

European Commission  
DG MARKET  
Financial Services Policy and Financial Markets

Submitted to *markt-consultations-mifid@ec.europa.eu*

London, February 2<sup>nd</sup>, 2011

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

Dear Sirs,

Markit<sup>1</sup> appreciates the opportunity to provide comments on the European Commission's Public Consultation on the Review of MiFID ("**Consultation Paper**" or "**CP**"). Markit and its affiliates offer a variety of products and services that create pre-trade transparency<sup>2</sup>, produce end-of-day valuations<sup>3</sup>, and perform public trade reporting<sup>4</sup> across asset classes and regions. We have significant and global experience in providing transparency around financial instruments, particularly for those traded over-the-counter ("**OTC**"). Our response is therefore focussed on those aspects of the consultation that relate to the transparency in equity and non-equity markets.

### Executive Summary

We believe the goals behind the design and implementation of new transparency regimes should be to create additional transparency that is meaningful to, and can be easily analysed by the recipients of such data, while avoiding unintended consequences such as damaging or eliminating product liquidity. With these goals in mind, we make the following recommendations related to the proposals in the CP:

**Non-equity markets:** i) the definition of Alternative Organized Trading Facility should be further refined; ii) given the number, complexity, and heterogeneity of "non-equity" products the transparency regime should be properly calibrated (based upon liquidity and other factors), and adopt a phasing-in approach; iii) any post-trade transparency requirements should consider current liquidity on product and maturity level, and should contain regular re-calibrations; iv) liquidity measurement for non-equity products will need to be based on a variety of factors; v) the channels and standards used for the creation of transparency in the

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<sup>1</sup> Markit is a financial information services company with over 2,000 employees in Europe, North America, and Asia Pacific. The company provides independent data, valuations, and reporting services for financial products across all asset classes in order to enhance transparency, reduce risk and improve operational efficiency. Please see [www.markit.com](http://www.markit.com) for additional information.

<sup>2</sup> Markit Quotes is a real-time quote parsing service that extracts indicative and live over-the-counter (OTC) pricing from on average 1 million messages every day. The service provides cross-asset class coverage to a broad range of market participants with an efficient pre-trade transparency mechanism and insight over the course of the day.

<sup>3</sup> Markit offers a range of observed and evaluated end-of-day pricing services for Credit Default Swaps, bonds, loans as well as for Structured Finance instruments.

<sup>4</sup> Markit BOAT facilitates the MiFID-compliant reporting of pre- and post-trade information in European equity markets. Currently 37 investment firms and 7 MTFs use the platform. In 2010 Markit BOAT reported 70 % of the total volume of European OTC equity trading, making it the biggest trade reporting venue in Europe ahead of Euronext and LSE Group.

non-equity markets should make consistent and cost-efficient use of those used in the equity markets; and v) reporting to Trade Repositories should not be a requirement for a derivatives trading platform.

**Equity markets:** i) to succeed in creating a European Consolidated Tape the Commission should a) continue the efforts to ensure standardisation and quality of data; b) define the principle of “reasonable” fees charged for pre- and post-trade data by creating additional guidance and enforcing it; c) provide for a single industry-led provider; and ii) provide further clarification on the APA regime and pursue its adoption.

## I. Non-equity Markets

### Ad 2.2.3. Trading of derivatives

#### **The Definition of Alternative Organized Trading Facility should be further refined (Question 9)**

The CP considers the introduction of a requirement for “standardised” derivatives to be traded on a certain type of execution platform (“*alternative OTFs*” or “*AOTFs*”) “where appropriate”. One of the characteristics required from those AOTFs is that they would “report transaction data to trade repositories”<sup>5</sup>.

