FEDERATION OF EUROPEAN SECURITIES EXCHANGES

FESE Response to IOSCO Consultation Report on 'Regulatory Issues Raised by Changes in Market Structure' – CR03

1. Introduction

The Federation of European Securities Exchanges (FESE) represents 46 exchanges active in equities, bonds, derivatives and commodities through 21 full members from 30 countries, as well as 7 observer members from European emerging markets. FESE is a keen defender of cross-border competition and many of its members have become multi-jurisdictional exchanges, providing market access across multiple investor communities. FESE members operate Regulated Markets (RMs), which provide both institutional and retail investors with transparent and neutral price-formation.

FESE members are pleased to have the opportunity to contribute to this IOSCO consultation report. FESE supports efficient, fair, orderly and transparent financial markets that meet the needs of well protected and informed investors and provide a source for companies to raise capital and for investors to hedge their portfolios. Below you will find our response to certain questions included in the consultation report. Please also find included in this response general introductory comments on the regulatory issues raised by changes in market structure.

2. General Comments

FESE welcomes the work by IOSCO to identify and analyse the various regulatory issues raised by changes in market structure. Currently, European legislators are negotiating the review of the Markets in Financial Instruments Directive (MIFID I). In its proposal for a new MiFID (MiFID II), the European Commission has stated that 'market and technological developments have outpaced various provisions in MiFID'. They also state that market developments since MiFID have partially challenged the current regulatory framework applicable to different types of execution venues, i.e. Regulated Markets (RMs), multilateral trading facilities (MTFs), systematic internalisers (SIs), all signalling the need to provide for a refinement of the present framework. The overarching aim of the MiFID review is to ensure strong organisational requirements and identical transparency rules, and upgrade key requirements across all European trading venues to account for the greater competition and cross-border trading generated together by technological advances and MiFID I.

FESE supports the goals of the MiFID Review to further the integration, competitiveness, and efficiency of European markets. However, given the increased levels of competition and the subsequent fragmentation in European markets this IOSCO consultation is a timely contribution to examine how best to assist market authorities in relation to issues raised by market fragmentation.

In summary, FESE has the following comments on this consultation:

- **Regulators must not act to unintentionally create further fragmentation:** In Europe, MiFID I has created greater competition between trading venues which has led to greater market fragmentation, therefore regulators must carefully consider any further regulatory proposals that could potentially further increase fragmentation.
- **Increased fragmentation could create a two-tier market:** Increased OTC trading with restricted access to liquidity could create a two-tier market which risks leaving small and midsize companies behind as in practice, only few investors will have the possibility to access prices displayed and trade on broker-dealers run platforms.
- **Increased fragmentation can have a detrimental impact on price formation:** Increased fragmentation would further fragment liquidity and compromise a neutral and transparent price discovery process. This is particularly the case in instances where additional venues would undermine goals to increase efficient price formation process and transparency.

- **Need to ensure that the highest level of trading takes place on neutral and transparent venues:** Regulators must take into account the benefits for all markets participants brought about by increased trading on neutral and transparent venues. These venues positively contribute to price formation and the assessment of best execution for clients. This function is not provided by any venue that is not open, neutral and transparent.
- **Regulators must assess the impact of non-open and non-neutral venues on the real economy:** The effect that any trading venue which does not live up to the goals of open, neutral and transparent price formation on equity trading and the financing of the economy, in particular for the small and medium sized companies, must be assessed.

Regulators need to better understand the impact of fragmentation

The increased fragmentation caused by the introduction of MiFID I is one of the key aspects to consider during the discussion by legislators on the proposed MiFID II. Market structure is extremely important for all asset classes (i.e. venue classification) as it is the basis for every other component of regulation. This is because the market structure determines how the rules attached to each type should be applied. In this regard there are a number of concerns to raise when considering the effects that increased fragmentation has had on the relevance, effectiveness or implementation of current regulatory requirements.

As a starting point, we believe that regulators need to have a comprehensive understanding of what has been happening in the EU equity markets since the introduction of MiFID I. Such a comprehensive 'big picture' view of the EU equity markets, in order to see where trading is executed and how it is regulated, is critical to any reform. Unfortunately, there is currently insufficient acknowledgement of how the evolution of MiFID has fundamentally changed market structures.

