

## The MiFID Metamorphosis

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The Markets in Financial Instruments Directive (MiFID), adopted by the EU in April 2004 and implemented at member state level by the end of 2007, has begun to achieve real success in transforming the EU's securities markets landscape. Judging from market data and sector publications, the Directive contributed to a revolution in trading methods and huge investments in technology, thereby bringing the EU and US markets closer together. Technology-driven systems, such as algorithmic trading and smart-order routing, have entered the mainstream of trading practice, with speed of trading and reduction of 'latency' being the key objectives. Large investments in market infrastructures are trying to strike the right balance between high capacity and speed on the one hand, and low operational and technological risk on the other, which represent a threat for these platforms, even in the post-trading space.

Work still needs to be done, however, on the 'conduct of business' side of the Directive, which is especially appropriate in a post-crisis context, but requires better enforcement and supervision. EU policy-makers should assess how the benefits of increased competition are passed on to end-users and how increased transparency has improved the quality of the price formation process. These elements could be the starting point of the MiFID Review, on which the European Commission will make formal proposals in early 2011.

### The origins and (r)evolution of the trading landscape

The birth of MiFID was not particularly well received. A lengthy debate ensued over whether there was a need for a radical overhaul, or whether limited amendments to the 1993 Investment Services Directive (ISD) would be sufficient. The adoption of the proposal by the European Commission in 2002 was overshadowed by a last-minute 'Prodi amendment' on pre-trade transparency, which was also the main focus of the discussions in the European Parliament. The implementation of the Directive was seen to

be painful, costly and complex – "Most Institutions Find It Difficult" became an alternative take on the Directive – and the starting date was formally postponed. Many firms were not prepared for the directive on the already belated implementation date of November 2007, but many member states also delayed transposing the EU Directive into national law.<sup>1</sup>

The tide started to turn in 2007, when some began to see that MiFID could be an opportunity as well. The UK's Financial Services Authority (FSA) worked hard to make sure that the City would be ready and well-prepared for the MiFID deadline. That deadline was overtaken by events in the first months of the financial crisis however, and the first 18-month period following the start date was entirely overshadowed by the problems in the banking sector. MiFID was a non-event, even if many of the conduct-of-business provisions of the Directive were well-adapted to the post-crisis context.

Important changes in market structure occurred in the course of 2009. MTFs – with their pan-European trading venues – began to gain an increasing market share to the detriment of the exchanges. Before MiFID, fragmentation was mainly driven by geographical and behavioural factors (e.g. home bias), even where the concentration rule did not apply. Under the new regime, new entrants managed to get a market share of about 20% of total trading in Europe by the end of 2009, from almost nothing the year before. Chi-X, the most successful new entrant, managed to become the 4<sup>th</sup> most important operator in the European trading landscape in 2009, and the 2<sup>nd</sup> in the first half of 2010. The market share of the largest regulated market in the EU, the London Stock Exchange (LSE), shrank from 35% to 22.48% between 2008 to 2010 (see Figure 1).

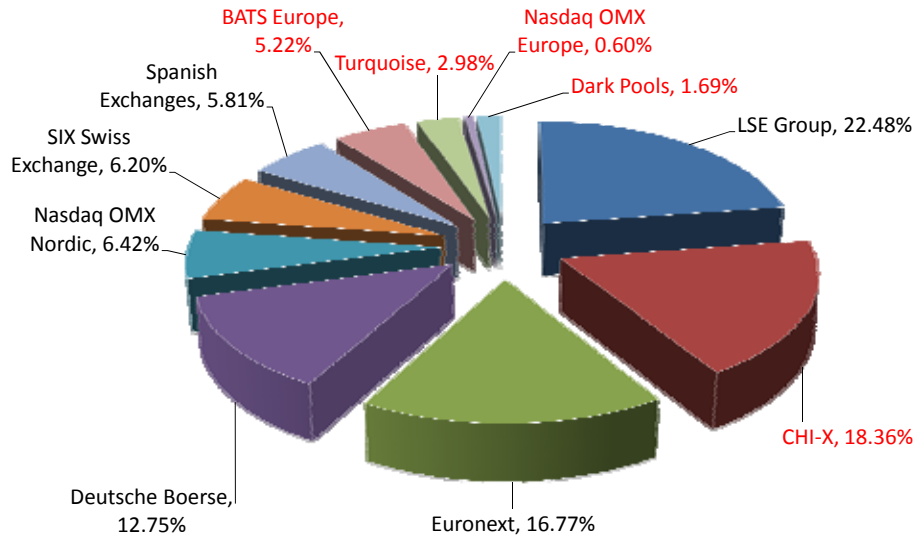
<sup>1</sup> See Casey & Lannoo (2009, pp. 12-13) for an overview of the costs estimates of implementing MiFID and Lannoo (2007) for an overview of the state of preparedness for implementation in 2007 (text available on [www.eurocapitalmarkets.org](http://www.eurocapitalmarkets.org) and [www.ceps.eu](http://www.ceps.eu)).

