MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

February 2, 2011

European Commission
DG Internal Market and Services, Unit G3
markt-consultations-mifid@ec.europa.eu

Dear Sir/Madam,

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

Managed Funds Association ("MFA")[1] welcomes the opportunity to provide comments to the European Commission in response to its Consultation Paper, Review of the Markets in Financial Instruments Directive (the "Consultation Paper").

MFA's responses are set out in the Annex to this letter.

As a preliminary comment, we wish to emphasize that MFA supports a regulatory framework that will minimize systemic risk, strengthen investor protection, and promote market discipline and integrity. Recognizing the deficiencies that contributed to the financial crisis and taking focused steps to remedy them in a manner that promotes clear and consistent rules are critical to restoring investor confidence and market stability. Our industry is composed of investors who rely on markets to be fair, open, and free from manipulation in order to conduct their businesses. Our members are subject to the same extensive rules and regulations under securities laws as other investors and are longtime advocates of clear guidelines and strong enforcement.

Our members actively deploy risk capital in markets throughout the world and invest heavily in proprietary strategies to identify new opportunities. We recognize the need for regulators to have access to information about our activities in order to have a comprehensive view of the markets and effectively oversee the financial system. At the same time, we note the importance of maintaining utmost confidentiality and conducting inquiries in a judicious manner so as to ensure privacy and manage the costs of compliance. We also note the significance of international coordination in ensuring consistent regulation across borders, minimizing duplicative regulatory burdens, and promoting competition and innovation in all markets. Consistent regulation also

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

provides for more timely implementation, enhanced surveillance tools and higher quality data analysis.

We note Commissioner Michel Barnier's statement in December 2010 that MiFID covers about half the scope of the Dodd-Frank Act in the United States. MFA was an active and constructive participant in the discussions leading up to the passage of the Dodd-Frank Act and is currently similarly engaged in the rulemaking process. We were supportive of the overall goals of the Dodd-Frank Act and are committed to seeing them faithfully implemented. We expect to be similarly engaged with the reform discussions in the European Union. As longstanding market participants, we strongly support the strengthening of the global financial regulatory system. The devastation of the financial crisis was felt by all, including hedge funds and, in turn, by institutional investors in our funds. Hedge funds were customers and counterparties of the large banks, and the harm that they encountered, along with investors of every type, underscores the need for reform.

We would be very happy to discuss our comments or any of the issues raised in the Consultation with the Commission. If the Commission has any questions or comments, please do not hesitate to call Jennifer Han or the undersigned at +1 (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director, General Counsel

ANNEX

MFA RESPONSES TO COMMISSION CONSULTATION
REVIEW OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)

EXECUTIVE SUMMARY OF MFA RESPONSES

Organised trading facilities – MFA supports the development of exchange-traded products as a complement to OTC products but notes the advice from CESR that this should be encouraged rather than mandated at this point in time.

Automated trading – MFA is of the view that automated trading and high frequency trading can be beneficial to financial markets. Separately MFA is concerned that the proposed definition of automated trading could capture certain types of trading which rely on execution strategy algorithms, but which do not necessarily relate to the execution of orders.

Pre- and post-trade transparency – MFA supports the Commission's proposals on increased transparency but at the same time is concerned that proprietary or confidential information of individual investors may be disclosed to the public.

Data consolidation – MFA supports the Commission's proposals to improve the quality and timeliness of data, subject as above to ensuring that proprietary or confidential information is not disclosed to the public.

Commodity derivatives market measures – MFA supports the disclosure of aggregated, as opposed to individualised, position information to the public, but is concerned by the risks to confidentiality because of the potentially wide distribution of detailed position information across numerous regulators.

Transaction reporting – MFA is concerned that highly sensitive proprietary information and trading strategies may be disclosed under the Commission's proposals to have client-identified trades reported through the whole chain of order transmission.

Investor protection and provision of investment services – MFA believes that the current MiFID disclosure obligations on inducements are sufficient. MFA does not support a prohibition on title transfer collateral arrangements involving non-retail clients, and instead favours clients receiving more detailed information about their collateral/assets.

Access of third country firms to EU markets – MFA believes that the introduction of a "strict equivalence" regime for third country firms could be interpreted to be protectionist and also restrict EU investor choice.

Reinforcement of supervisory powers in key areas – MFA believes that, even in emergency situations, any ban on a product, practice or operation should be carried out in a coordinated basis in order to avoid market instability. In relation to commodity derivatives, MFA believes that position management is more effective than hard position limits in achieving the Commission's stated aims.

SECTION 2. DEVELOPMENTS IN MARKET STRUCTURES

2.2 Organised trading facilities

2.2.3 Trading of standardised OTC derivatives on exchanges or electronic trading platforms where appropriate

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

MFA supports the goals of market transparency and enhanced liquidity. In this regard, we support the on-going development of trading markets that respond to the needs of both swaps dealers and end-users, whether this is exchange trading, OTC trading, or, as we think will eventually likely be the case, a diverse market, similar to markets for debt and equity instruments that accommodate both exchange and OTC trading. Further, MFA supports the development of exchange-traded products as a complement to OTC products and we believe that, given the recent and significant efforts regarding product standardization and clearing, such products will steadily emerge in the marketplace. We would also note that, in our members' experience, European OTC derivatives markets have already embraced electronic trading to a greater degree than in the U.S. or Asian markets.

In this regard MFA believes that one should be careful about necessarily forcing, in too short a time frame, even all eligible and sufficiently liquid OTC derivatives onto regulated markets, MTFs, or organised trading facilities. Many of our members already trade OTC derivatives through electronic markets. Nevertheless, as they work to optimize results for their investors, they find that having competitive trading options lead to the best outcomes.

It will be important for market stability to have a clear indication from ESMA as to whether or when a derivative which is eligible for clearing is "sufficiently liquid" to be traded exclusively on the various organised venues. We note that in its December 2010 Technical Advice to the European Commission on Standardisation and Organised Platform Trading of OTC Derivatives, CESR advised that "trading of standardised derivative products on Organised Trading Venues is to be incentivised by regulators, even though not mandated at this stage."

