LEBA WMBA

Wholesale Market Brokers' Association and London Energy Brokers' Association

Response to European Commission on MiFID2 Consultation

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V. Annex to reference materials:

a. The Function of an Organised Trading Facility
http://www.wmba.org.uk/execution_policy/function-of-an-otf.pdf

b. The Importance of the OTC markets
http://www.wmba.org.uk/execution_policy/importance-of-otc-markets.pdf

c. What is an IDB and what value do they add to the market infrastructure
http://www.wmba.org.uk/execution_policy/role_of_name_passing_broker.doc)

d. MTFs and Electronic Matching Operated by WMBA and LEBA members
http://www.wmba.org.uk/execution_policy/mtfs.pdf

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I. Wholesale Market Brokers' Association & London Energy Brokers' Association

The Wholesale Market Brokers' Association (WMBA) and the London Energy Brokers' Association (LEBA) are the European Industry Associations for the wholesale intermediation of Over-the-Counter (OTC) markets in financial, energy, commodity and emissions markets and their traded derivatives. Our members are Limited Activity firms that act solely as intermediaries in the said wholesale financial markets. As IDBs, the WMBA members' principal client base is made up of global banks and primary dealers. The replies below to the questions in the paper should be seen in the context of WMBA members acting exclusively as intermediaries, and not as own account traders. (Please see www.wmba.org.uk and www.leba.org.uk for information about the associations, its members and products.) For this reason some of the questions in the Consultation Paper are not entirely relevant to WMBA members' activities even though they are to most of their clients. Further, some answers take into account industry views and experience.

Operating as the hub of the global financial market infrastructure, Interdealer Brokers (IDBs) are MiFID compliant and highly regulated intermediaries by virtue of their regulatory authorisation and from being subject to supervision under CAD as Limited Activity firms. Our members are neutral, independent, and multi-lateral and provide free, fair and open access to their trading venues for all suitably authorised and regulated market participants. IDBs do not take positions in the markets they operate and their collective service as the gateway to the global financial marketplace creates price discovery and significant liquidity. All transactions, whether executed via voice, hybrid or fully electronic means, are immediately captured at the point of trade, are subject to straight-through-processing, and are made available for transparent and timely transaction reporting to the relevant regulators.

II Preface

The solution to current problems in financial markets does not lie in attempting to mandate the transfer of OTC trading onto either RMs or MTFs, since the very functionality of many OTC and derivatives markets require them to continue to trade, separate to and in conjunction with, such designated contract markets for many reasons. OTC markets are both larger in scale than RM and MTF markets and a vital risk management tool. As such, their use benefits governments, corporations, investors and individuals worldwide. An "exchange" solution needlessly grants a monopoly on trade execution (which is usually accompanied by restricted access to clearing) which thereby leads to increased trading costs with commensurately increased risk and diminished flexibility. By creating the broad category of Organised Trade Facility (OTF) and codifying these large, widely used and flexible OTC markets, the MiFID review should be able to bring almost all bilateral OTC trades inside the scope of a prudential and proportionate regulated environment. Critical to this is the regime of client categorisation since the array of products is unlimited, yet the population of participants is small, authorised and often global in extent.

Therefore, this categorisation allows the retail facing aspects and definitions of MiFID to be reapplied via participant rather than product, and with reference to the wholesale and professional nature of the transactions.

The IDB community facilitates fast and fully automated affirmation/confirmation of all OTC and derivatives trades. This affirmation and confirmation of all trades in all markets needs to be accelerated as close as possible to the trade date. The OTC market has already invested significantly in developing its infrastructure in pre-trade, electronic matching, affirmation and confirmation segments. This infrastructure already contributes hugely to reducing risk and will be continuously enhanced for the benefit of all. The infrastructure developments pioneered by the IDB community will foster quicker settlement cycles in all securities and derivative markets.

The IDBs are at the forefront of the wider adoption of electronic trading. However, we reiterated that voice initiated matching has nearly identical price transparency to electronic matching. Specifically, voice execution similarly enables simple and fast trade capture, including equivalent affirmation, confirmation and supervision of trading activity. It is imperative for the OTF framework to foster the wholesale gathering and building of liquidity through flexible means of execution including voice, hybrid and electronic.

III Key summary points

Introduction

- As a general point, the Commission proposals have closely followed the CESR technical advice (a series of reports that WMBA/LEBA (together defined for the purposes of this response as "the WMBA") made a great effort to cooperate with and inform). However, in those cases where the suggestions have in effect gone further, or away from the CESR advice, we would foresee them resulting in lower liquidity, higher costs for end users and therefore higher systemic risks and other adverse consequences for market utility.

- The characteristics of equity markets are significantly different to the interest rate, credit, money market, foreign exchange, and commodity markets and their derivatives. The Consultation Paper presented has failed to grasp the concept that the requirements for investor protection in the wholesale markets are fundamentally different to that required for retail business and accordingly should be treated distinctively due to the professional nature of the participants. The proposals the Consultation seeks to adopt are, incorrectly, a one-size-fits-all scenario whereas in practice there are clearly distinct, multiple market segments within the wholesale and retail spheres; cash and derivatives products; and the vast universe of investment products and non-investment-products.

- The WMBA request that the Commission confirms that any existing exemptions set out in Articles 19, 21 and 22(1) of MiFID are retained in any new amending legislation.

Developments in Market Structures

- The product-centric definition of 'admission to trading' is inappropriate to import to the OTC environment where most products are bespoke, and the WMBA recommend that defining a market by its regulated participating counterparties who are constant, relatively few in number, and global in scope would be more suitable.

- We support the creation of the '***Organised Trading Facility'*** category, and we are in broad agreement with the definition laid down in the Consultation Paper.

- The current definition of Investment Service under Annex 1, Section A of MiFID is sufficient to capture the operation of OTFs without amendment.

- Mandating a conversion from an OTF to an MTF is unnecessary, counter-productive and ignores the fundamental logic behind the creation of the OTF.

Pre- and Post-Trade Transparency

- IDBs provide pre-trade transparency as widely as possible in the normal course of our business as intermediaries with the intention and effect of enhancing liquidity. Whilst we support codifying the current practices, we consider the definition and mandating of pre-trade transparency for OTFs to be materially damaging to market efficiency by hampering price discovery and discouraging liquidity formation.

- The degree of post-trade transparency required to be made available publicly by trade venues must ensure market integrity, but it remains critical that it is proportionate to preserving and enhancing market liquidity. Immediate post-trade transparency provided to the regulatory community for supervisory purposes is endorsed fully by the WMBA.

Transaction Reporting and Investor Protection

- The WMBA supports the opinion that trade reports and transaction reporting be brought together under the same governance and protocols.

- In the wholesale markets, the "execution-only" regime should be preserved for all participants on the basis that the knowledge and experience of clients is currently adequately covered by the client classification regime

- The WMBA considers that any requirement for an IDB to inform professional or eligible counterparty clients on Complex Products to be one of those "unintended consequences" of which the market keeps warning

- The WMBA members have considerable experience in dealing with Local Authorities and Municipalities and do not support the proposal to reclassify these entities as retail for the legal, commercial and logistic reasons detailed in the body of the response.

- "Matched Principal" broking is an established method of intermediation that seeks and enhances market liquidity in OTC derivatives. We understand that the Commission seeks to maintain this, therefore a distinction needs to be made within the definition of own account dealing between market makers who internalise client order flows and IDBs who merely arrange trades by acting as a counterpart to both sides of a trade or act as agent.

- The WMBA is concerned that the abolition of the "execution-only" regime for professional clients could severely restrict their ability to access brokers MTFs.

Data Consolidation

- The WMBA is broadly in support of improving the consistency and quality of post-trade data made available to investors and market participants. In fact, our member firms are very active in the non-discriminatory provision of this information via our commercial data businesses. It is important however to point out some crucial requirements for success in this area:

  - As with execution venues, competition is key to a solution which provides for best pricing to consumers.
  - Any attempt to develop a consolidated approach to data collection/provision must be based on accepted and approved industry standard formats to ensure consistency across APAs and data contributors.
  - It is extremely important that the introduction of APAs does not impact efficiency, increase costs, or increase the risk of "double reporting" of trades.