FESE believes that the introduction of MiFID I has had a huge impact on market structure as trading has moved further away from neutral and transparent venues. Based on the CESR (now ESMA) Technical Advice there is a composite picture of the whole EU secondary markets trading in equity after three years of implementation of MiFID I. Based on these figures the following conclusions can be made on when assessing the impact of fragmentation on European markets:

- A significant amount of trading is taking place in the OTC space, i.e. 38%[1]
- The trading in the OTC space seems in particular to be quite important in *relative terms* when compared with the Multilateral Trading Facility (MTF – 15%) and Systematic Internaliser (SI – 2%) categories, which are the two main venue types created by MiFID to create competition with RMs and to capture the off-exchange trading.
- The great majority of dark trading (defined as trading that happens without pre-trade transparency) is happening in the OTC space, not in the RM or MTF platforms set up under the MiFID waivers.

Finally, the fact that a full picture of trading is not readily available is itself an important revealing fact that needs to be included in the MiFID Review as a topic of discussion. Precisely the fact that the public figures on OTC are so unreliable proves the necessity for a discussion on whether the supervisors need better tools and/or changes to the regulation to get a comprehensive view of the markets and the impact of market fragmentation.

[1] These figures are implicitly confirmed by CESR (http://www.esma.europa.eu/system/files/10_394.pdf) and calculated based on publicly available data. We do recognize that other analysis is available on this issue, notably: AFME: The Nature and Scale of OTC Equity Trading in Europe (2011)

3. Response to the Consultation Report

Recommendation 1
1.1 Regulators should regularly monitor the impact of fragmentation on market integrity and efficiency across different trading spaces and seek to ensure that the applicable regulatory requirements are still appropriate to protect investors and ensure market integrity and efficiency, including with regard to price formation, bearing in mind the different functions that each trading space performs.

1.2 Regulators should regularly evaluate the regulatory requirements imposed on different trading spaces and seek to ensure that they are consistent (but not necessarily identical) across spaces that offer similar services for similar instruments.

Questions:

1. **Does the evolving market fragmentation challenge the relevance, effectiveness or implementation of current regulatory requirements? If so, which ones and how are they impacted?**

- **Need to clearly define the existing trading boundaries**

The fundamental challenge in respect of equities market structure arising from the experience of MiFID I is the need to appropriately set the boundaries between organised trading (RMs, MTFs and SIs) on the one hand and over-the-counter trading (OTC) on the other. Both groups are legitimate and should be part of European market structure, but there is a need to appropriately frame the boundaries between them. This is because one of the main unintended consequences of MiFID I was the emergence of much greater trading volumes on OTC markets, in part due to increased fragmentation. Without prejudice to its practical implications, the market structure scheme established by MiFID I is by and large satisfactory, and does not need to be fundamentally changed although some adjustments are needed. MiFID already requires anyone running RM/MTF (multilateral) or SI (bilateral) to do this business subject to a set of safeguards intended to ensure that any liquidity pool set up will result in properly priced trades, will be accessible to all investors, and will be monitored for market integrity. However, there is a need to clarify and firmly implement the provisions.

- **Need to clarify what equity trading can take place OTC**

In order to tackle the increased fragmentation and to ensure that the same business is subject to the same rules, regulators must consider clearly defining what trading activities should and should not be conducted utilising the OTC regulatory freedoms. As OTC trading is subject to less stringent rules than existing multilateral and bilateral avenues in MiFID I, regulators must ensure that an increasing number of venues do not allow certain trading activity to compete with identical trading activity but subject to lighter rules. This should be based on existing definitions with additional clarifications. As a means to tackling increased fragmentation there is a need for regulators to adopt the approach of 'same business, same rules' to platforms that carry out multilateral and bilateral trading. As a result, we urge regulators to address again the fundamental issue at hand in respect of equities markets trading: the lack of a clearly defined boundary between organised and OTC trading. If no boundaries are set, trading in equity and equity-like instruments will continue to gravitate towards OTC since investment firms will be completely free to choose between executing on a multilateral, bilateral or OTC basis. This would come at the expense of investor protection and of the efficiency of price formation on European markets and would maintain the existing status quo from MIFID I.