2.3 Automated trading and related issues

MFA General Comment on Automated Trading

Algorithmic trading is an execution strategy most commonly used today by investors to execute orders with maximum efficiency, lowest information leakage, minimum market impact and in the most cost-effective manner (*i.e.*, reduced transaction costs). In particular, algorithmic trading allows broker-dealers and investors to break up large orders into smaller, more flexibly traded, lower profile orders to minimize market impact. Greater efficiency and lower costs lead to an increase in market participation by all investor types, which in turn results in additional liquidity as well as more accurate price discovery.

As the Commission has noted, high frequency trading ("HFT") is a specific type of automated trading that is commonly employed by investors, traders and market makers who seek to profit and manage risk through the use of strategies that require algorithms and low latency market execution technology. HFT methods and low latency technology have delivered important benefits to investors and to our markets; lowering transaction costs for most investors, increasing market capacity and creating more competition.

There are numerous types of HFT strategies. Not all market participants employing HFT techniques are pursuing the same investment strategies, nor do their strategies operate on the same time scale or require the fastest technology. Strategy holding periods can vary greatly, from seconds to seasons, with the shorter horizon strategies being more driven by fleeting arbitrage opportunities, market making, or risk management requirements and the longer horizon strategies by forecasts of stock returns.

We believe that by far the most common HFT strategies are electronic market-making. To a large extent, technology-driven market makers have replaced more expensive, more limited manual market makers of years past. It is important to bear in mind, however, that the economic principles that either type of market makers employ are identical – managing inventory risk to earn profits from providing liquidity. We note that HFT techniques have become an essential requirement in successful market making and risk exposure, including by traditional market makers. Other HFT strategies include inter-market arbitrage where small price discrepancies are eliminated by market participants using ultra low-latency technology. These strategies provide increased liquidity and more timely/accurate price discovery for all market participants.

We feel that it is important to acknowledge the benefits that technological advances provide to investors. Investor technology converges toward the best technology available at the time. Providers of connectivity are going to continually invest in cutting edge low latency technology to benefit their clients and remain competitive. While we believe that continued improvements in technology are important in any industry, we understand the Commission's need to better understand the rapid advances in the marketplace and welcome the opportunity to work with the Commission to help identify any strategies or practices that are detrimental to capital formation and liquidity.

The Consultation states that some market participants have raised concerns that they are at a disadvantage to high frequency traders as they are not able to make a similar investment in trading technology. Such participants argue that high frequency traders can execute orders and hit liquidity ahead of them. Nevertheless, the fact that certain investors and traders, who often are acting on behalf of many beneficial owners of the vehicles through which they invest or trade, may be willing to incur greater costs to develop more sophisticated trading tools does not make their possession of those tools inherently unfair. The Commission should be aware that, in recent years, automated execution technology has become readily available; it is now possible for institutional investors to lease such technology rather than making an investment in purchasing or developing it; and firms that execute on behalf of retail investors can, and do similarly use such technology.

We feel that most market participants incur a majority of their research and development costs on the investment selection or strategy portion of their business and not on the very expensive

global connectivity infrastructure, exchange connections and routing aspects. This global market connectivity infrastructure is usually provided and supported by larger financial institutions or third parties that are acting as market connectivity intermediaries. Very few investors or traders have direct market access; most rely on large financial institutions (banks or broker/dealers) to supply market access. It is these intermediaries that provide cutting edge technology and make the majority of the investment to keep latency low and to employ the most sophisticated technology in devising and implementing execution strategy.

Finally, we would encourage the Commission to consider the available empirical studies on the effects of high frequency trading. One paper published in July 2010 (after then May 2010 "flash crash") found that, among other things, there is no evidence suggesting that high frequency traders withdraw from markets in bad times or that they engage in abnormal front-running of large non-HFT trades; that HFT trades and quotes contribute more to price discovery than do non-HFT activity; and that HFT reduces volatility.[2]

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

MFA is concerned that the proposed definition of automated trading could capture certain types of trading which rely on execution strategy algorithms, but which do not necessarily relate to the execution of orders, which is what we believe the Commission is focussed on.

Algorithmic trading is often used by investors, whether they are asset managers, insurance companies, banks, or brokers, as a proprietary tool in selection of investments (that is, automatic selection of investments based on pre-determined parameters). It would not be appropriate or practical to apply the organisational requirements proposed in the Consultation to investors employing algorithms in their investment selection and, in particular, require them to notify and explain the design, purpose and functioning of proprietary algorithms to the regulator. The activity of investment selection by the use of algorithms does not carry the same risk of impacting the market's functioning. How an investor reaches a decision to buy or sell a security should be inconsequential; on the other hand, trading practices, or how investors operate in the markets can impact market functioning. We would encourage the Commission to focus on conduct, not the proprietary analytical processes of investment decision making.

MFA believes therefore that the proposed definition of automated trading should be amended so as to clarify that it relates only to the execution aspects of the order rather than to the investment strategy employed in the selection of investments.

Separately, we note that the Commission has provided a possible definition of "high frequency trading" in footnote 37 of the Consultation Paper as:

> "trading that uses sophisticated technology to try to interpret signals from the market and, in response, executes high volume, automated trading strategies, usually either quasi market making or arbitraging, within very short time horizons. It usually involves

[2] Available at http://www.futuresindustry.org/ptg/downloads/HFT_Trading.pdf.

execution of trades as principal (rather than for a client) and involves positions being closed out at the end of the day."

MFA notes the reference to the "execution of trades as principal (rather than for a client)"; we assume that the Commission's focus is on firms which trade on their own capital in exchange-traded markets, rather than, for example, asset managers which act as agents for investment funds they may manage. It would be helpful if the definition of high frequency trading could be made clearer in this regard.

