Association française des marchés financiers
FINANCIAL MARKET PROFESSIONALS

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OICV-IOSCO CONSULTATION REPORT

Regulatory Issues Raised by Changes in Market Structure

Comments by AMAFI

Association française des marchés financiers (AMAFI) has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

AMAFI welcomes the opportunity to comment on the Consultation Report (hereafter referred as to the Report) on "*Regulatory Issues Raised by Changes in Market Structure"* issued by the International Organization of Securities Commissions.

AMAFI would like to congratulate IOSCO on the quality of the information contained in the Report.

Before answering the questions of the Report, AMAFI would like to emphasise some general comments.

I) GENERAL COMMENTS

AMAFI welcomes IOSCOs' initiative to regularly assess regulatory issues raised by changes in market structure.

AMAFI's members carry out financial activities in Europe. Therefore our comments are mainly based on the European market framework which has been deeply modified since the implementation of MiFID in November 2007.

We agree with the four topics identified by IOSCO as being issues raised by the evolution of market structure and with the high level recommendations proposed in the Report. Having said that, AMAFI considers that fragmentation of trade information is the most important topic and that order handling rules and access to liquidity do not raise any current actual issues.

The European political choice is to organise and promote competition within trading venues in order to lower trading costs and encourage innovation. MiFID has lead, together with progress in technology, to important modifications in the equity market structure with benefits and drawbacks for investors, issuers and brokers-dealers.

Therefore, AMAFI would like to point out three mains subjects that should be taken into account by market regulators when regulating market structure.

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The first one is that we can observe that there is no consensus on the benefits and drawbacks of the current market structure. The lack of consensus concerns various area such as the quality of the price formation process, the proportion of trading carried out outside trading venues or the legitimacy of some pre-trade transparency waivers... Given the incapacity within the industry and within regulators to share common analysis and data on crucial aspects, it is very unlikely to build a sound regulatory framework. Regulatory bodies should play an important role in order, at least, to avoid overstated debates. The first step to achieve this goal is the standardisation and consolidation of market data that should be one of the objectives of regulatory bodies.

The second one is the effectiveness of competition. It must be noticed that, in Europe, competition is mainly due to the emergence of new competitors (Multilateral Systems Facilities –MTFs), dark pools and to the possibility given to brokers to manage orders in internal crossing systems. It must also be noticed that there is no actual competition between the established regulated markets (RMs). The increase of regulatory requirements for the various trading venues and the race to the size that naturally encourages trading venues to merge could lead to challenge to the reality of competition. If competition is considered to be the best organisation of markets infrastructures, the regulatory framework should not encourage the emergence of oligopolies, or regulate them as such.

Besides that in Europe, the situation of post trading (clearing and settlement) is not satisfactory because the fragmentation of post market infrastructure linked to actual barriers to competition results in high clearing and settlement costs due to complexity and some monopolistic situations.

The last issue is that the market framework for small and mid caps companies is not taken into account with sufficient consideration. The consequence of competition is that market infrastructures have put in place policies (fees, tick sizes, speed of transactions....) in order to attack liquidity (ie for big caps) at the expense of SMEs markets. For instance, it can be noticed that the trading and clearing fees for SMEs has increased since the implementation of MIFID. This contributes, in a much degraded economical environment, to diminish the capacity for SMEs to raise capital on the market, which is considered to be a key element for recovery in Europe.

Bas du formulaire

II) IOSCO recommendations and questions

1. Monitoring the impact of fragmentation on market integrity and efficiency

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.

As stated above the monitoring of the impact of market fragmentation needs to share common data and common analysis of the actual functioning of the market which is not the case today. For instance there is no consensus on the number of OTC trade (and the nature of these trade) carried out in the EU. Besides that, regulator should privilege clear goals and propose measures that are easily measurable and predictable.

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?*

As soon as there are different kinds of Trading Spaces in different regulations, the evolving market fragmentation challenge the current regulatory requirements. We should keep in mind the recent technology (IT, Internet) developments have totally changed the way the financial markets works. This new environment is by way of consequence more complex and could appear for investor, especially retails, as confusing, but not necessary dispute the investor's protection.
Markets fragmentation leads also to data fragmentation and creates uncertainty for the investors.

Data fragmentation is mainly caused by the lack of pre and post –trade information.

The question is how regulators can monitor the impact of fragmentation: adding new regulations is not the unique and necessary answer to face the complexity due to technology; the regulators should be able to upgrade their own surveillance and control systems/tools. Adding regulations to existing regulations can create legal complexity and finally insecure environment.

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.*

In Europe, regulatory requirements between RMs and MTFs tend to be harmonized.

The main resulting issue is to assess how regulation should take into account OTC trading systems (broker crossing systems-BCNs). This is a difficult issue because nobody agrees (and probably nobody knows) on the actual level of transactions that are carried out in these systems. The evaluation varies from less than 10% to more than 50%.