- **Need for effective enforcement mechanisms**

In order to allow the relevant regulatory framework deliver the effects intended by the legislation in place, it must be enforceable. This can be achieved in a twofold approach: (i) on the one hand it requires avoiding excessively complex regulation which may be overly difficult to implement, monitor and enforce; and, (ii) on the other, it requires providing the supervisory authority with both a legal framework and arrangements entitling it to exercise the competences and deploy the mechanisms

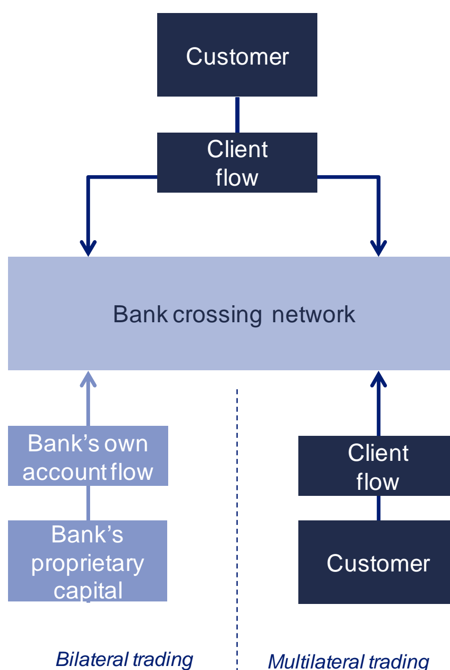
needed to ensure the fulfilment of the obligations set out under the applicable regulation. The lack of enforcement is one of the main failures affecting MiFID I. In effect, certain obligations under MiFID I are extremely difficult to supervise and enforce, due to either the complexity of the provisions and/or the lack of proper surveillance and enforcement mechanisms by the competent authorities. Should a truly effective supervisory and enforcement framework not be in place, regardless of a well-designed formal frame exists, the regulation will not deliver the intended effects.

Please note that this is a transversal need, not exclusively related to the issues discussed under IOSCO's Recommendation 1 in this Consultation Report. Therefore, while it should be read in each and every of the following sections, it will not be raised for the sake of keeping the document as simple to read as possible.

2. Are you aware of material differences in regulatory requirements between different trading spaces that from your point of view are not justified and create regulatory risks and unfair competition? For example, are there regulatory requirements that apply to one type of trading space in your jurisdiction and currently do not apply to others but, in your view, should apply to others that offer similar services? Please describe.

MiFID I created two types of multilateral trading venues, RMs and MTFs, fulfilling the same functions, but covered by different rules. Because RMs were the historical dominant players in the cash equity execution landscape, a more lenient regime was applied to MTFs, in order to foster competition. Now that competition has been successfully created, there are no reasons not to align the rules applicable to these two types of trading venues, which fulfil the exact same secondary market functions.

In addition, some trading spaces which perform the same functions as multilateral or bilateral platforms are currently not regulated as trading venues. For instance, banks crossing networks (BCNs) enable banks to internalise order flow. Rather than to send client orders to an external execution venue (typically a regulated market or a MTF), banks may prefer to internalise them: these client orders will be executed within the bank internal matching system, on BCNs notably.



Two main types of internalisation can be distinguished:

- **Matching of client orders against the own account flow of the bank:** The bank fills customers' orders against its own account, that is to say that the bank acts as a buyer to a customer's sell orders and as a seller to a customer's buy order. This activity corresponds to what is usually called "bilateral trading" and, under MiFID, when performed on a regular basis, should be registered under the systematic internaliser regime.
- **Matching of client orders to other client orders (multilateral trading):** The bank internalises the execution of client orders by matching orders from its different clients. Such activity is usually referred to as "multilateral trading", and is similar to that performed by regulated markets and MTFs. Therefore, this type of trading should be subject to the same rules as other multilateral venues and registered under the MTF regime.

As previously stated, European legislators are currently negotiating a review of the existing securities trading rules. We support the aim of this Review to ensure that the same business is subject to the same rules. However, certain provisions in the European Commission's MiFID II proposals accentuate differences in regulatory requirements between trading spaces.

FESE believes that the proposed Organised Trading Facilities (OTF) will endanger price formation, efficiency and fairness. This is because the proposed OTF, in contrast with other properly multilateral trading venues, can offer discretionary execution. If regulators approve the creation of the OTF category as currently proposed by the European Commission, this would have serious consequences for the quality of markets. In addition to further fragmenting Europe's already fragmented markets, the proposals would endanger proper price formation as well as efficiency and fairness of markets, and hinder competition among trading platforms. Instead, we support a functional approach to ensure proper market regulation. Venues that are in the same business have to be subject to the same rules. For this reason, multilateral trading of equities – wherever it takes place - should only happen on platforms that provide identical rules on transparency, non-discretionary execution, non-discriminatory access, and full market surveillance.