Regulatory Framework and Supervisory Powers

- The WMBA is strongly against competent authorities having the power to ban an OTC product which is eligible for CCP clearing but is not actually cleared by a CCP. Indeed, our members are firmly of the opinion that any reaction by the authorities that would seek to 'ban' trading in a product would be impossible to implement. Regardless, uncleared trades executed via an OTF could be delivered to Trade Repositories for analysis by prudential authorities.

- The more concise and designated the terms used to define a derivatives market, the more prone and vulnerable that market becomes to market manipulation and regulatory avoidance. As such, there is no justifiable logic supporting the imposition of position limits, whether the underlying transactions are executed OTC or via an exchange. We agree with the Commission's viewpoint that position management, would be dealt with more effectively via the Capital Requirements Directive and employing the Tier I and Tier II metrics reviewed recently by the Basle Committee on Banking Supervision, and these should be employed to monitor and reduce systemic risk.

- The WMBA members match counterparties who are global in nature and who operate continuously around all time zones. In creating an OTF, it is implicit that suitable access should be granted to global entities that have a common approach to market regulation. Any "strict equivalence approach" would decimate liquidity and be likely to result in the physical relocation of market infrastructures.

IV Answers to Consultation

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

The WMBA considers that the suggested definition of 'admission to trading' is inflexible by virtue of its product-centric standpoint. Contrary to this, we note the opening sentence of paragraph 2.2 of the Consultation that "*MiFID is not prescriptive about where trades must be executed and provides flexibility and a choice for investors about where and how they wish to execute trades*". Whilst equity markets have a single product and RMs list relatively few products compared to the number of participating counterparties, the derivatives markets are characterised by fewer major participants but an infinite variety of products. Indeed, OTC fixed income markets for investment products are also characterised by a multitude of products relative to the number of participants and these products are often very rarely traded in the secondary markets.

The definition centres on the concept of 'allowing' a financial instrument to be traded, 'on its systems', which implies that a financial instrument is traded <u>on</u> a system (for example, an exchange lookalike) rather than <u>through</u> a system and may not necessarily accurately capture the non-discriminatory, impartial and open access gateways which have globally evolved to enable the best practice execution method per OTC product (which may often involve broker discretion and may be effectively an electronically referenced voice generated price).

This implies that an IDB will have to have some formalised procedures for 'allowing' financial instruments to be traded on its systems, maintain lists of instruments allowed and make them public. This should not prove difficult in their operation of MTFs as they should already have this hard wired into their trading procedures as products traded. However, for all execution methods employed by IDBs it is the wholesale participants that are formalised and the products are described by these clients.

Therefore to begin the enlargement process of the initial MiFID by adopting a product centric definition may only serve to obfuscate and create unintended consequences. The WMBA believe that it would serve the intentions of the legislation better to define the participants who are admitted to trading under MiFID categorisation rather than failing to attempt to capture portions of an almost infinite spectrum of products.

Moreover, the concept of a "Market Operator/Investment Firm" who may be in control of the RM, MTF or OTF is misleading in the context of bilateral trades which are 'arranged' by an IDB, where effectively it is the counterparties who are defining these terms.

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Therefore, either a separate or bespoke review of the listed equities MiFID regime would be more appropriate. Consequently, the jurisdiction of derivatives under MiFID2 needs to be defined in terms of the market participants.

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.

The welcome addition of the organised trading facility category is vital as this regulatory status will capture the vast majority of voice and voice/electronic hybrid executed OTC product transactions that are not transacted on RMs or MTFs. It is reasonable for competent authorities, and in turn ESMA, to be notified of the scope of products offered by the facility operator to ensure that the authorities will be aware of all sources and types of post-trade data so as to maximise the range of transactions which can be included into post-trade systemic risk analysis schemes. Further, it is already standard business practice amongst the WMBA members to have facility execution rules, conflict resolution and escalation principles, market abuse avoidance practices and system disruption procedures. Therefore, to formally apply these criteria to the authorised operation of an OTF will not be disruptive or burdensome to the WMBA members or participants.

However, it needs to be highlighted that in the WMBA members' capacity as Limited Activity operators, IDBs do not engage in matching bids and offers by means of principal position taking. Therefore, it is dangerous to aggregate these OTF activities with SIs and similar single bank platforms where the capital treatment of the operator falls into an entirely different regulatory category.

As the range of financial instruments extant in the financial sphere is fluid over time, the notification process from the OTF operator to the competent authority should be continuously open to incorporate immediately the introduction, adoption and monitoring of additional products as innovation may allow and as customers may require.

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

The WMBA is in agreement with the definition of an OTF as laid down in paragraph 2.2 of the Consultation Paper.

In particular, the WMBA urges the Commission to request the insertion of the language contained in the Consultation Paper: '*and interdealer broker systems bringing together third-party interests and orders by way of voice and/or voice/electronic execution*' in the final document. This would avoid any potential for confusion with other OTFs not acting in an intermediary capacity.

The WMBA feels that it would be helpful to define an 'interdealer broker', perhaps in a footnote or appendix, to make it clear that they operate exclusively as intermediaries in their capacity as Limited Activity firms, or firms acting on a Limited Activity basis. It further believes that it would be important to differentiate between OTFs to identify

those that are used by firms that may be engaged in proprietary trading, such as single bank platforms. This would enhance the ability of regulators to monitor systemic risks.

The WMBA is in broad agreement with the requirements for OTFs (2.2.1 a) to h)) but urges that these should be supervised within the existing requirements for firms regulated on a Limited Activity basis.

The WMBA believes that the definition of an OTF should be restricted to facilities and systems operated by firms regulated by a Competent Authority and which are notifiable to ESMA.

On a more general point, the WMBA feel that MiFID as currently drafted is orientated too much towards equity markets in terms of the desired impact of the Directive. It does not adequately take into account either the nature of non-equity products or the different requirements of retail and wholesale markets. It is demonstrable that MiFID, and other regulation, would be more effective if it was focused on regulating financial entities rather than products. Both of these points are made to express the WMBA's concern that implementing MiFID as drafted may have unintended consequences on Europe as a market and specifically on London as its largest financial centre.

Q4: 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?

The current definition of Investment Service under Annex I, Section A of Directive 2004/39/EC is sufficient as it is intended to capture the operation of OTFs on the basis that the Investment Service allows (a) Reception and transmission of orders in relation to one or more financial instruments (b) Execution of orders on behalf of clients and (c) Operation of Multilateral Trading Facilities.

Individually or combined, these three services constitute the operation of an OTF. The passporting rules as they currently apply to activities covered by the existing definition of an Investment Service should therefore, by default, apply to operators of OTFs.

Q5: 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.

The flexibility envisaged by the definition of an OTF, regulated by ESMA and appropriate national authorities, means that regulation mandating a conversion into an MTF appears unnecessary, counter-productive and ignores the fundamental logic behind the creation of the OTF category.

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Similar to the operations of an MTF, the WMBA would assume that authorised firms regulated under the national authorities will be able to operate OTFs, which means that regulatory oversight of such entities should be satisfactory. An OTF would enable voice, hybrid/voice and electronic execution. Therefore, the mandatory conversion of an OTF into an MTF once an OTF has reached an asset specific threshold makes little sense and seems to provide no supervisory benefit. Crucially, the uneven and fluctuating trading volumes of many OTC products will create frequent scenarios where a given product's activity would achieve, dip below, and re-achieve any particular threshold value which would render the management of the OTF/MTF categories a potentially daily event. Further, it is difficult to understand what an asset specific threshold could be, as some OTFs may support a wide range of different asset classes. Even within the same asset classes, instruments are likely to have very different ranges of liquidity and trading volume. The liquidity volumes will often determine a customer's decision whether to trade electronically, by voice or hybrid. The percentage share between these execution methods do change over time and one instrument that is very liquid at one time may not be at another time. This is particularly the case during periods of market stress, when IDB electronic volumes migrate to voice execution due to market volatility and the desire of customers to be protected from adverse market exposure by IDB voice coverage. Accordingly, it would be difficult to determine and maintain such thresholds in all market conditions. Indeed, such unpredictable scenarios could cause some degree of market chaos as the terms of market access became unpredictable.

Finally, requirements to report trades to trade repositories by market participants will provide regulators with sufficient trade transparency for voice trades without the need for any form of mandated conversion of an OTF into an MTF.