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

To the extent that the Commission is of the view that such "high frequency trading" requirements could also apply to regulated investment managers when acting for investment funds managed by them (even though such firms are trading on behalf of their fund clients, i.e. not as principal), we do not believe that there is any reason that the underlying investment funds or managed accounts should themselves have to be authorised. The investment managers would after all already be regulated either as portfolio managers under MiFID, alternative investment fund managers under the AIFM Directive or as managers of UCITS under the UCITS Directive. If the Commission believes there are unregulated principal trading firms that need to be similarly authorized, we would support a "level playing field" where all market participants are subject to appropriate oversight.

Separately, MFA would be concerned if any authorization requirement would be extraterritorial in nature, such that non-EU asset managers would not be able to use HFT techniques in relation to shares admitted to trading on EU markets unless regulated by an EU member state regulator.

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

Provided that the scope of the definition of automated and high frequency trading is clarified as described above, MFA generally supports the Commission's proposals to require firms engaging in automated trading and/or allowing their systems to be used by other traders to have risk controls. Ultimately, the financial intermediaries (brokers/banks) must be responsible for the actions and oversight of their connectivity users. We are supportive of pragmatic protections which include pre-trade checks and risk management controls, particularly where these can be standardized on a global basis.[3] We note, however, that EU-based investment firms are already subject to systems and controls requirements under MiFID in relation to risk and it may not be necessary to specify particular risk controls. It is also unclear how specific risk controls would or

[3] Similar steps have been taken in the United States. In particular, in November 2010, the SEC adopted Rule 15c3-5 under the Securities Exchange Act of 1934 (the "Exchange Act"). Rule 15c3-5 prohibits so-called "naked access". Broker-dealers that provide direct access to trading securities to persons other than broker-dealers must establish, document and maintain a system of risk management and supervisory controls relating to the provision of such access. Those controls must be reasonably designed to limit the financial exposure of the broker-dealer providing access, and ensure compliance with regulatory requirements applicable to providing access.

could apply to firms engaging in automated trading from a location outside of the EU, thus, we believe the focus should remain on the banks and brokers through which they access the EU markets.

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

MFA supports risk controls such as market-wide single stock circuit breakers or limit up/limit down systems. We believe such systems will serve to prevent market disruptions during times of market stress, help restore confidence in the markets and limit harm to investors. However, such risk controls must be carefully designed to avoid unintended effects. Such controls must be of short duration and triggered only in limited instances, so as to provide a cooling-off period and add to investor confidence by removing a potential panic scenario, and not triggered by erroneously-reported prices.

We do not support risk controls such as speed bumps, trading delays or specified maximum execution speeds because such controls would likely harm investors by increasing trading and transaction costs. Limiting trading activities and strategies will only harm everyday liquidity and price continuity with no evidence of efficacy in times of severe stress. The Commission should avoid taking measures that penalize the introduction of new technology and that would likely diminish the competitive attractiveness of EU markets to investors on a worldwide basis.

We believe that the ultimate discretion as to imposing such risk controls should be left to the trading venues based on a common pan-European standard.

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

MFA supports the Commission's efforts to require equal access to co-location without artificial barriers designed to exclude some market participants. MFA believes that co-location is an important component to low latency technology which should be available to market participants that require this service.

Co-location demands are the natural result of competition among market participants to reduce latency (delays in accessing markets). Regulation should be designed to encourage liquidity, investor confidence and technological innovation. Provided co-location opportunities are available on a non-discriminatory basis to anyone, they should not be limited by regulation.

Co-location is particularly important for market participants whose strategies include market making or reacting to fast, short-term price swings. Co-location is a link in the low latency technology chain, not a latency solution. Many investors with longer-term investment horizons, however, also value and rely on the ability to co-locate. Many market participants are unaware that they are already utilizing co-locating technology since they rely on financial institutions to provide them with competitive global market connectivity which incorporates low-latency technology including co-location. As long as co-location is available to investors, traders and larger brokers on an equal basis, the secondary market for such services to smaller customers from their brokers should be competitive and thus, fairly priced. Accordingly, we believe market

centers should disclose whether they or third parties offer co-location services on a priority basis other than first available.

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

MFA generally supports minimum tick sizes as a measure that will help to prevent market disruption and restore confidence in the markets; among other things, harmonized minimum tick sizes contribute to better price discovery and a more level playing field among trading venues.[4] As investors, MFA members have a strong interest in liquid and deep markets that operate efficiently.

Such measures should be a matter for trading venues to design and implement but must be based on a uniform, pan-European standard. These measures must be periodically re-evaluated to determine their efficacy and ability to meet the demands of the market. Caution must be taken when implementing or changing minimum tick sizes in response to market events without having a meaningful opportunity to analyze and evaluate the cause of any such events and determine the most appropriate course of action.

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

MFA does not believe it is appropriate or practical to require high frequency traders to provide liquidity on an ongoing basis or become market makers in the traditional sense,[5] solely on the basis of trading strategies involved or the volume of trading.

There is no particular utility in imposing liquidity provision requirements on market participants, which are not in the business of holding themselves out to the market as willing to buy and sell a given security on a regular and continuous basis. Market makers receive certain benefits, which act like subsidies, in return for obligations such as requirements to provide liquidity. Indeed, we would note that it is in the interest of fair and orderly markets for there to be an opportunity for investors' orders to be executed without the participation of a dealer or market maker.[6]

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[4] In the United States, the SEC has established U.S.$.01 under Regulation NMS as the minimum tick for quotations, although trades can be effected at finer increments. The considerations involve allowing flexibility in trading, but the finer the increments for quotations, the less information is conveyed by the National Best Bid and Offer, making depth-of-market information all the more valuable when, for example, there are 100 price points to the dollar instead of the previous eight or sixteen.

[5] We note that "market maker" is defined in Article 4(8) of MiFID to mean "a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against his proprietary capital at prices defined by him."

[6] In the United States, this aim is codified in Section 11A of the US Securities Exchange Act of 1934, which provides: "It is in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets ... (v) to assure an opportunity for investors' orders to be executed without the participation of a dealer."

