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CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets

Response from EuroInvestors – May 2010

EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on investments, savings, borrowings and Personal Finances of individuals in Europe, by grouping the organisations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.

Executive Summary

The Markets in Financial Instruments Directive (MiFID) came into force on 1 November 2007. In the name of a quite abstract notion of "competition", it allowed and promoted the fragmentation of European equity markets: "MTFs" were created in addition to the existing "regulated markets" ("RM"); OTC trades were also encouraged and could represent today about 40 % of the trades, although it seems no one really knows for sure. The results are quite damaging for investors, especially individual ones[1]:

- Order ("pre trade") and trade ("post trade") data transparency has deteriorated considerably, as small investors do not usually get the data from the new market venues, i.e. they now probably miss about 60% of them;
- The costs for collecting consolidated market data is now much too high for small and even medium size investors to collect. MiFID has ignored the nature of capital markets data as a public good.
- The average size of disclosed trades has collapsed (but certainly not the orders size from end investors), and studies on the impact of the markets fragmentation on liquidity are contradictory at best.
- The cost of shares trading for final investors has clearly not gone down.

Overall, MiFID has helped to further marginalize individual investors, despite the fundamental economic purpose of capital markets which is to connect directly end investors and issuers of capital, not financial intermediaries. MiFID helped the reintermediation of equity markets to the benefit of financial intermediaries - especially the big ones which could invest enough in

[1] See for example the European Investors Working Group (EIWG) report *"Restoring Investor confidence in European Capital Markets"*, February 2010, pages 5 and 13:
http://www.ceps.eu/book/restoring-investor-confidence-european-capital-markets

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information technology to profit from the fragmentation – and to the detriment of end investors and non financial issuers.

This marginalization of small investors has continued in the MiFID revision process which has largely excluded them, as reflected in this consultation paper.

Small and medium size end investors ask for:
- A fact-finding study being conducted on the impact of MiFID induced changes on small and individual investors, and the consequences on the economic and social value of the now largely "re intermediated" European capital markets;
- a publicly enforced and controlled "consolidated tape" both for pre- and post-trade data, and that this "tape" be easily and freely accessible by all investors in the market as before MiFID;
- The reduction of "dark" and OTC trading to more acceptable levels, certainly less than 10% of total market activity.

Introduction

This consultation aims at assisting CESR to provide the European Commission (EC) with technical advice on the MiFID Review regarding equity markets by July 2010, so that the EC can report to the European Parliament and the Council on possible changes to MiFID.

On the substance of the consultation, EuroInvestors regrets that the questions raised by CESR are only "technical" and do not question the very economic rationale of the MiFID induced equity markets fragmentation. Equity markets are a public good that is supposed to enable issuers and investors to get and to provide capital directly, not to serve primarily the interests of financial intermediaries. To be efficient, capital markets must collect the maximum quantity of bids and offers and in the most transparent and economical way. Fragmenting them can only go against these goals. It is like creating several highways to get from point A to B for the sake of imposing competition between several highways: economically it does not really make sense.

On the format of the consultation, the CESR paper mentions that "*CESR held a series of meetings with representatives from regulated markets (RM), multilateral trading facilities (MTFs), investment firms, buy-side firms and market data vendors*", implicitly indicating the exclusion of small end investors (as well as non financial issuers) from this revision process. Also, as previously mentioned, the format and short deadline of this consultation paper are inadequate to collect the input from small investors, as it mixes more general issues with ones specifically addressed to professionals. It is also a 48 pages document, and available in only one of the languages of the EU. We are however grateful to CESR to have organized a very interesting "Retail Investor Day" which included a presentation and discussion on this paper; unfortunately only one business day (28 May 2010) before the response deadline.

Eventually, most of EuroInvestors analyses and requests have already been issued by the European Investor Working Group last February. This Group gathers retail and institutional investors, and therefore people from the whole "buy-side". We ask that CESR also takes its

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recommendations contained in its "*Restoring Investor confidence in European Capital Markets*"[2] into account.

Pre-trade transparency regime for RM/MTFs

Order ("pre trade") and trade ("post trade") data transparency deteriorated considerably, as small investors usually do not get the data from the new market venues, i.e. probably from about 60% of the markets.