Finally, it is not merely sufficient to introduce the appropriate rules; particular attention should also be paid to their proper implementation and enforcement. In Europe, the application for pre-trade transparency waivers is done at a national level. These waivers are currently granted by national regulators and certain discrepancies exist in respect to their application. While some regulators favour a strict application of pre-trade transparency waivers so as to promote a high level of pre-trade transparency, and to limit their application only to legitimate circumstances, other regulators tend to grant waivers on a less stringent basis. These discrepancies raise significant issues in terms of individual investors' protection across Europe, but also in respect to the overall efficiency of the price formation process on European financial markets and result in an uneven level playing field across European trading venues.

3. Do you think that the price formation process has been deteriorated or has been improved as the result of market fragmentation? If so, please explain how.

There are concerns among certain stakeholders that efficient price formation is hindered by increasingly fragmented pools of liquidity. In order to ensure that price formation works properly and that all investors have access to all liquidity pools directly or indirectly, all platforms must be open to all investors. However, currently the OTC platforms are not open to all investors which results in an unlevel playing field among trading venues and trading participants.

Unless there is an approved justification, i.e. via a pre-trade transparency waiver, to be exempt from pre-trade transparency, all equity trading activity should contribute to the price formation process. Therefore, European regulators should ensure that there is harmonised implementation of the trading

venue rules for efficient price formation and that the ‘same business, same rules’ principle is effectively delivered.

Recommendation 2
In an environment where trading is fragmented across multiple trading spaces, regulators should seek to ensure that proper arrangements are in place in order to facilitate the consolidation and dissemination of information as close to real time as it is technically possible and reasonable.

Questions:

1. **What options are available to manage the issues associated with data fragmentation in a competitive environment?**

In a fragmented market, various models of real-time data consolidation are possible in theory (e.g. Central vs. Competing Consolidation models, each with its specific pros and cons). However, in practice there is no one-size-fits-all-solution to the rather far-reaching question of how a Consolidated Tape should be set up. In order to be as effective as suitable for its purpose, characteristics of a consolidated tape depend on the specific regulatory system with its inherent goals and requirements in which it is embedded as well as on the provisions of the respective jurisdictions in their own rights. Most importantly policy makers must consider the potential users and specific design of the Tape, which should be suitable and should fit into the respective market structure.

European legislators are still discussing a number of options for data consolidation within Europe. FESE believes that a competing solution for data consolidation ('Competing Consolidators') is the best option to bring together European equity data in a reliable, comprehensive and efficient way. By contrast, the introduction of a bureaucratic data consolidation via one Central Consolidated Tape would be violating the spirit of MiFID I and that of the competitive European internal market.

2. **What conditions, if any, should govern access by investors to consolidated market data?**

We believe that the following conditions should be taken into consideration:

- **Relevant content**: The content made available on a Consolidated Tape (CT) should be defined according to use cases as foreseen by regulation, e.g. like best execution verification, Transaction Cost Analysis).
- **Reliable data:** Data included on the CT should be of high quality and reliable. The introduction of Approved Publication Arrangements (APAs) in the EU in order to improve the quality of OTC post-trade data is the right step forward. Consolidated data should not include content that is a result of 'gaming' by entities creating prices so that the gaming entities can increase their revenue from a CTP provider. Negative experience exist in the US where the revenue sharing model of the Central Tapes creates wrong incentives, which consequently might cause negative consequences to market microstructure as indicated by Caglio /Mayhew .
- **Continuity of service:** There should be no single point of failure for consolidated data. A competing CTP model ensures this.
- **Innovation / flexibility / efficiency:** Not all investors will require the same data or services. A competing CTP model is required to ensure that competition drives innovation, flexibility and efficiency and investment into new technologies if necessary and where driven by customer demand.

3. **Are there other challenges (technical, regulatory, prohibitively high costs) with regard to creating and/or accessing consolidated market data? What if anything, should be done to address these challenges?**

Data consolidation is useful in cases where the quality of market data is similar. Even before the introduction of MiFID I certain internal markets, such as the German Market had been fragmented and

data had been consolidated without problems (and no Central Tapes). With the introduction of MiFID I, additionally, OTC data also had to be published. However, any consolidated views on a combined data set of trading venues data with OTC data in the EU has failed to come up with a usable solution.