Imposing market maker-like obligations on non-market makers may perversely lead to less liquidity in the equity markets. Requiring market participants, including certain investors, to register as market makers could decrease liquidity as many may not be able to commit to meeting market-maker obligations, such as broker-dealer capital and margin requirements. Many investors' strategies have not been developed to take extended risks. The investors will not have the risk appetite or capital to take on more risk and, in particular, to hold the positions overnight on their books. Mandating non-market makers to take on risks that they have no expertise in or accept risks that they do not appreciate may lead to a concentrated risk reduction by these non-market makers at the first possible opportunity. For example, selling positions acquired as part of a forced market-making requirement at the end of the day or in the morning of the opening to avoid excess margin or capital charges. These concentrated orders by non-market makers will result in increasing market volatility and may also reduce market participants.

Fundamentally, moreover, it would be unfair to impose a regulatory "tax" on large investors by requiring them to shoulder affirmative and negative market making obligations, particularly if they would not receive any special trading privileges or be capable of taking advantage of any existing exemptions from disclosure and transparency obligations available to market makers.[7]

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

We believe that a requirement establishing a minimum duration of orders would limit and stifle competition. Orders are changed or canceled because prices for other relevant securities in the market have changed or because the market participant has learned new information. It would be particularly damaging if markets including their associated risks/exposures move with no constraints, but have the investors' ability to manage these risks is artificially constrained.

As for limiting the ratio of orders to transactions executed by any given participant, we would note that market makers have always cancelled and refreshed their quotes in response to market movements. With today's more democratic access to markets, liquidity providers working on very thin margins and empowered by low latency technology can respond quickly to changing circumstances. No longer at the mercy of specialists or an oligopoly of human market makers, market participants, including a large segment of investors, can now receive immediate cancellations and just as quickly enter new orders.

If cancellations were to be limited in any way, market participants would be more reluctant to post limit orders, which would likely result in a widening of spreads and a decrease in liquidity. Also, such policy could significantly harm the execution quality that investors receive, as many rely on the same technology and their own ability to cancel stale orders in order to minimize

[7] In the United States, exchange members were traditionally subject to "affirmative and negative obligations", that is, the obligation to provide liquidity to maintain a fair and orderly market and to refrain from trading that were not reasonably necessary to permit the specialist to maintain a fair and orderly market, but such obligations were largely disregarded and not enforced by the exchanges.

their transaction costs. While many orders may be short in duration, these orders contribute to more liquid and efficient markets.

SECTION 3. PRE- AND POST-TRADE TRANSPARENCY

MFA General Comment on Pre- and Post-Trade Transparency

As a general principle MFA is fully supportive of increased transparency in the markets. At the same time, we are deeply concerned about the prospect of proprietary or confidential information of the funds our members manage, including information related to their investment strategies, portfolio holdings and investor base, being disclosed to the public. Such information is highly sensitive from a competitive standpoint and our members employ substantial safeguards to protect this information. Moreover, an investment manager's strategies typically include multiple components and the disclosure of pieces of data would be incomplete and inherently difficult to understand. As a result, such information, in isolation, is misleading to the public, including investors, which could have negative consequences should they misguidedly try to act on it. Given the sensitive nature of such information, we believe that it is critical to have strong confidentiality safeguards in place to protect the proprietary interests of individual investors and the welfare of the public and capital markets.

3.1 Equity markets

3.1.1 Pre-trade transparency

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

MFA broadly supports the proposed changes. In particular, detailed guidance as to the consistent application of the waiver rules is essential in order to ensure legal certainty. A mechanism for review and monitoring the efficacy of the waivers and their consistent application throughout the EU is equally important.

In reviewing the waivers regime, it is important to strike a balance between the desire of investors to protect proprietary information about investment strategies and the goal of dissemination of key market information and efficient price discovery. It is clear that providing attribution to the specific entity, firm, fund or individual connected with a transaction, instead of on an anonymous or aggregated basis, to the public provides no inherent value and can reduce liquidity.

MFA is of the view that dark pools are important avenues for equity investors to use in seeking best execution. Competition in this space has led to important innovations and improvements in technology and execution costs that benefit equity investors of all sizes. Dark pools compete with traditional exchanges, and this competition has led to improvements in technology and execution costs that benefit equity investors of every size, from individuals to the largest and most sophisticated institutional investors. Our members, as investors, are active users of dark pools, and in particular believe that the ability to execute orders without "tipping one's hand" to the market is an important protection for investors to retain.

Changes to the pre-trade transparency waivers may increase the information and quality of quotation data available to all investors, but institutional investors are wary of having all the data

on their trades exposed in the public quote stream in real-time. This kind of disclosure could enhance the ability of other investors to glean competitive information.

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

MFA believes that actionable indications of interest should be treated as orders for the purposes of pre-trade transparency. A similar approach has been proposed in the United States, as described in the footnote to our response to Question 31 below.

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

MFA supports the Commission's proposals to clarify that remaining unexecuted parts of large-in-scale orders could not remain dark if they no longer meet the relevant thresholds for this waiver.

Although masking a large transaction may help the seller limit the market impact or the data which may be picked up by market participants including market makers, it puts potential purchasers at a disadvantage since important volume and execution information would not be disclosed.

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

We agree that trades executed under the reference price waiver should not incorporate any embedded fee in the price to ensure that more accurate price discovery can be obtained.

