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

January 30, 2016

Via Electronic Submission

DG Financial Stability, Financial Services and Capital Markets Union
European Commission
SPA2 06/070
1049 Brussels
Belgium

Dear Sir or Madam,

Re: Call for evidence: EU regulatory framework for financial services

Managed Funds Association ("MFA")[1] welcomes the opportunity to provide comments to the European Commission (the "Commission") on its Call for Evidence in relation to the EU regulatory framework for financial services[2], issued in connection with the EU Capital Markets Union ("CMU") project. MFA members, as investors in European markets and professional asset managers for European institutional investors, have a shared interest with policy makers in ensuring robust European capital markets and promoting the aims of the CMU. MFA therefore supports the Commission's goal of gaining a clearer understanding of the interaction of individual rules and the cumulative impact of legislation as a whole on the financial services sector, given that regulatory overlaps can create inefficiencies for regulators and market participants alike, and may in some cases lead to an unlevel playing field. We look forward to working with the Commission and other policy makers on this important project.

We have outlined below certain key points raised in our response to the Call for Evidence.

I. Unnecessary regulatory constraints on financing

At present, transfers of non-performing loan ("NPL") portfolios are at risk of being

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

[2] See http://ec.europa.eu/finance/consultations/2015/financial-regulatory-framework-review/docs/consultation-document_en.pdf.

characterised as "securitisations" under the Capital Requirements Regulation ("CRR")[3]. This result frequently proves a complicating factor when structuring NPL portfolio transfers. Such an outcome may dissuade professional investors, including asset managers, from involvement in such transactions (which would otherwise allow banks to de-leverage and divest risk, freeing up capital for other lending activities). We therefore suggest that the definition of "securitisation" in the CRR either be revised to ensure that transfers of NPL portfolios are clearly outside of its scope, or that EU regulators give clear guidance on NPL transfers being outside of the scope of the definition.

MFA also would highlight in this regard the issue of corporate lending by funds. The approach of individual Member States to the ability of funds to lend directly to corporates is currently fragmented, with certain Member States allowing for such activity without the imposition of unnecessary restrictions, and others requiring the lender to have a full banking licence. We therefore encourage the European Commission to consider how the position could be improved in this respect, ultimately with a view to allowing direct lending by funds throughout the EU. This outcome would be in line with the CMU's aim of increasing financing to small and medium sized enterprises ("SMEs").

II. Market liquidity

We stress in our response to this issue: (i) the need for EU authorities to take a pragmatic approach to equivalence with regard to third country CCPs, swap execution facilities, and non-EU firms doing business in the EU; (ii) the need for transparency to be effectively calibrated so as to avoid damaging liquidity; (iii) our view that investment research should not be required to be unbundled from other costs; and (iv) that a single channel should be established through which information on short selling bans is disseminated. MFA also urges EU authorities to take a more active role in ensuring that short selling bans do not harm liquidity.

III. Excessive compliance costs and complexity

MFA urges the European Commission to consider the efficiency of registration and disclosure or reporting requirements under the Short Selling Regulation ("SSR") and the Alternative Investment Fund Managers Directive ("AIFMD"). We urge the Commission to harmonise these requirements across Member States, with a single EU-wide portal set up for filing disclosures and reports. We also suggest that an EU private placement regime could be considered alongside the existing national private placement regime and AIFMD passport options.

IV. Reporting and disclosure obligations

At present, market participants are encountering difficulties in analysing and implementing the overlapping reporting requirements taking effect (or intended to take effect) under the European Market Infrastructure Regulation (EMIR)[4], the Regulation on Energy Market Integrity and Transparency (REMIT)[5], MiFID II[6] and the Regulation on Reporting and

[3] Regulation (EU) No 575/2013.
[4] Regulation (EU) No 648/2012.
[5] Regulation (EU) No 1227/2011.
[6] Regulation (EU) No 600/2014 and Directive 2014/65/EU.

Transparency of Securities Financing Transactions (SFTR)[7]. Each of these reporting regimes applies in a slightly different way (*e.g.*, in terms of content, ability to delegate, scope of application, entities authorised to receive trade reports). In our view, all four reporting regimes should be harmonised to the greatest extent possible, in order to reduce the operational burden for market participants. There should also be a move towards single-sided reporting and a pragmatic approach to delegation and backloading.

V. Rules outdated due to technological change

Given the evidence of a tendency towards increasingly detrimental and recurrent large-scale attacks conducted against information systems, it is critical that systems which will be used to receive and store data are secure. MFA notes there will be a number of obligations under MiFID II in particular, which will require proprietary information to be transmitted to third parties, trading venues, and national competent authorities. As authorities require market participants to make increasing amounts of data available under regulatory reporting regimes, additional regulatory safeguards should be put in place to ensure that the information to be reported remains secure and that effective controls are put in place to guard against cyber attacks.

VI. Barriers to entry

MFA believes that EU authorities should go further in implementing the MiFID II obligation for trading venues to have in place objective, transparent and non-discriminatory rules governing access. In particular, EU regulators should use the implementation of MiFID II as an opportunity to address the current "two-tier" market structure of dealer-to-dealer and dealer-to-customer markets. This market structure creates barriers to entry and inefficiencies that are harmful to liquidity.

VII. Links between individual rules and overall cumulative impact

The leverage ratio, as expressed in the CRR, currently requires EU clearing members of CCPs to count received client margin towards their own exposure, even where that margin is fully segregated from the assets of the clearing member and not available for re-use. MFA is concerned that this feature of the leverage ratio forms a significant disincentive for banks to become or to continue acting as clearing members. Recent exits from the client clearing business, which have occurred partly as a result of the leverage ratio, have limited access to central clearing and have resulted in concentration risk amongst those firms that have chosen to remain in the market for clearing services. We therefore urge EU regulators to take steps to reverse this trend by amending the CRR to revise the leverage ratio.

VIII. Overlaps, duplications and inconsistencies

MFA remains concerned about the conflicting or duplicative requirements that could result from the operation of Article 13 of EMIR. In particular, certain alternative investment funds ("AIFs") that are legally incorporated outside the U.S., but are managed by a U.S. based manager or are majority-owned by U.S. persons, are considered to be "U.S. persons" subject to the Commodity Futures Trading Commission's ("CFTC") derivatives rules. If these AIFs are not regarded as being "established" in the U.S. for the purposes of Article 13, both the AIF and

[7] Regulation (EU) No 2015/2365.

its EU counterparty will need to comply with both CFTC rules and EMIR. This results in an unnecessary regulatory overlap, and we therefore recommend that the Commission clarify that, for purposes of Article 13, "established" in a third country does not only mean where an entity is legally incorporated, but also includes any third country that regulates that entity as a person "established" in that third country. As noted in our submission, other laws present similar concerns.

In addition to the above points that are set out in more detail in our response, we would also like to refer the Commission to the following additional points that, whilst not necessarily suited to the nature of the Call for Evidence consultation, are in our view important to the successful implementation of the CMU project:

OECD-BEPS Project

The OECD Action Plan on Base Erosion and Profit Shifting ("BEPS"), published in July 2013, identified 15 actions to address BEPS in a holistic manner. One of these areas for reform was to "prevent the granting of treaty benefits in inappropriate circumstances" (Action 6)[8]. Whilst MFA fully supports the OECD's goal of preventing tax abuse in this respect, we also believe it is important for the BEPS project to establish a treaty benefit framework that avoids imposing double taxation on investors who would be entitled to treaty benefits when making a direct investment, but who choose to invest through a pooled investment vehicle (*e.g.*, a private investment fund).[9] To the extent that investors, including pension plans, endowments, and charitable foundations would become subject to an additional layer of tax simply because they choose to invest through a pooled vehicle, they likely would no longer choose to invest through that type of asset management structure, thereby losing the benefits of such investments. In our view, this would be to the detriment of capital markets in which investment funds participate, and thus contrary to the aims of the CMU project.

Financial Transaction Tax

Another area of potential regulatory reform that would likely harm capital markets liquidity if implemented (particularly in light of the mobile investor base) is the introduction of a financial transaction tax ("FTT"). An FTT likely would increase hedging costs and decrease asset values for investors, adversely affect credit and other financing costs for businesses, and would act as a barrier to accessing the EU capital markets.

* * * * * * *

[8] See: http://www.oecd.org/tax/treaties/revised-discussion-draft-beps-action-6-prevent-treaty-abuse.pdf
[9] MFA has submitted comments to the OECD regarding Action 6 (see: https://www.managedfunds.org/wp-content/uploads/2015/06/MFA-Letter-on-OECD-Discussion-Paper-Action-61.pdf).

MFA thanks the Commission for the opportunity to provide comments on the Call for Evidence. We would welcome the opportunity to discuss our views in greater detail. Please do not hesitate to contact the undersigned at +1 (202) 730-2600 with any questions that ESMA or its staff might have regarding this letter.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO

MANAGED FUNDS ASSOCIATION

RESPONSE TO CAPITAL MARKETS UNION CALL FOR EVIDENCE

Issue 1 – Unnecessary regulatory constraints on financing

The Commission launched a consultation in July on the impact of the Capital Requirements Regulation on bank financing of the economy. In addition to the feedback provided to that consultation, please identify undue obstacles to the ability of the wider financial sector to finance the economy, with a particular focus on SME financing, long-term innovation and infrastructure projects and climate finance. Where possible, please provide quantitative estimates to support your assessment.

EXAMPLE 1 – TRANSFER OF NON-PERFORMING LOAN PORTFOLIOS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 4(61) and 404-410 of the Capital Requirements Regulation (Regulation (EU) No 575/2013).

Please provide us with an executive/succinct summary of your example.

At present, transfers of non-performing loan ("**NPL**") portfolios are at risk of being characterised as "securitisations" under the Capital Requirements Regulation ("**CRR**"). This frequently proves a complicating factor when structuring NPL portfolio transfers, and may dissuade professional investors, including asset managers, from involvement in such transactions. Sales of these portfolios to professional investors should be encouraged to allow banks to de-leverage and divest risk, thereby providing banks with an ability to make new loans and support economic growth in the EU. We have set out below some background describing a number of the issues that discourage the transfer of NPLs, and some of the advantages that would be gained by facilitating these sales. Although we describe this issue in the context of the NPL asset class, MFA considers it to be relevant to other asset classes (*e.g.*, fully performing loans to SMEs) too.

Importance of facilitating transfers of NPL portfolios

European banks have undergone, and will continue to undergo, a significant deleveraging exercise in recent years, partly as a result of the financial crisis and partly due to the regulatory developments implemented in its wake. An essential component of this deleveraging exercise has been the sale of NPLs and the associated crystallisation of net loss positions. Asset managers have been key investors in these assets, and have therefore provided an active market enabling banks to dispose of NPLs and free up their balance sheet capacity for other activities, such as corporate lending, including to SMEs. We note in this respect that one of the primary aims of the Capital Markets Union project is to facilitate the ability of SMEs to access the financing that they require.

Banks may in particular gain the following benefits from the sale of NPL portfolios:

(a) Capital adequacy: the sale of an NPL portfolio to an entity not directly or indirectly owned by a bank will reduce its quantity of risk-weighted assets, and will therefore increase its overall capital adequacy ratio.

(b) Liquidity: a bank's liquidity position should improve as a result of the sale, given that a sizeable portfolio of illiquid assets will be replaced by cash generated from the sale.

(c) New Lending: Freeing up capital on banks' balance sheets allows banks to engage in new lending, which will allow for new loans to SMEs and other EU businesses.

Reducing risk on bank balance sheets and improving banks' capital and liquidity positions will create stronger balance sheets across the EU banking sector, reducing the potential for an event in the banking system to create financial or systemic risk. It will also permit banks to repurpose balance sheet assets currently being used in connection with NPLs to support increased financing to SMEs and other businesses.

Characterisation of NPL portfolio transfers as "securitisations" under the CRR

The sale of NPL portfolios frequently involves transferring the portfolio to a special purpose vehicle ("**SPV**"), which finances the sale through a combination of senior bank debt and sponsor equity. This sponsor equity will often take the form of subordinated debt (*e.g.*, unsecured notes), rather than simply common equity. Thus, the transaction would technically involve the transfer of a loan portfolio funded by debt that has been "tranched" into senior and junior liabilities. We note in this regard the definition of securitisation set out at Article 4(61) of the CRR, which describes a securitisation as:

> *A transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranched, having both of the following characteristics:*
>
> *(a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures;*
>
> *(b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.*

Given the breadth of this definition, each transfer of an NPL portfolio must be assessed carefully to consider whether the transaction could fall within the CRR definition of a securitisation. Although in certain structures it may be possible to argue that payments into the structure are not dependent purely on the performance of the NPL portfolio itself (such that limb (a) of the definition is not satisfied), but may instead depend on the skill or business plan of the sponsor in managing the portfolio, there is clearly an inherent degree of uncertainty in relying on that argument.

As noted above, limb (b) of the test would generally also be satisfied given that sponsor financing would generally take the form of subordinated debt or profit participating notes. The term "tranche" is defined under the CRR as "a contractually established segment of the credit risk associated with an exposure or a number of exposures, where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment". Thus, although such subordinated debt instruments may have a very similar economic effect to investing by way of common equity, their debt-like features mean that they would likely be treated as a "tranche" since their features are "contractually established".

Implications for transfers of NPL portfolios

Although the economics surrounding the sale of an NPL portfolio are entirely different from the economics and rationale surrounding a traditional securitisation, the portfolio sale will be required to meet certain prescribed standards due to overly broad wording under the CRR that could be interpreted to deem these transfers to be securitisations. In particular, Articles 408-410 of the CRR impose certain requirements directly on entities classed as "sponsor and originator institutions", and would therefore impose obligations on the selling bank itself to the extent that the sale was classed as a securitisation. In addition, alternative investment fund managers authorised under the Alternative Investment Fund Managers Directive (Directive 2011/61/EU) (the "**AIFMD**") may not cause the alternative investment funds they manage to become exposed to securitisation positions unless certain requirements have been satisfied. Importantly, one of these requirements is that the "originator", "sponsor" or "original lender" of the transaction must have disclosed that it will retain, on an ongoing basis, a net economic interest in the transaction of not less than 5%.

In the context of an NPL portfolio sale, no party to the transaction would appear to fall within the intended scope of these definitions. For example, whilst the seller of the loans could technically be treated as their originator, requiring the seller to retain a 5% interest in the NPL portfolio would effectively defeat the seller's aim of fully divesting itself of its interest in the portfolio, and thereby freeing up capital for other lending activities. The seller itself may even be in insolvency or some form of rehabilitative process, which may make it impossible to satisfy the retention requirement. Similarly, there are certain issues with attempting to treat asset managers investing in the scheme as "sponsors" for the purposes of the risk retention regime. In particular, the title of "sponsor" becomes extremely artificial in the context of a sale and purchase of assets (rather than, as intended, a transaction set up to provide funding, given that the CRR definition of "sponsor" refers to an institution that "establishes and manages" a securitisation scheme).

In light of these considerations, and the uncertainty around compliance with the risk retention provisions, many sales of NPL portfolios are structured in such a way as to comply with the CRR risk retention regime (for example, a new entity may be set up in order to retain a 5% interest in the portfolio). However, not only are such structures complex and potentially artificial in nature (*i.e.*, they do not reflect the economic reality of what the parties are trying to achieve), they add significantly to the time and costs involved in structuring the transaction. This will likely have a knock-on effect on the appetite amongst investors, including asset managers, seeking to purchase NPL portfolios, which in turn will dampen banks' ability to transfer these non-performing assets.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

See the EBA's Report on its 2015 EU-Wide Transparency Exercise, dated 25 November 2015 (available at http://www.eba.europa.eu/documents/10180/1280458/2015+EU-wide+Transparency+Exercise+Report+FINAL.pdf), which notes that across the EU, NPLs currently stand at close to 6% of total loans and advances, and at 10% when only exposures towards non-financial corporations are considered. The EBA Report also suggested that smaller banks currently "struggle with higher levels of non-performing loans". As such, it would clearly be of benefit to banks to facilitate transfers of NPLs. This point has been recognised by Piers Haben, Director of Oversight at the EBA, who noted in connection with the Report that "EU banks will need to continue addressing the level of non-performing loans which remain a drag on profitability" (see: http://www.eba.europa.eu/-/eu-banks-better-capitalised-in-2015-but-npls-remain-of-concern).