According to CESR, "*data from the fact-finding shows that more then 90 percent of trading on organised markets in Europe is pre-trade transparent*". This is not proven regarding small investors. As shown in Annex 1, we found no evidence that the best bid and offer orders accessible to small investors were comprehensive (actually they were not in at least one case) and that they included those from the MTFs.
In addition, supposing this statement was true for small investors, that would still leave about 40 % of the markets with no pre-trade transparency (the OTC share).
We therefore agree with CESR to apply the pre-trade transparency requirements to OTC as well. In addition; CESR needs to ensure that this pre-trade transparency is real for small investors.

Regarding exceptions to pre-trade transparency, we agree with CESR seeking to move from a "principle based approach" to waivers from pre-trade transparency to an approach that is more "rule based". As regards the scope and criteria for the waivers, we do not believe some should be recast (i.e. thresholds for, and scope of, large in scale waiver, introduction of a minimum order size for the reference price waiver). Indeed, the reasoning of some professional market participants, as mentioned by CESR, is based on the collapse of the average trades size in the last two years. But this trend has been totally driven by the market intermediaries, certainly not by the end investors. In fact the "trades" reported come from orders that have been sliced into pieces by intermediaries, not by the end investors. We urge CESR to analyze this evolution more in depth: we have absolutely no evidence that the average size of orders from end investors has significantly decreased. Intermediaries should provide all the facts and evidence and tell us how this massive slicing of end investors orders benefits them.

Definition of and obligations for systematic internalisers

Their obligations should be the same as the ones of "organized markets".

Post-trade transparency regime

Order ("pre trade") and trade ("post trade") data transparency deteriorated considerably, as small investors usually do not get the data from the new market venues, i.e. probably from about 60% of the markets. As the real case in Annex 1 shows, post-trade transparency has indeed become very poor for small investors.

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[2] See footnote 1

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The costs for collecting consolidated market data is now much too high for small and even medium size investors to collect. MiFID has ignored the very nature of capital markets data as a public good[3].
"The lack of effective implementation of best execution duties is another important source of concern and should be properly addressed in order to protect investors' interests at institutional and retail level. This problem is exacerbated by a fragmented trading landscape, which must be supported by consolidated data solutions".[4]
We ask for a publicly enforced and controlled "consolidated tape" both for pre- and post-trade data, and that this "tape" be easily and quickly accessible by all investors in the market, as it was the case prior to the MiFID –induced markets fragmentation. This implies of course to start with clear and harmonized standards and format for post-trade transparency information.

CESR indicates that "*to finalize the proposed standards for post-trade transparency information and to further specify proposed amendments to improve the quality of OTC post-trade transparency data by July 2010, CESR suggests establishing a joint CESR/Industry Working Group immediately following the publication of this Consultation Paper*". Again "Industry" means "financial intermediaries". The real economy, the very agents for whom capital markets exist in the first place – end investors and issuers –would then be excluded from this group ?

Application of transparency obligations to equity-like instruments

We agree with CESR's proposal, as we see no reason why depository receipts, exchange-traded funds, exchange-traded commodities and certificates should not follow the transparency obligations of "organized" equity markets.
However, we do not agree that all "*these instruments are considered to be equity-like, since they are..., from an economic point of view, equivalent to shares*". This may be true for example for equity ETFs (although they are also equivalent to investment funds in many respects), but not for fixed income ETFs. We wish to stress that the lack of transparency of fixed income markets is even much worse that the equity ones. If MiFID transparency rules are extended to fixed income ETFs, then they should also be extended to the underlying fixed income markets as well, especially the bond markets.

Regulatory framework for consolidation and cost of market data

As mentioned above, we are clearly asking for the second approach mentioned by CESR:
"The other approach would built on this APA (Approved Publication Arrangements) regime but would require a single consolidated tape to offer market users a single point of access".
The "industry" or commercially-driven approach has obviously failed to deliver any improvement of pre and post trade transparency for small investors. The commercial cost to get consolidated post trade data is astronomical, even for medium size investors. Therefore, we see no reason to continue with this approach where investors have already lost more than two years of trade transparency.