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

MFA broadly supports the proposals to retain the current thresholds for large in scale waivers and believes that this waiver is important for striking the balance between the need for market transparency and protecting the interests of large investors.[8]

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[8] In the United States, the SEC published proposals to increase the regulation of alternative trading systems ("ATSs") that do not publicly display quotations in the consolidated quotation data, so-called "dark pools" in November 2009. The proposed rules would amend the definitions of "bid" and "offer" to included "actionable" indications of interest ("IOIs") (not a defined terms, but described as IOIs that are functionally equivalent to quotations). Actionable IOIs with respect to block-sized trades, which would be defined as trades with a market value of at least $200,000, would be excluded from the revised definitions of bid and quote. The proposed rules would lower, from 5% to 0.25% the average daily trading volume threshold (that is, the ATSs average daily trading volume in a stock during four of the six preceding months) that triggers quote display and execution access requirements for ATSs, as set out in Regulation ATS under the Exchange Act. Finally, the SEC proposed amending the joint-industry plans for publicly disseminating consolidated trade date to require real-time disclosure of the identity of dark pools and other ATSs on the reports with respect to their executed trades. The SEC has not adopted the proposals or indicated whether it will adopt them.

3.1.2 Post-Trade Transparency

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

MFA broadly supports these proposals. We are not convinced that delays in the publication of transaction reports for large transactions are necessary to ensure adequate liquidity in the markets. While certain European trading venues have long permitted such reporting delays, the United States markets do not and are among the most liquid markets in the world. There are a number of alternatives to filling a large transaction as a single block in the public markets, including various order-slicing methodologies and the use of dark pools where necessary to reduce the market impact of large trades. For investment managers participating in the market, access to timely information ensures better price discovery and associated investment decisions.

We appreciate that the post-trade reporting proposals are intended to continue to protect the anonymity of buyers and sellers. The identity of buyers and sellers should never be publicly disclosed, and likewise individual market participants should never be required to publicly disclose their trades, as such level of information would not enhance the quality of market data and would only harm individual market participants by requiring them to reveal confidential and proprietary portfolio and trading information.

3.2 Equity-Like Instruments

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

MFA supports the Commission's statement that detailed transparency requirements for equity-like instruments should be suitably tailored to the specificities of the different non-equity classes.

The Commission should note, in particular, that there are legal and logistical limitations to any effort by the EU to expand its regulatory provisions to cover non-EU markets, such as, for example, in the case of depositary receipts relating to EU shares.

MFA believes that the assertion of regulatory requirements, such as those mandating quotation or trade transparency should not apply to non-EU markets or non-EU investment firms, in part because of the risk that EU requirements will conflict with local law requirements in non-EU markets.

3.4 Non-Equity Markets

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

MFA broadly supports the principle of improving transparency in respect of non-equity instruments, subject to our response to Question 32 about the need to ensure confidentiality of buyers and sellers. We note that any standards established for improving market transparency

need to take into account differences in asset classes as well as differences between standardized and customized instruments. For customized instruments, dissemination of comprehensive price and notional data may be confusing to the market generally and with respect to investors in these instruments, disclosure of such information could reveal too much information about a proprietary investment strategy. Additionally, with respect to block or large notional transactions, we recommend that the Commission conducts studies to identify the disclosure levels that will not impair market liquidity for such transactions prior to establishing any regulatory transparency thresholds.

SECTION 4. DATA CONSOLIDATION

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

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

MFA supports the Commission's stated desire to improve the quality and timeliness of raw data in the markets, and to have such data provided in a consistent format. To that end, we support the use of APAs. There must however be stringent safeguards for the confidentiality of raw data.

4.3 A European Consolidated Tape

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

MFA welcomes the Commission's proposals for a European Consolidated Tape. In this regard it may be helpful for us to explain our views through the experience we have had in the United States.

In the United States, the Congress called in 1975 for the creation of a national market system, including a composite quotation system and a consolidated transaction reporting system, as part of the Securities Acts Amendments of 1975. The reasons for consolidation were to provide for a market data resource that encouraged competition among the several exchanges trading the same securities. The Congress reasoned that market data is the "oxygen of the markets" and that:

> "In the securities markets, as in most other active markets, it is critical for those who trade to have access to accurate, up-to-the-second information as to the prices at which transactions in particular securities are taking place (*i.e.*, last sale reports) and the prices at which other traders have expressed their willingness to buy or sell (*i.e.*, quotations). For this reason, communications systems designed to provide automated dissemination of last sale and quotation information with respect to securities will form the heart of the national market system. . . . As our trading markets shift from independent, self-contained units to a single integrated system, clear regulatory control over the communications links among markets becomes imperative . . . to insure the availability of prompt and accurate trading information, to assure that these communications networks are not controlled or dominated by any particular market center, to guarantee fair access to such systems by all brokers, dealers and investors, and to prevent any competitive restriction on their operation not justified by the purposes of the Exchange Act."[9]

In ensuing years, the composite quotation and consolidated transaction reporting systems have worked well in the main. They are operated pursuant to plans submitted by the Consolidated Tape Association to, and approved by, the SEC. They have allowed quotations and transaction

[9] Senate Report to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 9 (1975).

reports from all participating market centers to be aggregated, with what is recognized as approximating proper sequencing of quotation entries and transactional reports, and have facilitated order routing by all market participants. As noted in our response to Question 31, reporting delays are not permitted for block trades and this has not evidently had a deleterious effect on market liquidity - the U.S. equity markets are among the most liquid in the world. Nevertheless, the desire to avoid having a block order disrupt a market has led to a variety of increasingly technological ways of slicing large orders into randomly sized pieces for presentation into the market and has also facilitated the creation of opaque or "dark" market centers in view of the desire of large players to avoid having market participants "sharp shoot" their order flow.

The disadvantage of consolidation through a single public utility, such as the U.S. Securities Industry Automation Corporation, is that it tends to stifle innovation with respect to the National Best Bid and Offer, but the SEC has responded to that by allowing individual market centers to decide whether and how to disseminate "depth of market" quotations, that is, bids below the best bid and offers above the best offer.

In today's technologically driven environment, an alternative to having a central consolidator might be to enforce common reporting protocols, requiring all reporting parties to adhere to a common atomic clock so that the quotation entries and trades can be properly sequenced. Such a regime, if appropriately implemented and maintained, could allow individual market participants or third party information vendors to buy data feeds from regulated markets and MTFs and consolidate the quotation and trade information on their desktops.