For all the reasons set out above, it is impossible to accurately or sensibly calculate a volume threshold for conversion of an OTF into an MTF. As previously explained, trading strategies, market conditions and product characteristics determine the execution form adopted by market participants on a product-by-product basis. Mandating a particular type of execution mode will be counter-productive, cause a reduction in liquidity and could result in a migration of execution outside of the relevant jurisdictions. In any case, this would be contradictory to the spirit of MiFID acknowledged by the Commission as not being prescriptive about where the trades must be executed.

RMs and MTFs are European regulatory definitions under MiFID and under the regulatory auspices of ESMA and relevant national authorities. Accordingly, capping the global activity outside of these entities would not seem possible. The WMBA is not clear on what supervisory, market transparency or systemic risk benefits such a cap would achieve.

Q8: 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.

Our members broadly support the trading of liquid derivatives suitable for intermediated execution to be executed on RMs, MTFs, or OTFs, subject to the final definition of an OTF. However, as is consistent with our approach throughout this Consultation response, we feel that the mandating of derivative execution "exclusively" on these venues is unnecessary and potentially counterproductive.

We would also recommend that any new regulation for execution processes should continue to recognise and, therefore, continue to allow for 'voice' interaction/execution in any definition of a RM, MTF, or OTF. This is important as the interaction of 'voice' broking and 'voice' sales expedites and improves pricing/liquidity provision, which is a requirement for a market to operate efficiently during periods of stress. The WMBA believes that the regulatory solutions intended by the definitions of these venues retain flexibility of execution capability, whilst satisfying the requirements of regulators and the market as a whole.

Q9: Are the above conditions for an organised trading facility appropriate? Please explain the reasons for your views.

The WMBA seeks objectively justifiable criteria for conduct of business on member facilities and generally supports the points I through IV made by Commission as they represent sensible and appropriate conditions for an OTF. Whilst IDBs are able to post-trade report close to real time, we recognise that it is vital that any post-trade transparency and reporting requirements need to be properly calibrated to ensure that they do not impact liquidity provision from market participants.

The WMBA is very concerned that the concept of pre-trade transparency in derivatives markets is exceptionally hard to define and potentially impossible to implement. Derivatives trade infrequently and in blocks. Pricing is not sequential but conditional on many factors, particularly the underlying instrument and the credit of the counterparties. Therefore, orders do not congregate around the market price but rather IDBs broadcast and discover related liquidity pools as transactions are requested and market interest begins to germinate where many market participants only disclose their interest once a transaction begins to be executed.

3. PRE- AND POST-TRADE TRANSPARENCY

3.1. Equity markets

3.1.1. Pre-trade transparency

Q28: 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.

The WMBA reminds the Commission that this rule whilst valid for retail classified clients, should not apply to the wholesale markets and constitutes an example where a tailored regime for professional and eligible clients dealing with one another is preferred.

3.2. Equity-like instruments

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

The WMBA understand the need for wholesale counterparties to utilise flexible and block-oriented execution mechanisms as proportionate to the nature of the business that market participants are seeking to transact. In this regard, we note that the Commission Consultation Paper states that large, in-scale waivers are essential and important in striking the right balance therein.

Therefore, whilst reduced post-trade publication delays may be beneficial in respect of clients executing under the retail categorisation regime, it would be inappropriate to extend the reduction to trade executions for professional clients.

Q33: 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.

An equities-like regime for depositary receipts, exchange traded funds and certificates issued by companies may be appropriate. Any rules regarding timescales applying to transparency must be subject to a liquidity impact analysis on each specific product and size and frequency of trading. It should be noted that the liquidity of these products may be significantly different, including subsets of each.

For example, the FTSE 100 ETF may be entirely appropriate for immediate pre-trade transparency but many more ETF products, such as the MSCI Islamic ETF, would not. By way of illustration, please see attached list of ETFs tradable on the London Stock Exchange to see the huge differential in volumes traded on a multitude of financial instruments http://www.londonstockexchange.com/statistics/specialist-issues/etfs-etps/etf-etp-weekly-070111.pdf. This regime, by virtue of limitations of jurisdictional reach, should only extend to European instruments available for trading on a regulated market.

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Q34: 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 some criteria for the definition of these thresholds for each of the categories of instruments mentioned above?

The WMBA would suggest that ESMA carries out an impact analysis to assess the appropriate levels and calculations relating to the timing of disclosure of pre- and post-trade information on an instrument by instrument basis. As the Commission correctly references in section 3.4.2 of the Consultation Paper "*as non-equity products are very different one from another, the Commission services consider that the exact post-trade transparency regime would need to be defined for each asset classes and in some cases for each type of instrument within this asset classes.*"

The broad elements identified in paragraphs 3.4.2 a), b) and c) cover the key issues that require analysis by ESMA in developing a suitable transparency and waiver regime and are in line with the system of thresholds used for equities that calculates average transaction value and standard market size when applying pre-trade transparency obligations. The WMBA would caution the Commission to ensure that the impact analysis is finalised before the implementation of any rules.

3.4. Non-equity markets

3.4.1. Pre-trade transparency

3.4.2. Post-trade transparency

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.

As mentioned in the introduction, the WMBA would counsel caution in terms of any attempt to retrofit the MiFID principles and regime (*which were designed primarily to address equity markets*) to non-equity markets. As the Consultation Paper notes: "*experience since the implementation of MiFID shows that reporting and publication of data under the MiFID regime is not living up to the expectations set at its inception*". Given the clear additional complexities of non-equity markets, a one-size-fits-all approach is fraught with risk.

Complete and immediate post-trade data delivery is desirable as long as competent authorities determine, allow and monitor the short data delivery delays which should be associated with transactions of the most capital intensive products. The WMBA believes that a post-trade transparency regime based on a sensible threshold system is practical and would be well received by market participants.

In particular, the transaction-based nature as proposed is logical as the information is readily available where regulators and supervisory agencies would benefit from granularity rather than aggregated data.

The WMBA members believe that rather than OTFs, RMs or MTFs being responsible for holding onto post-trade data and then releasing at designated post-trade intervals, execution venues should direct post-trade streams to location(*s*) nominated by competent authorities immediately (or as fast as are practically possible) where delays would be applied by that agency. The WMBA members do not wish to bear the costly onus of monitoring and regulating what may become a series of varying holding periods across a wide number of products.

Whilst the availability of certain market information on a bilateral basis between a dealer and an investor may be "*a function of the willingness of dealers to provide investors with quotes on request"* there are other market participants that actively promote transparency in OTC markets to a wide audience. Market data aggregators/vendors bring together quotes and trade data from the majority of market participants in many OTC instruments and distribute these either on a wholesale basis through data feeds to their customer base or integrated within their data terminal services.

In addition, specific service providers in the OTC space, such as IDBs, supply their customer base with both pre- and post-trade data either directly using electronic systems, dedicated data feeds or via market data aggregators/vendors. This disclosure of liquidity forms part of the service a broker provides to its customers. However, in addition to this, several IDBs provide high quality indicative data to the wider financial community on a commercial basis thus promoting general transparency across all sectors (*i.e. both sell-side and buy-side of the market*). This commercial approach by the IDB data divisions is achieved through substantial ongoing investment in the processes involved in the collation, normalisation, quality assurance and distribution of the underlying data.

Further, as outlined at length above, the nature of transactions within non-equity markets, particularly in the OTC arena, is significantly different to that within the equity markets. Typical lot sizes far exceed those traded on exchange. As a result, the market sensitivity to a particular institution's activity in an instrument is heightened with the release of information on transaction size or value within a certain time period having a disproportionate or asymmetrical effect on the price of the asset. An example of this includes the involvement of central banks in establishing and maintaining liquidity in the government bond markets during the financial crisis through Credit and Quantitative Easing measures. In these and other cases where dealers extend capital to support the operations of their customers continual and uninterrupted liquidity will depend on limiting the short-term exposure to the market of the volumes and prices of certain transactions in order for the volumes to be digested.

The efficiency in the operation of the market during this time therefore requires a degree of delay in the publication of this specific post-trade data. Although an extreme example in terms of the prevailing market conditions at the time, the general functioning of the financial markets depends on the ability of larger liquidity providers to purchase or dispose of large quantities of non-equity instruments OTC without undue or excessive impact on the price of the asset either being bought or sold. Thus the specific attributes of transparency including timing of publication may vary widely from instrument to

instrument with an advisable delay in publication in some asset classes and some specific market conditions.