See also:

- IFC's Distressed Asset Handbook, at http://www.ifc.org/wps/wcm/connect/9e40a3004dcf6f63a784a7ab7d7326c0/DA_Transfer_Handbook_2012.pdf?MOD=AJPERES

- IMF Working Paper: A Strategy for Developing a Market for Nonperforming Loans in Italy (February 2015), at: https://www.imf.org/external/pubs/ft/wp/2015/wp1524.pdf

- IMF Working Paper: A Strategy for Resolving Europe's Problem Loans (24 September 2015), at: http://www.imf.org/external/pubs/ft/sdn/2015/sdn1519.pdf

- The Wall Street Journal: European Banks Make Slow Progress on Bad Loans (1 November 2015), at: http://www.wsj.com/articles/european-banks-make-slow-progress-on-bad-loans-1446422647

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

MFA considers that the definition of "securitisation" in the CRR should either be revised to ensure that transfers of NPL portfolios are clearly outside of its scope, or the EBA should give clear guidance on NPL transfers being outside of the scope of the definition. We note that the latter solution may be an easier one to jumpstart bank lending to European SMEs without requiring legislative amendments to the CRR itself. Alternatively, the risk retention requirements described above could simply be disapplied in the context of sales of NPL portfolios.

EXAMPLE 2 – INCONSISTENT REGULATION OF LOANS TO CORPORATES ACROSS THE EU

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

N/A

Please provide us with an executive/succinct summary of your example.

At present, there is no pan-EU regime governing lending to corporates, which means that the activity of "lending" is inconsistently regulated across the EU (for example, whilst certain

Member States allow for such activity without the imposition of unnecessary restrictions, others require the lender to have a full banking licence). This has led to the anomalous result that, in some jurisdictions, an investment fund can "lend" to an EU corporate entity by subscribing for a bond issued by that corporate entity, but may not be able to provide finance to that same company simply by extending a loan.

This inability of funds to make loans to corporates in a number of EU jurisdictions adds cost and complexity to financing opportunities, and runs counter to the Capital Markets Union's aim of reducing corporate reliance on bank financing (as set out in the European Commission's Green Paper on Building a Capital Markets Union). It also decreases competition in the corporate lending market, meaning that borrowers have a limited choice of lending institutions. This increased concentration may have an upwards effect on cost, but more importantly, it will limit access to lending for smaller corporates, given that capacity to offer loans is limited.

We note that there is work currently being undertaken at a local level in certain Member States relating to loan origination by investment funds. Although such national initiatives are a positive development, challenges remain with respect to the approaches being taken by individual Member States as well as challenges with respect to the interplay between rules in different Member States.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

See PricewaterhouseCoopers ("**PwC**") report on the "Impact of Bank Structural Reforms in Europe", which suggests that across 24 banks surveyed by PwC, total assets fell by 12% between 2008 and 2013. PwC has estimated that market capacity (measured as total assets that can be supported by a given amount of Tier 1 capital) decreased by one fifth across all banks in the sample, and by one third across investment banks between 2009 and 2013. The full report is available at: https://www.pwc.com/gx/en/banking-capital-markets/pdf/pwc-study-impact-of-bank-structural-reform.pdf

For more detail, see MFA comment letter on the European Commission's Green Paper on Building a Capital Markets Union, at: https://www.managedfunds.org/wp-content/uploads/2015/05/MFA-Letter-on-CMU-Green-Paper1.pdf

See also:

- PWC Report: Increasing European SME Access to Credit with Non-bank Lenders (April 2014), at: http://pwc.blogs.com/files/non-bank-lending_final-report.pdf

- EBA Report: Overview of the potential implications of regulatory measures for banks' business models (9 February 2015), at: https://www.eba.europa.eu/documents/10180/974844/Report+-+Overview+of+the+potential+implications+of+regulatory+measures+for+business+models.pdf/fd839715-ce6d-4f48-aa8d-0396ffc146b9

- Bank of England: Response to the European Commission's Public Consultation on the Possible Impact of the CRR and CRD IV on Bank Financing of the Economy (7

October 2015), at:
http://www.bankofengland.co.uk/pra/Documents/crdiv/responsecrrcrdivbankfinancing.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

For the reasons given above, MFA believes that investment funds should be permitted to extend loans directly to corporates throughout the EU. We therefore encourage the European Commission to consider various approaches to achieve the goal of allowing and facilitating direct lending by funds throughout the EU.

Issue 2 – Market liquidity

Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on market liquidity. Please elaborate on the relative significance of such impact in comparison with the impact caused by macroeconomic or other underlying factors.

EXAMPLE 1 – THIRD COUNTRY EQUIVALENCE

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 25 and 89(4) of European Market Infrastructure Regulation (Regulation (EU) No 648/2012) ("**EMIR**"), Articles 28 , 29(2) and 46(2) of MiFIR (Regulation (EU) No 600/2014, "**MiFIR**") and Article 18(3) of the MiFID II Directive (Directive 2014/65/EU on markets in financial instruments).

Please provide us with an executive/succinct summary of your example.

Given that future "equivalence" assessments made under legislation such as EMIR and MiFID II will have a substantial bearing on the ability of EU investors to trade with non-EU firms, or to utilise non-EU market infrastructure such as third country CCPs and Swap Execution Facilities ("**SEFs**"), there is a need for a pragmatic and consistent approach to equivalence by EU authorities. If such an approach is not taken, liquidity fragmentation could occur on a cross-border basis, as market participants would be driven to focus their trading activity in local markets. This is a significant concern given the global nature of financial markets, and it could ultimately result in increased trading costs and a reduction in market efficiency and choice for market participants. In particular, this would damage SMEs and other corporates given the reliance by such entities on their dealers for pricing in the context of hedging transactions.

We would highlight in particular the following areas of concern:

Third country CCP equivalence under EMIR

The issue of whether a non-EU or "third country" CCP has been granted recognition under Article 25 of EMIR has three significant outcomes under the EU regulatory regime:

(a) under the CRR, EU firms that are CRD-regulated face higher capital charges when transacting with a non-EU or "third country" CCP that has not been recognised under EMIR. These higher charges become punitive in the case of exposure to an unrecognised CCP's default fund;

(b) in the absence of a positive recognition decision, non-EU CCPs are prohibited from providing clearing services to market participants or trading venues established in the EU (albeit that a transitional period is currently in force, as described below); and

(c) all market participants subject to the EMIR clearing obligation can only satisfy the EMIR clearing obligation by clearing through an authorised EU CCP or a recognised non-EU CCP.

Notably, a positive recognition decision in favour of a third country CCP is dependent on that CCP's home state regime being declared equivalent pursuant to Article 25 of EMIR. Such equivalence decisions have not as yet been made in relation to a number of jurisdictions, including the US.

We note that there is a transitional period in force under the CRR, which currently allows EU entities to hold off from applying the increased capital requirements described above; however, there is uncertainty surrounding how long this transitional period will remain in effect given that it has already been extended several times. In addition, and despite the transitional period, there is a concern that CRD-regulated firms will begin to withdraw from unrecognised third country CCPs, due to concerns surrounding open positions becoming "caught" in such CCPs following the expiry of the transitional period or a negative recognition decision. Notably, neither EMIR nor the CRR envisages the firm's portfolio being closed out in this situation.

In addition, although Article 89(4) of EMIR clearly allows for third country CCPs that were previously permitted to do business under a local Member State regime to continue providing such services even in the absence of a recognition decision, the position is less clear for third country CCPs that were not providing clearing services in the EU prior to the introduction of EMIR. It appears that such CCPs must simply wait for an equivalence decision prior to being permitted to do business in the EU. This situation could potentially be damaging to competition given that it forms a barrier to entry for CCPs that may otherwise meet the standards required to provide clearing services in the EU and wish to provide such services to European markets.

Despite the application of these transitional periods, which are intended to provide relief to CCPs established in jurisdictions where no equivalence decision has yet been made, EU counterparties will only be able to satisfy the EMIR clearing obligation by clearing through an authorised or recognised CCP. Thus, once the clearing obligation comes into force for a particular class of derivatives, counterparties will be forced to cease clearing those derivatives through an unrecognised CCP. Indeed, EU market participants may well begin to withdraw from unrecognised CCPs in advance of the clearing obligation's application date, given the time required to onboard with an alternative CCP. We note that this issue is exacerbated by the application of "frontloading" under EMIR.

The situation described above creates barriers to entry and market distortions that harm competition, and has the potential to fragment liquidity in the OTC derivatives market. It may also prevent EU market participants from accessing clearing services in relation to transactions in instruments that are clearable through one or more CCPs established outside of the EU.

Article 13 equivalence under EMIR

We would like to highlight in particular the importance of the equivalence process set out under Article 13 of EMIR, which is intended to avoid duplicative or conflicting requirements for clearing, reporting, the treatment of non-financial counterparties, and risk mitigation techniques for non-cleared trades (including margin requirements applying to uncleared OTC derivatives). The ongoing absence of a positive equivalence decision in relation to these requirements for jurisdictions with a significant share of the global derivatives market, such as the US, is concerning to many of our members who engage in cross-border trading. Once the clearing obligation and mandatory margin requirements are phased in in the EU, however, the impact of non-equivalence is likely to become particularly damaging. In the future, attempting to comply with overlapping margin requirements (which could, at worst, require that margin be posted and collected multiple times) would likely be so operationally challenging that many non-EU firms would simply be forced to cease trading with EU counterparties. Again, this would create a cross-border split in the liquidity of the derivatives markets, which are (at present) very much global in nature.

Third country trading venue equivalence under MiFID II

Under Article 28 of MiFIR, all derivatives that are declared subject to the MiFID II trading obligation must be traded either through an EU trading venue, or through an "equivalent" third country trading venue. Although it will be some time before the derivatives trading obligation comes into force in the EU, MFA urges the European Commission to take a pragmatic, principles-based approach to trading venue equivalence, in order to avoid liquidity fragmentation along jurisdictional lines. In particular, we would urge EU regulators to consider the outcomes of the foreign legislative regime; for example, although the transparency requirements applying to US SEFs may be somewhat different to the transparency requirements applying to EU multilateral trading facilities, it should be borne in mind that the SEF trading system is intended to achieve a similar regulatory outcome (*i.e.*, satisfaction of the G20 requirement to trade all standardised OTC derivative contracts on exchanges or electronic trading platforms).

Nevertheless, we also consider that the MiFID II equivalence regime presents EU regulators with a valuable opportunity to work with global regulators to maximise harmonisation, avoid regulatory arbitrage and establish an equivalence framework that maintains consistency with the core principles of the EU legislative framework. Principles enshrined in MiFID II that are critical to transparent and competitive markets must be protected, such as non-discriminatory access to trading venues pursuant to Article 18(3) of the MiFID II Directive and the straight-through-processing requirements for cleared derivatives set out in Article 29(2) of MiFIR. Non-discriminatory access to trading venues allows market participants to compete on a level playing field and facilitates access to liquidity providers, increasing transparency and competition. Straight-through-processing reduces systemic risk by ensuring trades intended to be cleared are actually submitted and accepted for clearing as soon as technologically practicable. Importantly, both of these principles are also found in the US framework for SEFs. In advance of the implementation of the MiFID II trading obligation, we continue to support regulatory efforts to maximise harmonisation while protecting core principles in the EU framework that are critical to a well-functioning derivatives market.

Third country investment firm equivalence under MiFID II

We note that MiFIR allows third country firms to register to provide investment services or perform investment activities in relation to EU professional clients and eligible counterparties, provided they are established in an "equivalent" jurisdiction. Again, EU authorities should apply a pragmatic and outcomes-based approach to equivalence, in the interests of promoting cross-border liquidity.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

See:

- Testimony of Terrence A. Duffy, Executive Chairman and President of CME Group Inc. before the House Committee on Agriculture Subcommittee on Commodity Exchanges, Energy and Credit Hearing on CFTC Reauthorisation (25 March 2015), at: http://agriculture.house.gov/uploadedfiles/duffy_testimony.pdf

- ESMA's EMIR Review Report no. 4: ESMA input as part of the Commission consultation on the EMIR review (13 August 2015), at: https://www.esma.europa.eu/system/files/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf

- Steven Maijoor of ESMA's Keynote Speech: Clearing the way towards an OTC derivatives union (22 September 2015), at: http://www.esma.europa.eu/system/files/2015-1417_steven_maijoor_isda_europe_conference_speech_2015.pdf

- Remarks of Chairman Timothy Massad before the 3rd Annual OTC Derivatives Summit North America (29 September 2015), at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-28

- Keynote Remarks of Chairman Timothy Massad before the Swap Execution Facility Conference (26 October 2015), at: http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-32

- CFTC QMTF No-Action Letter 14-46 (April 9, 2014), at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/14-46.pdf

For more detail, see also:

- MFA response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

- MFA response letter to ESMA Consultation Paper on MiFID II / MiFIR, at: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As noted above, it is vital that, in making decisions on the equivalence of third country regimes, the European Commission acts in a consistent and pragmatic way and makes its decisions on the basis of regulatory outcomes rather than a line-by-line comparison of legal regimes. It is also vital, for the reasons highlighted above, for the European Commission to act quickly in making decisions on equivalence, particularly given the impending implementation of the EMIR clearing and margin obligations in the EU.

There are two additional steps relating to the issue of equivalence that the European Commission may wish to consider further:

(a) The European Commission could consider advocating for greater international harmonisation of issues relating to the regulation of systemically important entities such as CCPs. One of the major issues that has arisen in relation to the EMIR equivalence process has been the differing and inconsistent approaches of local regulators to implementing the Principles for Financial Market Infrastructure, which has made it more difficult to compare like with like. MFA respectfully submits that cross-border debates surrounding issues such as procyclicality and liquidation time horizons are better raised in international fora such as IOSCO, rather than being dealt with via negotiations surrounding equivalence, which may result in delays to the recognition of non-EU entities, with a resulting detrimental impact on market certainty; and

(b) The European Commission could consider whether there is a need for an overarching piece of legislation governing the equivalence process, which other regulations such as EMIR and MiFIR could refer to, as necessary. This overarching legislation could, for example, set expectations surrounding timing, interaction with third country regulators, the ongoing application of national Member State access regimes during the equivalence process and require an outcomes-based approach to equivalence.

EXAMPLE 2 - TRANSPARENCY

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 8-11 and 18-21 of MiFIR.

Please provide us with an executive/succinct summary of your example.

In many cases, the impact of upcoming reforms to the financial services sector, particularly those contained in MiFID II, is not yet clear. However, the transparency requirements set out in MiFIR have in particular the potential to adversely affect and fragment liquidity across the EU, if they are not implemented in a way that is effectively calibrated according to the features of different types of instrument and trading system. Two particular concerns of MFA are the application of transparency requirements to: (i) fixed income products; and (ii) package transactions. We note that the application of the transparency regime will in both cases partly depend on certain Level 2 measures which have been proposed by ESMA, and which are currently being scrutinised by the European Commission.

Fixed income transparency

Although the application of the Instrument by Instrument Approach ("**IBIA**") to assessing liquidity is positive, the proposed thresholds for when a bond will be classed a "liquid" instrument (and therefore subject to full transparency) are arguably still too low; for example, under current proposals, a bond would only need to trade on average twice per day to be declared liquid. We also consider that a standard post-trade transparency deferral period capped at T+2 for large in scale transactions could prevent effective hedging in many classes of bonds.

Package transactions

MFA stresses that the transparency regime should apply to package transactions as a whole, based on a product-level liquidity assessment, rather than treating each component of the package as an outright transaction. However, we note that ESMA was unable to apply the pre-trade transparency regime to package transactions in this way given the restrictions inherent in its legislative mandate; for example, ESMA felt unable to provide for appropriate pre-trade transparency waivers relating to package trades. ESMA's suggestion that MiFIR be amended to allow for a more tailored treatment of package transactions should therefore be taken forward by the European Commission.

We note as a general point that package transactions may vary significantly in terms of overall liquidity. While certain package transactions are very standardised and liquid (*e.g.*, many packages containing two swaps of differing tenors (commonly referred to as "swap curves") or three swaps of differing tenors (commonly referred to as "swap butterflies")), and may therefore be appropriate for inclusion within the scope of full transparency requirements (or, indeed, the derivatives trading obligation), others are not – even those comprised of instruments that if executed on a stand-alone or "outright" basis may individually be liquid enough to be subject to full transparency requirements or the trading obligation. In the US, for example, many package transactions have been assessed as sufficiently liquid to trade on SEFs, but certain others have not. For more illiquid packages, the CFTC has had to resort to issuing no-action relief from mandatory SEF trading.

Given that the Recitals to draft RTS 4 on the criteria for determining whether derivatives should be subject to the trading obligation (see "Regulatory technical and implementing standards – Annex I, MiFID II/MiFIR, published by ESMA on 28 September 2015) acknowledge that the assessment of an instrument's liquidity for the purposes of the transparency regime will be taken into account in assessing whether it is suitable for inclusion in the derivatives trading obligation, we stress that it is critical for EU authorities to assess the liquidity of package transactions in an appropriate manner from the outset.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

Fixed income transparency

See letter from the European Parliament's ECON Committee to Steven Maijoor at ESMA on "Regulatory Technical Standards under MiFID II/MiFIR", dated 23 July 2015 (the "**EP Letter**"), which noted that "the definition for bonds should be tested to meet the requirements for continuous trading and therefore a test of 2-3 trades per day cannot be perceived to be liquid".