Markit supports the reporting of OTC derivative transactions to Trade Repositories (“*TRs*”) as a tool to increase transparency and enable systemic risk monitoring in the derivatives markets. However, we believe that introducing reporting to TRs as a characteristic of trading platforms for these products is unnecessary, could lead to confusion vis-à-vis other legislative proposals, create duplicative reporting obligations and would reduce the efficiency and timeliness of compliance. We note that the proposed *European Regulation on OTC derivatives, central counterparties and trade repositories* (“*EMIR*”)<sup>6</sup> already creates an obligation for counterparties to report derivative transactions to TRs. The timely and efficient establishment of such reporting obligation would be ensured by allowing the reporting party to decide how to best satisfy such requirement, which might be by delegating the reporting to an execution platform or other qualified parties. We believe that such an approach is in line with proposed rules in the United States<sup>7</sup> and is preferable to any prescriptive approach of who should perform the actual reporting depending on execution, clearing, or other characteristics of the transaction.

Offering flexibility to counterparties of how to best comply with the obligation to report a transaction to a registered TR, as is required by EMIR already, will help ensure the most timely, accurate and efficient establishment of reporting in the market. We believe that the requirement to “report transaction data to trade repositories” should therefore be removed from the definition of AOTFs.

#### **Liquidity Measurement needs to be sufficiently granular, dynamic and accurate (Question 10)**

The Commission envisages that market participants would be required to trade cleared OTC derivatives that are “sufficiently liquid” exclusively on AOTFs. ESMA would be tasked with making a determination on

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<sup>5</sup> See CP page 13

<sup>6</sup> Regulation on OTC derivatives, central counterparties and trade repositories, European Market Infrastructure Legislation (EMIR) as published on September 15, 2010

<sup>7</sup> Please see the U.S. Securities and Exchange Commission's *Regulation SBSR – Reporting and Dissemination of Security-Based Swap Information*

<sup>8</sup> See CP page 13

product liquidity, based on “for example, the frequency of trades in a given derivative and the average size of transactions”<sup>8</sup>.

Our experience in creating Liquidity Scores for a range of financial products has shown that producing meaningful measures of liquidity for products that trade mainly over-the-counter (“**OTC**”), which is the case for most non-equity products, involves compilation of multiple inputs and can be quite complicated. As these instruments trade infrequently, the traditional approach of using observed trading volumes to gauge liquidity fails to produce any meaningful results, and a range of indicators of liquidity must be taken into account instead. In addition, the liquidity of financial products can experience significant changes over time and will vary even for different maturities of the same product<sup>9</sup>. If the benchmark maturity of a product is determined to be “liquid” and the whole curve would have to be traded on an AOTF as a consequence, it would likely compromise any efforts to develop a market for the less liquid maturities.

We therefore believe that liquidity measurement for non-equity products as performed by ESMA should be based on a range of factors to ensure its accuracy, should be performed on a product and also maturity level, and should be re-calibrated on a regular basis.

### **Ad 3.4. Pre- and post trade transparency in non-equity markets**

#### **The need for appropriate calibration and phase-in of any regime**

We note that the CP establishes a wide scope of “non-equity products”. This significant range of products will result in a very large number of in many cases unique instruments being covered – in contrast to the equities universe.<sup>10</sup>

We believe that any transparency regime for non-equity products needs to be carefully calibrated to reflect the wide variety of product characteristics and also to avoid unintended consequences such as damaging liquidity, which is a particular risk for the less liquid and more customized products where the available liquidity is critical. We also recommend that the introduction of any such regime be phased-in, starting with the more liquid and standardised products while gathering additional information, e.g. transaction volumes or details of market structure, to decide whether and how it should be applied to the less liquid and more customized market segments so as to avoid damaging or eliminating liquidity that currently exists.

#### **Ad 3.4.1. Pre-trade Transparency**

##### **How to create meaningful pre-trade transparency in non-equity markets (Question 39)**

We believe that the proposed public quoting obligation for investment firms goes significantly beyond what is expected from investment firms for equities in Europe or for OTC derivatives in the US<sup>11</sup>. In fact, the way the requirement is drafted, it may dissuade market making and reduce the pricing quality and liquidity in the non-equity markets. Also, we do not think that such a broad-based, generic requirement will have the

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<sup>9</sup> Please see our comments on 3.4.2. *Non-Equity Post-Trade Transparency* for additional details on liquidity measurement.