Finally, a fundamental feature of non-equity markets that may have a significant impact on the ability to achieve "overarching transparency requirements" is the lack of a defined identification schema for OTC instruments. Whilst certain market data vendors apply instrument code methodologies that maintain referential consistency of instrument types within their specific product offerings, there are no mandated or authorised numbering/reference agencies involved in the classification of OTC instrument types. This will therefore impact the identification of the asset in both pre- and post-trade publications, the ability of market participants to consume this information, the ability of aggregators or APAs in consolidating post-trade reporting, and in the creation of a market wide 'tape'. Whilst not insurmountable it is likely that this specific activity would be an integral and inherent part of establishing the transparency regime appropriate to a specific asset class.

The above points demonstrate that simply adapting the current regime may not in itself address the overarching transparency requirements outlined by the Commission. Given the complexity of the instruments involved and the uniquely different characteristics of the various non-equity markets, it may be more prudent to look at each market individually in terms of its particular transparency requirements.

The core of systemic risk management is the post-trade stream of trade details to CCPs and Trade Repositories. WMBA members are in a position to ensure market integrity by transaction reporting to the relevant authorities the very moment transaction reports become reliably available.

Q38: What is your opinion about the precise pre-trade information that regulated markets, MTFs and organised trading facilities 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 explain the reasons for your views.

OTFs diverge from RMs and MTFs in regard to pre-trade transparency as the vast majority of non-equity trades are order driven due to the preponderance of voice and voice/electronic hybrid execution. Aside from the quote driven fixed bid/offer spread primary dealer requirements underlying the European Government Bond market, other derivative, credit, rate, commodity, foreign exchange, forward and cash money market prices are normally provided voluntarily on a single sided basis and then compiled and broadcast by the IDBs. Therefore, pre-trade transparency (usually defined as both a firm bid and a firm offer in minimum amounts posted for a reasonable duration in a widely available manner) is incomplete across the full spectrum of OTC products. Furthermore, since multiple buyers and sellers may elect to join a transaction executing during the broadcast phase, this 'work-up' process may mean that the resulting transaction when fully complete may bear little resemblance to the amounts quoted in the pre-trade phase.

As a result, the notion of fixed pre-trade transparency for all OTF products, while desirable in theory, does not exist for the most part in non-equity markets and certainly has no bearing on trades done between wholesale market participants accessing the IDB community. Imposing a uniform pre-trade transparency regime over the wide universe of diverse and interconnected OTC products will be hugely disruptive, will create distortions, will generate unwanted behaviour, will create conflicts, and will handicap the trade formation process. Indeed, the mandatory holding and publishing of pre-trade indications of interest is massively counterproductive to the smooth matching of orders and could result in a reduction of liquidity as dealers choose to not allocate capital to those markets or jurisdictions where the forced telegraphing of their interests exposes their intentions to the marketplace.

Further, OTC non-equities trading has never been continuous or contingent upon an exchange-like central order book, and these characteristics have never been the cause of market failure. Clearly, the many thousands of non-standardised products changing hands daily has been the engine behind the growth of the IDB community over the past 40 years. The price discovery process engineered by voice IDBs to arrange the identification and matching of multiple buying and selling interests is the essence of the OTC markets. To threaten this process with some vague notion of possible benefit for a small subset of retail oriented participants would be ill-advised, short-sighted and damaging as dealers withdraw liquidity or widen bid/offer spreads.

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.

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.

The WMBA supports the efforts of the EU Commission, and the wider remit of the G20 objectives, to increase post-trade transparency in the OTC derivative markets.

We are pleased that the Consultation Paper recognises that (a) the current Equity model does not and will not fit with other derivatives markets, and (b) that incorrectly implemented transparency measures would lead to the unintended consequence of a loss of liquidity impacting the core function of the financial markets to provide end-user clients with accurate hedging vehicles.

In principal, the WMBA members are in agreement with the transaction based approach but would urge caution in the following areas:

- Given that OTC derivatives are conducted within a wholesale market populated by professional and eligible counterparties who have ready access via a number of channels to the transparency information they require. It is not clearly understood to what end increased public transparency would benefit the operation of these markets. In fact, it could be detrimental to risk mitigation.
- The Commission should not confuse "prompt and precise as possible" with "appropriate" when setting post-trade transparency rules.
- In addition to transaction size, it is imperative that market liquidity be considered when assessing post-trade transparency rules. Information detailing the significant discrepancies in the depth, breadth and frequency of liquidity pools in equity markets versus OTC derivative markets is well documented.

It is the opinion and recommendation of the WMBA members that any extension of the post-trade transparency rules into non-equity products should be assessed on an individual product basis. Further, any new rules should be implemented following a market consultation period similar to that of ESMA's process for the purpose of defining products eligible for clearing.

3.5. Over the counter trading

Q42: Could further identification and flagging of OTC trades be useful? Please explain the reasons.

This question becomes non-applicable to IDBs in the context of this Consultation since by the definitions given, brokers will not be conducting purely bilateral, non-intermediated OTC trades.

We do, however, act as arranger for the vast majority of "name give-up" OTC trades, and these therefore become categorised as OTF.

4. DATA CONSOLIDATION

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

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

In principal, the WMBA support aggregating and publishing homogenous traded data sets between venues. Indeed the IDBs, both as arrangers and executors of trades, send their daily data sets in a variety of instruments for publication as Volume Weighted Averaged Prices (VWAP), end of day prices and windows inside the trading day to create the settlement prices for the floating rate of traded swaps or for clearing house variation

margins. The use of VWAP and windows enables the OTC markets to function throughout the day and across the globe, giving far greater market utility and prudential transparency.

In light of the above, we support approved publication arrangements and note that trade associations may provide the infrastructure to enable this without the compromises involved in third party commercial firms handling proprietary and valuable data sets. We would also concur with market participants that open source data software such as ISDA's Financial Products MarkUp Language (FpML) or EFET's Electronic Exchange Related Processes (eXRP) should be encouraged.

Q46: What is your opinion about applying these suggestions to non-equity markets? Please explain the reasons for your views.

The specific requirement for an APA would potentially assist in the standardisation of post-trade reporting thus introducing consistency, as described above, in extremely disparate instrument types.

There are, however, existing commercially available sources of OTC information which provide a large degree of transparency to the market. In order to ensure that these existing sources continue to be available, it is important that the definition of the APA arrangement (as well as the institutions that qualify for such designation) includes provision for competition between APAs. This will ensure that the inevitable and potentially extensive costs associated with aggregating such information will be minimised through market forces by competition.

4.2 Reducing the cost of Post-Trade Data for Investors

Q47: What is your opinion of the suggestions for reducing the cost of trade data? Please explain the reasons for your views.

The intention of reducing the cost to the end consumer of trade data is an appropriate and laudable objective but there are some key distinctions to the current nature and availability of non-equity market data that contrast strongly with the availability of equity trade data prior to the introduction of MiFID 1. This may affect the simple application of MiFID 1 principles to non-equity instruments.

Firstly, there is not the same degree of concentration of liquidity in trading systems in non-equity asset classes as is prevalent in equity markets especially with the dominance of national stock exchanges. By contrast, the OTC marketplace already includes numerous existing and competing OTFs (subject to their final definition). Taking IDBs as an example, each of these institutions currently makes data widely available to market participants on both the sell-side and the buy-side on a commercial basis in a competitive environment. No single participant in the IDB community commands the market dominance that was enjoyed by equity exchanges. This has the effect of ensuring that data is sold at market value with each of the entities involved being driven by the rigours of competition to ensure their data offering attains a high quality standard with

delivery on a timely and consistent basis at a price point that the market is prepared to pay.

Secondly, the great diversity in the nature, composition and operation of instrument types incorporated within the term "non-equity OTC market" far exceeds that in the equity space. As mentioned above, the inherent complexity and variability in the characteristics of individual OTC instrument types, the lack of standardised numbering and referencing and the widely varying nature of the participants within the available market places for different instruments are a barrier to cost efficiency.