Package transactions

See ESMA's Final Report on Draft Regulatory and Implementing Technical Standards Under MiFID II/MiFIR, dated 28 September 2015, which specifically states that "ESMA recommends an amendment of MiFIR, which would allow for a tailored treatment of packages also in the context of pre-trade transparency".

See also CFTC No-Action Letter 15-55 (Oct. 14, 2015), at: http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/15-55.pdf

For more detail, see generally MFA response letter to ESMA Consultation Paper on MiFID II / MiFIR, at: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

Fixed income transparency

Delaying the application of fixed income transparency until 2018, such that better data on fixed income markets can be gathered and the transparency regime properly calibrated would be helpful. As noted above, MFA considers that a higher threshold for a bond to be classed as "liquid", and a longer deferral period applying to the publication of post-trade transparency data, would both be advisable in mitigating the potentially harmful effects of transparency on liquidity in the fixed income markets.

Package transactions

As noted, the European Commission should take forward ESMA's suggestion that MiFIR be amended to allow for a more tailored treatment of package transactions, in particular the more illiquid types of packages.

EXAMPLE 3 – INDUCEMENTS REGIME

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 24(7)(b) and 24(8) of the MiFID II Directive.

Please provide us with an executive/succinct summary of your example.

Treatment of research under the MiFID II inducements regime

Under Articles 24(7)(b) and 24(8) of the MiFID II Directive, portfolio managers and firms providing investment advice on an independent basis are not permitted to accept and retain fees, commission or any monetary or non-monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of services to clients ("**inducements**"). However, excluded from these provisions are certain minor "non-monetary benefits" capable of enhancing the quality of service provided to a client.

ESMA has expressed the view in its Final Report on its Technical Advice to the European Commission on MiFID II/MiFIR (the "**Final Advice**") that research can amount to an inducement. ESMA has not listed research in its proposed (exhaustive) list of minor non-monetary benefits, and has stated that any research which is tailored or bespoke in its content, or rationed in how it is distributed or accessed, cannot be a minor non-monetary benefit. The result appears to be that while dealing commission can be used to pay for execution and minor non-monetary benefits, it cannot be used to pay for investment research.

Further, although there is some discussion of commission sharing arrangements by ESMA, the Final Advice appears predicated on the idea that research will only fall outside the category of an inducement where it is received in return for: (i) direct payments from the firm's own funds; or (ii) payment from a separate research payment account funded by charges to clients distinct to any charges paid by those clients for execution or other services.

Negative consequences for EU markets and SMEs

MFA is deeply concerned that ESMA's proposals for unbundling of research will disadvantage EU investors and SMEs. In particular, we are concerned that the proposals will have unintended consequences on the ability of EU asset managers to obtain access to research relating to EU SMEs.

As ESMA's Final Advice would require sell-side firms to charge separately for research (*i.e.*, separately from other services such as execution, in effect mandating the establishment of separate business lines for the provision of investment research), some brokers will likely decide to exit certain areas for which they carry on research activities or cease to provide any research whatsoever. MFA is concerned that this change will lead to a greater emphasis on research coverage of traditional markets and larger companies. This could lead to the availability of research relating to non-traditional investment opportunities and, in particular, SMEs becoming limited and, in turn, market interest in these types of investments being reduced. This outcome would be counterproductive to the wider policy goals of the Capital Markets Union in encouraging investment in EU SMEs, and would be detrimental to investors using the services of an EU asset manager.

Negative consequences for cross-border business

MFA is also concerned that ESMA's unbundling proposals will impose legal obstacles on hedge fund managers and other firms that operate on a global basis, and that seek to obtain high quality research from the best available sources. For example, US law specifically allows managers to "pay up" (*i.e.*, pay a higher commission rate) for research. ESMA's proposals would make it difficult for a manager to obtain research in the US market while still complying with ESMA's unbundling proposal, particularly given that a US broker-dealer would likely need to restructure its business in order to receive any "hard dollar" payments. MFA also has similar concerns for other global markets (such as those in Australia, South Africa and Hong Kong) in which the commercial and practical effect of ESMA's proposals are unknown. It is not clear how third country brokers would respond to a request from an EU asset manager to charge for research or other goods or services separately from execution services, and whether third country brokers would provide research to managers in the manner expected under ESMA's proposals, or whether there would be additional costs passed on to managers.

As a result of the issues set out above, MFA is concerned that the proposed requirement for research unbundling could result in a general reduction in demand for research (both in relation to EU corporates and on a wider scale), which will in turn lead to a decrease in investment and market liquidity, particularly in the shares of smaller corporates. The research we have cited below from Charles River Associates confirms that this could well be an outcome of the proposed regime.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

As evidence of the potential negative outcomes of ESMA's proposals, we would refer you to a study undertaken by Charles River Associates in 2003, in response to similar unbundling proposals that were being considered by the UK Financial Services Authority ("**FSA**") but were not adopted (see: Bundled Brokerage and Soft Commission Arrangements, April 2003, available at: http://www.fsa.gov.uk/pubs/cp/cp176.pdf).

The Charles River Associates study concluded that the FSA proposals would likely lead to a reduction in demand for research below optimal levels, which would decrease the level of trading, in particular of small and mid-cap shares, and increase spreads of trades that do take place. Ultimately, reduced demand for research of small and mid-cap shares would likely raise barriers when smaller companies wish to raise capital. See: an Assessment of the Proposed Changes to Regulation of Bundled Brokerage and Soft Commission Arrangements, October 2003, Charles River Associates, pages 64 to 67, available at: http://www.charlesriverassociates.com/sites/default/files/publications/an-assessment-of-the-proposed-changes-to-regulation-of-bundled-brokerage-and-soft-commission-arrangements.pdf.

We note also the comments on ESMA's proposed inducements regime made by France, Germany and the United Kingdom in their "non-paper to accompany the FSC Sub-group Report on Level 2 Processes", dated 22 May 2015. Notably, the non-paper states as follows:

> *there was no discussion during the Level 1 process regarding the classification of complimentary research as a non-permissible inducement. The Level 1 text specifies that investment firms providing portfolio management services may not accept or retain from third parties monetary or non-monetary benefits, except minor nonmonetary benefits but does not address research. The Commission must be able to demonstrate that the treatment of complimentary research as an inducement, and the complex and burdensome requirements for investment firms regarding the financing of research, is within the level 1 requirements.*

The text of the non-paper is available at: http://www.eifr.eu/files/file0632190.pdf

In addition, the European Commission has itself highlighted the issue of insufficient investment research in the context of corporates (particularly SMEs), which creates a barrier to investment (see comments on pages 51-52 of the Commission Staff Working Document dated 30 September 2015, at http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-economic-analysis_en.pdf).

See generally MFA's response to ESMA's May 2014 Consultation Paper on MiFID II/MiFIR, which discusses these issues in detail (in particular at page 28). The response is available at: https://www.managedfunds.org/wp-content/uploads/2014/08/Complete-Response.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

In general, MFA does not consider that investment research should be required to be unbundled from other costs, for the reasons set out above. However, to the extent that unbundling is required, we would suggest that the separate research payment account ("**SRPA**") necessary to achieve unbundling should simply take the form of a ledger operated by investment firms subject to the unbundling requirement.

This ledger would achieve the regulatory goal of providing cost transparency and reducing the potential for conflicts of interest, without requiring the investment firm to hold the funds represented by the SRPA with a third party. Such a third party arrangement could in particular give rise to client money obligations for the firm. Instead, a ledger/bookkeeping approach to collecting charges and tracking payments for research would allow for a fully transparent scheme but without the additional operational complexity and expense associated with holding client money.

EXAMPLE 4 – COMMUNICATION AND IMPLEMENTATION OF SHORT SELLING BANS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 7 and 27 of the Short Selling Regulation (Regulation (EU) No 236/2012) (the "**SSR**").

Please provide us with an executive/succinct summary of your example.

At present, there is a lack of harmonisation in relation to when and upon which criteria an individual national competent authority can impose a short selling ban. In addition, there is no single channel by which market participants can monitor short selling bans, and no standard process for announcing such bans (*e.g.*, immediate or delayed implementation) and the form that such bans could take (*e.g.*, which securities will be affected). We believe, for example, that it is procedurally unrealistic to monitor each national competent authority's website on a real time basis to establish when a short sale ban is to be implemented. MFA would therefore prefer to see greater harmonisation in this area, which could in particular include establishing a single channel (*e.g.*, the ESMA website) through which information on these bans is disseminated on a real-time basis. Further, in order to minimise the uncertainty and confusion past bans have caused, MFA recommends that some form of minimum notice period for bans be considered (which member states may disapply in emergency situations by giving reasons to ESMA). This will reduce the likelihood of investors suddenly finding themselves in breach of a ban without realising it and help minimise market disruption.

In addition, MFA members would prefer to see EU authorities taking a more active role in monitoring national short selling bans and using empirical evidence to consider whether bans may have a disproportionately adverse effect on liquidity in the relevant markets. Indeed, EU-level authorities such as ESMA could play a valuable role in developing guidance on the design of such bans, which national competent authorities would then need to consider before any such ban is implemented. This would in particular fit with the coordinating role envisaged for ESMA under Article 27 of the SSR, which stresses, for example, that ESMA should ensure that national measures are "appropriate and proportionate to address the threat and whether the proposed duration of any such measure is justified".

Finally, we respectfully submit that the CMU process, which is intended to consider the overall impact of EU regulation on the capital markets sector, presents an ideal opportunity to consider whether the initial and incremental notification thresholds for disclosure of net short positions in shares and sovereign debt are set at an appropriate level. At present, the low levels at which they have been set (0.2% notification to competent authorities; 0.5% public disclosure) increases the regulatory burden on market participants in terms of reporting their positions, and, based on the evidence set out below, they may well have a dampening effect on liquidity generally. We note that the current thresholds for sovereign debt positions may, for example, be easily exceeded, hence requiring disclosure (this is particularly the case in relation to the sovereign debt of smaller jurisdictions). Article 7 of the SSR provides that in specifying the incremental levels for disclosure of net short positions, the European Commission is required to take into account "the liquidity of each sovereign bond market". In MFA's view, this requirement to take into account the liquidity profile of the sovereign bond market should be treated as an ongoing requirement, and if there is evidence that existing thresholds have disproportionately affected liquidity, they should be revised.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See in particular our joint response with AIMA to the Call for Evidence by ESMA regarding the evaluation of the SSR (at https://www.managedfunds.org/wp-content/uploads/2013/03/AIMA-MFA-Joint-Response-to-ESMA-SSR-call-for-evidence-15-March-2013.pdf), which gives evidence for why sovereign debt thresholds for countries with less debt, in particular less long dated debt, are disproportionately sensitive.

In relation to the relationship between short selling bans and liquidity generally, see:

- ESMA's Technical Advice evaluating the impact of the Regulation on short selling and certain aspects of credit default swaps (available at http://www.esma.europa.eu/system/files/2013-614_final_report_on_ssr_evaluation.pdf), which concluded that the lifting of long-term short-selling restrictions appeared to increase trading volumes.

- Statements made by then-SEC Chairman Cox (in 2008) in relation to the negative effects of imposing a short selling ban in the United States, summarised at: http://www.reuters.com/article/2008/12/31/us-sec-cox-idUSTRE4BU3GG20081231

- Oliver Wyman report on the effects of short-selling public disclosure regimes on equity markets, which examined the effects of manager-level public short-selling disclosure requirements, and concluded that such disclosure requirements have a negative effect on liquidity http://www.managedfunds.org/wp-content/uploads/2011/06/plugin-Oliver_Wyman_Financial_Services_Report.pdf

- CFA Institute Market Integrity Insights: Impact of European Short-Selling Regulation: Mixed Effect on Markets (7 June 2013), at: https://blogs.cfainstitute.org/marketintegrity/2013/06/07/impact-of-european-short-selling-regulation-mixed-effects-on-markets/

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

For the reasons set out above, MFA recommends that certain operational improvements be made to the communication of short selling bans, in particular establishing a single channel through which information on bans is disseminated. MFA also recommends that some form of minimum notice period for bans be considered (which Member States may disapply in emergency situations by giving reasons to ESMA).

In addition, MFA urges EU authorities to take a more active role in monitoring whether short selling bans are disproportionately affecting liquidity in the relevant markets, and taking action to reverse this impact where necessary. In addition, the Commission should track whether the current initial and incremental notification thresholds are set at an appropriate level for each Member State concerned, especially in light of the differing features and depth of sovereign debt markets in those individual states. To the extent that the thresholds are adversely affecting the liquidity of each sovereign bond market, the European Commission should act to amend them, as per Article 7 of the SSR.

Issue 3 – Investor and consumer protection

Please specify whether, and to what extent, the regulatory framework has had any major positive or negative impacts on investor and consumer protection and confidence.

EXAMPLE 1 – LOCAL AUTHORITY PENSION FUNDS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Annex II of the MiFID II Directive, Article 46 of MiFIR.

Please provide us with an executive/succinct summary of your example.

MFA wishes to draw the European Commission's attention to the treatment of local authority pension funds under MiFID II. Although "pension funds and management companies of such funds" remain categorised as professional clients under MiFID II, municipalities and local public authorities will in the future be treated as retail clients (albeit that they may "opt up" to professional client status). It appears that in certain jurisdictions, due to the specific structure of local authority pension funds and the way in which assets are held, local authority pension funds may be treated as retail rather than professional clients. For example, in the UK, such pension funds are held by local authorities as a ringfenced amount within the local authority's accounts, rather than as a fund separate from the local authority itself (we understand that this structure is driven by UK statutory requirements).

In light of these local differences in structure, MFA would urge EU authorities to ensure that local authority pension funds are receiving equal treatment under the MiFID regime throughout the EU. Given the relative sophistication of these funds and the size of their assets under management, it appears to us to be incongruous to treat them as retail clients. In addition, unless the relevant funds elect up to professional client status, they will find themselves faced with a considerably reduced pool of asset managers willing to provide them with services, and a significantly restricted range of products available to achieve their investment objectives.

Electing up to professional status is of course possible, but will require local authority pension funds to demonstrate to each asset manager they use that they meet the various qualitative and quantitative criteria set out under the MiFID regime. Different interpretations of the qualitative criteria could lead to similar entities having different status across the EU, and could potentially even result in a local authority pension fund being treated as having different status by asset managers established in different EU Member States. This process also could be time-consuming where a number of asset managers are involved, and introduces a level of cost and complexity that appears to us to be unwarranted. In addition, we note that elective professional clients are required to keep firms informed in relation to any change which could affect their status as an elective professional. This introduces an ongoing compliance obligation, and where such changes are reported, the assessment process may need to be repeated.

Further, we note that the MiFID II "third country" regime governing when non-EU investment firms may interact with EU clients depends on the clients' status as elective or non-elective professionals. Specifically, the registration regime applying to third country firms, as set out in Article 46 of MiFIR, provides that:

> *A third-country firm may provide investment services or perform investment activities with or without any ancillary services to eligible counterparties and to professional clients <u>within the meaning of Section I of Annex II to Directive 2014/65/EU</u> established throughout the Union without the establishment of a branch where it is registered in the register of third-country firms kept by ESMA in accordance with Article 47.*

Accordingly, if local authority pension funds are treated not as *per se* professional clients, but as elective professionals, third country asset managers accessing the EU markets via the MiFIR registration regime will not be permitted to deal with them. This might in future limit the access of such pension funds to a narrower range of service providers (*i.e.*, solely to those that are established in the EU).

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

"Local Government Association Briefing: Pooled investments", dated 3 November 2015, discusses these issues in relation to the UK regime and can be found annexed to various local authority public documents, such as City of Westminster Committee Agenda http://committees.westminster.gov.uk/documents/g3762/Public%20reports%20pack%2016th-Nov-2015%2019.00%20Pension%20Fund%20Committee%20Formerly%20Superannuation%20Committee.pdf?T=10).

See also:

- Investment & Pensions Europe Article: UK local authority funds face £115bn asset 'fire sale' due to MiFID II (23 October 2015), at: http://www.ipe.com/news/regulation/uk-local-authority-funds-face-115bn-asset-fire-sale-due-to-mifid-ii/10010387.fullarticle

- Financial Times Article: EU rules threaten UK infrastructure investment (25 October 2015), at: http://www.ft.com/cms/s/0/520d45d4-78e0-11e5-933d-efcdc3c11c89.html#axzz3tjlzVIdV

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As members of the asset management industry, MFA members perform a valuable service in relation to pension funds. We are very concerned by the possibility that, pursuant to the MiFIR third country registration regime, asset managers established outside of the EU may ultimately be forced to stop dealing with certain EU local authority pension funds as a result of their status as elective professionals. Thus, we suggest that the European Commission issues guidance to the effect that all local authority pension funds, regardless of whether they are segregated from the local authority itself, should be classed as *per se* professional clients.