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

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

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

If a consolidated tape is run by individual market participants, or a consortium of market participants (e.g., dealers), the market participants in control of the tape may have their own interests that may conflict with the interests of market participants generally. Also, a privately run organization controlling the tape may have an incentive to charge monopoly rents for the resulting market data, which will not benefit investors.

Again, it may be helpful for us to provide the U.S. perspective, since that is referred to in Question 54.

In the United States, the Congress directed the SEC in the 1975 Securities Acts Amendments to assess the fairness and reasonableness of market data fees charged by exchanges and by the

Consolidated Tape Association. The SEC has steadfastly declined to engage in typical ratemaking proceedings and, in the past, has relied on a "see if anyone objects" approach. Until very recently, there were few serious objections. Last year, however, a U.S. federal appellate court adjudicated an appeal brought by the Securities Industry and Financial Markets Association and by NetCoalition, a consortium of internet service providers and data vendors including Google, Yahoo Inc.!, Bloomberg L.P. and others, challenging a decision by the SEC to approve depth-of-market fees filed by NYSE Arca. *NetCoalition v. Securities and Exchange Commission,* 615 F.3d 525 (D.C. Cir. 2010). The Court held that the SEC's approval could not be sustained because the SEC had failed, in its evaluation of the fairness and reasonableness of NYSE Arca's fees for depth-of-market data, to gather and consider data as to NYSE Arca's costs of collecting and distributing the data. The Court remanded the matter to the SEC for further proceedings. This case is attracting additional litigation to challenge exchange market data fees. One of the court's findings in the NetCoalition case rejects the idea that exchanges are to be treated as public utilities but challenges the very way in which the SEC has treated the Consolidated Tape Association fees for "core" (that is to say, National Best Bid and Offer) data:

> [P]ortions of the legislative history [of the Exchange Act] suggest[] the Commission was supposed to assume a special oversight and regulatory role over exclusive processors by treating them as public utilities, a role inconsistent with allowing market forces to determine market data prices. . . . These statements, however, refer to an 'exclusive *central* processor for the *composite* [*i.e.*, consolidated core data] tape or any other element of the national market system," not to an exchange acting as the processor of its proprietary non-core data.

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

As noted above, accurate sequencing of information on the consolidated tape is crucial. Of paramount concern also is that there be sufficient funding to permit the introduction of new technology and that the consolidated tape not be controlled or dominated by any particular market center, to guarantee fair access to such systems by all investment firms and investors, and to prevent any unjustified competitive restriction on its operation.

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

In the United States, the composite quotation system and the consolidated transaction reporting system began operations several years after the Congress mandated their creation.[10] Presumably,

[10] The SEC approved the original consolidated transaction reporting system on May 20, 1974 (Securities Exchange Act Release No. 10787 (May 10, 1974), 39 FR 17799 (May 20, 1974)). It temporarily authorized a plan calling for the establishment of the Composite Quotation System on August 7, 1978 (Securities Exchange Act Release No. 15009 (July 28, 1978), 43 FR 34851 (August 7, 1978)) and permanently authorized the CQ plan on January 28, 1980 (Securities Exchange Act Release No. 16518 (January 22, 1980), 45 FR 6521 (January 28, 1980)).

once decisions are taken as to how to proceed in Europe, implementation could be on a more accelerated time schedule.

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

MFA has no particular comment on this issue.

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

MFA believes that the introduction of a transparency regime for non-equity products would be more effective on a consolidated tape.

SECTION 5. MEASURES SPECIFIC TO COMMODITY DERIVATIVES MARKETS

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

MFA supports the concept that any position information made available to the public should be on an aggregated (as opposed to individualized) basis only.

In respect of detailed position information to regulators, we are concerned about the prospect of public disclosure of position-level data (including the identities of the counterparties) and other sensitive details. Trading strategies are often complex in composition, with various pieces combining to express a single view. A narrow or otherwise compromised perspective, particularly in a pressurized environment, could lead to misunderstanding and potentially misuse. Given the multitude of national regulators involved, and the various interests represented, we would be concerned that unfettered access without precondition could have harmful side effects on the very markets that are meant to be protected.

As such, we believe that the Commission should establish a "reasonable threshold" or "nexus" requirement for a regulator in one member state to gain access to data from an organized trading venue in another member state. Without constraining legitimate interests, such a requirement would appropriately balance the proprietary nature of market transactions with the overall goals of the regulation.

SECTION 6. TRANSACTION REPORTING

6.2 Content of reporting

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

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

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

MFA notes the proposal is to have transaction reports identify the person who has made the investment decision through the chain of order transmission to the final execution of the transaction, as well as a more detailed transaction reporting format to include the identification of the client and trading capacity.

As we have noted in several places above, MFA members are concerned that if strict confidentiality obligations are not placed on each person in the report chain (as well as the trading venues and competent authorities), the highly sensitive proprietary information and trading strategies of the funds MFA members manage may be disclosed. In particular, the concerns expressed in our response to Question 60 apply equally here. We would urge the Commission to consider making it an obligation that such transaction reports must not be made available to the public, particularly as the reports attribute trades to an identified buyer or seller. Secondly, any client identifier should remain anonymous to any firm in the reporting chain; only a competent authority should be able to access the identity of the relevant client.

6.3 Reporting channels

As a general matter, MFA believes that the obligation to report transactions should attach to the market maker or broker. It should only ever extend to the end investor if there is no market maker or broker involved in the transaction.

In each case, the reporting mechanism should be subject to a statutory obligation to maintain confidentiality of the reported data, particularly information about the identity of the investors. *Question 82: What is your opinion on waiving the MiFID reporting obligation on an investment firm which has already reported an OTC contract to a trade repository or competent authority under EMIR? Please explain the reasons for your views.*

MFA supports such a waiver of the MiFID reporting obligation, as duplication of reporting seems unnecessary.

SECTION 7. INVESTOR PROTECTION AND PROVISION OF INVESTMENT SERVICES

7.2.4 Inducements

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

MFA believes that the requirement to provide full disclosure in each case would be impractical and is unlikely to benefit professional clients.