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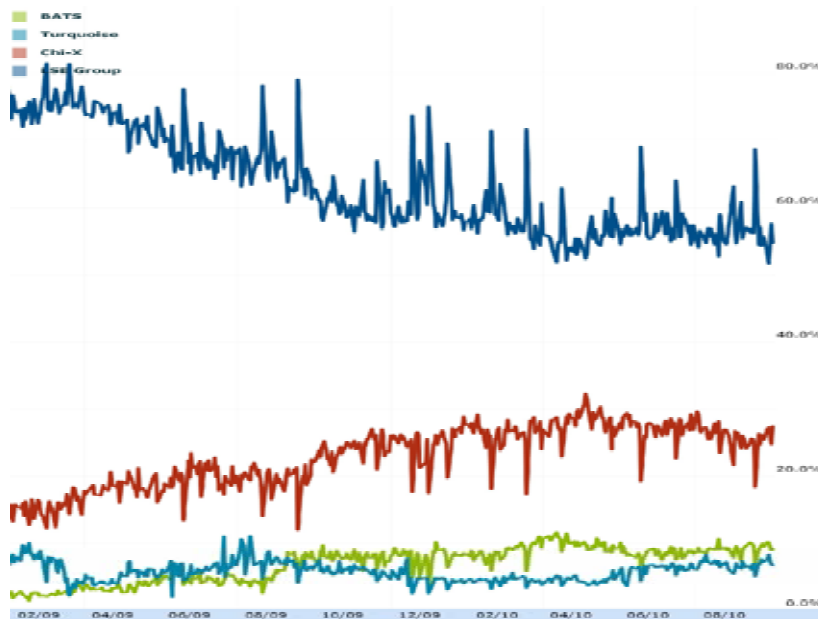
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Figure 1. EU equity markets – 2010 market shares



Source: Thomson Reuters, FESE (Jan-June 2010; % total turnover).

Figure 2. Market Share of trading venues on the FTSE 100



Source: BATS Europe

Within the local stock market indexes, for instance on the FTSE 100, the LSE currently has a market share of about 60%, down from over 80% two years ago (see Figure 2). Estimates reduce this market share to 40% by 2012.<sup>2</sup>

This revolutionary change happened in a context of sharp declines on Europe’s stock markets and the consequent dramatic reduction in the turnover of Europe’s trading venues and their revenues. Sudden losses have hit exchanges’ balance sheets, forcing them to rethink their business models and to diversify into other revenue streams.

Specialised services in the realm of market data and new infrastructures run as MTF platforms with so-called dark and lit pools of liquidity are the main targets of this diversification process.<sup>3</sup> As a result of fierce competition, exchanges are building their own dark and lit pan-European platforms that are progressively competing with newcomers and other regulated markets on a cross-border level. On the other hand, the market for data remains costly and highly segmented by incumbents and data vendors, which are

<sup>2</sup> See Bruce Hamilton, presentation at ECMI Conference on “MiFID & EU Markets: What is next?”, 1 February 2010 (<http://www.eurocapitalmarkets.org/system/files/Bruce+Hamilton.pdf>)

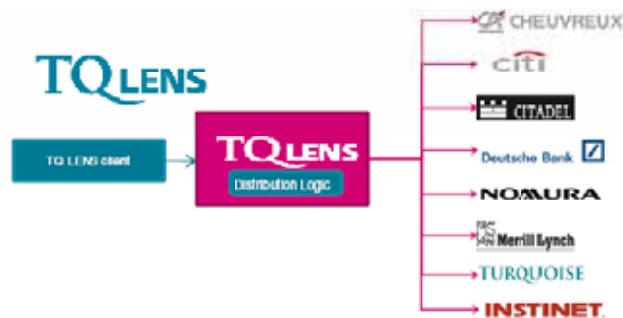
<sup>3</sup> LSE Group has completed the acquisition of Turquoise (early 2010) and merged its MTF Baikal with the purchased trading venue. Euronext created Smartpool and purchased NYFIX technologies with Euro-Millennium dark pool, which has been shut down. Deutsche Börse is running its own dark and lit MTF platforms.

benefiting from the lack of standardisation for data formats. With no harmonised formats framework and pro-competitive practices, final products (market data) are not homogeneous and competition cannot really be unleashed into the market. More should be done to disclose market data “in a manner which is easily accessible [and readable] to other market participants” (Art. 28 MiFID).