In the context of investor and consumer protection issues, we would also refer you our response on the proposed MiFID II inducements regime (see Issue 5, Example 3).

EXAMPLE 2 - INVESTOR PROTECTION REQUIREMENTS SHOULD BE IMPLEMENTED IN A PROPORTIONATE WAY

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 8-11 of MiFIR, Article 24 of the MiFID II Directive.

Please provide us with an executive/succinct summary of your example.

MFA is in favour of effective and proportionate investor protection measures, which can play a critical role in reducing issues surrounding information asymmetry and disparities in investor sophistication. However, in considering the scope of investor protection requirements, EU authorities should have regard to the relative sophistication of market participants, and whether more sophisticated entities consider that they actually require the relevant protection. Excessive regulatory requirements can result in higher costs for such entities (which will ultimately be passed on to end users), and could increase costs of entry to the financial services sector.

Recent examples of situations that have resulted in, or may in the future result in, the application of disproportionate levels of investor protection are:

Transparency in request-for-quote systems: under the proposed MiFID II Level 2 transparency regime, each quote from a member or participant in a request-for-quote ("**RFQ**") system will need to be published individually to the market. In the view of our members, this heightened level of transparency is not necessary for the benefit or protection of market participants. Transparency of individual quotes does not reflect how RFQ systems are structured or run, and could in fact have a negative impact on the willingness of sell side entities to provide such quotes.

Inducements regime: as explained in detail in our response to Issue 2, we do not consider that investment research should be required to be unbundled from other costs under MiFID II. In the hedge funds industry in particular, this type of regulation is unnecessary. Hedge fund investors are almost exclusively professional clients (*i.e.*, institutional investors or other sophisticated investors) who are typically assisted by advisers, consultants and/or legal counsel in carrying out detailed due diligence on the fund manager and in assessing (and, in some cases, negotiating) investment terms. The allocation of costs is disclosed and contractual in nature and any risk in respect of investor protection and transparency is significantly mitigated because the investor (being professional) has made an informed decision to accept the relevant allocation of costs and expenses as disclosed. In light of the nature of hedge fund investors and the adverse effects of requiring unbundling, as discussed in our response to Issue 2, it is our view that there is little need to impose full unbundling of research costs in this scenario.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

Transparency in request-for-quote systems: See letter from the European Parliament's ECON Committee to Steven Maijoor at ESMA on "Regulatory Technical Standards under MiFID II/MiFIR", dated 23 July 2015, which stated that:

> "it would be preferable to require RFQ operators to disclose information on prices and volumes on an aggregate basis, *i.e.*, the average of provided quotes with the average of attached volumes. Such a solution would not encroach on the transparency objective and, in the meantime, would better cater for the characteristics of the RFQ trading systems."

Inducements regime: As evidence of the potential negative outcomes of ESMA's proposals on inducements, we would refer the Commission to a study undertaken by Charles River Associates in 2003, in response to similar unbundling proposals that were being considered by the UK Financial Services Authority ("**FSA**") but were not adopted (see: Bundled Brokerage and Soft Commission Arrangements, April 2003, available at: http://www.fsa.gov.uk/pubs/cp/cp176.pdf). The implications of this study are discussed more fully in our response to Issue 2.

> **If you have suggestions to remedy the issue(s) raised in your example, please make them here.**

As a general matter, EU authorities should ensure that in extending investor protection requirements to more sophisticated market participants, the views of those market participants surrounding the need for the relevant protections is taken into account. In relation to the specific issue highlighted above, we would make the following recommendations:

Transparency in request-for-quote systems: as noted in our response to Issue 2, we would suggest that a better approach to transparency in the context of RFQ trading systems would be to publish an aggregate of bid and offer prices rather than individual quotes.

Inducements regime: In general, MFA does not consider that investment research should be required to be unbundled from other costs, for the reasons set out above. Note, however, that if unbundling is required, we have put forward an alternative approach involving a separate research payment account in our response to Issue 2 above.

Issue 4 – Proportionality / preserving diversity in the EU financial sector

Are EU rules adequately suited to the diversity of financial institutions in the EU? Are these rules adapted to the emergence of new business models and the participation of non-financial actors in the market place? Is further adaptation needed and justified from a risk perspective? If so, which, and how?

Issue 5 – Excessive compliance costs and complexity

In response to some of the practices seen in the run-up to the crisis, EU rules have necessarily become more prescriptive. This will help to ensure that firms are held to account, but it can also increase costs and complexity, and weaken a sense of individual responsibility. Please identify and justify such burdens that, in your view, do not meet the objectives set out above efficiently and effectively. Please provide quantitative estimates to support your assessment and distinguish between direct and indirect impacts, and between one-off and recurring costs. Please identify areas where they could be simplified, to achieve more efficiently the intended regulatory objective.

EXAMPLE 1 – REGISTRATION AND DISCLOSURE REQUIREMENTS UNDER THE SSR

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 5-9 of the EU Short Selling Regulation (Regulation (EU) No 236/2012) ("**SSR**").

Please provide us with an executive/succinct summary of your example.

Under Articles 5 and 6 of the SSR, persons with net short positions must notify and/or publicly disclose such positions to or through EU competent authorities. Notwithstanding the SSR is a directly applicable Regulation, however, the method of notification/disclosure is unique to each Member State. The result is that position holders have to register with individual Member State competent authorities' web portals/systems in order to satisfy the notification/disclosure requirement. Not all web portals are easy to understand (and may be in the local language).

In our view, the lack of harmonisation in the notification and disclosure processes results in unnecessary cost and complexity for market participants seeking to invest in the EU, and presents a significant operational burden to our members. There should be one single form of disclosure under the SSR, and preferably one central portal (*e.g.*, run by ESMA) where market participants are able to file the required notifications. Implementing such a system would better conform to the original objective of the SSR, namely to "ensure that provisions directly imposing obligations on private parties to notify and disclose net short positions relating to certain instruments and regarding uncovered short selling are applied in a uniform manner throughout the Union" (see Recital 3 of the SSR).

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See:

- ESMA: Links to National Websites for the Purpose of Notification of Net Short Positions
  https://www.esma.europa.eu/system/files/2012_epsc_680_short_selling_-_nca_weblinks_for_notification_30092013.pdf

- MFA comment letter on the European Commission's Green Paper on Building a Capital Markets Union, at: https://www.managedfunds.org/wp-content/uploads/2015/05/MFA-Letter-on-CMU-Green-Paper1.pdf

- MFA-AIMA Response to the Call for Evidence by ESMA regarding the evaluation of the SSR, in particular the table set out at page 6, which identifies differences in notification forms and communication methods across Member States, at: https://www.managedfunds.org/wp-content/uploads/2013/03/AIMA-MFA-Joint-Response-to-ESMA-SSR-call-for-evidence-15-March-2013.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As noted above, the notification and disclosure process under the SSR should be harmonised across EU Member States allowing, for example, single-batch uploading of notifications using one file format. This would significantly reduce the costs and operational burden associated with the frequent notifications required by the current threshold levels. There should preferably be one central portal to file disclosures (*e.g.*, with ESMA), rather than different filing requirements applying in each individual Member State.

Although such a pan-EU system would be the best outcome, a potential alternative would be for national competent authorities to implement a standard form and communication method developed in cooperation with market participants. This would permit our members to develop more automated solutions to the form completion and dispatch processes than are currently possible given the existing diversity of forms and communication methods.

EXAMPLE 2 – REGISTRATION AND DISCLOSURE REQUIREMENTS UNDER THE AIFMD

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 42 of the AIFMD.

Please provide us with an executive/succinct summary of your example.

Where a non-EU alternative investment fund manager ("**AIFM**") markets its alternative investment funds ("**AIFs**") under Article 42 of the AIFMD (*i.e.*, under the national private placement regime), the non-EU AIFM must comply with the reporting requirement under Article 24 (Annex IV reporting) to the regulator in each Member State into which the AIFs are being marketed. However, the form used and process for filing the form differs across Member States. This is notwithstanding that Annex IV reporting is the subject of the AIFMD Level 2 Regulation (Regulation (EC) No 231/2013) and so should be consistent across all Member States. As with notification requirements under the SSR, the variations between filing processes in different EU Member States is a source of unnecessary cost and complexity for non-EU managers, thereby discouraging them from offering investment opportunities to investors in the EU.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA comment letter on the European Commission's Green Paper on Building a Capital Markets Union, at: https://www.managedfunds.org/wp-content/uploads/2015/05/MFA-Letter-on-CMU-Green-Paper1.pdf

See also evidence cited in our response to Example 3, immediately below.

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

There should be one single form of disclosure under the AIFMD, and preferably one central portal (*e.g.*, run by ESMA) where non-EU managers are able to file the required forms.

EXAMPLE 3 – EXCESSIVE, BURDENSOME REQUIREMENTS UNDER THE AIFMD

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 42 of the AIFMD.

Please provide us with an executive/succinct summary of your example.

The asset management industry has played a critical role in market recovery and growth in the EU following the financial crisis, providing greater risk-adjusted returns to investors and performing a valuable intermediary role for institutional investors, including both public and private pension/retirement funds. As noted elsewhere in this response, the asset management industry can also play a significant role in freeing up bank balance sheets to lend to SMEs. As such, it is within the interests of the capital markets union project to facilitate asset management activity and investment within the EU, whether by EU or third country managers. In order to maximise the ability of both EU and non-EU asset managers to engage in the EU markets and provide services to EU investors, MFA considers it is important to maintain existing well-functioning mechanisms integral to the flow of capital, namely the mandated AIFMD passport and importantly the national private placement regimes, as well as to deal with identified obstacles to promoting a well-functioning European regime. With these ends in mind, MFA suggests that a "three-pronged" approach to AIFMD implementation be adopted, which would include retaining the passport and national private placement regimes, whilst also incorporating a form of a harmonized private placement regime that would permit marketing AIFs under a consistent set of private placement rules in multiple EU Member States. Such an approach would ensure against risks to current practices as well as promoting cross border capital flows whilst further increasing investor choice as a wider range of managers are attracted to doing business in the EU.

Promoting workable European and national private placement regimes in particular is crucial to the success of the AIFMD regime. We note in particular the studies cited in the "Evidence" section of this response below, which found that the vast majority of non-EU managers did not plan to market their funds to EU investors at the time of writing, either through national private placement regimes or through the AIFMD passport (should it become available). The Prequin study in particular found with respect to US managers, that only 12% of managers indicated that they plan to market under national private placement regimes, and only 4% planned to establish an EU AIFM to take advantage of the AIFMD passport. Based on our anecdotal experience with MFA members, we do not believe that there would be substantially more interest from US managers in becoming fully authorised AIFMs to be able to market under the AIFMD passport if it were expanded to non-EU AIFMs. In addition, the Prequin study found that 78% of US managers cited compliance costs or uncertainty about the AIFMD as the reason why US managers do not plan to market their funds to EU investors.

We would encourage EU authorities to take additional steps to maximise the ability of EU investors to gain exposure to US hedge funds, which form an attractive investment opportunity and allow EU investors to diversify their exposure across a broader range of assets and investment strategies. As noted above, we consider that providing the option of utilising either the AIFMD passport or the national private placement regimes currently in place (certain of which we have found are functioning well, whilst others are simply not available to non-EU managers), alongside a broader harmonized private placement regime, would provide maximum flexibility and would allow non-EU asset managers to adapt their approach depending on their business profile and the EU markets they wish to become active in.

Although as noted above our members consider that there are at present certain workable national private placement regimes, there remain a number of Member States that do not have private placement regimes for non-EU managers. In addition, the significant uncertainty resulting from a lack of guidance and clarity regarding the rules in different Member States is complicated and costly, and we believe that this has acted as a disincentive to US managers wishing to raise capital from investors across the EU. In addition to Member States sharing best practices on private placement regimes in order to increase the effectiveness of national private placement regimes, we consider that a harmonised private placement regime would act as a valuable additional option to what is currently in place. We note that for those asset managers that wish to market only into one, or perhaps a limited number of, EU Member States, it is important that the current system of national private placement regimes remains in place, particularly given that it is already being utilised by a number of non-EU managers. We recognize that a harmonised private placement regime would require careful structuring and we look forward to continuing to work with EU policymakers and regulators on ways that a harmonised regime could be developed and implemented.

In general, and as illustrated by the studies we cite below, the AIFMD passport is a considerably less popular choice for non-EU managers given the substantial compliance costs it entails, so we consider that this should remain as a third option rather than replacing the option of private placement, even if the EU goes forward with extending the AIFMD passport to non-EU managers.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

In relation to the appetite of non-EU managers to market in the EU following implementation of the AIFMD, see:

- Report by Prequin, "Global Hedge Fund Managers Respond to the AIFMD" (July 2014), at: https://www.preqin.com/docs/reports/Preqin-Special-Report-Hedge-Fund-Managers-Respond-to-AIFMD-July-14.pdf; and

- Aksia 2015 Hedge Fund Manager Survey, available at http://www.aksia.com/media/2015_HF_Manager_Survey.pdf. The Aksia survey notes in particular that at the time of writing, a majority of hedge fund managers surveyed did not plan to market to EU investors, and that 87% of managers described "significant challenges" regarding the AIFMD.

In relation to challenges surrounding individual national private placement regimes, see:

- "AIFMD - The Road to Implementation - Joint AIMA and EY Survey" (at http://www.aima.org/en/document-summary/index.cfm/docid/20398275-A1D6-4912-91544D27107509ED), which gives examples of gold-plating in different jurisdictions.

- HFMCompliance article: Key EU states gold-plate AIFMD annual report rules (29 June 2015), at: https://hfm.global/hfmcompliance/aifmd/exclusive-key-eu-states-gold-plate-aifmd-annual-report-rules/

- Hedgefund Journal article: AIFMD: One Year On (7 July 2015), at: http://www.thehedgefundjournal.com/node/10263

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As noted above, the AIFMD private placement regime is not working as intended in a number of jurisdictions, and it is clear that many non-EU managers do not see the AIFMD passport as a viable alternative. We would therefore suggest implementing a harmonized private placement regime alongside the existing national private placement regime and AIFMD passport options for the reasons set out above.

<u>Issue 6 – Reporting and disclosure obligations</u>

The EU has put in place a range of rules designed to increase transparency and provide more information to regulators, investors and the public in general. The information contained in these requirements is necessary to improve oversight and confidence and will ultimately improve the functioning of markets. In some areas, however, the same or similar information may be required to be reported more than once, or requirements may result in information reported in a way which is not useful to provide effective oversight or added value for investors.

Please identify the reporting provisions, either publicly or to supervisory authorities, which in your view either do not meet sufficiently the objectives above or where streamlining/clarifying the obligations would improve quality, effectiveness and coherence. If applicable, please provide specific proposals.

Specifically for investors and competent authorities, please provide an assessment whether the current reporting and disclosure obligations are fit for the purpose of public oversight and ensuring transparency. If applicable, please provide specific examples of missing reporting or disclosure obligations or existing obligations without clear added value.

EXAMPLE 1 – OVERLAPPING REPORTING REQUIREMENTS UNDER EMIR, MiFID II, REMIT AND THE SFTR

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 9 of EMIR, Article 26 of MiFIR, Article 8 of Regulation (EU) No 1227/2011 ("**REMIT**"), and Article 4 of the Regulation on Reporting and Transparency of Securities Financing Transactions (Regulation (EU) No 2015/2365, the "**SFTR**").

Please provide us with an executive/succinct summary of your example.

At present, market participants are having difficulties analysing and implementing the overlapping reporting requirements taking effect (or intended to take effect in future) under EMIR, REMIT, MiFID II and the SFTR. Each of these reporting regimes applies in a slightly different way (*e.g.*, in terms of content, ability to delegate, scope of application, entities authorised to receive trade reports). In our view, all four reporting regimes should be harmonised to the greatest extent possible, in order to reduce the operational burden for market participants, preferably with a move towards single-sided reporting and a pragmatic approach to delegation and backloading.

We have set out below some major areas of divergence that could be better harmonised in relation to all four regimes.

<u>Which entity has the obligation to report?</u>

There is a question of which entity has a reporting obligation varies across the four pieces of legislation. For example, whereas reporting requirements take effect at counterparty level under EMIR, the MiFID II reporting obligation applies only to authorised investment firms, and under REMIT, a specified definition of "market participant" governs which entity is required to report (specifically, "any person, including transmission system operators, who enters into transactions, including the placing of orders, to trade in one or more wholesale energy markets"). Whilst we understand the rationale for MiFID reporting being limited to authorised investment firms rather than applying at counterparty-level, the differing scope of the four regimes means that whilst a derivative contract may be reportable at fund (*i.e.*, counterparty) level under EMIR, the same contract would be reportable at the level of the investment manager or sub-manager under MiFID II. Thus, although Article 26(7) of MiFIR allows for transaction reports filed under EMIR to at least partially satisfy the MiFID II reporting obligation in ordinary circumstances, it seems unlikely that fund managers could take advantage of this provision given that a different entity (*i.e.*, the fund) would be filing the underlying EMIR transaction report. Thus, a provision that was intended to avoid double-reporting may simply not be applicable or effective in this situation.