A balance needs to be maintained between the importance of having specific trading regimes for specific asset classes and a generic regime for transparency in pre- and post-trade transparency for all non-equity instruments. To this end it is overly simplistic to generically class all OTC asset classes as "non-equity". The implementation of generic rules or obligations in reporting across these markets may in effect increase the cost of post-trade data as considerable investment will be required to standardise this process. Further, mandating that certain institutions have the right to provide this data to the market will not ensure that these costs are necessarily minimised, unless competition is encouraged.

Q49: In your view, what would constitute a "reasonable" cost for selling or dissemination of data? Please provide the rationale/criteria for such a cost.

As explained in the answer to question 47, "reasonableness" is best determined by the application of free market competition to the availability of information. This ensures that an appropriate level is set for the data that is acceptable to the market.

Q50: What is your opinion about applying any of these suggestions to non-equity markets? Please explain the reasons for your views.

As outlined above, there are some significant differences in non-equity markets as opposed to equity markets that will impact the ability to achieve "*overarching transparency*", certainly in a cost effective manner as is required. In particular:

1. the lack of consistent numbering/referencing schema for non-equity instruments and

2. the negative impact of transparency on size and time of a trade on the trading efficiency and liquidity of certain asset classes.

It is likely that following a review of the appropriate "*transparency regimes*" as many regimes as asset classes, even instruments, would be required. The concern would be that this creates highly costly, onerous and involved reporting rules that will significantly impact existing participants. The unintended effect may well be an increased fragmentation of data types, and hence reporting, which in effect makes such data harder and more costly to produce and consume.

4.3. A European Consolidated tape

Q58: Do you have any views on a consolidated tape for pre-trade transparency data?

Given the sometimes unique nature of OTC trades including the limited number of participants, it is likely that pre-trade transparency would seriously impact liquidity in certain non-equity instruments. We would repeat our comments set out in response to question 59 below.

Q59: What is your opinion about the introduction of a consolidated tape for non-equity trades? Please explain the reasons for your views.

We are concerned that any attempt to introduce a consolidated tape for non-equity trades will present such complex structural problems that the costs of introducing such a tape will far outweigh any perceived benefits that might accrue.

To this end, we feel strongly that the process of compilation of a consolidated tape should be subject to commercial competition, that is to say that Option A should be avoided.

As outlined above the requirement for standardised numbering or referencing of non-equity instruments would make the consolidation of post-trade reports for non-equity asset classes very difficult. In addition, if the Commission accepts that in order to maintain market efficiency certain asset classes will only be reported after differing time periods it would either require that the consolidated tape for non-equity trades took place after the end of the longest 'delay' period, or that consolidated tapes were separate for each asset class with a similar transparency regime.

Given the unique nature of many OTC trades in conjunction with the limited number of participants, it is likely that pre-trade transparency would seriously impact liquidity in these instruments.

5. MEASURES SPECIFIC TO COMMODITY DERIVATIVE MARKETS

5.1. Specific requirements for commodity derivative exchanges

Q60: 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.

The WMBA support the adoption of a harmonised approach towards position information and the importance of regulators obtaining "*a comprehensive and objective picture of the activities of different types of traders*".

We note the inconsistent usage of the term "exchanges" in the title of 5.1 with the reference to Organised Trading Venues (OTV) in question 60. We understand that CESR

has recommended that the term OTV is to be encouraged to include the broad subset of RM, MTF & OTF and the WMBA would encourage the Commission to adopt this classification across the piece in order to avoid confusion.

It is evident, however, that whilst all OTVs are able to inform regulators of price and volume flows, none of the venues hold any information on the underlying positions of either the counterparties transacting, or of the underlying clients who are instructing the counterparties. We would recommend the more widespread use of Trade Repositories with global scale to allow the prudential supervision of risk. It should be noted here that without transposing raw position information into basic factor risks such as "*Value at Risk*" which are fungible and commutable, then trade flows themselves will reveal little about underlying systemic risks. Therefore, in our opinion the regulatory "objectives" behind the obligations suggested need to be set out in more detail.

Q61: 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.

The long experience of the WMBA members of arranging and intermediating the vast majority of trades in all derivative types draws us to the inescapable conclusion that any categorisation of either trades or trading entities can only lead to ill-defined definitions, meaningless categorisations, poor quality data sets and therefore at best only very confusing outcomes.

Trades are executed for a number of reasons, all of which redirect risk to a more efficient portfolio set, the complex and holistic nature of which could not be captured by such a rudimentary regime. Rather, risk sets need to be analysed as a function of the ongoing supervision for each regulated firm within the framework of the CRD and the Basle risk metrics.

Furthermore, the Commission's suggestion would entail each trade being surrounded by a query set that, besides being impossible to properly answer, would be difficult, costly and imprecise to collect. The only outcomes of which would be higher trading costs and lower market liquidity, neither of which are desired or stated objectives. We note the costs, delays and difficulties in the building of the relatively narrow and straightforward SABRE2 system by the FSA.

Q62: What is your opinion about extending the disclosure of harmonised position information by type of regulated entity to all OTC commodity derivatives?

The artificial division between OTC derivatives and "*other*", or "*all*", derivatives can only serve to confuse and obfuscate any underlying systemic risk provisioning and analysis. Therefore, to avoid entering into deep definitional semantics, the WMBA would ask the

Commission to note the Council redraft of the current EMIR text wherein all reference to OTC derivatives have been replaced simply and clearly by the term derivatives.

The public disclosure of harmonised position information would evidently require the scope of derivatives reported to be transposed into their various underlying factor risks, including the counterparty risks inherent in each bilateral trade. To be of any utility, this data would need to be global in scope to capture the systemic provenance of all traded commodities and participants. In our opinion, the sheer scope and size of such an undertaking for little or no public gain would be difficult to gauge positively in the context of any impact or risk-reward analysis.

Q63: 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? Please explain the reasons for your views. Please explain the reasons for your views.

Consistent with our replies through this document, and speaking principally for the OTF and MTF segments of the market, of which the WMBA members compose the vastly dominant market share, it is inappropriate to base regulation on products as opposed to participant.

We further understand from meetings with the Commission on 14 January 2011 that it is specifically not the intention of the Commission for this proposed legislation to change the manner that markets currently employ efficiently and liquidly to conduct business.

The derivative products for which the WMBA members arrange transactions are designed and defined by the market counterparties in conjunction with the market supervisors. Should the regulatory authorities decide to unilaterally change those market practices then it is more likely that volumes, liquidity and therefore end-user energy security and pricing would be detrimentally impacted.

We would note that all OTC products should be treated equally, whether cash deals, forwards, financially settled derivatives or physically settled derivatives. Within this level playing field of scope and regulation, the market should decide how best, and most efficiently, to organise its business with respect to price formation and risk transfer. We do, however, note from media and official reporting that there is a wrongly held belief that excessive speculative positions exist which should be reduced. This misreporting induces the prejudice and political populism that surrounds the debate, and could generate disproportionate solutions and damage market functionality and liquidity.

We also note as market intermediaries that:

i. there are practicality and deliverability concerns over the proposed trade reporting obligations;
ii. the narrowing of Article 2(1)(i) and the deletion of the exemption in Article 2(1)(k) will have implications that need to be considered very carefully;

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iii. the proposed revision of the definition as to when a commodity contract is a financial instrument must continue to exclude not just spot, but also physical forward business.

5.2. MiFID exemptions for commodity firms

Q64: What is your opinion on the three suggested modifications to the exemptions? Please explain the reasons for your views.

As intermediaries operating under Limited Activity Licences (ie, no position taking), MiFID exemptions have no direct relevance to the WMBA members; however, MiFID Article 2 (1) (k) is a useful tool in respect of client classification.

MiFID Article 24 currently states: "*Member firm shall recognise as eligible counterparts for the purpose of this article... undertakings exempted from the application of this directive under Article 2 (1) (k) and (l)*".

Deletion of this exemption would result in client classification difficulties for intermediaries, particularly with clients such as overseas oil producers and large energy companies, who would then be classified as professional clients and the more onerous COBS rules regarding execution would apply.

5.3. Definition of other derivative financial instrument

Q65: 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.

We note that this definition juxtaposes the MiFID Directive close to the EMIR regulation and request that all efforts are made to ensure that both proposed legislative texts work closely in conjunction.