<sup>10</sup> The universe of European non-equity products that would be covered by the regime ranges from an estimated more than 250,000 European corporate, government, supranational, and covered bonds, some of which are reasonably liquid and traded also by retail investors, to a variety of equity, credit or commodity derivatives that tend to be complex, customized and purely institutional.

<sup>11</sup> We note that in the United States the creation of pre-trade transparency in the swaps markets is a statutory requirement of the Dodd-Frank-Act. The rules that have been proposed so far (Federal Register 76 FR 1214, January 7, 2011, CFTC *Core Principles and Other Requirements for Swap Execution Facilities*) aim to achieve this goal by establishing certain requirements and functionality for Swap Execution Facilities (“SEFs”), instead of creating any direct quoting obligations for investment firms.

desired effect of creating pre-trade transparency in those segments of the non-equity markets where it might be needed, or that it will create a flow of useful information.

We therefore encourage the Commission to consider other, more targeted measures that could deliver a meaningful increase in the pre-trade transparency for non-equity products. For example, to increase pre-trade transparency in the OTC derivatives markets that are largely institutional, the Commission could consider establishing an organized, regular provision and dissemination of pre-trade transparency for a set of benchmark OTC derivative products.

### **The Issues of Consolidation and Standard Market Size**

We believe that in any effective pre-trade transparency regime, the following issues need to be addressed:

- The value of pre-trade information will depend on how the actual quote publication is performed, and whether quotes are consolidated. In order to achieve any significant level of consolidation, reported data needs to be sufficiently standardised and of consistent quality. Therefore, the channels used to distribute quotes for non-equity products should satisfy substantially the same stringent requirements as those in the equity markets.
- Because of the range of relevant instruments and products, it will be difficult to determine a “commonly accepted” “size threshold”<sup>12</sup> for non-equity products, with OTC derivatives presenting a particular challenge. This variable, in fact, will likely change over time depending on market conditions and with contracts turning off-the run, and will vary by maturity. We believe that any regime that relies on such thresholds should be based on appropriate technical standards and should also include regular re-calibration.

### **Ad 3.4.2. Post-Trade Transparency**

#### **Any post-trade transparency regime for non-equity markets should be liquidity-calibrated on a product, and ideally on a maturity level (Questions 40 and 41)**

We agree that any post-trade transparency regime for non-equity products should be appropriately calibrated, and should include the use of thresholds and delays to limit the potential negative impact of transparency on liquidity or pricing quality. Also, given the variety and complexity of non-equity products the regime should differentiate between asset classes and product variations.

However, as we have suggested in prior consultations<sup>13</sup>, effective liquidity calibration should not rely solely on transaction sizes but also on the liquidity of individual products. The following recommendations may help achieve this goal:

- As a provider of Liquidity Scores for a variety of products,<sup>14</sup> Markit has found that liquidity measurement for products that trade mainly over-the-counter is challenging given their low trade frequency. However, reasonably accurate gauges of liquidity can be derived from a combination of observable factors such

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<sup>12</sup> See CP page 28: “This could represent a commonly accepted value of trades in each asset class beneath which the risk associated with the trade can easily be laid off in the market...”

<sup>13</sup> See for example Markit’s response to the *Consultation on CESR’s advice in the context of the MiFID Review: Non-equity markets transparency*, available via [www.esma.europa.eu/index.php?page=response\\_details&c\\_id=164&r\\_id=5684](http://www.esma.europa.eu/index.php?page=response_details&c_id=164&r_id=5684)

<sup>14</sup> Markit currently supplies liquidity scores and metrics for Structured Finance products, bonds, syndicated loans as well as for Credit Default Swaps. Our Liquidity Scores are based on a number of factors that are specific to each financial instrument and are updated on a daily basis, including the size of the bid/offer spread, the number of liquidity providers, the number of quotes that are sent, the average trade size for a given security and soon also transaction volume information.

as trade frequency and average transaction size, bid/offer spreads, and the number and size of quotes. Liquidity of those products can also experience significant changes over time, and any liquidity-calibrated regime should be sufficiently flexible to reflect such changes.

