakter's TRAX system was unintentionally captured, this could potentially dramatically increase the instruments which would be considered under the directive. This would include significant Global (non-EU) issuance which is not believed to be the regulators intention.

Q70. 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.

Euroclear would point out that the commodity markets vary again from the derivatives which required the implementation of Alternative Instruments Identifier (Aii). Given the considerable experience gained in the regulatory reporting space, we believe the Commission needs to consider all the standards of information required

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from a reporting perspective before implementing such a requirement. It is understood that underlying securities do not even have ISIN codes. Such issues need to be considered by the authorities before creating reporting obligation in such instruments.

Q76. How do you consider that the use of client identifiers may best be further harmonised? Please explain the reasons for your views.

CESR has recognised the complexities and impracticalities of establishing a European client/counterparty identifier. This difficulty also arises at a local level and the industry is extremely concerned about the overall benefit. It is very difficult to establish a unique standard per jurisdiction and it is felt that beyond the use of the BIC – if one is available – the use of a firm's unique internal identifier should be accepted. If such unique local identifiers cannot be cannot be used, the regulatory authorities would need to consider establishing an industry-acceptable standard.

Q77. 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 industry believe the reporting requirement is currently sufficiently outlined with the requirement for market and client side reporting. Requiring receipt and transmission would only complicate the reporting undertaken today and potentially confuse the information provided to regulators for their detection of potential market abuse.

Q78. What is your opinion on the introduction of a separate trader ID? Please explain the reasons for your views.

The industry would question the need requiring the specific trader ID. This clearly can be provided in the event of a specific query or concern being raised by a Competent Authority (CA) for potential market abuse. The industry believes that providing this for every submission provides no additional value to CAs however adds considerable complexity to the transaction reporting space.

Q79. What is your opinion on introducing implementing acts on a common European transaction reporting format and content? Please explain the reasons for your views.

The industry would be fully supportive of a harmonised reporting requirement across the EU. This would ensure the complexities are removed for firms undertaking cross boarder activity and which operate in multiple jurisdictions.

Q80. 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.

As an ARM, Xtrakter is aware that reducing the complexity of the transaction reporting process is of inherent value to the industry in terms of data quality and overall cost. Harmonisation of reporting requirements across the EU is the pre-requisite to have a single mechanism. Client firms generally question the practicability and feasibility of the build, testing and implementation of such a system.

ARMs, such as Xtrakter, have a longstanding record as collector and provider of information to the non-equity markets offering services to both wholesale and retail

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markets. If regulators want to deliver greater transparency to the markets, they should, where possible, leverage on existing solutions.

We would emphasise the desirability of arriving at market-led solutions where possible, utilising reliable and cost-effective mechanisms which already exist (such as the service provided by Xtrakter both to wholesale and retail markets) since this will help firms keep the costs of compliance to a minimum. These post-trade market infrastructures have proven to be very resilient in times of market turmoil and played an important role for the stability and efficiency of the financial sector, and the solutions offered by these infrastructures have implications for the financial markets and the economy as a whole.

Q81. 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.

The provisions relating to ARM designation are designed to ensure the greatest level of data quality and security for clients firms and regulators, as well reliability and stability of service provisions. Xtrakter believes that third parties undertaking reporting activities should be approved for the reasons described above.

Xtrakter would like to question the suggestion in section 6.3 b that a reporting mechanism should be subject to similar sanctions as investment firms. It should be duly noted that the majority of reporting mechanism are not trading institutions with the same level of revenue streams and capital resources gained from the trading activity associated with the transaction being reported. Nor are they providing investment services to the public.

We are very concerned that the imposition of similar sanctions on reporting mechanisms could have unintended impacts upon the cost of reporting for the market. In addition, the consequences of an error in post trade reporting are arguably very different from an error at the level of the actual price formation and execution processes themselves.

In the event sanctions are deemed appropriate by authorities we would therefore emphasise that they should be proportionate to the risks of the reporting mechanism and its structure.

Q 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.

If CAs are able to collect transaction reports from trade repositories in a timely and efficient manner and that the mechanism is approved under the ARM regime, such an approach could eventually reduce the burden upon the reporting firms. From a risk perspective though, managing all of a firm's reporting centrally appears to valuable, and also consistent with regulators' concerns that the firms themselves monitor the accuracy of their reporting. In this regard it should continue to be acceptable for a firm to freely elect the mechanism it chooses as its reporting solution.

Q. 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.

To ensure industry standards and the sharing of information across all regulatory authorities, we believe that a trade repository would require approval under the ARM regime.

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Section 7. INVESTOR PROTECTION AND PROVISION OF INVESTOR SERVICES

Q. 95 – 100.

Section 7.2.3 outlines a number of obligations that are placed on intermediaries (e.g. Q93. provide clients about any relevant modifications in the situation of the financial instruments pertaining to them, and, in Q 99 applying the information and reporting requirements concerning complex products also to the relationship with eligible counterparties).

We believe that these obligations should not apply to intermediaries such as Central Securities Depositaries (CSDs), order routing and matching services which cannot influence the decision of an investor to engage in a specific transaction.

Section 7.2.5. touches on the assumption that, in relation to the products and services for which a client is classified as a professional, he/she has the necessary level of experience and knowledge. Q104 through 106 seek our views about the client classification regimes. Euroclear agrees with the considerations of CESR set out in its Technical Advice to the European Commission in the context of the MiFID Review – Client Categorisation (CESR/10-1040) of October 2010. We believe that the current tiered approach to client categorisation provides adequate and appropriate levels of investor protection to the three categories. We therefore see no need to limit the availability of the ECP regime in certain circumstances, nor to impose suitability or appropriateness assessments on professional clients.

One should also take into account that every professional client is already allowed to request non-professional treatment. It is thus the responsibility of the client, considered to be a professional client, to ask for a higher level of protection when it deems it is unable to properly assess or manage the risks involved.

Q114-117

Finally, while we understand the Commission's concerns regarding the internal control functions, overly prescriptive rules should be avoided. The handling of client complaints is important but the added value of an additional compliance check can be questioned. This check could be performed by Internal Audit, for instance. The same logic applies to the involvement of the compliance function in the product approval process. This will not only increase the workload of compliance teams, but also require specific expertise regarding the product approval process. It is uncertain that such costly investments, which would ultimately be borne by the investor, would lead to an equivalent increase in investor protection.

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