On the competition policy side, in effect, widespread bundling practices may create unfair advantages for some market players and final users, who may find difficulties to access markets. The obligation to purchase bundled data services or products without the possibility to buy the product separately favours incumbents and helps segmentation in a network industry setting dominated by

national markets and very few pan-European players. A clear-cut example is the practice to bundle pre- and post-trade data, obliging the final user to subscribe to both products. Another bundled solution is the use of common fee structures for broker, execution and other trading and (potentially) post-trading services. For instance, the Turquoise project (see figure below) represents an example of bundling that – thanks to the merger with the LSE – allows this market participant offering all services related to a typical transaction in equity markets, in particular if the LSE Group decides to enter the market also for post-trading services in the UK through its Italian subsidiaries, Monte Titoli and CC&G.

Figure 3. Turquoise’s TQ Lens



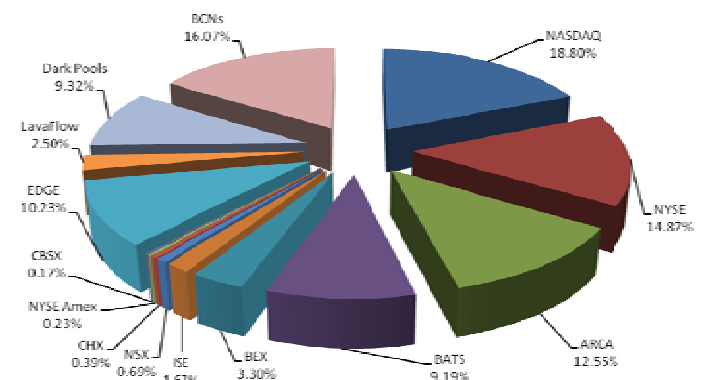
Source: Turquoise trading.

This project is an interesting innovation that may reduce costs of access and intermediation while increasing the quality of the transaction at the same time. Bundling of services can create significant economies of scale and scope. From a competition policy point of view, bundling solutions do not necessarily harm final investors if investors are free to choose single services from the bundle with no lock-in effects due to high switching costs and the bundle *per se* does not foreclose new entrants. If the market participant that offers the bundle is not dominant and if the bundle is potentially replicable and the offer does not involve loyalty rebates, foreclosure effects are generally low.<sup>4</sup> The Committee of European Securities Regulators (CESR) has taken a clear position in this debate, requiring the unbundling of pre- and post-trade trade data for regulated markets, MTFs and data vendors (which will need to follow Approved Publication Arrangements, APAs).<sup>5</sup> However, this may need a follow-up by the competition policy unit of the European Commission and national authorities, which have direct competence in matters of competition policy.

A similar and even more pronounced market trend can be observed in the US, where the abolishment of order protection for manual quotations in Reg NMS (Regulation National Market System) and the rule against trade-

throughs<sup>6</sup> have led to a dramatic reduction in the market share of the New York Stock Exchange. In January 2005, NYSE executed 79.1% of the consolidated share volume in its listed stocks, compared to 27.4% in December 2009 (see SEC, 2010a and Figure 4). But so far, the increased fragmentation of trading venues has not deteriorated orderly price formation. Spreads at the larger European and US exchanges narrowed further in the course of 2009.

Figure 4. US equity markets – 2009 market shares



Source: TABB Group (December 2009).

Securities markets in the EU and the US have thus started to move in parallel. Whereas the main European exchanges have had automated trade matching in place since the early

<sup>4</sup> See, in general, CEPS and Van Dijk Consultants (2009) at [http://ec.europa.eu/internal\\_market/consultations/docs/2010/tying/report\\_en.pdf](http://ec.europa.eu/internal_market/consultations/docs/2010/tying/report_en.pdf).

<sup>5</sup> CESR (2010b), p.30. Data vendors and investment firms, in particular, should follow specific Approved Publication Arrangements (hereinafter, APAs), as a supplement to the introduction of new standards on data quality and guidelines on trade publication.

<sup>6</sup> “A trade-through occurs when one trading center executes an order at a price that is inferior to the price of a protected quotation, often representing an investor limit order, displayed by another trading center.” SEC, “Regulation NMS”, Release No. 34-51808; File No. S7-10-04, p. 22.

1990s, the US continued to protect manual quotations until the entry into force of Reg NMS. The EU maintained the monopoly of exchanges until the entry into force of MiFID the main markets since the mid-1990s. Both regulations – Reg NMS and MiFID – aim at increasing market efficiency and reducing trading costs through creating fiercer competition between trading venues. An exact comparison between Europe and the US is difficult because of poor data quality and a different post-trading infrastructure, however. A similar trend towards fragmentation driven by competition can be observed, even though market integration in Europe still has some way to go. Legal, fiscal and behavioural barriers prevent greater and more cost-effective competition at European level, as well as a more open architecture for market infrastructure.