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

MFA believes that this additional requirement would be impractical and is unlikely to benefit professional clients.

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

MFA disagrees with this proposal as applied to dealings with professional clients.

The current MiFID rules requiring disclosure of inducements and applying strict standards to the circumstances where commission sharing is permitted are, in our view, sufficient to manage conflicts of interest and ensure fair treatment of professional clients.

7.3.6 Segregation of client assets

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

MFA makes no comment on the prohibition of title transfer collateral arrangements involving retail clients' assets.

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

There should not be a prohibition on title transfer collateral arrangements involving non-retail clients' assets, as non-retail clients should be in a position to determine whether such arrangements are commercially acceptable. Among other things, non-retail clients are able to judge whether better pricing that could result from permitting such arrangements would outweigh the risks. However, MFA would support a requirement for investment firms to report to non-retail clients, on a daily basis: (i) what assets of the non-retail client have been used/rehypothecated by the investment firm; (ii) the amount of assets (including cash balances)

which remain; and (iii) the outstanding obligations of the non-retail client to the investment firm which are secured by those assets and cash. MFA also supports the requirement for non-retail clients to receive risk warnings of the consequences of title transfer collateral arrangements.

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

MFA makes no comment as this relates to retail clients.

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

MFA supports the extension of information requirements concerning the use of client financial instruments to include non-retail clients. Please see our response to Question 120 in relation to information as to the use of non-retail clients' collateral, *etc.*

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

MFA supports a requirement to specify due diligence obligations in the choice of entities for the deposit of client funds, particularly in relation to the depositing of funds with affiliates of the relevant investment firm. MFA would also support a requirement that investment firms be permitted to deposit only a specified percentage of client funds with affiliates.

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

8.3. Access of third country firms to EU markets

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

MFA is of the view that it is not necessary to introduce a third country regime in MiFID based on the principle of exemptive relief for equivalent jurisdictions. MFA is concerned by the statement that "third country firms must be subject to a regulatory regime which is at least equivalent to that offered by the MiFID." We would urge the Commission to reconsider applying, on a pan-EU basis, access based on what is in effect a "strict equivalence" standard. The concern is that such a standard implies that no aspect of a third country's regulatory regime could be different to that of the standard set in MiFID; this may give the impression of the EU taking a protectionist stance. Separately, in setting such a high standard the EU would be preventing its residents from seeking investment opportunities in many non-EU economies which may have appropriate and comparable regulatory standards, but not meet the strict equivalence standard.

SECTION 9. REINFORCEMENT OF SUPERVISORY POWERS IN KEY AREAS

9.1. Ban on specific activities, products or practices

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

MFA fully supports strong, stable and predictable markets. In that regard, MFA believes that unilateral and sudden bans on financial products or activities, without adequate warning and consultation, can result in significant market instability, and in many cases can exacerbate or prolong the market turmoil they seek to address.

As a general principle, therefore, MFA believes that any decision to ban a product, practice or operation should be taken only after prior consultation, considered analysis of empirical data and a thorough impact assessment and cost/benefit analysis.

MFA recognizes the desire of regulatory authorities to have emergency powers to take certain actions in limited circumstances, and notes certain actions ESMA may take under Article 9(5) and Article 18 of the ESMA Regulation (Regulation No. 1095/2010). However, given the potential for sudden actions (such as bans) to cause market instability and a sudden reduction in liquidity in the markets, MFA believes that such actions should only be taken in very limited circumstances.

In respect of the proposal to give national regulators the power to temporarily ban or restrict the trading or the distribution of a product by one or more investment firms or the provision of an activity, MFA supports the Commission's statement in the Consultation Paper that "the exercise of this power could be pre-notified to and coordinated through ESMA." However, MFA would also ask the Commission to consider a mechanism under which such coordination with ESMA would involve having ESMA (i) consider the proposed action by the national regulator within a certain time, (ii) issue advice to the national regulator as to whether the action is appropriate, and (iii) give the market sufficient notice of the proposed action so that the effect of the proposed action can be properly absorbed without causing market instability.

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

MFA members are active participants in OTC derivatives markets around the world and have a strong interest in promoting the integrity and proper functioning of those markets. MFA believes that well-functioning OTC derivatives markets are essential for the restoration of capital flows given the critical role of such markets in the investment and risk management activities of many market participants. For instance, banks and other financial institutions have been able to engage in increased lending and corporate finance activities as a result of their ability to trade OTC derivatives, which provides them with a mechanism through which they can transfer risks to other market participants who are willing to accept such risks. Ultimately, increased lending and credit flows lead to lowered costs of borrowing for many businesses across the world and also

greater access for consumers to credit to purchase necessary goods and services. According to the International Swaps and Derivatives Association, 94% of the 500 largest companies in the world and 50% of medium-sized businesses use derivatives. In addition, many other smaller businesses also use OTC derivatives to manage risk.

In that light, MFA believes that any proposed ban along the lines of that proposed in Question 143 would be disproportionate and could have far-reaching consequences. Amongst other things, a CCP might not accept a transaction for clearing for one of two reasons: (i) the transaction does not meet the relevant clearing criteria; or (ii) the CCP does not wish for a particular transaction to be subject to clearing requirements for commercial reasons. An outright ban on trading such derivatives would therefore be a disproportionate measure under these circumstances and incompatible with the idea of market stability and systemic risk. We believe that, where no CCP offers to clear a particular derivative, the derivative should continue to trade bilaterally while ESMA investigates the reasons for the lack of such offers and works out a solution with the relevant CCP(s).

Finally, MFA supports an internationally coordinated approach to regulation that reflects the global nature of the OTC derivatives market. We note in particular the Commission's statement in its Commission Communication "Ensuring efficient, safe and sound derivatives markets" (COM(2009) 563/4) at paragraph 2.1:

> "In order to ensure a coherent implementation of these policies across the globe, the Commission intends to further develop the technical details in cooperation with its G20 partners, the Financial Stability Board, and in particular with the US, which is also in the process of designing a new approach to derivatives markets."