The reason behind this is the poor quality of OTC market data which tends a) to be unreliable and incomplete in terms of published overall volume and b) partly significantly time delayed compared to trading venues data. The mix of data of different qualities therefore detrimentally impacts any potential use case of a consolidated view.

In order to improve the quality of OTC data and in order to facilitate easy consolidation a set of necessary pre-requisites (e.g. standards, harmonized trade reporting requirements, compliance enforcements) needs to be established. In fact the introduction of these pre-requisites are necessary for any sort of consolidation, be it via a centralized plan (US style) or decentralized, within the spirit of MiFID and as proposed by the Commission.

Within Europe the introduction of Approved Publication Arrangements will certainly improve the quality of OTC data. However, clear reporting publication rules, especially in case of trades across national jurisdiction, will need to be implemented as well, in order to improve the reliability of OTC trade publications going forward.

Furthermore, any significant deviation to real-time publication (e.g. publication delays allowed by MiFID) will in fact reduce the usefulness of a real-time consolidated tape. Therefore, any publication delays should be reduced to a minimum.

4. What views do you have on the relative merits of a single consolidated tape mandated by the regulation versus multiple competing tape providers? Please elaborate.

FESE believes that a competing solution for post-trade data consolidation (‘Competing Consolidators’) is the best option to bring together European equity data in a reliable, comprehensive and efficient way. By contrast, the introduction of a bureaucratic post-trade data consolidation via one Central Consolidated Tape would be violating the spirit of MiFID I and of the competitive European internal market. The market is the best placed mechanism to determine the value of data. It should be up to the market to determine what the value of RM, MTF or OTC data is. It also explains what needs to be done for any effective data consolidation to work. The priority should be to tackle the current lack of granularity and poor quality of OTC post-trade data. This can be achieved by better regulatory classification of OTC trading and better standardisation of OTC data reporting requirements via the introduction of Approved Publication Arrangements (APAs) for OTC. Regulation is necessary to achieve these aims as market participants are hesitant to adopt any industry led initiative for post-trade data consolidation which may not have the support of regulators as this could duplicate costs.

We have outlined below our views on why the competitive model is superior to a central consolidated tape:

- A single, monopolistic consolidated tape would not solve the main problem faced by consumers of data, namely a lack of transparency and harmonisation of OTC trade data. By contrast, the introduction of APAs to publish OTC post-trade data does aim to address the quality, availability and consistency of OTC data. Contrary to common beliefs, there are already numerous competing consolidated tapes in Europe, but these suffer from the lack of regulatory harmonisation of data and the absence of reliable OTC data. Once these issues have been solved, the existing solutions for data consolidation will be fully capable of delivering enhanced information based on a standardised set of technical rules and guidelines. These are due to be developed by ESMA and should fulfil all users’ expectations.
- A single consolidated tape would introduce additional unintended consequences to Europe. In addition to removing competition, innovation and efficiency – contrary to the principles of the

Internal Market - it is more than likely that it would also change the market microstructure of European markets. This is because it will introduce the possibility of "tape gaming" for data revenues – whereby trading venues have the perverse incentive to generate trading volumes that may not reflect true price formation simply to gain a share of data revenue. This is a serious and inevitable problem with any central system – creating an overly complex, distorted and unrepresentative trading environment - for which the US authorities have not been able to find a solution[2]. In order to avoid such problems inherent with the US model, the competing solution should be preferred.

- Instead of building a new and costly Consolidated Tape from scratch, existing infrastructures operated by data service providers should form the basis of the new regime.
- The Competing Consolidators Model would retain and enforce incentives which will provide for flexibility, innovation and high quality services.
- Finally, the Competing Consolidators Model avoids the establishment of a monopoly and thus the creation of a single point of failure.

Moreover, multiple competing tapes provide benefits for market participants and investors:

- The market data industry currently operates CTP infrastructures which remain capable of delivering the aims envisaged in the original proposals subject to being fine-tuned through the introduction of common rules and standards implemented by MiFID and Regulatory Technical Standards which will be defined by ESMA.
- Multiple competing tapes would be available both as a real-time consolidated data feed and as a 15-minute delayed data feed. Following the mandatory core set of standards, all of these tapes would offer consistent and similar information but each firm would design its product depending on the diversity of needs for its clients, offering the full benefits of competition.
- The provision of 15-minute delayed data, free of data license fees[3], would make data accessible and reliable at attractive terms for retail investors and fulfil their needs fully.