### **Broker-dealer crossing networks: Legal classification and transparency issues**

Within Europe, an intense debate is on between the European exchanges and investment banks concerning the size of over-the-counter broker-dealer networks (or ‘crossing engines’; hereinafter BCNs). In effect, the MiFID revolution, especially with the introduction of new technologies, has caused the emergence of new crossing venues as a result of new pre-trade transparency requirements and their missing classification under the Directive. Crossing engines represent the evolution of brokerage services, applying discretionary rules to the selection of liquidity (as systematic internalisers), supported by best execution obligation and non-application of pre-trade transparency rules, as they deal – in their view - with liquidity that may produce market impact. Hitherto, there is no evidence that these pools of liquidity have negatively impacted price formation (see for example Chartered Financial Analysts, 2009). Besides, they are systemically irrelevant.<sup>7</sup>

For legal certainty and market transparency, all trading venues need to be classified, as do BCNs. However, the current legal classifications do not reflect the evolution of the market and may need to be updated. CESR has thus proposed a formal recognition in the regulation of BCNs as discretionary systems complying with an ad hoc reporting regime to competent authorities and proper flagging. The European authority has also proposed to set a trading threshold, so they should become MTFs if the level of client business exceeds a certain amount. As a result, all OTC trades should be subject to a more detailed post-trade reporting to authorities (CESR, 2010b).

We agree with the need for a specific legal framework and proper post-trade transparency obligations to these venues, but we do not concur with the solution of setting a threshold, at least as long as we do not have empirical evidence on the optimal size or the level of over-the-counter trading that may affect price formation. In addition, it may be easily circumvented by increasing the number of crossing platforms run by a subsidiary or joint ventures, ultimately. In any case, the threshold should be defined around the size

in November 2007, whereas in the US Automated Trading Systems (ATS) have been competing with

of business actually ‘internalised’, and not on the overall amount of client business since the non-internalised part is typically executed on lit and dark order books, so in line with the transparency requirements set by MiFID.

### **New technologies: Impact on execution services and market structure**

With the liberalisation of market access and an improvement in service choice, trading venues and broker-dealers have invested massively in technology to accelerate trade execution and improve capacity. The NYSE’s speed of execution for small, immediately executable orders was 10.1 seconds in January 2005, compared to 0.7 seconds in October 2009. NYSE Euronext Paris will move its servers to London to reduce latency and to be closer to the main trading community in Europe, while the LSE Group – after the acquisition of the IT firm Millennium – has launched an infrastructure called ‘Millennium Exchange’, to which the Group and third parties – as Oslo Bors –migrated in 2010.<sup>8</sup> Banks are continuously developing and fine-tuning their order-routing systems to be ahead of the competition. Quantitative automated trading strategies, such as smart order routing and algorithmic trading, have become mainstream in trade execution. Among these quantitative strategies, high frequency trading is now a more significant component of the market, and the success of this strategy has encouraged more entrants.

The impact of new technologies has benefited displayed order books (hereinafter, ‘lit order books’) and dark order books, and their mechanisms of price formation. As we can see from Figure 5, the comparison of pre- and post-MiFID scenarios in the UK FTSE 100 – which applied an OTC reporting regime even before MiFID – shows a dramatic fall in the turnover and number of off-order book trades and a big rise in the number of on-order book ones, while the turnover has not been concretely affected. For on-order books, in effect – despite the terrible course of the financial crisis – the normalised turnover is slightly declining while the number of trades soared, even though the crisis may have reduced incentives to provide liquidity and investments to the market. In our view, this result can be considered as a positive outcome of MiFID because on-order books – where prices are formed – have largely benefited from the new trading environment.

This structural shift is due to the introduction of electronic trading (such as algorithmic trading), which aims to reduce market impact by slicing trades and sending orders in real-time to multiple trading venues. Market impact itself has become a more significant variable in investment decisions with the use of new trading technologies that permit investors to sniff out new sources of liquidity more easily. These new systems slice big orders into many small orders, designing a trajectory for orders that will be executed at