- There are often significant differences in liquidity between the various maturities of the same product<sup>15</sup>. We therefore encourage the Commission to explore how a liquidity calibration could be established not only on a product, but also on a maturity level.

Markit would be pleased to share additional information on this subject and support the Commission and ESMA in their endeavours if desired.

### **Consistent Standards and Consolidation for non-equity product data is important to create effective transparency, but will have complexities even more challenging than for equities (Questions 46 and 50)**

We support the Commission's approach of applying the MiFID principles also to non-equity markets whilst tailoring the regime to the specifics of the asset classes and products in question. We believe that the post-MiFID lessons in European equities, i.e. the fragmentation of data and the ensuing loss in transparency, should be taken into account when constructing a regime for non-equities, where, given the complexity of these products, the task of data consolidation will be even more daunting.

With the MiFID post-trade transparency regime being extended to cover non-equity products, we support the introduction of similar identification and flagging practices for these instruments and asset classes. Introduction of such rules at the outset would promote clarity, consistency and increase the efficiency of price formation.

Also, the ability to access a consolidated view of the non-equity market is critical to achieving the regulatory objective of actually increasing transparency in this market segment. The Commission should seek to avoid any unnecessary fragmentation of data, and to establish consistent standards for data quality and formatting to enable consolidation where necessary. We believe that the following recommendations could help the Commission in achieving these goals:

- We expect that execution in the non-equity markets will continue to occur on a variety of venues and that some initial level of data fragmentation will be unavoidable. To address such fragmentation in execution, post-trade reporting for non-equity transactions should, similar to equities, only be conducted through specific approved channels, such as Approved Publication Arrangements or Trade Repositories.
- Technical standards for the quality and formatting of such data should be set by ESMA before a regime is actually established. Such standards should also include flags to identify "addressable liquidity", i.e. trades that any market participant could have entered into, in contrast to other reportable trades such as compression or option exercises. Furthermore, the reporting obligations for investment firms should be clarified to ensure the consistency of trade reports.
- Any regime should require that the data that is reported is available widely at reasonable cost and not on unduly discriminatory terms.

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<sup>15</sup> Often, for example, the 5 year maturity of a Credit Default Swap on a certain name would qualify as "liquid", while this would not be the case for many other maturities, and the 15 year maturity might only trade a couple of times each year even for the most liquid names.

As the experience in the equity markets post the introduction of MiFID has shown, all of the above factors are relevant to ensure that not only the reported data is consolidatable but also that a consolidated dataset will be available at affordable terms, helping to achieve the desired increase in transparency.

## **II. Equity Markets**

### **Ad 3.5. Over the counter trading**

#### **Trade Flagging should be more granular and harmonised (Question 42)**

Markit supports the further identification and flagging of OTC equity trade types in a harmonised manner across European publication venues<sup>16</sup>. In our experience as the owner and operator of Markit BOAT, granular and harmonised flagging is valuable in promoting market transparency and enabling both market participants and other parties to perform a number of important functions in an accurate and reliable fashion, for example:

- Transaction Cost Analysis (TCA)
- Proof of best execution
- Calibration of trading algorithms
- Calculation of total traded volumes and high/low, open/close prices based on economic trades
- Detailed statistical analysis around market structure
- Effective data consolidation

We believe that flagging standards should be uniform and binding for all European publication venues and data vendors and that they should include the harmonisation of flags across Regulated Markets. Markit endorses CESR's Technical Advice to the European Commission in the context of the MiFID Review<sup>17</sup> in its proposals related to Post-Trade Transparency Standards in the equity markets. However, a review mechanism should be established to allow regulatory authorities to further develop such standards in a timely fashion on the back of industry feedback and market evolution. Markit strongly encourages the continuation of the joint Industry/ESMA Forum for this purpose.

### **Ad 4. Data Consolidation**

We believe that effective data consolidation in the European equity markets will depend upon improvement of the quality of the input data and consistent formatting. While a successful introduction of the APA regime is an important step in this respect, an equal focus needs to be placed on ensuring that the cost of data is "reasonable" and the right model is established for the creation of a European Consolidated Tape.