Anyway, asset managers, which are clients of AMAFI's members, consider that BCNs constitutes a mean to fulfill some of their trading needs. It must also be noticed that the use of a BNC is included in the best execution policy agreed by investors.

Because competition is the key element of the EU regulation, there is a need to maintain the possibility for brokers to put in place this kind of systems and regulation should recognize the specificities of discretionary systems. It must be noticed that current BCNs are subject to the same post-trade transparency requirement as RMs and MTFs which is a key element of a sound market structure.

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 is no evidence that the price formation process has been impaired since the implementation of MIFID. Nevertheless the position of established regulated markets remains dominant in terms of price formation process. In particular, it must be noted that new market entrants have not gained significant market share concerning opening and closing prices which are key elements in this perspective.

For liquid shares, implicit costs have decreased due to the narrowing of the spreads and the increase of liquidity. Explicit costs have probably increased. Indeed, even if competition between trading venues has a positive effect on the tariffs (and we probably have reached a point where fees will begin to raise again due to the economical situation of MTFs in Europe), the total cost of execution has not decreased in particular because of the costs of investments, market data and clearing and settlement which are higher in a fragmented market.

For non liquid share, explicit costs have increased. The evolution of trading and clearing fees has been done at the expense of shares where there is no fragmentation and therefore no competition.

2. Monitoring the impact of fragmentation on trade information

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.

This recommendation is a key element. In a fragmented environment there is a need for all market stakeholders (market supervisors, brokers, investors and issuers) to have a sound and reliable database where all the trades are registered in an orderly manner. Regulators should aim to the consolidation of data.

Questions:

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

Six years after the implementation of MIFID it is fair to point it out the failure of voluntary industry action in order to consolidate data in a proper manner and at a reasonable cost. On the contrary the cost of data has increased dramatically.

The cost and data quality issues raised cannot be dealt without mandatory data standardization, consolidation and cost controls.

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

Market data should be considered as a public good and should ideally be provided at cost. However, we recognize the need for a cost structure that incentivizes continual improvements in the service delivered and so accept that cost plus a reasonable and transparent return is appropriate. Price should be based on the cost of production and not on pricing power of the providers, which is currently the case.

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?*

The key challenge is that the European Commission policy of preserving an element of competition in the provision of consolidated data has made it reluctant to appoint a single consolidated tape provider. This reluctance and resulting uncertainty as to the conditions of data standardization, consolidation and dissemination has in turn disincentived potential providers from stepping forward. Multiple, ultimately futile attempts to develop a single consolidated taper have proven that that this is not something the industry can do on its own: regulatory intervention is required

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*

AMAFI supports the consolidated tape operated by single for-profit commercial entity for limited period on grounds that a CT operated by a single non-profit entity in perpetuity is unlikely to result in a continually improving and cost-efficient service; and that a CT operated by multiple competing commercial providers, while theoretically attractive, may be unworkable in practice and in the short term (e.g. why would one provider be incentivised to provide a service that another is already providing). In the context of the single-entity commercial provision of the CT for a time limited period, it is crucial that EU regulators accept market participant input on a RFP and responses to it.

3. Monitoring the impact of fragmentation on order handling rules and best execution

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.

AMAFI considers that order handling rules and best execution obligations do not currently raise any particular issue. The rules where set up in MIFID in the perspective of market fragmentation.

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?*

There is no reason to re-examine these rules in the MIFID regulatory framework. Besides that, brokers are in a very competitive environment and are continually challenged by their clients on the quality of the execution they provide.

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'?*

We believe that sufficient detailed data is already available on the execution policies adopted by investment firms to allow verification of those firms' compliance with existing best execution requirements.

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

Given the fragmentation of clearing and settlement in the EU, the order handling tools should remain on a best effort basis as soon as the execution policy is public and agreed by the broker's clients. A trade through rule could be a next step but first requires a single clearing and settlement system as it is the case in the US.

4. Monitoring the impact of fragmentation on access to liquidity

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.

AMAFI considers that access to significant sources of market liquidity does not currently raise any particular issue

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.*

In the EU, investors have fair and reasonable access to liquidity in both exchange and non-exchange trading market systems. It should be re-assed that intermediaries, according to their best execution obligations intermediaries must be allowed discretion in providing access to liquidity

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?*

No, at this stage.

5. Monitoring the impact of fragmentation on market efficiency and resilience

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.*

As stated above, the main issue regulators should focus on is fragmentation of market data.

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

The question of the integration of clearing and settlement should also be addressed by IOSCO when considering market fragmentation. In the EU the fragmentation of post market adds fragmentation to market fragmentation which implies unnecessary costs and risks.

Besides that, the issues raised by changes in market structure cannot be assessed independently of micro-structure issues such as tick size or tariff policy.

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.*

No, at this stage.

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