Also, in an increasingly fragmented equity trading environment, consolidated post-trade data can serve investor needs:

- MiFID has enabled inter-market and inter-venue competition which has yielded significant benefits for European markets but also resulted in fragmentation of liquidity and the sources of data. Tackling the underlying problem with data in Europe, i.e. the lack of consistency, granularity and the poor quality of post–trade OTC data, will serve investors' needs better than a single tape provider[4], which in addition would be against the competitive approach to other layers of the securities industry.
- Consolidation of post-trade data, like other services provided in the European trading landscape, should continue to be subject to a competitive approach via a multitude of data providers which will increase the choice for investors and consumers of the services. Hence we believe that the key is to get common data standards which will allow different CTPs to offer the same complete picture to their consumers in a flexible manner which meets their needs. Exchanges have led an industry initiative – the Market Model Typology (MMT) - which is offering a practical solution to implement certain standards before MiFID II comes into force.

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[2] In the US the introduction of a Central Tape regulation introduced economic incentives to conduct trades solely for the sake of that market data revenue generated on such Tapes and to the detriment of price formation.

[3] For retail and professional data users.

[4] High-quality data is provided by RMs, which is made available through many channels and is being consolidated along with other available data – i.e. MTFs - by commercial providers. The underlying problem with data in Europe is the lack of availability of pre-trade OTC data, and the lack of consistency, granularity and poor quality of post-trade OTC data.

Recommendation 3
Where markets are fragmented, regulators should consider the potential impact of fragmentation on the ability of intermediaries to comply with applicable order handling rules including, where relevant, best execution obligations, and take the necessary steps.

Questions:

1. **Should existing order handling rules, such as best execution, be re-examined in the context of fragmented markets? If so, in what way?**

In naturally fragmented markets such as the EU where multiple post trade channels exist, it is important to take into account the overall costs of trading into the best execution for the client. In a fragmented market in Europe, best execution cannot be reduced to best price because of the fragmented post trade as different channels have different costs.

2. **Do you think that rules relating to the disclosure of order handling practices by investment firms are appropriate to facilitate compliance with and evaluation of 'best execution'?**

3. **Are there any other appropriate 'order handling' tools that should be considered in the context of fragmented markets?**

FESE supports a re-examination of the order handling rules to ensure that all orders are handled in order to provide the highest level of investor protection. In particular, regulators must differentiate between the role of the broker and the role of the trading venue, i.e. that best execution is what the broker owes to the investor while non-discretionary rules is what the operator of the platform owes to the market for its efficient and fair functioning. Hence the market needs both rules.

In this sense, we warn against the excessive complexity of the current best execution regime in the EU, which is not envisaged to be significantly modified within the current MiFID Review. The EU best execution regime in place is extremely complex, to such extent that it is nearly impossible to be effectively monitored and enforced by the competent authorities, which seriously endangers the investor protection that the regulation aims to deliver.

Fragmentation is not the only factor that raises some issues in respect to order handling rules at the level of intermediaries. The fact that numerous intermediaries hold stakes in trading venues, or internalise order flow, or may receive payment in exchange for the routing of client flow towards particular venues raise significant conflicts of interests.

These conflicts are especially important in the EU, where the best execution obligation is borne by brokers. The problem is that "best execution" is intrinsically difficult to define (does it relate to the execution price solely, or to the speed, or consistency at which the orders is executed?) which leaves brokers with a certain scope for interpretation. Brokers typically face conflicts of interest between, on one hand, providing the best service to their clients, and, on the other, increasing their own revenues and lowering their costs.

Three main levers:

(i) Limitation of risks of conflicts of interests by prohibiting payment for order flow practices
(ii) Greater disclosure to investors, in order to give them the means to accurately monitor the quality of execution they receive from their intermediary and as such incentivise intermediaries to act in their client best interests;
(iii) Ensure that multilateral venues are truly multilateral and prohibit the combination of multilateral and bilateral trading.

Here as well, getting the rules right is not sufficient, rules need to be properly implemented and enforced.