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[3] See Hautcoeur, Lagneau-Ymonet, Riva: L'information boursière comme bien public. Enjeux et perspectives de la révision de la directive européenne « Marchés d'instruments financiers » ; to be published in Revue d'économie financière, 2010
[4] EIWG Report, op. cit.

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In the USA, a country which can hardly be suspected of being anti free market rules, the publicly controlled consolidated tape has been the chosen approach. We would welcome the intermediaries "Industry" to explain why this solution suitable for the US equity markets is not suitable for the European ones.
This consolidated tape of trade data must be made available to all investors (including small ones) at no cost and with a reasonable delay (a few minutes), like what they got before the markets fragmentation.
In addition, we suggest that CESR analyses the MiFID induced development of monopolies and oligopolies in the trade data collecting and selling business, and its economic and social impact for the real economy market participants (issuers and and end investors).

Regulatory boundaries and requirements

We ask for the reduction of "dark" and OTC trading to more acceptable levels, certainly less than 10% of total market activity.
Therefore, we support CESR's proposal to require investment firms operating crossing systems/processes to set up MTFs for their crossing activity once they have reached a certain size on its own or in combination with other crossing systems/processes with which they have a private link. This is indeed one way to reduce the inflated share of OTC trades in the equities markets.

*

Overall, small investors interests and needs seem largely ignored in this consultation. Although it is addressed to all "stakeholders", all proposals are designed for what CESR calls "market participants" which quite obviously include all market intermediaries but not the small investors, who are not mentioned anywhere. We ask for a fact-finding study being conducted by CESR on the impact of MiFID induced changes on small and individual investors, and the consequences on the economic and social value of the now largely "re intermediated" European capital markets.
CESR should also investigate another potentially dramatic economic consequence of MiFID: the impact of the MiFID induced fragmentation and re intermediation of equity markets on small and medium size businesses in Europe (also not mentioned at all in the consultation paper). SMEs are the only significant net provider of jobs in the EU. It seems that capital access for SMEs is now left to the RMs which have had little choice but raise prices for these issuers or would-be issuers, in face of the competition of the new alternative venues (MTFs, OTC) on large caps only[5]. Also, CESR should investigate about the evolution of liquidity, transparency and costs in small and mid cap markets since MiFID came into force.

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[5] See for example the Demarigny Report to the French minister of finance:" Un « *Small Business Act* » du droit boursier européen - Mettre en place un environnement financier et réglementaire adapté aux petits et moyens émetteurs cotés en Europe (« SMILEs »), Mars 2010
http://www.minefe.gouv.fr/services/rap10/100318_rapdemarigny.pdf

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ANNEX: Trades and quotes data available to retail investors

Big market cap example: Sanofi-Aventis on 28/01/2010 trade date after closing

Source: two online retail brokers: one based in France, one in Luxembourg

Findings

Scope of markets data:

- One indicates a market of listing (Euronext Paris), the other none
- None indicates to which market(s) the data pertain: Euronext only or also others (like MTFs)?
- Probably, these data <u>are not consolidated</u> and pertain only to Euronext.

Post trade data

- Total daily volume does not match between the 2 sources
- Last trade and last trade time do not match
- Of the last 15 trades disclosed, only 4 match in quantity
- The one indicating total daily volume does not add up (always the same accumulated total for many trades)
- Most trades are of a relatively small size and very atomized (many small trades executed at the same price and at the same time); only one trade above 10,000 shares: probably larger trades are not reported by these sources
- One source provides a maximum of last 30 trades, the other one 15.

Pre trade data

- Bid and ask books do not match: the number and volume of bid offers at 52.64, and of ask offers at 52.68 are different: apparently one source missed both several bid and ask offers.
- Most orders are of a relatively small size and very atomized; apparently very few above 10,000 shares: probably larger orders are not reported by these sources or “sliced” by intermediaries
- One source provides a maximum of 10 different bid/ask prices, the other one 5.

Conclusion

Trade data communicated to retail investors are:
- most probably incomplete,
- inconsistent between one source and the other,
- and therefore unreliable,
- and therefore misleading.

One can suspect that at least some institutional investors do have access to consolidated trade and quote data, and more consistent and reliable ones: this situation creates an information asymmetry and discriminates retail investors.

