



Association of British Insurers

Call for evidence on the impact of MiFID on secondary market functioning

The ABI's Response to CESR 08-872

The ABI is the voice of the insurance and investment industry. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters. The ABI prides itself on thinking for tomorrow, providing solutions to policy challenges based on the industry's analysis and understanding of the risks we all face.

Our members – as both issuers and investors - have a strong interest in the integrity and efficiency of financial markets and in promoting the confidence of the investing public. Matters relating to market efficiency are of fundamental importance to them. There is a great deal of concern that the introduction of MiFID has had a detrimental effect on the functioning of the secondary markets and that the fragmentation of both pre- and post-trade data has led to a decrease in transparency.

We would urge CESR to review the MiFID requirements and the way in which they have been implemented, and take action to improve secondary market functioning.

If you have any queries, please do not hesitate to contact me.

Yours sincerely,

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Policy Adviser, Investment Affairs

ANNEX

Questions for Consultation

Q1. What do you think are the key benefits for yourself or the market more generally that have risen as a result of MiFID?

Our members believe that the key benefit for them and for the market more generally has been the increase in competition between the trading venues across Europe.

New trading platforms such as Chi-X and Turquoise have challenged the dominance of incumbent exchanges even in member states which did not have the concentration rule prior to the introduction of MiFID. This has in turn led to a reduction in costs of trading as venues lower their fees in an attempt to attract customers.

For investment managers, who are by and large not members of exchanges, the benefits have been minimal. Some of our members report that they have been able to negotiate lower commissions from brokers due to the lower costs charged by venues they use but they are few. By and large, the cost savings have not been passed on to our members and therefore, in turn, to the underlying investors.

The decrease in costs is evident in tighter spreads offered by some of the new venues. Having said that, the liquidity on new venues is still pretty limited so the benefits are not yet significant.

Q2. Do you consider that there are any remaining barriers to a pan-European level playing field across trading venues?

Our members report that the remaining barriers are to do with the lack of a centralised clearing and settlement infrastructure linking all the European venues.

Q3. Do you think that MiFID has supported innovation in the equity secondary markets?

If the increase in the number of venues, including dark pools and MTFs, equals innovation, then we would agree that MiFID has been directly responsible for this. This is particularly evident in many European countries

which had the concentration rule before MiFID came into place. In that sense, the amount of innovation experienced in the UK may be more limited.

Other notable recent changes to the market functioning, such as the emergence of dark pools of liquidity or algorithmic trading probably have more to do with the technological developments than with MiFID itself - though MiFID best execution requirements may have accelerated their development.

Overall, MiFID has laid down a regulatory structure that allows innovation to happen.

Q4. Have you faced significant costs or other disadvantages as a result of MiFID? Have these been outweighed by benefits, or do you expect that to be the case in the long run?

For our member firms, the costs of implementing MiFID were largely compliance costs. These were considerable, especially when senior management time and legal fees are taken into account. In some areas, such as transaction reporting, there have also been costs of systems changes for some UK portfolio management firms. These costs do not appear to have been borne by these firms' European counterparts. Altogether, the implementation of MiFID has been relatively costly for our members.

In terms of trading, the biggest ongoing cost has been the implicit one - namely the opportunity cost of having to trade on the basis of inaccurate data. Arguably, this has outweighed any benefits brought about by MiFID. There have also been considerable explicit costs of obtaining market data because of the market fragmentation.

Q5. Have you seen / experienced any unexpected consequences in terms of level playing field arising from the implementation of MiFID provisions?

Because MiFID was implemented unevenly across the EU, our members feel they have been disadvantaged in certain areas such as transaction reporting.

There may also be disadvantages between firms of different sizes – larger firms may be in a better position to invest in trading technology.

Q6. What impact do you consider that increased competition between equity trading venues is having on overall trading costs?

It is probably still too early to determine what the effect of the increase in competition is going to be in the medium to long term. This is partly because many of the venues have only been operational for a few months. Their current market share may therefore increase and their pricing change as a result.

But it is also because market conditions have been extremely volatile. This may have had a major impact on trading decisions. For example, some claim that volatility and concerns about counterparty risk have resulted in a move away from dark pools and onto exchange order books. For asset managers in particular, the recent conditions have in many cases led to a rebalancing of best execution criteria, with the certainty of execution, i.e. the ability to complete the deal at all, becoming one of the most important factors.

Also, issues related to the quality and availability of data have an impact on overall trading costs, as we explain in our answers to Question 1 and 7.

Q7. Do you think that there has been significant fragmentation of trading and/or liquidity in European equity markets? Do you think that such fragmentation raises concerns?

There has been some fragmentation of liquidity across different venues and it is continuing to increase. Some venues have done reasonably well, attracting sizeable volumes in certain stocks. But the overall volume attracted by new venues is relatively small and price formation still seems to be taking place on the dominant exchange.