(i) Prohibiting payment for order flow practices

Payment for order flow can take diverse forms (direct payment, rebates on other services, etc.), but in all cases encourage brokers to focus on the payment they can receive in exchange for the routing of client orders rather than on the quality of execution offered by trading venues. Therefore, all forms of payment for order flow (monetary or non-monetary benefits, inducements, direct or indirect forms of payment) should be prohibited in respect to the routing of client orders.

(ii) Greater disclosure to investors

Highlight the importance to give investors tools to assess the service of their intermediary i.e. measure the quality of the execution choice and potential conflicts of interest.

Adopting requirements inspired by the rule 606 of reg NMS in the US adopted in 2005, which provides that:

- Intermediaries are required to publish, every quarter, a report identifying the venues to which they route client orders, together with the nature of their relationships (internalization, payment for order flow) with these venues, when these can raise conflicts of interests.
- Intermediaries are required to make available to their clients, on request, the venues to which their individual orders are routed.

Brokers should have an obligation to provide automatic execution reports to each of their clients, on a monthly basis. These reports should detail the quality of execution received for the client's individual orders and the exact nature of the relationships existing between the intermediary and the execution venues toward which these orders were routed.

(iii) Ensuring that multilateral venues are truly multilateral and prohibit the combination of multilateral and bilateral trading

A number of regulated or unregulated platforms enable, in the EU, certain counterparties to choose the type of flow they interact with on a discriminatory basis, and to combine multilateral and bilateral trading: BCNs, mono-member owned MTFs, user-owned trading venues, amongst which certain restrict access only to their shareholders (HFT firms) and to retail brokers.

The combination of multilateral and bilateral trading is intrinsically problematic from an investor protection perspective important conflicts of interests, since the interests of own account traders and multilateral venue operators are intrinsically contradictory.

- **Execution risk:** Traders on own account are primarily interested in the execution price, since their revenue directly derives from the execution price they get. On the contrary, the operator of a truly multilateral trading venue, that is to say, a venue which only enables the matching of third parties trading interests, has absolutely no direct interests in the execution price, since its revenue is not derived from it. Its only interest resides in ensuring fair and orderly trading, and in the objective setting of the execution price, which must reflect the meeting of buying and selling interests. The neutrality of the venue operator in this respect is crucial to protecting the interests of the final investor.
- **Market surveillance risk:** The lack of neutrality of an OTF operator dealing on own account would also raise significant issues in respect to market surveillance and the prevention, detection and sanctioning of fraudulent trading practices, since the operator would act, at the same time, as a monitoring and monitored entity.

A number of mono-member owned MTFs (operated by banks, and where the operator is the sole member in the platform) have been launched in the EU, which enable one single entity (the bank operating and owning the platform) to be the unique counterparty to all the trades on the platform, at the expense both of investor protection and price formation. In order to end this situation, a minimum of

4 active trading participants should be imposed; with none of them being allowed to represent more than 25% of the volumes on that platform (this would avoid platforms with many members, but with one entity acting as counterparty to all of the trades and thereby accounting for 50% of the volumes).

Recommendation 4
Regulators should regularly monitor the impact of fragmentation on liquidity across trading spaces.

Regulators should seek to ensure that applicable regulatory requirements provide for fair and reasonable access to significant sources of market liquidity on the exchange and non-exchange trading market systems.

Questions:

1. **Do you have views on regulatory mechanisms and specific arrangements that might be needed to help ensure that investors have an appropriate, fair and reasonable access to liquidity in both exchange and non-exchange trading market systems? If yes, please elaborate.**

Effective pre-trade transparency rules are vital to ensure efficient price formation by allowing appropriate, fair and reasonable access to liquidity. Regulators should ensure that all multilateral venues provide fair and open access for market participants and that all multilateral trading should be non-discretionary to protect investors from arbitrary prices. Otherwise, a platform operator might be tempted, for example, to give a better price to some clients that bring more business. Moreover, a marketplace in which the individual platforms do not deliver non-discretionary execution will have neither proper price formation process, nor proper investor protection. In all instruments, this will make pre-transparency meaningless, as quotes would not be executed at the displayed prices on the order book of the platform, hence would not contribute to price formation.