We agree that criterion (b) concerning CCP clearing is superfluous, and further note that (c) which defines "Standardised" becomes impossible once attempted with any degree of rigour or scientific method. We further note that margin is generally not paid on most commodity derivative contracts since they are mostly traded under umbrella credit agreements between large non-financial firms.

Given the interchangeable nature of physical forward contracts and cash settled derivatives, and additionally given the fact that the intention to make or take delivery is unable to be proven and irrelevant, it would be unworkable legislation to differentiate between cash settled, physically settled derivatives or forwards in the scope of the directive.

Therefore, once again, we would recommend that the Commission bring into scope as much of the traded universe as possible, but do not apply unworkable or regime changing rules that would diminish liquidity and security for the end users of energy, emissions and other commodity markets.

Q66: What is your opinion on whether to classify emission allowances as financial instruments? Please explain the reasons for your views.

A spot carbon emission allowance is essentially a commodity as a physical element. To classify this as an investment creates a set of ambiguities and difficulties that derive from our previous arguments about the need to create differential regimes for investment products as opposed to non-investment products (such as commodities, FX and derivatives).

Concerns that have recently come to light regarding VAT fraud and Registry thefts have no bearing on the financial asset classification of the spot carbon either as it is transacted or as it resides within the Registry.

6. TRANSACTION REPORTING

6.2. Content of reporting

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 traditional role of the WMBA's name passing broker members is to distribute, via price dissemination, quotes to other market participants showing both price and volume. For voice brokered products, these prices and volumes are dependent on market convention, either firm or indicative levels of interest, and must be confirmed prior to the trade being completed. For electronically brokered products through MTFs, these prices are typically firm and are traded without further communication. Once the trade price, volume and terms have been agreed, either via further conversation with the broker or with the direct hit or taking of prices on a MTF, the counterparties' names are disclosed and the broker steps away from the transaction. Bilateral contractual agreements are then put in place between the counterparties and the broker will invoice the brokerage fee. Based on this business model, the WMBA considers that the current proposal to introduce an obligation to transmit required details of orders when not subject to reporting requirements would require the premature disclosure of client interests, is commercially inappropriate in the wholesale IDB markets in which it operates and conflicts with the brokers' role of providing anonymity and confidentiality to the client. The WMBA is concerned that the premature disclosure of names when transmitting an order to the market for execution could result in firms receiving the information having the ability to front-run the order and pre-position themselves in the market.

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

The WMBA does not support the proposal to introduce a requirement to identify the individual trader within the firm who executes the transaction. As there is no reasoning or supporting evidence within the Consultation Paper to justify this proposal, the WMBA assumes that the rationale behind the proposal is to provide a reference for competent authorities enabling the latter to identify the person that initiated the trade. However, all the WMBA members' transactions are made on behalf of their clients and the client's trader, who executes the trade, is often not the person who has made the individual decision to trade. Indeed, in these circumstances it seems immaterial who the individual trader is.

The Market Abuse Directive, whilst currently limited to financial instruments traded on a regulated market, is not limited in coverage to financial institutions and consequently it is the responsibility of all persons in the EU to ensure compliance. Hence, whilst the WMBA members undertake due diligence on the counterpart they consider that it is the responsibility of the latter to undertake appropriate checks in respect of its staff, maintain sufficient records to identify the initiator of the trade and monitor their activities for abnormal trading.

The WMBA is of the opinion that given the characteristics of the markets in which it operates, the identification of traders would be arduous to carry out, prone to error and would not facilitate the detection of market abuse/manipulation.

The proposal, if adopted, would also involve substantial systems development and record retention, and associated costs, at both supervisory and regulated institution level, which the WMBA believes would be disproportional to the amount of additional useful information obtained.

For the reasons detailed above, the WMBA is of the opinion that the current procedure of reporting at entity level should be maintained. National Regulators already have the ability to trace traders via the transactions reporting regime and hence the WMBA would respectfully suggest that the Commission consider adopting the FSA approach (the success of which is shown by several of their recent disciplinary actions), whereby the regulator is able to follow the transaction back through the regulatory chain via the reporting firm as an alternative solution to the use of trader ID.

6.3. Reporting channels

Q82: 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 support the opinion that trade reporting and transaction reporting be brought together under the same governance and protocols. It has become a great concern

across our membership that reporting obligations, especially those placed upon intermediaries who are not paid for such roles, may easily become onerous and costly. We have referred before to the "*Sabre2*" process in the UK as an example of a costly (and behind schedule) way of reporting obligations falling disproportionately upon those least able to afford the initiatives and least well placed to benefit from them.

Therefore, there is an urgent need for the reporting requirements within the EMIR to be coordinated with those obliged by MiFID review.

7. INVESTOR PROTECTION AND PROVISION OF INVESTMENT SERVICES

7.2. Conduct of business obligations

7.2.1. "Execution only" services

Q90: 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.

The WMBA considers that in the wholesale markets in which they operate, the "execution-only" regime should be preserved for all participants on the basis that the knowledge and experience of clients is currently adequately covered by the client classification regime (see question 105 below).

In the wholesale markets in which the WMBA members operate, its clients, albeit they are classified as eligible counterparty, professional or retail under MiFID, are experienced market participants with considerable knowledge of the financial markets in which they operate. Hence the client is already aware of the risks involved in the instruments it wishes to trade and only requires a cost effective and efficient method of executing trades. In these instances, to withdraw the execution only regime from these clients will result in increased costs for no additional protection.

Whilst having no direct involvement in the retail markets, the WMBA supports the British Banking Association's stance that execution-only services are a useful, cost effective and efficient method of trading, demanded by retail and professional clients who are confident in trading in the market (for example, users of self select investment funds and pension plans) or who need to trade for a range of reasons (for example, in order to liquidate an investment) over which they have no control. For this reason (and because of the potential impact of the changes to the client classification regime) it would be disproportionate and would harm retail investors in the EU, and the interests of the EU economy, to forbid firms to provide retail clients with an execution only service

Withdrawal of the execution-only regime will potentially involve the WMBA members providing investment advice. This, together with the requirement for brokers to be appropriately trained and registered with the regulator, would result in additional execution costs to the client or the potential of the withdrawal of services.

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MiFID currently defines a Multilateral Trading Facility (MTF) as "a multilateral system, operated by an *investment firm* or a *market operator*, which brings together multiple third-party buying and selling interests in *financial instruments* in the system and (in accordance with non-discretionary rules) in a way that results in a contract in accordance with the provisions of Title II of *MiFID*". The WMBA is of the opinion that the requirement to have non-discretionary rules for MTFs dealing on a matched principal basis results in these platforms providing an execution-only services to their members clients. Hence, the WMBA members are concerned that an unintentional consequence of the proposed amendments/abolition of the facility to provide execution only services to professional clients would be to limit access to certain MTFs for these types of clients and potentially creating an opaque liquid market available only to Eligible Counterparties.

Informing Clients on Complex Products

Q95: 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.

Q96: 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?

Q97: 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.

Q98: 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.

Q100: 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 Consultation Paper does not currently define the meaning of intermediary and the questions refer to "client" (which is defined in MiFID as any natural or legal person to whom the investment firm provides investment and/or ancillary advice) albeit that eligible counterparties are currently exempted from article 19 (3) and (8). Hence, the Commission's intentions in this respect are unclear and further clarity is required.

The dictionary definition of intermediaries currently covers a wide range of firms and a distinction needs to be made between firms providing a custodial service, a portfolio management service, an execution service to retail clients, or those servicing the wholesale markets (which would include the WMBA members).

As mentioned in the WMBA response to question 90, in the markets in which the WMBA members operate its clients are experienced wholesale market participants with considerable knowledge of the financial markets. They are already aware of the risks involved in the instruments they trade and only require a cost effective and efficient method of executing trades. However, with the proposed new classification rules for non financial/ small financial institutions a number of experienced clients (especially in the energy markets) would be subject to the new requirements to provide pre-trade risk/gain and valuation profiles. Clearly this requirement cannot be cost justified for the wholesale markets and the WMBA believes that the reporting obligation should be subject to an exemption for wholesale market participants (similar to that already provided to professional clients in the MiFID Implementing Directive Article 35 (2) for the assessment of suitability) and hence be restricted to end users in the retail sector. Whilst the WMBA believes it was the intention of the Commission to limit the reporting requirements to the retail markets it would like to point out that from a practical point of view:

(a) the majority of intermediaries (even those holding client money and asset permissions to facilitate timing differences, dividends and corporate actions) only provide an execution service and hold no post-trade details;

(b) retail clients could use a number of brokers (thereby limiting an individual broker's understanding of a client's activities) or self invest;

Hence only portfolio managers, who would not be classified as an intermediary, would retain sufficient post-trade/ position information to fulfil these obligations. It should be noted that even this approach is limited in respect of certificated trading.