Also, from these data, retail investors have no way to ensure that they benefit from a “best execution” (MiFID) of their trades.

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Post trade info – Luxembourg broker

Derniers ordres exécutés : SANOFI

Source Luxembourg 28/01/2010

Prix execution	Volume	(Volume total)	Heure
52.68	450	3,581,821	28/01/2010 17:39
52.68	2059	3,581,371	28/01/2010 17:37
52.68	2893	3,579,312	28/01/2010 17:37
52.68	1048	3,576,419	28/01/2010 17:35
52.68	900	3,575,371	28/01/2010 17:35
52.68	1400	3,574,471	28/01/2010 17:35
52.68	4800	3,574,471	28/01/2010 17:35
52.68	4736	3,574,471	28/01/2010 17:35
52.68	22735	3,574,471	28/01/2010 17:35
52.68	259	3,574,471	28/01/2010 17:35
52.68	173	3,574,471	28/01/2010 17:35
52.68	80	3,574,471	28/01/2010 17:35
52.68	130	3,574,471	28/01/2010 17:35
52.68	266	3,574,471	28/01/2010 17:35
52.68	2422	3,574,471	28/01/2010 17:35
52.68	488	3,574,471	28/01/2010 17:35
52.68	441	3,574,471	28/01/2010 17:35
52.68	559	3,574,471	28/01/2010 17:35
52.68	223	3,574,471	28/01/2010 17:35
52.68	223	3,574,471	28/01/2010 17:35
52.68	200	3,574,471	28/01/2010 17:35
52.68	663	3,574,471	28/01/2010 17:35
52.68	150	3,574,471	28/01/2010 17:35
52.68	1408	3,574,471	28/01/2010 17:35
52.68	165	3,574,471	28/01/2010 17:35
52.68	313	3,574,471	28/01/2010 17:35
52.68	469	3,574,471	28/01/2010 17:35
52.68	3320	3,574,471	28/01/2010 17:35
52.68	163	3,574,471	28/01/2010 17:35
52.68	47	3,574,471	28/01/2010 17:35

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Post trade info – French broker

SANOFI-AVENTIS
FR0000120578- SAN
Cours Nyse Euronext
Dernier echange : 28/01/10 17:37:27

Les Transactions

Heures	Cours	Qté
17:37:27	52.68	2 059
17:37:09	52.68	2 893
17:35:29	52.68	1 048
17:35:26	52.68	900
17:35:00	52.68	4 976
17:35:00	52.68	4 870
17:35:00	52.68	785
17:35:00	52.68	383
17:35:00	52.68	97
17:35:00	52.68	115
17:35:00	52.68	1 161
17:35:00	52.68	223
17:35:00	52.68	25 000
17:35:00	52.68	2 739
17:35:00	52.68	18

Pre trade info – Luxembourg broker

SAN
SANOFI-AVENTIS
Euronext Paris
52.680 EUR
-1.120 EUR (-2.08%)
2010-01-28 17:40:00

BID ASK
Dernière mise à jour : 2010-01-28 17:39:53

Nbr	Bid quantity	Bid	Ask	Ask quantity	Nbr
4	10281	52.67	52.68	8277	6
2	311	52.66	52.72	12000	1
10	11507	52.65	52.73	16691	2
1	100	52.64	52.75	22302	5
6	3097	52.63	52.77	1516	1

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Pre trade info –French broker

SANOFI-AVENTIS
FR0000120578- SAN
Cours Nyse Euronext
Dernier echange : 28/01/10 17:37:27

Carnet d'ordres

Ordres	Qté	Achat	Vente	Qté	Ordres
4	10 281	52.67	52.68	11 620	7
2	311	52.66	52.72	12 000	1
10	11 507	52.65	52.73	16 691	2
2	3 400	52.64	52.75	22 302	5
6	3 097	52.63	52.77	1 516	1
2	5 381	52.62	52.79	5 209	2
7	7 739	52.61	52.80	11 302	1
13	2 846	52.60	52.85	1 000	1
2	4 255	52.58	52.87	3 300	1
6	14 246	52.57	52.90	18 602	3
54	**63063**	**TOTAL**	**TOTAL**	**103542**	**24**