We note that under the SFTR, whilst reporting obligations would generally take effect at counterparty-level, AIFMs and UCITS management companies rather than AIFs and UCITS will be required to report. This adds another layer of complexity, and suggests that the position should be harmonised in favour of managers rather than underlying funds taking on the obligation to report. In general, however, MFA supports the position under REMIT, and the Agency for the Cooperation of Energy Regulators' pragmatic interpretation of which counterparties should be treated as a "market participant" and therefore subject to the reporting obligation.

Delegation

Although EMIR, REMIT and the SFTR allow for a straightforward delegation of reporting, MiFID II places certain conditions on the delegation of reporting (which we note are not a feature of the current MiFID regime). Under MiFID II, a specific transmission agreement which includes certain defined terms will need to be put in place. Given the drafting of the proposed technical standards governing such transmission agreements, it seems likely that many asset managers will choose to take on reporting themselves rather than negotiating a potentially significant number of such transmission arrangements with their brokers. MFA respectfully submits that the approach to delegation set out in EMIR, which leaves responsibility for accurate reporting with the delegating party but does not impose any formalities on the delegation arrangement itself, has worked more efficiently than the MiFID II approach seems likely to function.

Despite the fact that the EMIR approach to delegation appears more desirable than the MiFID II approach, however, MFA considers that issues surrounding delegation, and the inconsistencies surrounding which entity should report, would both be greatly reduced by the application of single-sided reporting (as set out below).

Single-sided or dual-sided reporting?

Article 8 of REMIT effectively provides that single-sided reporting by one counterparty is sufficient given that "once the required information is received" from a person or authority listed in Article 8, "the reporting obligation on the market participant in question shall be considered to be fulfilled". However, EMIR requires dual-sided reporting, as does MiFID II (assuming the transaction involves more than one authorised investment firm).

The position under the SFTR is slightly more complex, given that, while single-sided reporting would be the usual position, there is an obligation for financial counterparties to take on reporting where they are trading with a smaller corporate (as per certain tests set out in the EU Accounting Directive). This may be an attempt to resolve some of the issues with EMIR-style dual-sided reporting, and although we commend EU authorities' aim of putting in place a reporting waterfall which would require reporting by the more sophisticated counterparty, we believe that this single-sided "waterfall" structure should be extended more broadly, across all entities within scope of the regime.

MFA therefore urges the European Commission to adopt single-sided reporting across all four regimes. A single-sided reporting framework would be beneficial to both transaction counterparties and their regulators, given that it would eliminate the problems associated with ensuring that the data in transaction reports matches. We note in this respect that, under EMIR, there is an ongoing issue with single-sided reports not being effectively "matched" or paired by trade repositories. In that sense, dual-sided reporting has effectively fallen short of the aim of providing EU authorities with accurate data on the derivatives market, thus undermining their ability to assess systemic risk and monitor for market abuse. In addition, in the case of EMIR in particular, valuation and other data reported would need to be reconciled by the counterparties pursuant to Article 11 of EMIR in any event; this forms a safeguard against inaccurate data being reported to trade repositories. Single-sided reporting under MiFID II would arguably also be more reflective of current market practice (*e.g.,* in the UK, there is currently a portfolio manager exemption to reporting aimed at reducing instances of double-reporting).

Given that dual-sided reporting does not necessarily increase the quality of data received by national competent authorities (and, indeed, may even decrease it), in MFA's view the significant administrative, operational, and costs burden presented by dual-sided reporting is wholly unnecessary, and the European Commission should spearhead a move towards single-sided transaction reporting across the SFTR, EMIR and MiFID II. Specifically, the adoption of a single-sided reporting regime would reduce the operational complexity of the current framework, and the burden for less sophisticated derivatives users to report, which will lead to a vast improvement in the availability of accurate data to regulators.

Backloading

Although MiFID II does not contain a backloading obligation, we note that EMIR, REMIT and the SFTR all require backloaded reporting of trades. Although backloaded reporting is generally challenging from an operational perspective, it may in particular present problems in the context of REMIT, which requires the reporting of trades which an entity may simply have executed (*e.g.,* in terms of "placing an order"), but not retained an interest in. Although reportable details of backloaded transactions need only include "data which can be extracted from market participants' existing records", given that the relevant entity will no longer be a party to the transaction, there are questions surrounding exactly how helpful the information contained in these existing records is likely to be.

The backloading obligation under EMIR presents another, far greater, challenge for market participants. Due to the operation of Article 5(4) of European Commission Implementing Regulation (EU) No 1247/2012 of 19 December 2012, financial counterparties ("**FCs**") and non-financial counterparties ("**NFCs**") must report transactions to a trade repository that were: (i) entered into before 16 August 2012 and were still outstanding on that date; or (ii) entered into on or after 16 August 2012, and which terminated prior to 12 February 2014 ("**Terminated Transactions**") by 12 February 2017. This requirement, if left in place, will result in market participants reporting an enormous volume of Terminated Transactions. In many cases, such market participants will need to implement substantial new procedures from an operational perspective, and onboard with a trade repository in order to self-report, given that many reporting delegation agreements do not provide for the reporting of Terminated Transactions. As a result, it would be both administratively burdensome and costly for market participants to report these Terminated Transactions. In our view, it is difficult to see that data relating to transactions that will have terminated more than three years before the data is reported will assist national regulators or ESMA in reducing systemic risk.

Content

In general, MFA supports the harmonisation of content across different trade reports where appropriate. However, we note that a number of the fields set out in EMIR transaction reports, whilst appropriate for OTC derivatives, are not well tailored to exchange traded derivatives. We would suggest that, given the frequency with which exchange traded derivatives are often traded, T+1 position level reporting would be more appropriate than filing individual transaction reports for each trade. Indeed, in the view of our members, it would in fact be most appropriate for trading venues themselves to report this data given that they have the systems necessary to access and collate this information more efficiently than market participants themselves. The European Commission might also consider the impact of differing content requirements on a cross border basis (*e.g.,* the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "**Dodd-Frank Act**") vs. EMIR, where differences in reporting fields have created practical implementation issues).

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See table separately uploaded under the title "Issue 6, Example 1 Evidence of Overlaps in Regulatory Reporting Requirements" and annexed to this document, which sets out a number of the various different features of the MiFID II, SFTR, REMIT and EMIR reporting regimes.

For more detail, see MFA response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As MFA notes above, issues surrounding delegation of reporting, and inconsistencies regarding which entity should report, would both be greatly reduced by the application of single-sided reporting across all four transaction reporting regimes. This single-sided reporting regime could be based on the "SSR Framework Blueprint" proposed by ISDA in the context of the EMIR Review, which aims to ensure that the most sophisticated counterparty best able to collate the relevant data is given the task of reporting. Such a regime would be similar to the approach to reporting under the Dodd-Frank Act in the US.

We also urge the European Commission to eliminate the requirement for FCs and NFCs to report Terminated Transactions under EMIR. We do not consider that Terminated Transactions should be subject to the reporting obligation, and importantly, this approach to reporting trades that have long since terminated should not be carried through the Level 2 standards required to be drafted pursuant to the SFTR.

As noted above, T+1 position level reporting should also be considered in relation to exchange-traded derivatives, given that the current EMIR reporting regime is a poor fit in this context. We note that this issue is likely to be exacerbated under MiFID II, which looks set to reproduce many of the same reporting fields for derivative transactions that are currently in place under EMIR. In our view, and as explained above, we consider that trading venues would in any event be best placed to report this data.

Finally, we respectfully suggest that the European Commission give further consideration to consolidating all four reporting requirements into a single regulation, aimed at streamlining and simplifying compliance for market participants, and enhancing the consistency of data received by regulators across the different regimes. We also note in this context our response to Issue 8, which urges EU authorities to take greater steps to ensure that reported data is being held in a secure manner.

EXAMPLE 2 – COMMODITY DERIVATIVE POSITION REPORTING

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 58 of the MiFID II Directive.

Please provide us with an executive/succinct summary of your example.

As a general comment, in light of the huge quantity of data on derivative transactions which market participants are already required to submit under the EU regime (in particular pursuant to EMIR and MiFID II), MFA is not convinced that the position reporting regime set out in Article 58 of the MiFID II Directive is strictly necessary. In our view, EU authorities should focus on the quality of data received rather than having the same data reported from a number of different sources and through a number of different reporting channels (see, for example, our response to Issue 6, which relates to overlapping reporting requirements, and our response to Issue 8, on the difficulties surrounding reporting to trading venues, which are not subject to any specific regulatory confidentiality obligation).

By way of technical comments on the proposed position reporting regime (as set out in the ESMA Consultation Paper on MiFID II/MiFIR of 19 December 2014, which contains the most recent proposals on this issue) we wish to highlight the following points:

- ESMA's explanatory comments on the draft position reporting form state "the report shall be produced as at the close of the business day and submitted by 09.00 am local time on the next business day". In our view, firms should have the benefit of a T+1 deadline (in line with EMIR, SFTR and MiFID transaction reporting requirements) in order to assimilate and report the relevant data. While we acknowledge that trading venues are required to submit position data to national competent authorities within a specific deadline, we consider that reporting positions to trading venues should be considered equivalent to submitting MiFID transaction reports to Approved Publication Arrangements, which would ordinarily be done on a T+1 basis. Fragmenting reporting deadlines across different pieces of legislation for the same instruments will become extremely onerous for market participants attempting to collate, review and send the relevant information to the appropriate body;

- An explicit mechanism for delegated reporting of position limits should be introduced into the MiFID II regime (*i.e.*, delegated either to the trading venue or to a counterparty where applicable). Given that positions are to be reported on a gross rather than a net basis, such delegation should not pose a problem for regulators receiving and analysing the data;

- As explained further in our response to Issue 8, MFA would like to see stronger confidentiality safeguards introduced in order to protect position data reported either to trading venues or to national competent authorities; and

- Finally, although market participants are required to report the position of their end client, EU authorities have not yet given any indication as to how data on the firm's end client should be obtained in a confidential manner, particularly where there is a chain of intermediaries present.

  Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA response letter to ESMA Consultation Paper on MiFID II / MiFIR, at: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf

  If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As noted above, MFA urges the European Commission to consider whether position reporting of commodity derivatives is truly warranted in light of other regulatory reporting requirements attaching to derivative transactions. However, if the position reporting regime is to be retained, we consider that the following technical points should be addressed:

- reports should only be required to be submitted on a T+1 basis;

- there should be an explicit mechanism for delegated reporting;
- stronger confidentiality and cybersecurity safeguards should be introduced to protect position data which is reported either to trading venues; and
- EU authorities should give thought to a regulatory-backed solution for passing data relating to end clients up a chain of intermediaries, in such a way that the end client's identity is protected.

EXAMPLE 3 – DISCLOSURE REGIME UNDER PROPOSED SECURITISATION REGULATION

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

The European Commission's Proposal for a Regulation of the European Parliament and of the Council laying down common rules on securitisation and creating a European framework for simple, transparent and standardised securitisation (the "**Proposed Regulation**").

Please provide us with an executive/succinct summary of your example.

In general, MFA supports the European Commission's efforts to create a workable regime governing "simple, transparent and standardised securitisations". However, we are concerned that the provisions on disclosure set out in the Proposed Regulation will have a negative effect on transparency in relation to securitisations, and potentially, therefore, a dampening effect on secondary market liquidity for securitisation debt.

As a threshold matter, we note that there are a number of new transparency rules set out in the Proposed Regulation, which appear to us to be intended to replace those currently set out in the Credit Rating Agency Regulation ("**CRAR**"), albeit that there are no provisions formally repealing the relevant sections of the CRAR. Significantly, under the proposed Regulation, information will no longer need to be made publicly available; instead, it need only be made available to "holders of a securitisation position and to the competent authorities". In our view, it is deeply unfortunate that the European Commission has proposed restricting the information required to be published to entities that are actually investing in the securitisation; this is a considerable step backwards in terms of market transparency. If potential investors are unable easily to access the information they require in relation to the securitisation, they may well be dissuaded from investing in the relevant instruments. This is clearly contrary to the Capital Markets Union's clear objective of facilitating investment in high quality securitisations across the EU.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See "Pillar III: transparent securitisations", at page 60 of the EBA's Report on Qualifying Securitisation, available at https://www.eba.europa.eu/documents/10180/950548/EBA+report+on+qualifying+securitisation.pdf. The EBA recommends in particular that simple, standardised and transparent securitisation should meet the requirements of Article 8(b) of the CRAR on disclosure to investors and prospective investors "to ensure that these parties have access to the data which is relevant for them to carry out the necessary risk and due diligence analysis with respect to the investment decision on an ongoing basis".

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

MFA would propose extending the disclosure requirements contemplated by Article 5 of the Securitisation Regulation to prospective as well as existing investors. This would not only reflect the need to introduce a system whereby relevant information on the transaction is disclosed openly and publically, but would also circumvent questions surrounding when, for example, an entity becomes an "investor" for the purposes of the Proposed Regulation, and is thereby entitled to the disclosures contemplated by the Proposed Regulation. We acknowledge that there may be a need for the regime to accommodate private transactions, where data should not be publicly disclosed, but we consider that a narrowly worded exemption should suffice to specifically carve these transactions out of the disclosure regime.

Issue 7 – Contractual documentation

Standardised documentation is often necessary to ensure that market participants are subject to the same set of rules throughout the EU in order to facilitate the cross-border provision of services and ensure free movement of capital. When rules change, clients and counterparties are often faced with new contractual documentation. This may add costs and might not always provide greater customer/ investor protection. Please identify specific situations where contractual or regulatory documents need to be updated with unnecessary frequency or are required to contain information that does not adequately meet the objectives above. Please indicate where digitalisation and digital standards could help to simplify and make contractual documentation less costly, and, if applicable, identify any obstacles to this happening.

EXAMPLE 1 – THE NEED FOR GREATER BUY SIDE INPUT INTO STANDARDISED DOCUMENTATION

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 9 of EMIR.

Please provide us with an executive/succinct summary of your example.

MFA is in favour of standardised documentation where appropriate. However, a number of standard form documents that have recently been drafted to address regulatory change (*e.g.*, certain standard-form protocols/documents in respect of EMIR) have been one-sided, in favour of the sell side.

An example of such a document is the ISDA/FOA EMIR Reporting Delegation Agreement, which includes a very broad limitation of liability and indemnity provision in favour of the reporting party, and also an ability for the reporting party to unilaterally amend the document to accommodate any change in law, rule, regulation or "operational requirement". If such an amendment is rejected by the delegating client of the reporting party, the reporting party may terminate the agreement, leaving the client without the means to report its transactions until it can put alternative arrangements in place. We note that standard form agreements such as the ISDA/FOA EMIR Reporting Delegation Agreement may be very difficult, or even impossible to negotiate; as such, it would be considerably better for the buy-side if they were drafted in a more even-handed manner from the outset.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See ISDA/FOA Reporting Delegation Agreement, available at: http://www2.isda.org/emir/

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

It may be helpful for the European Commission to facilitate a forum representing both buy and sell side interests for the purposes of drafting standard-form documents required under EU regulation. We note that the UK Fair and Effective Markets Review has given thought to implementing a similar forum at national level.

Issue 8 – Rules outdated due to technological change

Please specify where the effectiveness of rules could be enhanced to respond to increasingly online-based services and the development of financial technology solutions for the financial services sector.

EXAMPLE 1 – RISK OF DATA LEAKS BY REGULATORS AND TRADING VENUES

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Articles 58 and 76 of the MiFID II Directive (Directive 2014/65/EU).

Please provide us with an executive/succinct summary of your example.

In general, MFA supports effective and cohesive reporting requirements that enable authorities to monitor the markets effectively for abusive behaviour. However, given the significant amount of data that will become reportable on an electronic basis under MiFID II, EU authorities should take greater steps to ensure that this data (particularly in relation to proprietary algorithms and identity of clients etc.) is being held in a secure manner. In our view, the professional secrecy obligation applying to national competent authorities set out in Article 76 of the MiFID II Directive does not go far enough, given that it only mandates that no confidential information may be divulged other than in summary or aggregate form. There are, for example, no specific references to data security in Article 76.

Another concern is that under the MiFID II commodity derivatives position reporting regime, significant amounts of data will be reported to trading venues, which are not even subject to the professional secrecy requirements referred to above (as noted in our response to Issue 6).

Article 58 of the MiFID II Directive requires, for example, that members of trading venues submit to the trading venue a daily report of their positions in commodity derivatives traded on that trading venue. This report must identify not only the market participant's positions, but also "those of their clients, the clients of those clients and so on until the end client is reached", and so will contain highly confidential data on the identity of the end client to the transaction.