While we recognize that the MiFID review may need to diverge from similar initiatives in third countries – including the Dodd-Frank Wall Street Reform and Consumer Protection Act in the U.S. – in order to address issues specific to the EU, we strongly encourage European policymakers to maintain an open dialogue with their U.S. counterparts and actively work towards commonality, not only in relation to the European Market Infrastructure Regulation (EMIR), but also in relation to bans on OTC derivatives as contemplated in this question.

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

MFA does not believe that at present any products or services call for greater regulatory scrutiny. MFA notes the recent interest of the EU in sovereign CDS. In this regard, it is important to emphasize that restrictions on trading of sovereign CDS or a ban on uncovered sovereign CDS are likely to lead to a significant reduction in the liquidity of the sovereign CDS market. Investors use sovereign CDS to hedge risk from investments in those specific bonds, but also to hedge some risk from investments in corporate debt and equity. Restricting investors' ability to use CDS could impair investors' ability to manage risk, harm price discovery, and raise borrowing costs for sovereign and corporate issuers alike. MFA notes that the European Commission's Report on Sovereign CDS states at page 33 that: "According to several academics, prohibiting naked positions in credit default swaps could dramatically impact the market. If the CDS market is reduced to hedgers only, market liquidity is likely to drop

substantially." In addition, there is no evidence that uncovered sovereign CDS cause financial instability. The recent Commission's Report on Sovereign CDS found no conclusive evidence that trading activity drove up funding costs for EU Member States.

9.2 Stronger Oversight of Positions in Derivatives, including Commodity Derivatives

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

and

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

As noted above, MFA is a strong supporter of stable and predictable markets. In this regard MFA would caution the Commission against hard position limits in favour of a "position management" approach. Restrictive position limits could severely impact liquidity and market participants' ability to manage risk.

We believe that the mechanical imposition of position limits for commodity derivatives will have the effect of reducing liquidity and the ability of commercial participants to hedge against future changes in price by limiting the ability of market participants to appropriately diversify and reduce risk. It is also likely to reduce the competitiveness of European markets and indeed may distort markets, particularly in light of the global nature of commodity derivatives markets.

Academic and governmental studies and real world examples show that policies restricting investor access to derivatives markets impair commercial participants' ability to hedge and restrict the use of risk management tools. We note CESR's response to the Commission in October 2010 that:

> "*Q12(d): Position limits*
>
> There is little evidence so far to suggest that markets where position limits have operated for the life of the derivative contract have been any less volatile than those which have not. Nor is there sufficient evidence so far that position limits can systematically be used to limit the impact that significant positions may have on the prices markets generate. Accordingly, it remains to be further assessed

> whether or not position limits are suited to achieving the objectives of reducing volatility or limiting the impact that large positions may have on market prices."[11]

We also agree with the views expressed in the December 2009 UK Treasury and Financial Services Authority paper "Reforming OTC Derivative Markets: A UK perspective":[12]

- In relation to the use of position limits to combat market manipulation:

  > "We do not believe, nor have we seen evidence, that a blanket approach through specific position limits is necessarily the most effective way to monitor, detect and deter manipulative behaviour in derivative markets, whether they are on exchange or OTC."

- In relation to controlling or limiting price movement:

  > "[W]e have seen no evidence to suggest that one particular type of market participant has been solely responsible for systematically driving derivative market prices. As a result, we do not believe that limiting one class of market participant by imposing specific limits is a desirable or warranted response to the changing nature of derivative markets. Furthermore, there is no evidence to date which demonstrates that prices of commodities, or other financial derivatives, can be effectively controlled through the mandatory operation of regulatory tools such as position limits. We therefore do not believe these measures would achieve the goal of solving the perceived problems."

- In general terms:

  > "In our view a broader position management approach which does not focus on one type of participant is the most effective approach to ensuring market integrity in derivative markets."

MFA thus urges the Commission to consider alternatives to position limits, such as enhanced post-trade transparency obligations and reporting of derivatives position (as proposed in Sections 3.4.2, 5.1 and 6.1 of the Consultation). With equities, the issues of ownership and control are addressed by disclosure and reporting obligations under the Transparency Directive. We believe that the same approach should be applied consistently to all types of financial instruments.

Finally, we note that both Questions 145 and 146 refer to position limits for "some or all types of derivative contracts". We assume that the Commission is referring to "some or all types of *commodity* derivative contracts" and is not proposing position limits for other types of derivative contracts, such as security-based derivatives, as to which our observations above on the detrimental impact of position limits apply equally. In this regard we note that footnote 282 and

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[11] See *CESR's Responses to Questions 1-14 and 19 of the European Commission Request for Additional Information in Relation to the Review of MiFID*, October 2010, CESR/10-1254.

[12] See paragraphs 9.4 and 9.5 of the paper, available at http://www.fsa.gov.uk/pubs/other/reform_otc_derivatives.pdf.

paragraph 9.2(c) of the Consultation refer to position limits as a tool to manage manipulation in commodity derivatives markets, particularly when the contract is approaching expiry.

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

It is sometimes argued that, where the relevant underlying commodity in a derivative contract is in finite supply, it may be appropriate to impose hard position limits (particularly towards the end of the life of a contract) in order to prevent certain market participants from cornering or manipulating the market.

However, research and experience demonstrate that hard position limits have not reduced volatility or prevented market manipulation. We believe position limits are the wrong set of tools to use to address fraud and manipulation concerns with respect to an underlying securities market. Price manipulation is better policed through market data and reporting regimes, rather than limitations on ownership or economic exposure. MFA is concerned that a misguided application of position limits might have significant, negative effects on the liquidity of the equities markets, and inhibit capital formation and investors' ability to hedge risks.

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?

MFA's position, as expressed above, is that the imposition of position limits is not the right regulatory tool, either to deal with market manipulation or controlling price movements.