We do believe that the trend for fragmentation raises concerns. First and foremost, brokers and different reporting venues interpret MiFID rules differently. For example, the lack of consistency has led to double (and worse) reporting of some trades. The same trade can be reported by both of the brokers doing the trade and possibly the exchange as well. This in turn means that the overall picture of liquidity in the market is inaccurate. In addition, there are inconsistencies around the reporting of delayed trades.

There are also problems with the data quality inherent in MiFID (rather than due to inconsistent interpretations of the rules by different venues), particularly around the use of permitted delays and the absence of flags on certain types of trades such as agency crosses. Some large trades have been reported to venues (or in currencies) generally not used by the firm, which makes it hard for other market participants to monitor what is going on.

Our members have described the regime as 'lax' and less stringent than before the introduction of MiFID. They are now in a position of having to pay more for a data of lower quality.

Q8. Do you think that MiFID pre and post trade transparency requirements adequately mitigate potential concerns arising from market fragmentation?

We do not believe that this is the case. Competition has not been successful in producing the consolidation that allows market participants to get a comprehensive picture of the market.

An asset manager wanting to get a consolidated view cannot do so unless he subscribes to each European exchange. Even then, there are questions about reporting volumes and accuracy.

Our members would therefore wish to see the introduction of a mandated consolidated tape.

Q9. Is the categorisation of shares appropriate in relation to: the definition of liquid shares; “standard market size”; “orders large in scale”; and “deferred publication”?

As mentioned in our response to Q7, we believe there are issues stemming directly from MiFID that are responsible for the decrease in market transparency. In particular, we believe CESR should review rules on how trades are flagged and how delayed trades are reported, as these have been some of the most acute problems experienced by our members and other market participants.

Q10. Do you see any benefits (e.g. no market impact) to dark pools of liquidity? If so, what are they?

Q11. Do you see any downsides to dark pools of liquidity (e.g. impacts on the informational content of light order books)?

Our members believe there are benefits to the dark pools of liquidity, namely the reduction of market impact as CESR highlights. Portfolio managers often trade in large sizes so minimising market impact – and thus reducing the cost of trading - is of great importance to them.

We do not at this point in time see any downsides. As long as market participants can access both dark pools and public order books, our members do not envisage that dark pools will create problems for pre-trade transparency.

However, one could envisage a situation where this stops being the case – if the balance tilts too far the other way and dark pools attract a much larger percentage of the trading flow, there may be problems around price discovery that need to be addressed by the regulators.

Q12. Do you consider the MiFID pre and post trade transparency regime is working effectively?

No, we do not think the regime is working effectively. We have already explained the problems related to market fragmentation and the omissions in MiFID rules. Both have lowered the quality of data in the UK - although they might have increased it elsewhere in the EU.

Q13. What MiFID pre and post trade transparency data do you use, and for what purpose? Does the available data meet your needs and the needs of the market in general?

In terms of data availability, asset managers report that they have had to subscribe to more data feeds at an additional cost in order to get the relevant information. As already explained, they feel that the data they do receive is not always accurate and different information providers use different data feeds.

Q14 – 15 Do you think that MiFID pre and post trade transparency data is of sufficient quality? If not, how could it be improved?

Do you think that there has been significant fragmentation of market data in the EEA equity markets? Do you think that such fragmentation raises concerns (for example, does it impact on the price formation process, the overall efficiency of the markets, search costs)?

Please see our answer to questions 6, 7 and 8.

In terms of future policy choices and possible improvements, we would stress the need for an EU-wide response. Unilateral moves by member states will lead to less, rather than more transparency and a worse outcome for users of the market due to potential for regulatory arbitrage.

Q16. Does the current availability of data facilitate best execution?

The poor quality of data has had an impact on the provision of best execution. This is because the transaction cost analysis, used by many investment managers to demonstrate best execution, and any other post-trade analytics, may now not be entirely accurate due to inaccurate inputs used.

Q17. Do you think that commercial forces provide effective consolidation of data?

We do not believe that commercial forces have succeeded in effectively consolidating market data and we are not convinced they will do so in the future.

The European regulators should consider introducing a mandatory consolidated tape instead.

Q18. Do you think that the implementation of MiFID is delivering the directive's objectives in relation to equity secondary markets? If not, why do you think those objectives have not been met?

We believe that only some of the objectives of MiFID have been delivered in a year since the implementation. The emergence of new venues and the abolition of the concentration rule in many member states have undoubtedly been beneficial: competition has lowered some of the explicit costs of trading and this is likely to continue.

However, the overall picture is less positive: the quality and availability of trading data is significantly worse than before MiFID was introduced and this has increased the implicit costs of trading. Market efficiency is therefore lower. Importantly, it is the ordinary savers and investors, who are our members' clients, will ultimately bear these higher costs.

Q19. Do you see any other impact or consequence of MiFID on equity secondary markets functioning?

We do not see any other impact at the moment.