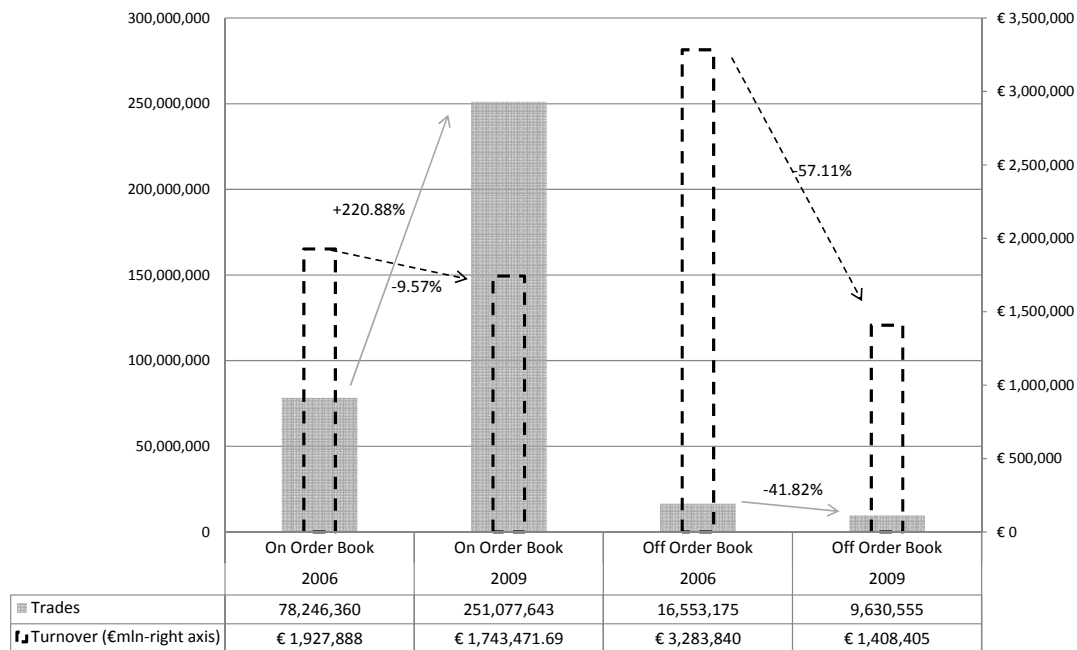
<sup>7</sup> CESR (2010b) has recently calculated the size of these crossing networks as 1.5% of the total EEA trading.

<sup>8</sup> See <http://www.londonstockexchange.com/traders-and-brokers/products-services/millennium-exchange/millennium-exchange-migration/millennium-exchange-migration.htm> and <http://www.thetradenews.com/trading-venues/exchanges/4192>.

different points in time during the trading day. As result, the average size of orders went down drastically in Europe, for

instance on the LSE FTSE 100 from £21,000 in 2003 to almost £10,000 in 2008 (CESR, 2009).

Figure 5. London Stock Exchange – FTSE 100



Source: FESE, Thomson Reuters, Markit BOAT, Chi-X, BATS Europe (turnover normalised by drop in FTSE 100 index value from January 2006 to December 2009 [-13%]).

Despite these results, higher speed and trading volumes have put trading platforms under severe strain. In the aftermath of latest market crashes and outages in Europe and the US, policy-makers are at a crossroads. In particular, the Securities and Exchange Commission report on May 6<sup>th</sup>, 2010 (SEC, 2010) highlighted issues concerning the speed of execution of big size orders. Regulators, then, are assessing the possibility to introduce measures to halt trading temporarily cross-market in case of sudden changes in market prices, in order to avoid triggering uncontrolled cascade effects on the whole market (for instance, circuit breakers;<sup>9</sup> Swinburne, 2010). Open questions remain on the table: should regulators or infrastructures set a speed limit? Is there a trade-off between market freedom and its security? Should regulators ban specific trading practices (e.g. layering, quote stuffing)?

### Best execution: Laying the road for a consolidated European Best Bid and Offer (EBBO)

Automated trading strategies (smart order routers) are specially driven by regulatory conduct of business requirements, such as best execution. Well-programmed systems will be more capable of delivering best execution than manual systems, provided the criteria are clearly set. On this account, the US Reg NMS is clearer than the EU’s MiFID, as best execution is price only in the US, with a

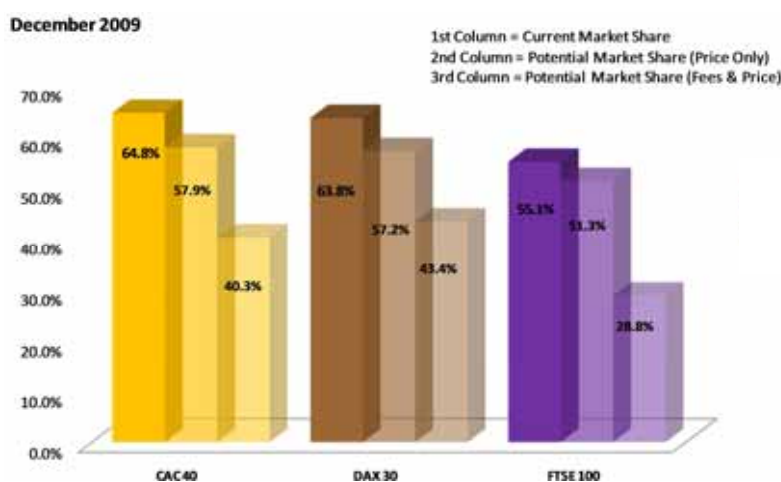
strict prohibition of trade-throughs, whereas the EU rule is more loosely defined, and may need tightening. Hence, narrowing of the rules in the EU for investor protection reasons will further automate trading, but not necessarily at the expense of the main markets if they adapt trading fees and costs for end-users.