MFA would therefore like to see a specific confidentiality safeguard introduced in relation to trading venues, given that they will be collecting significant amounts of confidential data under MiFID II. Data security is a particular concern in relation to data reported to trading venues, which may be more vulnerable to data breaches. Clearly, any data leaks of a market participant's positions (or those of its end client) could be enormously damaging in revealing that entity's proprietary trading strategies (which may be critical to providing an attractive return to investors) and risk exposure to the market.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

See the Bank of England's Systemic Risk Survey Results, 2015, which indicate that the UK financial industry sees online attacks as a top risk, outweighing sovereign defaults and market disruptions. Specifically, 46% percent of respondents to the Survey cited the threat of cyberattacks as one of the three greatest threats to their operations – see http://www.bankofengland.co.uk/publications/Documents/other/srs/srs2015h2.pdf

We also note reports that on 18 January 2016, the Japanese Financial Services Agency was subject to a cyber-attack, resulting in its website going down. See: http://www.the-japan-news.com/news/article/0002691234

> **If you have suggestions to remedy the issue(s) raised in your example, please make them here.**

As noted above, MFA would like to see the confidentiality safeguards set out in Article 76 of the MiFID II Directive amended to incorporate specific references to data security.

MFA would also like to see a specific confidentiality obligation introduced for trading venues, as a result of their role in collecting position reports under Article 58 of the MiFID II Directive. This could take the form of an extension of Article 76 in the Level 1 text of the MiFID II Directive, or alternatively binding guidelines (*i.e.*, "comply or explain" guidelines) relating to trading venues' data security practices in this regard.

As a general comment in relation to technological change, the EU should consider facilitating the ability of market participants to access documentation such as prospectuses via a centralised electronic database (potentially taking the U.S. Securities and Exchange Commission's ("**SEC's**") "integrated disclosure system" as a template).

<u>Issue 9 – Barriers to entry</u>

Please document barriers to market entry arising from regulation that the EU should help address. Have the new rules given rise to any new barriers to entry for new market players to challenge incumbents or address hitherto unmet customer needs?

EXAMPLE 1 – IMPARTIAL ACCESS TO TRADING VENUES

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 18(3) of the MiFID II Directive.

Please provide us with an executive/succinct summary of your example.

MFA believes that ESMA should go further in implementing the Article 18(3) obligation for trading venues to have in place objective, transparent and non-discriminatory rules governing access. The impending application of the MiFID II derivatives trading obligation serves to highlight the urgent need to put in place specific regulatory requirements intended to address the "two-tier" system of trading venues currently operating in the derivatives markets. This two-tier system should be replaced with a system of non-discriminatory access to trading venues.

In particular, all market participants subject to the derivatives trading obligation should be able to gain access to the full range of trading venues available in the derivatives markets, not only to satisfy their regulatory obligations under the trading obligation, but, equally importantly, to gain access to the most beneficial pricing and liquidity possible in the derivatives markets.

As noted, by virtue of explicit or implicit barriers, many derivatives markets currently operate a "two-tier" system, whereby exclusive groups of dealers trade with one another on interdealer venues, with other types of market participants, including many of our members and other buy-side market participants, only able to trade with that group of dealers either bilaterally or on a limited number of dealer-to-customer venues. These barriers may, for example, take the form of a requirement for trading venue participants to be direct clearing members of CCPs (or to have a blanket guarantee from a CCP clearing member), or a requirement for minimum trade volumes or capital levels that the vast majority of market participants would not be able to satisfy.

In our view, excluding market participants that should otherwise be eligible to trade on trading venues offends against the principle of open, competitive and fair market access, and presents a barrier to access for those firms wishing to access pricing and provide liquidity on such venues. The barriers may also act as an anti-competitive bar to the emergence of new, non-bank liquidity providers.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

In the US, the "impartial access" standard applying to SEFs (which is very similar in nature to the principle of non-discriminatory access set out in Article 18(3) of the MiFID II Directive) has recently come under a significant level of scrutiny from the CFTC. In particular, the CFTC has had to take certain steps to help ensure that the impartial access standard is being adhered to (albeit that these steps have yet to achieve full success). For example, the CFTC has been obliged to confirm in its final SEF rules[10] that the purpose of the Dodd-Frank Act's impartial access requirement is to prevent a SEF's owners or operators from using discriminatory access requirements as a competitive tool against certain market participants. The CFTC has also issued targeted guidance to registered and prospective SEFs stating that arrangements that prevent a market participant from interacting or trading with, or viewing the bids and offers (firm or indicative) displayed by, any other market participant on a SEF are inconsistent with the Dodd-Frank Act's impartial access requirement.

The experience of the CFTC suggests that EU regulators are likely to encounter very similar problems in applying and enforcing the MiFID II non-discrimination standard across a much broader range of trading venues, which will in future include organized trading facilities ("**OTFs**").

For more detail, see MFA response letter to ESMA Consultation Paper on MiFID II / MiFIR (from pages 67-72), at: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf

> **If you have suggestions to remedy the issue(s) raised in your example, please make them here.**

As explained above, EU authorities should use the implementation of MiFID II as an opportunity to address the current "two-tier" market structure of dealer-to-dealer and dealer-to-customer markets. One way of achieving this would be via the MiFID II "Level 2" drafting process. However, a more expedient solution may be to put in place guidelines (*e.g.*, ESMA Q&A guidelines) outlining direct and indirect forms of discrimination which are not permissible under the MiFID II regime. These guidelines should make clear that access to multilateral trading facilities and OTFs in particular should be on terms that do not confer an unfair advantage on large or incumbent firms, and that market participants should be permitted to act simultaneously as both liquidity providers (or "makers") and "takers" of liquidity.

Issue 10 – Links between individual rules and overall cumulative impact

Given the interconnections within the financial sector, it is important to understand whether the rules on banking, insurance, asset management and other areas are interacting as intended. Please identify and explain why interactions may give rise to unintended consequences that should be taken into account in the review process. Please provide an assessment of their cumulative impact. Please consider whether changes in the sectoral rules have affected the relevancy or effectiveness of the cross-sectoral rules (for example with regard to financial conglomerates). Please explain in what way and provide concrete examples.

EXAMPLE 1 – IMPACT OF THE LEVERAGE RATIO ON CLEARING

> **To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?**

Articles 429-430 of the CRR.

[10] (CFTC Final Rule on "Core Principles and Other Requirements for Swap Execution Facilities", 78 Fed. Reg. 33476 (June 4, 2013) at 33508).

Please provide us with an executive/succinct summary of your example.

Operation of the leverage ratio

The leverage ratio, as expressed in the CRR, currently requires EU clearing members of CCPs to count received client margin towards their own exposure, even where that margin is fully segregated from the assets of the clearing member and not available for re-use. Given that the leverage ratio is essentially comprised of a Tier 1 capital numerator and a denominator intended to measure the bank's overall exposures, counting client margin towards a bank's overall exposures results in a considerably less favourable treatment of client cleared derivative transactions. This is an anomalous result given that segregated margin would generally be seen as protecting against exposure rather than increasing it.

Impact of the leverage ratio on client clearing

MFA's concern is that the leverage ratio, as currently constructed, provides less incentive for banks to become or to continue acting as clearing members (which, even without the effect of the leverage ratio, could be considered to carry a relatively high capital cost in return for relatively narrow profit margins). It is clear that the impact of the Capital Requirements Directive (Directive 2013/36/EU, "**CRD IV**") regulatory capital requirements, including the leverage ratio, has directly resulted in a number of high-profile exits from the client clearing business (see below).

Not only have these exits resulted in concentration risk amongst those firms that have chosen to remain in the market for clearing services, they have had the effect of reducing competition, and most importantly, of limiting access to central clearing. This last factor is highly significant in light of the EMIR clearing obligation; if there are too few clearing members of CCPs, or if those clearing members that remain have too little capacity to take on additional clients or further business of their existing clients, it will become impossible to effectively implement the EMIR clearing obligation. Firms that are required to clear their contracts may simply not be able to do so. Thus, there is an inherent tension between the aim of EMIR to promote central clearing, and the outcome of CRD IV, which has been a reduction in access to clearing services.

In addition, a reduction in clearing member capacity will limit clients' ability to port their positions in the event of a clearing member default, given that others left in the market will have less capacity to absorb the additional exposure. Given that the possibility of porting on default is a key principle of the EMIR regime, this is another area in which there is a tension between the goals of EMIR and the drafting of the CRR.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

Please see:

- Goldman Sachs' recent decision to increase derivatives clearing costs by up to 75 basis points (see http://www.risk.net/risk-magazine/news/2401060/goldman-hikes-clearing-fees-by-75bp-as-leverage-ratio-bites).

- CFTC chairman Timothy Massad's comments at the US House Committee on Agriculture meeting held on 12 February 2015, during which Chairman Massad indicated that the leverage ratio as it currently applies under Basel III could have a "significant negative effect on clearing".

- Certain statements made by Martin Moloney of the Irish Central Bank, as quoted in Risk, at http://www.risk.net/risk-magazine/news/2431688/irish-central-bank-warns-of-swaps-market-shut-out. Mr. Moloney noted in particular that "Sooner rather than later, existing levels of capital are going to be saturated...We have to be vigilant in monitoring the development of the market to see if it responds adequately to the increased demand."

For more detail, see also:

- MFA response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

- MFA letter to the Basel Committee on Banking Supervision in relation to the Treatment of Segregated Initial Margin in the Calculation of Centrally Cleared Derivatives Exposures under the Basel III Leverage Ratio Framework, dated 8 January 2015, at: https://www.managedfunds.org/wp-content/uploads/2015/01/MFA-Letter-to-BCBS-on-Basel-III-Leverage-Ratio-Impact-on-Cleared-Derivatives-Final-Letter.pdf

- Joint letter from MFA and the Commodity Markets Council to the Basel Committee on Banking Supervision in relation to an End-User Proposal to Mitigate the Detrimental Impact of the Leverage Ratio on Consumers and Investors, dated 2 November 2015, at: https://www.managedfunds.org/wp-content/uploads/2015/11/CMC-MFA-Leverage-Ratio-Letter-End-User-Impact-Final.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

For the EMIR clearing obligation to function as intended, it is extremely important that the European Commission amend the CRR in order to address the issues faced by clearing members in providing client clearing services. Such an amendment will ensure that clients that are subject to the EMIR clearing obligation have robust and viable access to CCPs in order to fulfil their regulatory obligations.

The required amendment to the CRR could simply take the form of an exemption carving segregated client margin out of the required leverage exposure calculation. We note, however, that another possibility currently being considered by the Basel Committee on Banking Supervision ("**BCBS**") would be to replace the current exposure method in the leverage calculation with the more risk-sensitive standardised approach to counterparty credit risk ("**SA-CCR**"). We understand that the SA-CCR generally produces lower exposure-at-default results for collateralised trades, and as such, would solve many of the issues currently relating to the treatment of client clearing under the CRR.

Whilst the BCBS route may well be a suitable solution to the leverage ratio issue in the longer-term, we would urge EU regulators to act as soon as possible to find an interim solution, given that any changes to the leverage ratio as a result of the BCBS process could come as late as 2017. By this time, more banks may have exited the client clearing business, resulting in a further reduction in the availability of clearing services.

EXAMPLE 2 – TREATMENT OF HEDGE FUNDS AS "SHADOW BANKING ENTITIES"

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 395 of the CRR, and Points 7 and 11 of Annex 1 of CRD IV.

Please provide us with an executive/succinct summary of your example.

MFA would caution EU authorities against extending bank-like regulation to hedge funds in light of the differing risks attaching to the activities of each type of entity, and the role that they each perform. Hedge funds pool risk capital from underlying investors to invest in capital markets activities, which, as described below, is fundamentally different from engaging in banking activities. Extension of bank-like regulation to the hedge fund industry is of particular concern in the context of recent "shadow banking" initiatives. We refer the European Commission in particular to the definition of "shadow banking entities" set out in the European Banking Authority's ("**EBA**") final guidelines on limits on exposures to shadow banking entities that carry out banking activities outside a regulated framework under Article 395 of the CRR.

Although the EBA has moved away from its original position of treating all AIFs as shadow banking entities, a significant proportion of AIFs will still be classed as shadow banking entities for the purposes of the Guidelines. Specifically, AIFs will be classed as shadow banking entities for the purposes of the Guidelines where they:

1. employ leverage on a "substantial basis" (*i.e.*, where the AIF's exposure exceeds 300% of its net asset value, as calculated according to the "commitment method" set out in Commission Delegated Regulation (EU) 231/2013); and/or

2. are permitted to originate loans or purchase third party lending exposures onto their balance-sheet pursuant to the relevant fund rules or instruments of incorporation.

As we explain in our response to Issue 1, asset managers have been key investors in loan portfolios (particularly portfolios of non-performing loans or "NPLs") in recent years, providing an active market enabling banks to dispose of NPLs and free up their balance sheet capacity for other activities, such as corporate lending, including to SMEs. Classifying AIFs that have the ability to purchase third party lending exposures as "shadow banking entities" and subjecting them to additional regulation or exposure limits thus seems to us to be counter-productive to the aims of the Capital Markets Union project, and the intention to promote SME financing. It is also very unclear how these tests would apply to AIFs established outside of the EU, whose managers may not be subject to the AIFMD requirement to calculate leverage (as set out in

Commission Delegated Regulation (EU) 231/2013). It would seem disproportionate to require such AIFs to undertake the commitment method calculation required simply so that they may disclose to EU banks that they do not fall within the scope of the Guidelines. Indeed, the likely result would be EU banks treating all such AIFs as being within scope of the Guidelines, which does not appear to be the intention of the EBA. Finally, although many AIFs are substantially less highly leveraged than credit institutions, for example, we do not agree that a higher level of leverage should alone result in an entity being classed as bank-like in nature. We note in particular that while some hedge funds use more leverage than others, managers would typically use leverage with terms that more closely match the investment period of the assets they are financing and are not dependent on continuing access to overnight financial markets.

Aside from these issues surrounding the definition set out in the Guidelines, and for the reasons set out below, we do not consider that it is appropriate to subject AIFs, as capital markets participants, to restrictions intended to limit exposures to entities performing "bank like" activities.

In addition, and as a general comment, we believe that the term "shadow" banking is itself unhelpful when applied to the hedge fund industry, given that hedge funds are subject to a robust and detailed system of regulation (as contained, for example in the AIFMD and the U.S. Investment Advisers Act of 1940, as amended by the Dodd-Frank Act). This system of regulation has been specifically designed to address the risks and activities of hedge funds, and whilst it differs in certain respects from the banking regulatory framework, those differences are in our view appropriate in light of the different nature of banking activities and hedge fund activities. Imposing bank-like regulation on hedge fund activities would have adverse effects on the capital markets, including reducing liquidity and increasing the cost of capital for businesses and investors. Given that one of the aims of the Capital Markets Union project is to promote use of the capital markets as an important supplement to traditional bank financing, we believe the EBA's characterisation of capital markets activities undertaken by hedge funds as "shadow banking" is entirely at odds with the goals of the Capital Markets Union.

Please see below a summary of why we consider hedge funds to be fundamentally distinct from banks, and why they should be regulated in a way that is consistent with the specific risks and features of the hedge fund industry, rather than as bank-like entities:

1. Hedge funds are less vulnerable to runs and/or liquidity problems

Hedge funds do not generally rely on unsecured, short term financing to support their investing activities. Instead, they would typically rely on collateralised borrowings, which are designed to more closely match the term or expected liquidity of the asset and the financing which funds it. In addition, hedge funds are not subject to mandatory redemption requirements under any statute or regulation, and their organisational documents generally impose certain limits on investors' ability to redeem their interests. Thus, although hedge funds were at times faced with investor redemptions during the financial crisis, they were not subject to "runs" because of the redemption restrictions agreed between funds and their investors and because of investor expectations when allocating risk capital to investment funds.

2. Hedge funds present a lower risk of contagion

Another structural aspect of hedge funds is the legal separation of different funds managed by the same adviser. These legally distinct funds often have different investors and can engage in entirely distinct trading activities in different assets and markets. Any losses at one fund will be borne exclusively by the investors in, and counterparties to, that fund. In addition, unlike bank holding companies and other nonbank financial institutions such as insurance companies, hedge funds only engage in one distinct business – namely, making investments for investors in that specific fund.

Notably, hedge fund borrowings are undertaken almost exclusively on a collateralised basis. The posting of collateral by hedge funds reduces the credit exposure of counterparty financial institutions to those funds. Consequently, hedge funds are substantially less likely to contribute to systemic risk by causing the failure of a systemically significant counterparty, such as a major bank. Moreover, it is important to note that hedge funds often diversify their exposures across many counterparties, mitigating the risk that a fund poses to any one counterparty. These factors serve to substantially reduce the risk of contagion posed by hedge funds.

3. Hedge funds do not have the benefit of private or public backstops

Given the limited leverage and the collateral posted by hedge funds, any losses that hedge funds incur are almost exclusively borne by their investors, not their creditors, counterparties, the general financial system, or taxpayers.