#### **How to ensure a successful introduction of the APA regime (Questions 43 to 46)**

Since November 2007 Markit BOAT has been an authorised Trade Data Monitor ("**TDM**") under the UK Financial Services Authority's Guidelines for Investment Firms. As such, the platform has been subject to

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<sup>16</sup> For the avoidance of doubt, please note that our response is limited to those flags that disclose the type of an OTC trade, rather than its method of execution, e.g. in a dark pool.

<sup>17</sup> See CESR *Technical Advice to the European Commission in the Context of the MiFID Review and Responses to the European Commission Request for Additional Information*, July 29, 2010

an annual certification process, which in many cases involves external auditors and targeted system penetration tests.

Based on our experience with the TDM regime, we support the proposed introduction of an Approved Publication Arrangement (“**APA**”) regime for reporting venues across Europe. We believe that the successful introduction of APA requirements will reduce the degree of fragmentation of European OTC equity post-trade data and improve overall data quality. However, several factors should be considered in this context:

- The APA criteria are presently framed as high-level principles and will be subject to interpretation by venues as well as by regulators. However, without a common specification, a level playing field for regulatory approval as an APA will not exist. For example, whilst all reporting venues will need to have controls in place to monitor data quality and isolate erroneous trade reports, the actual results may vary widely as thresholds and tolerance levels are set individually by the various venues. We encourage the issuance of further guidance to specify the controls that would allow a reporting venue to comply with APA criteria, for example a detailed framework around data validation.
- Due to the lack of information within a trade report, an APA will not be in a position to identify with certainty an inconsistent or incorrect interpretation of MiFID by an investment firm, which might for example result in the incorrect use of a trade flag or the reporting of both legs of a transaction. We therefore suggest that MiFID outlines specific use cases and require investment firms to publish trade reports in a prescribed manner in order to ensure the harmonised interpretation and application of the post-trade transparency requirements.
- Also, further thought should be given to how the regulators would ensure compliance with such use cases. The proposed data quality reports that are provided by APAs to the regulators would only address measurable errors, such as errors related to timely reporting, but not all aspects of the quality of the reporting. Should regulators expect APAs to monitor the data for consistent application of the MiFID principles with a view to potentially eliminating double-reporting, further information would need to be disclosed within a trade report, including basis and side of trade.

Consistent with our view on trade flagging, Markit endorses CESR’s Technical Advice to the European Commission in the context of the MiFID Review and its proposals around the Post-Trade Transparency Standards in the equity markets<sup>18</sup>. Importantly, we think that the existence of an Industry/ESMA Forum where questions can be raised and clarified on an ongoing and confidential basis when they emerge will be vital to ensure consistency and the development of appropriate standards.

#### **Ad 4.2. Reducing the cost of post trade data for investors**

##### **The concept of “reasonable cost” has to be defined and enforced (Questions 47 to 49)**

The unbundling of pre- and post-trade data has been identified as one necessary step to make European equity data affordable. However, recent experience has shown that if the “unbundling” principle is applied in isolation, it might actually lead to an increase of the fees that are charged by reporting venues. One Regulated Market reportedly recently “unbundled” its dataset while at the same time significantly increasing

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<sup>18</sup> See CESR *Technical Advice to the European Commission in the Context of the MiFID Review and Responses to the European Commission Request for Additional Information*, July 29, 2010

the fee that it charged for the stand-alone pre- and post-trade datasets. The unbundled post-trade data is therefore now available at 80% of the price that was charged for the pre- and post-trade package before the unbundling, and the entire dataset now costs significantly more than previously. Also, whilst initiatives like data disaggregation, i.e. further “unbundling” of datasets to provide country, index, sector, or instrument type packages, are helpful, they alone are unlikely to address the heart of the problem.