7.2. Conduct of business obligations

7.2.5. Provision of services to non-retail clients and classification of clients

Q104: 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.

Q105: What is your opinion of improvements 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 counterparty's 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 non-standard 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.

The WMBA agrees with the Commission's conclusion that the general framework of the client classification system provides an adequate and satisfactory degree of flexibility. After initial teething problems regarding understanding and interpretation, the framework is now understood by market participants and has worked satisfactorily for the last 4 years.

The WMBA considers that the current eligible counterparty regime should be retained without any amendments for the following reasons:

1. The system already provides a mechanism for Eligible Counterparties to opt down if they consider they require the additional protection afforded to professional clients;
2. Financial institutions, whatever size, will already be regulated (either under the Markets in Financial Instruments Directive or Banking Co-Ordination Directive) and are sophisticated enough to make their own informed decisions regarding the level of investor protection they require;
3. Per se professionals (i.e. Non Financial Undertaking) are currently required to meet a size criteria test. Whilst this test does not provide any assessments of knowledge or experience in the financial markets, the original intention when the Markets in Financial Instruments Directive was adopted was that firms meeting this criteria would prima facie have in-house expertise (or, in its absence, have the resources to buy in the expertise). The WMBA still considers this assumption remains valid;
4. From an operational perspective it is not practical to differentiate client classifications based on instrument types. Where a client meets the current Eligible Counterparty criteria it should be the responsibility of the client to assess (either by internal or bought in expertise) the risks involved in all its trading activities.

The WMBA members have considerable experience in dealing with Local Authorities and Municipalities and hence WMBA would not support the proposal to reclassify Local Authorities and Municipalities as retail for the following reasons:

1. Since the adoption of MiFID in 2007, the WMBA members have not received any requests from Local Authorities to opt down to retail clients and, in fact, have received some requests for opt-up to Eligible Counterpart.
2. Within the UK there is a comprehensive regulatory regime for Local Authority treasury management including government legislation and statutory Codes. This framework is endorsed by the Audit Commission's report *Risk and Return* and by the Communities and Local Government Select Committee review of Local Authority Investments.
3. The regulatory regime for Local Authority treasury management places the responsibility for adherence to the treasury management practices and risk strategy with the Chief Financial Officer (CFO). This obligation cannot be delegated and hence the ultimate responsibility is on the CFO, and where he does not have the necessary in house expertise, he is under an obligation to request advice that enables him to obtain this expertise.
4. The other counterparties in the wholesale markets may be less willing to transact with organisations that must be classified as retail.

5. As a result of the liquid nature of Local Authorities' cash flow requirements, the majority of trades undertaken by Local Authorities are non-investment products. Hence the only area that would be affected by the new classifications is trades in Certificates of Deposits, Government Bonds and the issue of Local Authority Debt. The WMBA is of the opinion that the number of these trades undertaken in the course of a year is small and hence would not be sufficient to satisfy the quantitative threshold in MIFID ANNEX II (II.1) which needs to be met to allow the Local Authority to opt up to a professional client. As a result all Local Authorities (whatever their size) would be classified as retail clients.
6. The WMBA has spoken to members of the Chartered Institute of Public Finance and has contacted a number of Local Authorities and their major concerns in respect of the proposed retail classification are:
   a. Potential reduction in the number of counterparties willing to deal with Local Authorities due to the increased level of protection required;
   b. Additional cost of regulatory paperwork for counterparties which would be likely to be passed onto the Local Authority which may not be matched by a material additional benefit.

7.2.6 Liability of firms providing services

Q107: What is your opinion on introducing a principle of civil liability applicable to investment firms? Please explain the reasons for your views.

We understand the logic behind this suggestion but consider that it would involve such wholesale changes to the legal systems of the UK and other EU Member states as to endanger the stability of the financial services sector. If the EU were determined to bring in such revolutionary reform, we would make two suggestions:

1. This form of remedy should be an alternative to, not a supplement to other methods of redress. In other words, complainants would not be permitted to practice complaint arbitrage by claiming against a financial institution in the courts, via the financial ombudsman and the regulator.
2. This type of redress should only be available to retail clients. Here there is a risk that a financial services provider will have deeper pockets to fund its case than the complainant. Professional clients by comparison, are already sufficiently cognisant of the forms of redress available to them and are not intimidated by the courts, lawyers or litigation generally. Opening up a new avenue of complaint, especially one without a costs inhibition could lead to investors bringing speculative or frivolous claims against brokers.

Q108: 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 have no specific comments.

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7.2.8 Dealing on Own Account and Execution of Client Orders

Q112: 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.

In the matched principal model, the broker facilitates its clients in anonymous trading activity by taking part in a matched transaction as principal, becoming the buyer to the seller and the seller to the buyer. The broker's own credit with its counterparts and the nature of its netting and settlement procedures will determine the amounts that are executed in this manner.

While operating as matched principal, the broker will not trade speculatively for a client or for his own book. The trade will only be executed as a result of a firm client order to buy or sell at a set price or size. Once the trade is complete, price, volume and terms are communicated through the broker and back office confirmations.

Similar to the name give-up format, settlement is made between each client based on the market convention with the brokerage fee being either incorporated in the all-in price passed to the client through a disclosed brokerage agreement or through a monthly invoice.

Hence the WMBA believes that within the definition of own-account dealing a distinction needs to be made between market makers who internalise client order flows and IDBs who merely arrange trades. This is already recognised in the Capital Adequacy Directive by the majority of the IDBs being classified as limited activity firms, the provision of which requires IDBs to only execute trades to facilitate client orders and prohibits IDBs from trading on a proprietary basis.

The WMBA considers that the restrictions placed on matched principal brokers under the Limited Activity categorisation in the Capital Adequacy Directive are incompatible with the proposed requirements for SIs and hence the latter should be restricted to market makers.

7.3.6 Segregation of client assets

Q119: What is your opinion of the prohibition of title transfer collateral arrangements involving retail clients' assets? Please explain the reasons for your views.

Our sector does not typically deal with retail clients and we have no strong views here, other than that title transfer offers a quick and simple method of collateral management.

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Q120: What is your opinion about Member States be granted the option to extend the prohibition above to the relationship between investment firms and their non retail clients? Please explain the reasons for your views.

Title transfer affords a quick and simple method of collateral management. Professional Clients and Eligible Counterparties understand the risks involved and additionally the benefits. We therefore see no need to change this.

Q121: 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.

Our sector does not typically deal with retail clients and we have no strong views here.

Q122: Do you consider that information requirements concerning the use of client financial instruments could be extended to any category of clients?

No. Any counterparty other than a retail client should be sufficiently expert to understand the products they are buying. We feel that extending information requirements would serve only to add a layer of bureaucracy, of benefit only to our non-EU competitors.

Q123: What is your opinion about the need to specify due diligence obligations in the choice of entities for the deposit of client funds?

IDBs already do this, when necessary, in order to comply with the Client Asset Rules of the FSA. We see no purpose in adding further obligations.

8. FURTHER CONVERGENCE OF THE REGULATORY FRAMEWORK AND OF SUPERVISORY PRACTICES

8.3. Access of third country firms to EU markets

Q138: 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?

The WMBA believes that a third country access regime should be implemented on a broad equivalence basis. Perhaps such equivalence regime - *to avoid regulatory arbitrage* - should be advised upon by IOSCO who could assist in the establishment of high-level cross-jurisdictional equivalent standards.

The WMBA is concerned that the Consultation Paper references a “strict approach”. Such an approach may damage fair and reciprocal access to safe jurisdictions and could fragment the global approach to cooperation on the regulatory framework. Accordingly exemptive relief, based on home country approval, with notification provided to the host country should be a suitable access mechanism. The pan-European access mechanism

under MiFID relating to MTFs may be a relevant precedent to consider but with the understanding that this should not provide anti-competitive treatment by national regulators vis-à-vis the European framework established under MiFID.