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

Hedge funds are less vulnerable to runs and/or liquidity problems

The then UK Financial Services Authority (which has now been replaced by the UK Financial Conduct Authority) conducted several studies on the hedge fund industry which found that the assets of the surveyed hedge funds could be liquidated in a shorter timeframe than the period after which their liabilities (to investors and finance providers) would become due. See: http://www.fsa.gov.uk/static/pubs/other/hedge-fund-report-feb2012.pdf

See OFFICE OF FIN. RESEARCH, 2013 ANNUAL REPORT 94 (2013), available at http://financialresearch.gov/annualreports/files/office-of-financial-research-annual-report-2013.pdf, which states that:

> *[O]n average, funds with higher leverage have a lower proportion of hard-to-value assets. Hard-to-value assets represent a little more than 20 percent of the assets of funds with no leverage. For the category of funds with the highest leverage (mean ratio of debt to net asset value of about 2.8), the corresponding fraction was less than 5 percent. That suggests funds with larger leverage ratios may be choosing assets that are relatively easier to dispose of during a crisis.*

The influential Turner Review on the global banking crisis, published by the FSA, noted that:

> *[Hedge funds] typically have not promised to their investors that funds are available on demand, and are able to apply redemption gates in the event of significant investor withdrawals. They are not therefore at present performing a maturity transformation function fully equivalent to that performed by banks, investment banks, SIVs and mutual funds, in the run-up to the crisis.*

See page 72 of The Turner Review – A Regulatory Response to the Global Banking Crisis, March 2009 (the "Turner Review"), available at: http://www.fsa.gov.uk/pubs/other/turner_review.pdf

Hedge funds employ lower levels of leverage

See Andrew Ang, et al., Hedge Fund Leverage 25 (Nat'l Bureau of Econ. Research, Working Paper No. 16801, 2011), available at http://www.nber.org/papers/w16801.pdf, along with Sebnem Kalemli-Ozcan et al., Leverage Across Firms, Bank and Countries 14–15 (Nat'l Bureau of Econ. Research, Working Paper 17354, 2011), available at http://www.nber.org/papers/w17354.pdf. These studies indicate that the average leverage ratio of the hedge fund industry from December 2004 to October 2009 was 2.1x. This compares to average leverage ratios of approximately 13x for the U.S. banking industry and 11.8x for the insurance industry in the same periods.

Hedge funds do not benefit from private or public backstops

We note that the authors of an International Monetary Fund ("IMF") working paper published in 2014 proposed that shadow banking should be defined as "all financial activities, except traditional banking, which require a private or public backstop to operate." See IMF Working Paper WP/14/25, available at: http://www.imf.org/external/pubs/ft/wp/2014/wp1425.pdf

For more detail, see MFA's response to EBA consultation paper on limits on exposures to shadow banking entities, available at https://www.managedfunds.org/wp-content/uploads/2015/06/MFA-comment-letter-on-EBA-consultation-on-exposures-to-shadow-banking-entities1.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

Given that hedge funds do not have deposit-like funding structures and do not present the same risk of high leverage as banks, EU authorities should not seek to extend bank-like regulation to them, *e.g.*, by treating them as "shadow banking entities". We consider in particular that the definition of "shadow banking entities" set out in the EBA Guidelines is overly broad as it would include many AIFs that are engaged in traditional capital markets activities rather than banking or bank-like activities. We would therefore urge the EBA to remove AIFs entirely from the scope of the definition of a "shadow banking entity".

Issue 11 – Definitions

Different pieces of financial services legislation contain similar definitions, but the definitions sometimes vary (for example, the definition of SMEs). Please indicate specific areas of financial services legislation where further clarification and/or consistency of definitions would be beneficial.

EXAMPLE 1 – DEFINITION OF "OTC DERIVATIVE"

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 2(7) of EMIR.

Please provide us with an executive/succinct summary of your example.

MFA would like to highlight the definition of "OTC derivative" set out in Article 2(7) of EMIR. At present, this definition reads as follows:

> "a derivative contract the execution of which does not take place on a regulated market as within the meaning of Article 4(1)(14) of Directive 2004/39/EC or on a third-country market considered as equivalent to a regulated market in accordance with Article 19(6) of Directive 2004/39/EC".

Given that the European Commission has not yet considered any third country markets to be equivalent to a regulated market as described in this definition, NFCs are currently required to treat derivatives transacted on non-EU exchanges (*e.g.*, US futures contracts) as if they were OTC derivatives, and to include them in their clearing threshold calculations. Consequently, many smaller non-financial counterparties ("**NFCs**"), that would not otherwise meet the clearing threshold, may be categorised as NFC+s (*i.e.,* non-financial counterparties falling above the clearing threshold) and fall within the scope of EMIR's clearing and collateral requirements, thereby incurring additional cost and administrative responsibilities.

We note that (potentially in light of the issues surrounding the lack of an equivalence assessment under Article 19(6) of MiFID), the SFTR revises the definition currently set out in EMIR, to provide for a specific and independent equivalence assessment of regulated markets. However, although we support EU authorities' attempts to find a way around the issues attaching to the current wording of EMIR, the practical effect of the definition inserted by the SFTR will remain the same until such time as a list of equivalent third country markets has been published.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA's response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

MFA would encourage the European Commission to release a list of third country markets considered "equivalent" to regulated markets as soon as possible, in order to solve this issue. If EU authorities consider that this is not possible under the existing wording of EMIR, they should release the list as soon as possible after the SFTR comes into effect and amends the definition of "OTC derivative" in EMIR. We realise that a separate equivalence assessment will in the future need to be made in relation to third country trading venues under MiFID II, but the European Commission should not wait for this MiFID II process to commence (particularly given that this may occur as late as 2018, and will cover trading venues other than regulated markets).

An alternative solution would be to amend the requirements for the calculation of the NFC clearing threshold, such that all derivatives commonly regarded as exchange-traded derivatives or futures contracts are excluded from the scope of the calculation.

EXAMPLE 2 – DEFINITION/MEANING OF "GROSS NOTIONAL VALUE"

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 11 of Commission Delegated Regulation (EU) No. 149/2013 of 19 December 2012.

Please provide us with an executive/succinct summary of your example.

A second definition/meaning which presents difficulties in relation to EMIR is the definition of "gross notional value" (*i.e.*, notional amount). Specifically, for an NFC to determine whether it has exceeded any of the clearing thresholds set out under EMIR, the NFC must determine the "gross notional value" of each of its OTC derivative contracts. This determination is not straightforward in the context of certain OTC derivative contracts, such as options. ESMA's guidance on EMIR (given at OTC Answer 9 of its EMIR Q&A document) states that the notional amount is the "reference amount from which contractual payments are determined in derivatives markets" or "the value of a derivative's underlying assets at the applicable price at the transaction's start (in the case of options, this is not the premium)". However, this guidance does not appear to allow for a delta adjustment of the notional amount of an equity option transaction. Given that the transaction's delta ratio is designed to compare the change in the price of the underlying asset with the corresponding change in the price of a derivative, allowing for a delta adjustment will reflect more accurately the notional amount of the contract.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA's response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

MFA urges the European Commission to provide guidance that the calculation of the gross notional amount of an equity option transaction may take account of a delta adjustment. Such a clarification should apply to all threshold determinations under EMIR and not solely the clearing threshold calculation.

EXAMPLE 3 – ASSESSMENT OF EMIR THRESHOLDS FOR INVESTMENT FUNDS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 10 of EMIR.

Please provide us with an executive/succinct summary of your example.

MFA notes that EMIR and its related technical standards do not take a consistent approach towards the way in which AIFs and UCITS are required to calculate certain thresholds.

There are three circumstances in which AIFs and UCITS must calculate thresholds under EMIR. First, AIFs that are NFCs must calculate the clearing threshold. Second, AIFs and UCITS must determine their initial margin thresholds under the draft regulatory technical standards ("**RTS**") on margin requirements for non-centrally cleared OTC derivative contracts (the "**EMIR Margin Rules**"). Third, AIFs and UCITS must calculate the EUR 8 billion threshold set out in the latest draft RTS on EMIR's clearing obligation (the "**Clearing RTS**"), which is used to determine an entity's categorisation as a "Category 2" or "Category 3" entity.

AIFs and UCITS must calculate each of the applicable threshold calculations referred to above at group level, and MFA is concerned that each of these calculation tests is different. MFA believes that there is regulatory consensus that the European Commission should view each AIF and UCITS separately for purposes of the applicable tests. Therefore, MFA considers that there is no justification for treating AIFs and UCITS differently in any of the three circumstances set out above. It is complicated, inefficient, and administratively burdensome to require funds to consider and apply multiple definitions under EMIR when performing calculations that are seeking to achieve a similar result.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA's response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

MFA strongly recommends that the European Commission take a consistent approach towards the way in which an AIF or UCITS determines its group for purposes of the applicable threshold calculations described above.

We support the language proposed by ESMA at Article 2(3) of the Clearing RTS, which provides:

> When counterparties are alternative investment funds as defined in Article 4(1)(a) of Directive 2011/61/EU or UCITS as defined in Article 1(2) of Directive

> 2009/65/EC, the EUR 8 billion threshold referred to in point (b) of paragraph 1 shall apply individually at fund level.

Accordingly, we suggest that the European Commission also adopt this language for purposes of the clearing threshold and the initial margin thresholds.

EXAMPLE 4 – DEFINITION OF A FINANCIAL COUNTERPARTY

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 2(8) of EMIR and Article 3(3) of the SFTR.

Please provide us with an executive/succinct summary of your example.

We note that the definitions of "financial counterparty" set out in EMIR and the SFTR differ in scope. Although the SFTR has made some understandable updates to the European legislation cited in the EMIR definition, it has also added the following categories of entity to the definition:

(a) CCPs authorised in accordance with EMIR;

(b) central securities depositories authorised in accordance with the Central Securities Depositories Regulation; and (most notably)

(c) any third-country entity that would require authorisation or registration in accordance with the legislative acts referred to elsewhere in the definition of a "financial counterparty" if it were established in the EU.

Given the operation and scope of the SFTR framework, we understand the necessity for these entities to be included within the same category as entities appearing in the EMIR definition of a "financial counterparty". However, given that the "financial counterparty" classification is so widely utilised in relation to the EMIR regime (*e.g.*, in terms of defining how EMIR obligations apply), we are concerned that it may create confusion to define the term differently in the SFTR. We would therefore propose importing the EMIR definition of "financial counterparty" into the SFTR, and then introducing a second, umbrella, definition including the three additional categories of entity listed above.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

For more detail, see MFA's response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As described above, MFA would propose importing the EMIR definition of "financial counterparty" into the SFTR, and then introducing a second, umbrella, definition including the following entities:

(a) CCPs authorised in accordance with EMIR;

(b) central securities depositories authorised in accordance with the Central Securities Depositories Regulation; and

(c) any third-country entity that would require authorisation or registration in accordance with the legislative acts referred to elsewhere in the definition of a "financial counterparty" if it were established in the EU.

Issue 12 – Overlaps, duplications and inconsistencies

Please indicate specific areas of financial services legislation where there are overlapping, duplicative or inconsistent requirements.

EXAMPLE 1 – ARTICLE 13 ISSUE

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 13 of EMIR.

Please provide us with an executive/succinct summary of your example.

MFA remains concerned about the conflicting or duplicative requirements that could result under EMIR due to the operation of Article 13 of EMIR. Pursuant to Article 13, the European Commission may adopt an implementing act declaring that the legal, supervisory and enforcement arrangements of a third county are equivalent to EMIR's requirements set out in Article 4 (clearing), Article 9 (record-keeping and trade reporting), Article 10 (NFCs) and Article 11 (risk mitigation techniques). Where the European Commission adopts such an act, counterparties that enter into a transaction subject to EMIR will be deemed to have fulfilled their obligations under Articles 4, 9, 10 and 11 of EMIR, if they comply with the equivalent rules of the third country and at least one of the counterparties is "established" in that third country.

The notion of being "established" in a jurisdiction and the related equivalence determinations present difficulties for the AIF industry and their EU counterparties. Many AIFs are legally incorporated outside the United States in jurisdictions that may not have rules equivalent to EMIR (*e.g.*, in the Cayman Islands). However, because these AIFs are managed by US-based investment managers or are majority-owned by US persons, these AIFs are, in some circumstances, deemed to be US persons ("**US Offshore AIFs**") and are directly subject to US derivatives rules.

As a result, when US Offshore AIFs enter into derivatives transactions with EU counterparties subject to EMIR, if the European Commission does not regard these US Offshore AIFs as being "established" in the US for purposes of Article 13, then the US Offshore AIFs and their EU counterparties would need to comply with both the EMIR obligations set out in Articles 4, 9, 10 and 11 and the equivalent US obligations. This duplicative and potentially conflicting regulation would occur despite the fact that the purpose of Article 13 is to prevent counterparties from having to comply with two separate and equivalent regulatory regimes and encountering all of the related compliance difficulties.

MFA emphasises that this fact pattern is reflective of a significant volume of business in the EU derivatives market. Therefore, the European Commission should not underestimate this issue, which could have serious consequences for the business of EU banks and US Offshore AIFs, as they may cease transacting with one another to avoid duplicative or conflicting rules. Such unintended consequences would be contrary to the interests of global trading as well as to ease of access to markets. As a result, this issue is as significant an issue for EU banks as it is for US Offshore AIFs.

Finally, MFA notes that a similar issue arises under Article 33 of MiFIR with respect to the MiFIR trading obligation, and also under Article 21 of the SFTR in relation to the SFTR reporting obligation. In the case of the SFTR, this point has been overlooked in the definition of "established", which refers only to the registered office of counterparties that are legal persons, or if they have no registered office, their "head office".

> **Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)**

See, for example, Hedgeweek article "Split boards favoured as fund governance intensifies", which highlights this issue, at: http://www.hedgeweek.com/2014/12/19/215050/split-boards-favoured-fund-governance-intensifies

For more detail, see MFA's response to the European Commission on its "Public Consultation on Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories" related to the Commission's review of EMIR, at: https://www.managedfunds.org/wp-content/uploads/2015/08/European-Commission-EMIR-Review-Final-MFA-Consolidated-Response-and-Cover-Letter.pdf

> **If you have suggestions to remedy the issue(s) raised in your example, please make them here.**

In order to address the issues described above, MFA urges the European Commission to clarify that, for purposes of relying on equivalence acts under Article 13, an entity is deemed "established" in a third country if it is either legally incorporated in and/or subject to regulation in that third country. Similar action should be taken in relation to Article 33 of MiFIR with respect to the MiFIR trading obligation, and also under Article 21 of the SFTR in relation to the SFTR reporting obligation, as indicated above.

<u>Issue 13 – Gaps</u>

While the recently adopted financial legislation has addressed the most pressing issues identified following the financial crisis, it is also important to consider whether they are any significant regulatory gaps. Please indicate to what extent the existing rules have met their objectives and identify any remaining gaps that should be addressed.

EXAMPLE 1 – ABILITY FOR ESMA TO SUSPEND CLEARING AND TRADING OBLIGATIONS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

Article 4 of EMIR, Articles 11(2) and 28 of MiFIR.

Please provide us with an executive/succinct summary of your example.

In MFA's view, two "gaps" in the capabilities of EU regulators that should be rectified as soon as possible are the inability of regulators to: (a) expeditiously remove classes of derivatives from the scope of the EMIR clearing obligation; and (b) suspend the MiFID II derivatives trading obligation where necessary.

Removal of derivatives from the clearing obligation

In MFA's view, ESMA's assessment of whether a class of derivatives is suitable for mandatory clearing should be a fluid and ongoing assessment.

It is difficult to anticipate the precise circumstances under which ESMA would need to remove a class of derivatives (or a subset of a class of derivatives) from the clearing obligation. However, if a situation arises in which it is necessary to do so, it is highly probable that ESMA will need to act expeditiously to prevent or stem market turmoil. For example, ESMA would need to be able to act promptly if: (i) a class of derivatives (or a subset thereof) became insufficiently liquid such that parties could no longer clear such class of derivatives (or subset thereof); (ii) the composition of market participants in relation to a class of derivatives (or a subset thereof) shifted dramatically such that there were fewer clearing members for the class of derivatives (or subset thereof); or (iii) there were no longer a sufficient number of CCPs available to clear the class of derivatives (or subset thereof).

Under the current regime, if ESMA wished to remove classes of derivatives from the scope of the clearing obligation, it would need to go through the process of proposing new regulatory technical standards, which would then need to be scrutinised by the European Commission, European Parliament and Council of the European Union. Given that this process is time-consuming in nature, it seems unlikely that it would permit ESMA to act with the necessary degree of urgency. As such, we recommend that ESMA be granted emergency powers to remove classes of derivatives from the scope of the clearing obligation with immediate effect in situations where it needs the ability to react quickly (including following a market event such as a default, or a CCP's failure to continue operating). We note that ESMA itself has lent support to the introduction of such emergency powers (see below).