The MiFID implementation has highlighted some further problems, related not only to a loose definition, but primarily to bad enforcement in particular for retail investors. In effect, while dark books – where big size orders are traded – have kept their size as before the crisis, lit books of regulated markets and MTFs – where retail investors and funds represent a big part – have lost a relevant share of turnover in the last two years (CESR, 2010b). In addition, the automatic splitting of orders in smart order routing and matching on banks’ own books often mean that certain criteria for systematic internalisation of MiFID are not met.

As shown in Figure 6, many trades on the first three European indexes in December 2009 missed the best price and lowest cost. If we consider that - under MiFID - best execution for retail investors is mainly price and cost, this chart gives evidence of the poor quality of execution for retail investors who mainly invest through systems only linked with incumbents and do not access advanced technologies, so rarely have the opportunity to choose multiple trading venues.

<sup>9</sup> Last June 2010, the SEC introduced a circuit-breaker programme, which “will require the exchanges and FINRA to pause trading in certain individual stocks if the price moves 10% or more in a five-minute period.” See <http://www.sec.gov/news/press/2010/2010-98.htm>.

Figure 6. Incumbent market's market share under best execution routing – December 2009



Source: Orange LFA Viewer - Equiduct Systems.

The cost opportunity for retail investors to invest in the most liquid shares through another trading venue, in January 2010, was more than €12 million (see Table 1). If we add fixed costs, this opportunity cost grows even more.

In effect, overall costs to access several trading venues and to provide a consolidated view are still prohibitive for the majority of investors (which are retail investors and funds). Access to new technologies allowing consolidated pan-European trading (through pre-trade consolidated data) is only provided to a small part of the market, i.e. to some professional investors who are able to bear the high costs of access and connectivity to all trading venues. Data costs and access do not support the development of these technologies at low costs. On the one hand, data feed providers by regulation (exchanges) are trying to subsidise losses due to new acquisitions and competition by other trading venues. Therefore, data fees are kept stable while demand for more specialised services is increasing. In addition, the quality of post-trade data is quite low, especially when transactions involve several players without proper flagging (as broker-dealer crossing systems). On the other hand, however, the lack of standardisation (formats, identifiers, etc.) allows data vendors and distributors maintaining market segmentation through the use of different formats, which increases switching costs and may lock clients in.

The use of bundled fees for data, in addition, helps to keep prices high or stable and markets segmented as long as different formats or bundling prevent the product from becoming more homogeneous, so more subject to competition.<sup>10</sup> This creates an artificial non-homogeneity of data that are technically homogeneous and highly complementary. In this regard, allowing more competition on market data distribution will further push down fees and costs for final users. Competition by newcomers is confined to new specialised services and for a niche of the demand

(providers of investment services with low-demand elasticity for trading data), since the costs are prohibitive for a large part of the demand (providers of investment services with high-demand elasticity, such as the ones providing services for retail investors).

As shown in Table 2, bundled data services and fees supported by non-standardised data formats have made costs of consolidated data solutions prohibitively high (over €500 per month/user). Opening up market to competition would thus sensibly reduce fees in order to make access to data cheaper and easier. In this competitive environment, industry-led pre- or post-trade consolidated data solutions may benefit markets more than policy-led solutions (consolidated tape in US style),<sup>11</sup> which should be left in the European Commission's powers if the market does not provide solutions in the short term. CESR recommended to give these powers to the Commission in case mandating an industry-led post-trade consolidated solution would not make pan-European consolidation of information "adequate and affordable" (CESR, 2010b, pp. 32-33).

<sup>10</sup> There is an important flow of literature assessing the potential risk to foreclose competition through bundling complementary services. For a review of the literature on bundling, see Centre for European Policy Studies (CEPS) and Van Dijk Consultants (2009).

<sup>11</sup> The US consolidated tape solution finds its legal ground in the obligation by RegNMS to execute orders at the best execution price only (order protection rule). This price is the result of collecting, processing and distributing data from all trading venues through the Consolidated Tape Association (no-profit entity), which split profits between data providers following specific criteria. Benefits of this solution might be balanced with wrong incentives for trading venues to promote volumes in order to increase their revenues from data, even though this situation may increase the overall risk of the infrastructure.