2. **Are there any other issues resulting from the market fragmentation that should be addressed with respect to access to liquidity on exchange and non-exchange trading market systems?**

Brokers running unregulated Broker Crossing Networks (BCNs) must be subject to the supervisory authority of the regulator. We disagree with any proposals that allow for a multilateral trading platform to execute trades against its own capital (proprietary trading). RMs and MTFs, per its nature of being multilateral trading venues, are neutral platforms, hence the operator of any other multilateral platform (such as the proposed OTF) should be neutral and therefore not be allowed to trade against the platform's clients (own account flow) as this would rise serious conflicts of interest. It is important to note that the interest of a multilateral trading operator (not interest at all in the execution price but in ensuring fair and orderly trading) and a trader that trade on own account (mainly interest in the execution price) are fundamentally contradictory. Some market participants argue that the prop trading ban could lead to a huge withdrawal of liquidity from the markets, particularly from the off-exchange derivatives market. Instead of a ban, banks argue that it would be possible to achieve fair and orderly trading by 'rigorously' implementing conflicts of interest rules.

A trading venue should be subject to rules which ensure that the operator has no interest in the execution price only in ensuring fair and orderly trading. That is why in the MiFID Review the Commission proposed preventing a trader that operates a trading venue from trading on its own account. Allowing matched principal trading on OTFs would create a breach in the prohibition of own account flow in OTFs. Despite the intention to only allow own account flow in OTFs strictly for 'matched principal trading', there may be delays between the client trade and the offsetting trade in the market and, during this delay, the market price may move. In this instance the bank would assume the risk of the trade, which means that it acts in a proprietary capacity and therefore the trade would no longer take place on a riskless principal. A bank operating an OTF would therefore be faced with conflicts of interest if matched principal trading were to be permitted in OTFs. On one hand the bank, as a proprietary trader, is interested in the execution price, while on the other hand, as a multilateral platform operator, the bank has a duty of neutrality. The SI regime already provides a framework for banks to execute client order against own account. Combining own account trading and multilateral

trading is only in the commercial interest of the bank operating the platform, not in the interests of the client.

Questions:

1. **Are there any regulatory requirements that should be examined in addition to the recommendations already made in the above mentioned IOSCO reports in light of the evolution of market structure and trading strategies in the very specific context of market fragmentation? If so, please describe.**

We support a robust transaction reporting regime and welcomes the extension in the scope of instruments covered and harmonisation of these reports as proposed by the Commission (with the exception of extending the obligation to trading venues, which we believe goes against the objective of transaction reporting).

2. **Are there any other issues associated with the fragmentation of markets that have not been mentioned in the current report?**

3. **Are there any changes to regulatory structure that you would recommend to regulators in your jurisdiction to address issues raised by market fragmentation? If yes, please elaborate.**

- **Systematic Internaliser Regime**

In order to set a good scene for the coming changes to the securities markets regulatory framework, it would be desirable that regulators deeply analyse the causes, as well as the effects, of the failures observed with regard to market structure following MiFID I. As an example, it could be useful to analyse the reasons behind the low success of the Systematic Internaliser, which was originally designed for catering the bilateral trades not qualifying for OTC exemptions.

- **Cross Venue Surveillance**

The implementation of MiFID I has promoted competition between trading venues which has yielded significant benefits for European markets. However, this has also resulted in a significant increase in the fragmentation of liquidity for equities. The current problem with market surveillance is that today, the same product[5] can be traded across multiple venues in Europe. Yet no single venue or Regulator can see all trading activity in any single product or ensure that investigations are conducted collaboratively for all those instruments traded across multiple venues. It is therefore likely that manipulation is probably occurring and subsequently remains undetected. Each venue is able to assess market abuse within its own domain. However, no supervisor or trading venue can see all trading activity and therefore manipulation is probably occurring across venues that remain undetected. It is only when the full picture is assessed can the full extent of abusive behaviour be detected across venues. Can a solution be found which will address this problem, strengthen market integrity and better protect investors?"

It must also be recognised that manipulation may be possible by use of the same securities product across multiple trading venues or alternatively across asset class by use of a "similar" or "linked" product, such as a derivative or structured product, which is capable of impacting price formation of the security and vice versa. MIFID I did not change the relationship between securities and derivatives except for the effect of fragmentation in equities which makes it harder to assess the correlation of the derivatives and underlying securities product now traded in multiple places.

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[5] As example it was recently suggested that Nokia was available for trading in over 40 different trading venues