We believe that, in tandem with requiring the “unbundling” of pre- and post-trade equity data, standards need to be established and enforced to ensure that the fees that are charged by reporting venues for the various datasets are “reasonable”. Such standards could be based on the following parameters:

- The ratio of pre- and post-trade data fees relative to each other in form of an agreed “value ratio”,
- The fees for pre- and post-trade data on its own relative to the fee for the “bundled” package, and
- The relative market share of a venue in comparison to venues operating under the same regime. For example a Regulated Market may be compared to other Regulated Markets, a lit MTF to other lit MTFs, an APA to other APAs etc. Using such factor in the analysis would ensure fairness in assessing relative market share whilst providing sufficient flexibility to further define “reasonable cost” for each of these market segments, depending on operating costs, value of data, additional revenue streams and overall viability of the business.

Whilst we acknowledge that significant hurdles need to be overcome to establish such standards, including the diverging commercial interests of the various stakeholders, we believe the costs of disparate and bundled data sets must be directly addressed before a consolidated and affordable dataset can be produced.

#### **Ad 4.3. A European Consolidated Tape (Questions 51 to 59)**

Given the degree of data fragmentation that has existed in the European equity markets since the introduction of MiFID, the creation of consolidated transparency has become an urgent issue. We believe that the ability to access a consolidated view of activity in the equity markets is important to achieving the regulatory objective of creating sufficient transparency and ensuring the efficiency of price formation in this market. Whilst the biggest market participants can generally afford to purchase, harmonise and aggregate data feeds from various sources, medium-sized and smaller users as well as retail investors and the public are not otherwise able to gain a clear picture of market activity.

Markit supports the introduction of a European Consolidated Tape (“**ECT**”) as means to facilitate important functions such as accurate Transaction Cost Analysis, proof of best execution, and detailed statistical analysis around market structure. We believe measures that ensure the quality, consistency and reasonable cost of trade data are necessary steps to create an efficient and affordable ECT.

#### **How should an ECT be operated?**

The CP considers three options of how an ECT could operate. We note that, despite the existence of several initiatives to create an ECT with several competing providers, i.e. Option 3, only little tangible progress has been made. We believe that the conflicting commercial interests of the various stakeholders and the question of who would ultimately pay for multiple operating systems that all provide a similar service will tend to make this path unsuccessful.



We are of the opinion that choosing a single provider that is accountable for the efficient and timely delivery of an ECT will be the most effective approach and therefore regard Option 2 as the most viable option.<sup>19</sup> However, we strongly encourage the authorities to be open to proposed commercial models that are different than Options 2 A or B. We are confident that a suitable commercial model will emerge once the scope of the project has been clearly defined and stakeholder interests have been identified. Commercial providers should be encouraged to be creative and to devise a commercial model that ensures the viability of a high quality ECT whilst minimising operating costs.

### **Additional focus on ECT revenues might be needed**

While there is broad agreement on the need for an ECT, discussions are complicated by the lack of clarity about who would actually subscribe to it and for what purpose. We believe that to make an ECT commercially viable and ensure its ongoing success, a sufficient revenue stream needs to be established. Incentivising all market participants to use a real-time ECT for various purposes, such as proving best execution, would be one option to achieve such objective. Alternatively, the ECT provider could be permitted to establish a standard connectivity charge or redistribution licence fee.

We believe that by establishing such commercial principles that would ensure a certain level of expected revenue for the ECT provider, it will significantly increase the likelihood of several providers entering viable competing offers in the planned RFP process, which would ultimately be in the interest of all stakeholders.

Markit appreciates the opportunity to provide you with our comments related to the important topics of transparency and data consolidation in the European non-equity and equity markets. We hope you will find our response useful. Please do not hesitate to contact Marcus Schöler on +44 207 260 2388 or [marcus.schueler@markit.com](mailto:marcus.schueler@markit.com) if you require any additional information.

Kind regards,

A handwritten signature in black ink, appearing to read 'Armins Rusis', with a long horizontal stroke extending to the right.

Armins Rusis  
Executive Vice President  
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Markit Group Limited

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<sup>19</sup> Whilst we are in favour of appointing a single provider, we do not believe that appointing a public authority would be desirable, as operation by such kind of entity would be less likely to achieve effective cost and time management or ensure the ability to innovate and continuously improve the services it provides.