Table 1. Recent statistics (January 2010 on the 1,000 + most liquid stocks – Europe)

	Most liquid stocks in Europe	FTSE 100	CAC 40	DAX 30
Traded volume	€341.22 Bn	€122.30 Bn	€77.26 Bn	€61.32 Bn
Volume missing the best available price	45.38 Bn <b>13.30%</b>	14.36 Bn <b>11.74%</b>	11.13 Bn <b>14.40%</b>	9.14 Bn <b>14.90%</b>
Opportunity costs	€12.38 Mn	€4.00 Mn	€2.5 Mn	€1.65 Mn
Potential average price improvement	3.3 Bps	3.5 Bps	2.5 Bps	2.4 Bps

Source: Orange LFA Viewer – Equiduct Systems.

Table 2. Bundled fees

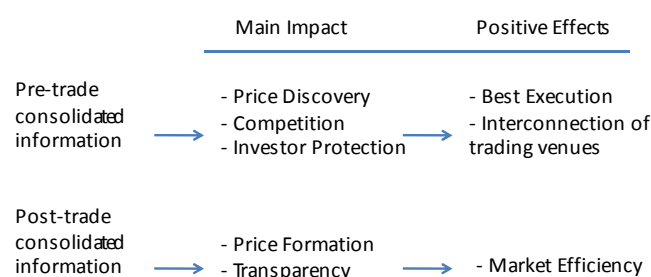
	Market share	€Bundled fee (per month/ per user)
Chi-X	6%	0
Nasdaq OMX	5%	22
Spanish exchanges	5%	34
Markit BOAT	24%	40
LSE	21%	42
Deutsche Börse	8%	56
Euronext	21%	59
Other venues (est.)	10%	250
<b>TOTAL</b>	100%	503

Source: Markit and companies' websites (last access, March 2010).

Unbundling and standardised data formats will reduce costs of access to pre- and post-trade consolidated data solutions. A priority in the MiFID review is to bring back retail investors and funds to EU capital markets. Reinforcing investor protection – through real enforcement of retail best execution (based on dynamic execution policies) on a pan-European basis – can only be delivered through a market-led initiative, which should preferably favour the creation of a consolidated European Best Bid and Offer (EBBO) data solution. Despite the importance of having more accessible consolidated pre-trade data solutions, the debate - pushed by sell-side and big buy-side representatives - is turning once again to market efficiency, leaving the question on how better to restore retail investor confidence on a cross-border level unanswered. Focusing on a more effective investor protection – through the real implementation of dynamic best execution duties – may put MiFID ahead within the measures promoting recovery for European capital markets after the crisis.

In effect, the role of regulators should focus on restoring investor confidence and the efficient market functioning, bringing back liquidity into the market in order to generate new investment opportunities and pushing economic growth. Therefore, after years of debate on market efficiency, the attention in our view should focus on boosting liquidity and promoting a pan-European equity market. A more efficient price discovery can help to make links within the internal market stronger to achieve the above-mentioned targets. There is no evidence that price formation has been harmed by MiFID (or by the low quality of post-trade data) and the financial crisis. However, investor protection duties - such as best execution (but also conduct of business duties) - are being poorly performed across Europe due to the lack of price discovery, fostering investors' distrust in a pan-European market.

Figure 7. The impact of pre-trade and post-trade consolidated solutions



Source: Authors.

Turning to post-trade transparency, the depth and quality of data seem to constitute the major concerns for regulators and market operators. The accuracy, reliability and granularity of post-trade data are very low for some areas, such as OTC trades. Action is needed to ameliorate the quality of post-trade information through common symbols (identifiers, etc.), shorter delays and common messaging formats. Improving the quality of post-trade reporting is important in order to increase market efficiency and should receive more attention by regulators in the short run; nevertheless, once the quality of data is improved, we do not think that post-trade consolidated solutions need the support of a regulatory action as for a pre-trade consolidated one (EBBO). Once accuracy and formats of data are up to date, consolidating post-trade data will be a normal market outcome of competitive forces in that market, which are already struggling to provide the most advanced consolidated solutions. Instead, opening the market for data to competition and improving price discovery (delivering benefits of competition to final users through best execution and pre-trade consolidated solutions) shall be the priorities of the European Commission and CESR in the MiFID Review. On the scope of post-trade transparency regime, even though MiFID has extended the regime to OTC trades in countries as Germany, a further extension to non-equity markets might benefit the market as a whole, as regulators decided to clamp down over undisclosed areas of financial markets. However, many of these markets are dealer-driven, therefore they may need specific requirements to avoid side effects on liquidity and overall efficiency.

In conclusion, the Directive's best execution duties (e.g. execution policies), know-your-customer rules (e.g. suitability and appropriateness) and conflict of interest provisions seem to be applied in a 'static' way, which only implies the mere compliance with the minimum requirements set by the legal text.<sup>12</sup> The recent proposals to transform CESR into a fully fledged European Security and Markets Authority (ESMA) will undoubtedly add a great deal to ensure that the rules are interpreted consistently and applied evenly across Europe. But it will also mean that new rules can be enacted much more rapidly.