Suspension of the derivatives trading obligation

Although MiFIR provides national competent authorities with an ability to temporarily suspend transparency requirements where liquidity drops below a certain threshold, there is no equivalent "emergency" power to temporarily suspend the derivatives trading obligation. This could potentially leave market participants subject to the trading obligation, but with no market data to support mandatory trading activities. This issue should be addressed by EU regulators prior to the introduction of the trading obligation.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

See page 8, paragraph 33 of ESMA's recommendation to the EMIR Review: http://www.esma.europa.eu/system/files/esma-2015-1254_-_emir_review_report_no.4_on_other_issues.pdf

For more detail, see MFA response letter to ESMA Consultation Paper on MiFID II / MiFIR (in particular pages 37-38), at: https://www.managedfunds.org/wp-content/uploads/2015/03/ESMA_CP1.pdf

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

Removal of derivatives from the clearing obligation

MFA strongly supports a review of the EMIR clearing process, which would allow ESMA to address unexpected events that may impact a class of derivatives (or subset thereof) subject to the clearing obligation, such as sharp or sudden declines in the liquidity of such class (or subset). MFA encourages the European Commission to revise the procedural requirements associated with disapplying or suspending the clearing obligation with respect to a class of derivatives (or subset thereof).

In particular, we request that the European Commission permit ESMA to disapply or suspend the clearing obligation immediately in urgent circumstances, rather than requiring ESMA to amend the existing RTS or to prepare new RTS in order to disapply or suspend the clearing obligation. During stressed market conditions, providing ESMA with such discretion would ensure that there would not be any undue delay in disapplying or suspending the clearing obligation, and thus, would minimise the potential for market disruptions or the inability of the market to comply with the clearing obligation.

Suspension of the derivatives trading obligation

In a similar vein, MFA requests that the European Commission provide ESMA with an "emergency" power to temporarily suspend the MiFID II derivatives trading obligation, rather than requiring new RTS to be drafted and approved in each case. Such a power could be linked to suspension of the transparency requirement, as envisaged by Article 11(2) of MiFIR.

Issue 14 – Risk

EU rules have been put in place to reduce risk in the financial system and to discourage excessive risk-taking, without unduly dampening sustainable growth. However, this may have led to risk being shifted elsewhere within the financial system to avoid regulation or indeed the rules unintentionally may have led to less resilient financial institutions. Please indicate whether, how and why in your view such unintended consequences have emerged.

EXAMPLE 1 – POTENTIAL NEED FOR NO-ACTION RELIEF BY EU REGULATORS

To which Directive(s) and/or Regulation(s) do you refer in your example (if applicable, mention also the articles referred to in your example)?

The MiFID II Directive and MiFIR.

Please provide us with an executive/succinct summary of your example.

Although MiFID II is still in the process of being finalised, once implemented it could result in a number of new market risks and unintended consequences. Most significantly, transparency requirements could have a negative effect on hedging and large in scale trades, whilst the new commodity derivatives regime could result in a number of large energy firms exiting the EU markets in favour of less heavily regulated jurisdictions.

Please provide us with supporting relevant and verifiable empirical evidence for your example (please give references to concrete examples, reports, literature references, data, etc.)

There have been a number of situations where no-action relief has been used successfully in the US. For example, the CFTC's Conditional No-Action Relief with respect to Swaps Trading on Certain Multilateral Trading Facilities Overseen by Competent Authorities Designated by European Union Member States (released on 12 February 2014) resulted in a positive outcome for EU multilateral trading facilities, which received relief from certain Swap Execution Facility registration requirements.

If you have suggestions to remedy the issue(s) raised in your example, please make them here.

As a general comment, EU authorities should be willing to be flexible, and to review and amend any requirements of MiFID II or other pieces of legislation that are simply not working as intended or are creating undue risks to the market. Although there is scope for the European Commission to review the functioning of MiFID II in 2019, such a review process may well be time-consuming in nature, and EU authorities may be unwilling to make changes to the Level 1 text of the legislation out of fear of reopening previous political discussions. It is important, therefore, that EU authorities keep track of the consequences of implementation, and that they are willing to move quickly to resolve any emerging issues that may damage the markets outside of this formal Review process.

We note that ESMA has previously requested a form of no-action relief in relation to the issues surrounding suspension of the clearing obligation (as detailed in our response to Issue 13). No-action relief is a highly flexible tool, and could work effectively to stem any potential negative effects on market liquidity arising from MiFID II, and other regulatory initiatives. It might in particular have been helpful in the context of the EMIR reporting start date, which would likely have run more smoothly with a phased approach to implementation. As such, the use of a no-action tool appears worthy of further consideration by the European Commission. We note, however, that any such relief would need to be exercised in close cooperation with national competent authorities given that they will likely have greater market intelligence and oversight as a result of their supervisory function.

ANNEX

ISSUE 6, EXAMPLE 1: EVIDENCE OF OVERLAPS IN REGULATORY REPORTING REQUIREMENTS

Summary of Transaction Reporting Obligations under EMIR, MiFID II, REMIT and the SFTR

Topic	EMIR	MiFID II/MiFIR	REMIT	SFTR
Citation	Regulation (EU) 648/2012 ("EMIR"), Commission Implementing Regulation (EU) No 1247/2012 ("EMIR Implementing Regulation") and Commission Delegated Regulation (EU) No 148/2013	Markets in Financial Instruments Directive (2014/65/EU) ("MiFID II") and Implementing Regulation 600/2014 ("MiFIR")	Regulation (EU) No 1227/2011 ("REMIT") and Commission Implementing Regulation (EU) No 1348/2014 ("REMIT Implementing Regulation")	Regulation (EU) 2015/2365 of the European Parliament and of the Council of 25 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012 (the "SFTR")
Supporting documents	European Securities and Markets Authority's ("ESMA") Questions and Answers on the Implementation of EMIR ("Q&A") dated 1 October 2015 and ESMA's final report Review of the Regulatory and Implementing Technical Standards on reporting under Article 9 of EMIR.	ESMA's draft regulatory and implementing standards for MiFID II and MiFIR (draft dated 28 September 2015) ("RTS").	Agency for the Cooperation of Energy Regulators ("ACER") guidance, including Guidance on the application of REMIT (3rd edition, dated 3 June 2015) ("ACER Guidance"), Questions & Answers on REMIT (2nd edition) ("ACER Q&A") and REMIT Transaction Reporting Manual ("TRUM") dated 7 January 2015, including subsequent amendments to TRUM appendices.	Regulatory technical standards and implementing technical standards for the SFTR are to be drafted by ESMA and submitted to the Commission for approval by 13 January 2017.
Expressed purpose of the reporting obligation	Required to allow information on the risks inherent in derivatives markets to be centrally stored and easily accessible to regulators.	Required to enable the regulator to detect and investigate cases of market abuse (potential or actual), monitor market functioning and investment firms' activities.	Focused on the prevention and detection of market abuse in wholesale energy markets.	Required to allow information on the risks inherent in securities financing markets to be centrally stored and easily and directly accessible to regulators and other supervisory authorities.

<table>
<tr><td>When does the reporting obligation arise?</td><td>Under Article 9 EMIR, “counterparties and CCPs shall ensure that the details of any derivative contract they have concluded and of any modification or termination of the contract are reported...”.</td><td>Under Article 26(1) MiFIR, “investment firms which execute transactions in financial instruments shall report complete and accurate details of such transactions...”.</td><td>Under Article 8(1) REMIT, market participants are required to provide a record of wholesale energy market transactions, including orders to trade.

This includes wholesale energy products executed at organised market places and wholesale energy product contracts concluded outside an organised market place (see e.g., Article 6 REMIT Implementing Regulation).</td><td>Article 4 SFTR requires counterparties to securities financing transactions (“SFTs”) to “report the details of any SFTs they have concluded, as well as any modification or termination...”.</td></tr>
<tr><td>Instruments covered under the reporting obligation</td><td>Any derivative contract (whether executed OTC or through a trading venue) is covered under the reporting obligation in EMIR.

The definition of a derivative contract cross-refers to MiFID (Section C (4-10), Annex 1).</td><td>The obligation to report transactions arises in relation to:
financial instruments which are admitted to trading or traded on a trading venue or for which a request for admission to trading has been made;
financial instruments where the underlying is a financial instrument traded on a trading venue; and
financial instruments where the underlying is an index or a basket composed of financial instruments traded on a trading venue. (Article 26(2) MiFIR)
Financial instrument is defined in Article 4(1)(15) MiFID II as the instruments listed in Section C of Annex I of MiFID II.</td><td><u>Wholesale energy products</u>, which is defined in Article 2(4) of REMIT as:

Contracts:
contracts for the supply of electricity or natural gas where delivery is in the European Union
contracts relating to the transportation of electricity or natural gas in the European Union
Derivatives:
derivatives relating to electricity or natural gas produced, traded or delivered in the European Union
derivatives relating to the transportation of electricity or natural gas in the European Union</td><td>Article 3(11) SFTR defines a <u>SFT</u> as:
a repurchase transaction;
securities or commodities lending and securities or commodities borrowing (both terms are defined in Article 3(7));
a buy-sell back transaction or sell-buy back transaction;
a margin lending transaction (as defined in Article 3(10).</td></tr>
<tr><td>Who is under the obligation to</td><td>Under Article 9 EMIR, counterparties and CCPs are under the obligation to report to a trade repository the details of any</td><td>The transaction reporting obligation may apply to the following:</td><td>The ultimate responsibility for the transaction reporting obligation lies with the market participant.</td><td>Article 4(1) SFTR states that the counterparties to SFTs are under the obligation to report the details of the SFT. However, there is further details on what</td></tr>
</table>

report the transaction?	derivative contract they have concluded and any modification or termination of the contract. Counterparties include financial counterparties and non-financial counterparties, as defined in Article 2(8) and 2(9) EMIR. A CCP is defined in Article 2(1) EMIR as a "legal person that interposes itself between the counterparties to the contracts traded on one or more financial markets, becoming the buyer to every seller and the seller to every buyer". The ESMA Q&A addresses queries in relation to who would be considered the counterparty in the case of funds and fund managers. Generally, the fund is to be considered the counterparty to the derivative transaction, however, where the fund manager is transacting on its own account, it would be the counterparty for the purposes of EMIR. Article 9 EMIR requires both counterparties and CCPs to report, however both are required to ensure that there is no duplication in reporting under the same provision. ESMA's Q&A provides that this requirement to avoid duplication means that "each counterparty	• Investment firms, as defined in Article 4(1)(1) MiFID II, which, in the course of their business, provide investment services and/or perform investment activities; this includes credit institutions as defined in Article 4(1) of the Capital Requirements Regulation (Regulation (EU) No 575/2013); • Trading venues as defined in Article 4(1)(24) MiFID II where financial instruments are traded on the venue by a firm not subject to transaction reporting under MiFID II/MiFIR • EU branches of non-EU firms that are authorised under Article 39 MiFID II	Market participant: Market participant is defined in Article 2(7) REMIT as "*any person*, including transmission system operators, *who enters into transactions*, including the placing of orders, *to trade in one or more wholesale energy markets*". This is not restricted to the European Union or the European Economic Area, therefore the obligation to report applies irrespective of the location of the person entering into a transaction in one or more wholesale energy markets. ACER's Guidance sought to further clarify the definition by providing a list of persons considered to be market participants under REMIT if entering into transactions in one or more wholesale energy markets: • energy trading companies carrying out either transportation, supply or purchase of electricity or natural gas; • producers of electricity or natural gas; • shippers of natural gas; • balance responsible entities; • wholesale customers; • final customers, acting as a single economic entity that have a consumption capacity of 600 GWh or more per year for gas or electricity; • transmission system operators;	this means for more specific transactions. Counterparties include financial counterparties and non-financial counterparties as defined in Articles 3(3) and 3(4) SFTR. The definitions of such counterparties do not match the definitions in EMIR and are broader. Where the counterparty is a UCITS managed by a management company, the management company is subject to the reporting obligation. Where the counterparty is an AIF, the AIFM is subject to the reporting obligation. Generally, the SFTR reporting obligation applies to: • counterparties established in the European Union; • counterparties established in a third country if the SFT is concluded in the course of the operations of a branch in the European Union of that counterparty; • management companies for UCITS and UCITS investment companies; • AIFMs.

	should ensure that there is only one report produced by them for each trade that they carry out".		• storage system operators; • LNG system operators; and • investment firms (as defined in MiFID I). TRUM Annex III (updated as at 6 October 2015) provides guidance in relation to exchange traded derivatives and the various parties involved therein. An investment manager acting solely as agent on behalf and on account of its client is only a 'market participant' if it is a member of the exchange. <u>Wholesale energy market</u>: Article 2(6) REMIT defines wholesale energy market as: "any market within the Union on which wholesale energy products are traded". Recital 5 of REMIT states that this includes both commodity markets and derivative markets. ACER's Guidance provides the following examples of wholesale energy markets: • regulated markets; • multilateral trading facilities; • over-the-counter transactions; and • bilateral contracts (traded directly or through brokers).	

			There is some recent clarification in Annex III of the TRUM, in which ACER attempts to distinguish between physical and financial markets. Annex III states that the wholesale energy market is the place where the energy commodity changes ownership (*i.e.*,, where it is traded) versus where the commodity is negotiated (which would be, for the purposes of REMIT, an Organised Market Place).	
Events covered under the reporting obligation	The obligation under EMIR requires reporting of the conclusion, modification or termination of a derivative contract.	Execution of transactions in financial instruments. The proposed Level 2 text accompanying MiFID II (draft RTS 22) defines both the meaning of execution and transaction for the purpose of the reporting obligation under Article 26(1) MiFIR, along the following lines: <u>Transaction</u>: the conclusion of an acquisition or disposal of a financial instrument, regardless of whether the transaction is carried out on a trading venue. (Article 2, RTS 22) Acquisition includes, in relation to a financial instrument, the purchase, entering into a derivative a derivative contract and the increase in the notional mount for a derivative contract. Disposal includes, in relation to a financial instrument, the sale, closing out of a derivative contract and a decrease in the notional amount for a derivative contract.	Transactions in a wholesale energy market: a) executed in a wholesale energy market (see Article 6(1) REMIT Implementing Regulation); b) concluded outside a wholesale energy market at least in respect of derivative contracts for financial settlement where the underlying relates to gas or electricity produced, traded, delivered or transported within the EU (see page 28 TRUM).	The obligation under SFTR requires reporting of the conclusion, modification or termination of a SFT.

		<u>Execution</u>: where an investment firm performs any of the following services or activities that result in a transaction (as defined above): • reception and transmission of orders in relation to one or more financial instruments; • execution of orders on behalf of clients; • dealing on own account; • making an investment decision in accordance with a discretionary mandate given by a client; • transfer of financial instruments to or from accounts. (Article 3, RTS 22). An investment firm will not be deemed to have executed a transaction if it transmits an order in accordance with the following conditions set out in Article 4, RTS 22: • the transmitting firm has a written transmission agreement with the receiving firm; and • the information relevant to the reporting obligations is transmitted to the receiving firm under the terms of the written transmission agreement.		
Can the transaction reporting	Yes. Under Article 9 EMIR, a counterparty or a CCP subject to the reporting obligation may delegate the	The investment firm under the obligation to report can delegate to an approved reporting mechanism ("ARM") that reports on the	Yes. Article 6 REMIT Implementing Regulation requires a market participant to delegate its	Yes. Article 4(2) SFTR provides that a counterparty subject to the reporting obligation may delegate the reporting of

obligation(s) be delegated?	submission of transaction reports (*e.g.*, to its counterparty). ESMA's Q&A sets out possible delegation situations, including: • one counterparty delegates to the other counterparty; • one counterparty delegates to a third party; • both counterparties delegate to a single third party; • both counterparties delegate to two different third parties.	investment firm's behalf. Alternatively, a specific transmission agreement may be utilised in certain situations, which effectively allows for delegation of reporting (albeit subject to a number of conditions specified in the proposed Level 2 text accompanying MiFID II).	reporting obligation if the transaction takes place on an organised market place, in which case, the organised market place or trade reporting system would fulfil the reporting obligation. If the transaction does not take place on an organised market place, the reporting obligation can be done by any of the following (in accordance with Article 8(4) REMIT): • the market participant; • a third party acting on behalf of the market participant; • a trade reporting system; • an organised market, a trade-matching system or other person professionally arranging transactions; or • a competent authority or ESMA.	the details of the SFT. However, in accordance with Article 4(3) SFTR, where a financial counterparty and non-financial counterparty transact, the relevant financial counterparty is responsible for reporting on behalf of both counterparties. This is contingent on the non-financial counterparty not exceeding at least two of three balance sheet limits, which are set out in detail in Article 3(3) of Directive 2013/34/EU (the EU Accounting Directive).