

**BETTER FINANCE Open letter to the EU Authorities**

To:

**Jean-Claude Juncker**, President of the European Commission  
**Valdis Dombrovskis**, Commissioner Financial Stability, Financial Services and CMU  
**Steven Maijoor**, Chair of European Securities and Markets Authority (ESMA)  
**Roberto GUALTIERI**, Chair of Committee on Economic and Monetary Affairs

C/C:

Olivier Guersent, Director-General for Financial Stability, Financial Services and CMU  
Markus Ferber, MEP Vice-chair ECON Committee, Group of the European People's Party  
Kay Swinburne, MEP Vice Chair ECON Committee, European Conservatives and Reformists Group  
United Kingdom  
Thierry Cornillet, MEP ECON Committee, Group of the Alliance of Liberals and Democrats for Europe  
Sven Giegold, MEP ECON Committee, Group of the Greens/ European Free Alliance

**Brussels, 6<sup>th</sup> October 2017**

**Re: MiFID II rules for “Systematic Internalisers” will hurt European investors**

**Dear Madam, Dear Sirs,**

In principle, European individual Investors welcome the introduction of the new Markets in Financial Instruments Directive (MiFID II) which is due to come into force on 3 January 2018. We welcome the commitments made by the co-legislators European Parliament and Council to increase and safeguard market transparency, as well as fair and open price formation.

We acknowledge that there are still certain details that the European Commission and the European Securities Markets Authority (ESMA) are working on to uphold the spirit of the legislation and we applaud the latest amendment to the Delegated Regulation on the “Systematic Internaliser” (SI) regime. We support rules that firmly differentiate between bilateral and multilateral trading activity to safeguard the price formation process on transparent regulated venues.

However, given BETTER FINANCE’s priority to ensure the protection of individual European savers and investors, **we are concerned about the shrinking share of regulated securities markets in the EU, now down to around 50 % of transactions, compared to 67 % in the US and 88% in East Asia<sup>1</sup>**. MiFID I induced market fragmentation (i.e. due to the artificial increase of competition via MTFs and other

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<sup>1</sup> OECD Business and Finance Outlook 2016 – changing business models of stock exchanges and stock market fragmentation. Fidessa Fragmentation Index - September 2017 for East Asia.

less- and or non-regulated venues) has resulted in regulated markets losing considerable ground. This is concerning for the EU, as the EC has rightly identified the inadequate bank/non bank financing mix and the need for more funding from capital markets. This is the main goal of the Capital Markets Union (CMU) initiative.

Worse, recent research<sup>2</sup> reveals that the majority of OTC trades (58%) are retail-sized trades while less than 5% are “large in scale” according to the definition of MiFID. Contrary to the MiFID spirit and text<sup>3</sup>, these results reveal that **OTC trades are not infrequent and large, but are rather frequent and small**. A significant part of the trades of European individual investors is now executed on these “dark” venues.

European capital markets must be transparent, liquid, fair and accessible to the benefit of end-investors and the real economy. Individual investors benefit from the transparency of- and the easy access to- regulated securities markets, and they do not want less regulated, less transparent and less accessible “dark” market venues (or venues under less strict regulation) to be given legal advantages and exemptions that will further undermine the only market venues where EU citizens as individual investors can trade easily and transparently. It is not only an issue of level-playing field, but also and even more importantly of **democracy: capital markets must remain fully open and transparent to individual investors**.

This is why we share the concerns of asset managers and securities exchanges, that were raised by MEPs Markus Ferber and Kay Swinburne in their recent letter to Commissioner Dombrovskis.

We are concerned about the impact of rules where investors could be obligated to have their orders routed to SIs that can offer a minimal price improvement over accessible, regulated and lit trading venues that will not be meaningful to the end investor, but risk to destroy price formation, liquidity and transparency. This is due to the fact that SIs will not be subject to the “tick size” regime<sup>4</sup> that will be introduced in MiFID II.

We echo the European Parliament that the current interaction between best execution rules and tick size regime will result in an unfair advantage for SIs over lit trading venues and could see a significant volume of equity trading moving further to these non-transparent platforms. The result will be a further increase in opacity of European markets to the detriment of end-investors. **Already today European markets are significantly less transparent than markets in the US and Asia** as mentioned above.

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<sup>2</sup> Gomber, P., Sagade, S., Theissen, E., Weber, M.C. and C. Westheide (2015): The State of Play in European Over-the-Counter Equities Trading. In: Journal of Trading, Vol. 10, No. 2, pp. 23-32.

<sup>3</sup> MiFID (Recital 53) stipulates that OTC trades should be ad-hoc and irregular, should be carried out with wholesale counterparties, should be above standard market size, and should be conducted outside of systems used for systematic internalization.

<sup>4</sup> The tick size regime requires regulated markets and MTFs to quote prices in a specific increment whereas under MiFID II systematic internalisers (SIs) do not have this obligation. It means that SIs can improve on the price offered by regulated markets or MTFs with an infinitesimal increase and obtain the flow of orders for execution in application of the best execution rule.

Unlike lit trading venues (such as RMS and the lit segments of MTFs), SIs are private pools of liquidity where market makers have the ability to choose who they are trading with and adapt their prices depending on the type of client. This undermines the fairness of markets and investor protection.

European investors are concerned that the current rules could lead to a fundamental change of market structure away from public, transparent, and multilateral markets to private, opaque, and bilateral liquidity pools. We do not believe this is what policy-makers had in mind when designing the new framework.

Moreover, SIs will have control over the timing of trade publication on their platforms, where they can delay publication up to 1 minute after the trade takes place. This will give firms operating SIs a considerable advantage over market makers on public markets, and if significant volumes move to SIs, will result in the public price not reflecting the market value being executed on dark platforms.

Therefore, while we understand that the timeline for final application is nearing, we still urge the European Commission and ESMA to heed the warnings from the European Parliament and to address such a big and well-identified loophole as soon as possible. We have read the recent ESMA Q&As, we welcome them and urge the Commission to go further and include this both in Level 1 and 2. Actually the very recent EC proposal on reforming European financial supervision is re-opening level one capital markets legislation anyway.

Guillaume Prache  
Managing Director