## The Review

The MiFID review should not modify the basic principles set out in the 2004 text but only clarify some definitions and analyse the possibility of extending pre- and post-trade transparency requirements to other venues and asset classes (Art. 65, MiFID). The issues to be addressed can be subdivided into two areas: regulation and market practices.

On the regulatory side, some issues for the review need an urgent answer.

1. A legal classification of broker-dealer crossing networks appears necessary in order to increase legal certainty and transparency. These networks represent the evolution of advanced brokerage services and they operate either as a systematic internaliser or broker,

since they deal with selected liquidity (they apply discretionary rules) that they redirect where their algorithms find best execution. Reviewing the current SI regime by removing non-discretionary clauses and pre-trade transparency requirements may succeed to capture these networks. However, the benefit of applying discretionary rules and pre-trade transparency waivers should be offset with sound transparency and reporting requirements, and stricter enforcement of best execution rules, plus setting a threshold for the 'internalised' business if regulators feel comfortable with it.

2. The definition for certain waivers may be subject to revision (e.g. the large in-scale order waiver or the price reference waiver) and the definition of standard market size needs to be updated. In effect, reducing the 'volatility' of definitions – due to the direct link with the average size of orders – may be an efficient method to preserve legal texts from pro-cyclical effects.
3. There is a need for stricter best execution requirements and commonly available consolidated pre-trade transparency (EBBO). The latter, in effect, is only accessed by professional investors able to pay costly brokerage services and sophisticated technologies (e.g. smart order routing systems), while retail investors often receive a low quality execution in terms of price and costs. A push is needed to restore investor confidence and attract new liquidity in financial markets. A consolidated pre-trade solution – preferably industry-led but with a strong push from regulators in order to end 'free lunches' – not only may reduce costs of intermediations and provide easier access to retail investors, but it may also boost competition between market-makers in order to improve the quality of execution and reduce the costs for final users.
4. The quality of post-trade transparency and reporting should be improved. The granularity and quality of some post-trade data are still very low (e.g. OTC trades). This situation does not allow for an efficient definition of trading strategies and verification of best execution, and also impedes the creation of consolidated post-trade data solutions. However, this does not imply that a consolidated tape (based on post-trade data) should be seen as the priority. Improving the quality of post-trade and transaction reporting will boost consolidated data solutions by itself – once this target has been accomplished – without the need to legally mandate a consolidated tape. The CESR proposal to define APAs seems the right way to solve the quality issue and make data provision and distribution requirements (and hopefully supervision) homogeneous across national markets.

On market practices, European capital markets lack a competitive market for data and selling practices.

1. Unbundling data services and standardising formats are of paramount importance to remove market segmentation and reduce costs at data source and distribution levels. In effect, data costs and formats of feeds and distribution channels make consolidated pre-

<sup>12</sup> See the forthcoming ECMI survey on MiFID 'real' implementation (preliminary results available at <http://www.eurocapitalmarkets.org/node/441>).

and post-trade solutions fairly costly. Industry should take the initiative, but regulatory action is needed to promote actions as unbundling of services and products.

2. Selling practices need to be addressed by competition authorities, as conduct of business rules are limited to the perimeter of the single transaction of the investment firm with its customer. These rules do not permit an assessment of whether the practice is competitive and enhances consumer welfare, in a market where high switching costs often lock customers into expensive transactions and market structure does not allow an easy entrance for newcomers.
3. Art. 34, MiFID ensures the freedom of access by investment firms to national clearing and settlement infrastructures in a cross-border transaction in order to promote an open pan-European architecture, thus competition in other segments of the value chain (clearing and settlement, in particular). Links from incumbent infrastructures are still under slow negotiation and the ambiguity around the possibility to refuse the link on 'legitimate commercial grounds' - set by MiFID – does not seem to make things easier.

## Conclusions

MiFID may have received rather cursory attention in the midst of the several reviews undertaken of the pre-crisis financial rules, but the analysis in this Policy Brief demonstrates that the Directive has been remarkably successful in terms of improving market structure and efficiency in a short time frame (three years), although much progress should be made on investor protection and conduct of business rules. Its initial objective has largely been met: to introduce more competition between trading venues, while maintaining an orderly price formation process. The upcoming MiFID review should therefore take a 'light touch', clarifying some definitions and extending the transparency regime to non-equity markets. The biggest priority is to improve pre- and post-trade transparency, but this should essentially be initiated by the industry, under the proper pressures of regulators. Easier and cheaper access to consolidated data solutions will also allow end-users to fully participate in the changes brought about by MiFID, restoring investor trust and pushing more liquidity in equity markets. The start of European Security and Markets Authority (ESMA) will allow better enforcement of the conduct of business rules and harmonised supervision across member states.

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