Q139: 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.

The WMBA believe that suitable access should be granted to entities regulated in countries that have a common approach to market regulation. In the WMBA's view, this would involve the establishment of high level international standards. With regard to the above reference, it may be appropriate for IOSCO, working in concert with appropriate regional and national regulators, to draft up suitable international standards of co-operation and access, taking into account the public policy objectives of reducing systemic risk whilst avoiding protectionism, dislocation and regulatory arbitrage.

9. REINFORCEMENT OF SUPERVISORY POWERS IN KEY AREAS

9.1. Ban on specific activities, products or practices

Q142: 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.

The WMBA believe that it is a very dangerous precedent to suggest that regulation be introduced which would give regulatory bodies the ability to arbitrarily ban products which they believe "*give rise to significant and sustained investor protection concerns" or where "there is a product or activity threatening the orderly functioning and integrity of financial markets or the stability of the whole or part of the financial system*"

The WMBA believes that the current authority, available to Regulators, to ban practices (through suspension of Licence which relate to any product a market operator or Investment Service provider has authority to operate in) is sufficient, well understood and logically sound in nature.

Whereas the WMBA agrees that, should there be reason to consider the banning of a product, a consultation process which results in appropriate evidence of risk and has gone through an appropriate cost/benefit analysis, would be appropriate.

However, we fear that as this process in itself is likely to be lengthy, it would most likely result in intervention and attempts to fast-track the process. This will inevitably result in decisions being taken too quickly and for the wrong reasons, and not consistently across regulatory jurisdictions (Germany's ban on Short Selling is a case in point).

In addition, to ban a product which could be widely held by market participants would impact portfolio valuation for risk purposes, temporarily remove the ability of a holder to exit positions, and potentially increase the possibility of systemic risk.

All things considered, the idea that on any given day a product could suddenly be deemed too risky to trade and be subject to an impending ban, would bring unnecessary instability and uncertainty to specific areas of the market and to specific investors.

Q143: 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.

The WMBA is strongly against competent authorities having the power to ban an OTC product which is eligible for CCP clearing but is not actually cleared by a CCP. Indeed our members are firmly of the opinion that any authority reaction involving the "banning" of trading in a product would be impossible to implement. It would additionally be counterproductive, in that substitute products, possibly outside of the banking sector, would be created in order to assume the same risk profile.

In the event that the CCP community, for many legitimate reasons, decide that this is a product they do not want to clear, then the WMBA believe that the correct way to deal with this situation is via the Capital Requirements Directive for non-cleared products, rather than to simply ban the product "until further notice".

The WMBA believes that the decision criteria to assess the eligibility of a product for clearing should be driven by the public consultation process run by ESMA which:

(a) requires the CCP community to among other things, assess their capability to risk manage the product,

(b) conducts a review of the liquidity of the product for daily margining, and

(c) develops an understanding of the methods by which the product is traded prior to acknowledging its suitability for clearing.

Furthermore, it is conceivable that, as a result of this process, a number of products are deemed unsuitable for clearing.

Q144: Are there other specific products which could face greater regulatory scrutiny? Please explain the reasons for your views.

The WMBA firmly believes that there is no scope for this direction whatsoever.

9.2 Stronger oversight of positions in derivatives, including commodity derivatives

Q145: If regulators are given harmonised and comprehensive 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.

There is no justifiable logic supporting the imposition of position limits, whether executed OTC or via an exchange. Untangling trades into separate segments denoting single leg proprietary activity, spread trades, curve trades, basis trades, trading as agent for clients, hedging for house, hedging for customers and the resulting net positions for each set is an inexact science. This difficulty notwithstanding, due to the fungible nature of products, unless position limits were imposed globally on equal terms, any restrictions outlined under MiFID not universally applied would merely spark a flight of business to other geographies.

Q146: What is your opinion of using position limits as an efficient tool for some or all types of derivative contracts in view of any or all of the following objectives: (i) to combat market manipulation; (ii) to reduce systemic risk; (iii) to prevent disorderly markets and developments detrimental to investors; (iv) to safeguard the stability and delivery and settlement arrangements of physical commodity markets. Please explain the reasons for your views.

As we state above, there is no justifiable logic supporting the imposition of position limits whether executed OTC or via an exchange. We agree with the Commission's viewpoint that position management, would be dealt with more effectively via the Capital Requirements Directive and employing the Tier I and Tier II metrics reviewed recently by the Basle Committee on Banking Supervision, and these should be employed to monitor and reduce systemic risk.

As we state above, the necessary decomposition of trades into sets of underlying risk factors, the ongoing correlations within portfolios and changes in the external environment mean that position limits could neither function as efficient nor as a useable tool. They are, therefore, unable to address any of the four objectives stated in the question.

Issues concerning market manipulation are best addressed by reducing the degree of designation and uniformity within market structures (such as common contract expiry dates and deliverable baskets) and also via reporting to the competent authorities and to trade repositories.

Disorderly markets are not prevented by any defined infrastructure legislation but rather by allowing market signals to influence supply and demand policy in a timely and efficient manner. It is not evident, especially in derivatives where investors may be as likely to be short as they are long and as positioned for volatility in a similar manner, that the assumptions made in the question are, in fact, true.

The efficacies of physical commodity markets need to be addressed in measures specific to each market and not in legislation such as MiFID. Any measures in MiFID which may serve to treat financially settled derivatives in a different way to those which specify physical delivery would be ripe with unintended consequences. Further, those measures contemplated by the Commission which look towards a statement on intent vis-a-vie market participants expecting to take delivery at the point of trade execution would be practicable and serve to either kill or reduce liquidity. We note that in mature and efficient markets, such as crude oil, it is the derivative that holds all the liquidity and in effect "becomes" the commodity, whereas each physical delivery contains a bespoke

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agreement making it opaque and idiosyncratic. In such markets, the Commission should ensure that the conditions to fulfil liquid and efficient derivatives markets exist in order to minimise price opacity and volatility and market manipulations. Many of the suggestions in the Consultation Paper would serve to facilitate quite the opposite, either by obligations on market participants by their categorisation and position limits, or as trades are executed by attempts at redefining market structures.

Q147: 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.

The more concise and designated the terms around a derivatives market, the more prone and vulnerable that market becomes to market manipulation.

There are many instances in futures markets where, in respect of contracts, defined with designated roll dates or deliverable baskets, the roll has been pre-empted or the delivery basket has seen a market "squeeze" or suffered "cornering" of the cheapest-to-deliver bonds (negative implied repo rate) which has artificially ramped the derivative price relative to the underlying market. Examples of such manipulations whereby the physical has been squeezed in a small amount to create a disproportionate move in the derivative have been frequent in the listed commodities markets.

As a consequence of the above, the rules surrounding designated contract markets multiply and proliferate, with the entire market obeying quarterly (or more frequent) roll/expiry conventions and with a common, but narrowly defined, delivery specification, both leaving these types of contracts vulnerable to manipulation.

The OTC derivatives markets have, by contrast, been free of such manipulations by virtue of the great variety of expiry dates and contract specifications which are generally tailored to suit each end-user.

Q148: How could the above position limits be applied by regulators:

(a) To certain categories of market participants (e.g. some or all types of financial participants or investment vehicles)?

(b) To some types of activities (e.g. hedging versus non-hedging)?

(c) To the aggregate open interest/notional amount of a market?

In reality, regulated firms do have natural position limits as dictated by the level of capital they hold. Similarly, unregulated firms still have to have sufficient funds to meet margin calls, so they too already have a limit to the size of position they can take.

Further, there is the risk that by setting limits, other non-EU venues (particularly exchanges) will list identical contracts without position limits and in doing so attract liquidity to their shores. This, in turn, will have an impact on the price discovery process on EU exchanges and platforms.

The WMBA, therefore, feels that the application of position limits would be extremely difficult to implement and also that the competent authorities would find this a difficult process to manage. The ability to distinguish between hedged and non-hedged trades in the derivatives space being an example of the almost impossible challenges a competent authority would face.

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WMBA and LEBA

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WMBA and LEBA members are Limited Activity firms that act as intermediaries in wholesale financial markets, with a principal client base made up of global banks, primary dealers, leading regional banks, asset managers, oil companies, energy generators and transmission operators.

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