ABI's Remarks to CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets

25 May 2010

POSITION PAPER

General Remarks

The Italian Banking Association (ABI) welcomes the opportunity to participate to the current CESR's consultation on MiFID review, a topic particularly important for the system and closely identified with by national operators.

So far, MiFID regulation has demonstrated an efficient structure, even if there still remain some areas for improvements, in relation to which it might be appropriate to define suitable amendments.

The position outlined in this document was drawn up by ABI in cooperation with a specific working group, made up of leading Italian brokers active on the capital markets.

The document is divided into topic-related sections within which, where possible, information has been provided in response to specific questions posed by the CESR. It has not always been possible to draw up specific positions on each of the individual topics raised, because, firstly, the time for the consultation was not compatible with the time-frame needed to gather the necessary empirical data, and, secondly, because Italian brokers are not significantly active in some markets segments (e.g., Systematic Internalisers on shares and crossing networks).

Nevertheless, ABI remains available to be contacted for any further analysis on the matters under scope, where CESR would consider this appropriate.

Remarks on Single Sections

1. Pre-trade transparency regime

The approach adopted by CESR of maintaining the set-up of the current regulation on pre-trade transparency, for regulated markets and MTFs, appears fully endorsable.

Specifically, confirmation of the current system of pre-trade transparency waivers appears endorsable. Indeed, these exceptions make it possible to reconcile the need for transparency with the need of greater market efficiency.

The application of this overriding system has not led to particular problems in relation to market transparency and price discovery process: according to the data provided by the CESR, the volume of orders executed under pre-trade transparency waivers represents still a limited percentage of the total, even if it is increasing.

Should a decision be taken to participate to the amendment of the pre-trade transparency regime, ABI would underline the appropriateness to limit the intervention to a recalibration of the thresholds, in consideration of the fact that the latter were introduced in a different (market) context to the current one. The threshold review process, however, cannot prescind from a preliminary analysis of the market conditions (for instance, in terms of liquidity).

Furthermore, a recalibration should take into account the impact on dark pools, i.e. those trading systems (Regulated Markets or MTFs) which, availing themselves of the pre-trade transparency waivers, make it possible to send orders skipping the prior publication of the related prices, volumes and spreads.

With specific regard to this aspect above, ABI would like to draw CESR's attention to the fact that the development of the dark pools is a consequence of the application of the principle of competition between trading venues, as set in the MiFID. Actually, the possibility of creating dark pools represents an element of competition between trading venues, to the extent that the brokers or the management companies of regulated markets can choose to create them so as to extend their service supply to investors.

Large in Scale waiver

The use of LIS waiver has so far shown itself to be effective for ensuring market transparency and it is regarded as to be maintained.

Regarding the possible recalibration of the trigger of this waiver, ABI considers that CESR's proposal to reduce the current value of the trigger by 25% is an acceptable starting point for further discussion.

Anyway, it should be guaranteed a high degree of flexibility in the possibility of using this exemption.

With regard to the stubs (i.e. the part/s of an order which is/are not executed), ABI deems that it would be necessary to continue to ensure the exemption to the pre-trade transparency also for them, even when the stubs do not fall within the thresholds of the LIS waiver. This is based on the view that it could be excessively expensive for a broker to "split up" the order into two parts and treat what is not executed as an order itself.

Reference Price waiver

The rationale underlying the definition of the reference price waiver is to avoid that irrelevant information, with no value or significance, produced on the market, such as the pre-trade information produced by "passive" price taker systems which do not add value to the information already present on other markets.

With regard to this, ABI believes that the use of the reference price waiver should be maintained. The elimination of this exception would mean that those brokers who manage dark pools, on the basis of use of the reference price waiver, would see a reduction in their services supply to the investors. This would be in contrast with the principle of competition between trading venues, introduced by MiFID.

Negotiated Trade waiver

There are no comments on this waiver.

Order management facility waiver

There are no comments on this waiver.

2. Systematic Internalisation

In the section of the consultation paper which deals with the regulation of the Systematic Internalisers, CESR expresses a number of perplexities regarding the definition and the regulation of this activity.

Generally, there is awareness that the current regulation envisaged for Systematic Internalisers might be improved, essentially by means of clarification of its definition, which in turn could favour a further development and spreading of this trading venue within the EU.

With regard to the qualification requirements of Systematic Internalisation, it is considered that the removal of reference to non-discretionary rules could be helpful to characterize this activity: this condition, in fact, represents a clear element that distinguishes OTC business from other methods of execution, including Systematic Internalisation.

In this respect, ABI agrees with CESR's proposal to clarify the concept of "material commercial role", also by possibly setting quantitative thresholds for its definition.

Furthermore, ABI underlines that in Italy no national broker has so far launched systematic internalisation activities for shares (while 18 brokers qualified for such activities on instruments other than shares) and therefore it is not possible to provide tangible proposals regarding the definition of specific threshold values. With regard to the definition of quantitative indications, further analysis by the CESR in collaboration with the industry in Europe is however considered necessary.

Regarding the above, the Italian experience could be taken as a point to start from as it led the National Supervisory Authority (CONSOB) to provide indications as to say that an activity should be regarded as having an "important commercial role" for the intermediary who carries it out, if this represents a significant source of income or costs. For this purpose, when defining and establishing the main characteristics of this activity, it must be taken into account the extent to which the activity is carried out or organized separately, the monetary value of the activities and their relative importance to the overall activities of the business and/or the activities of the company on the market in question.

3. Post-Trade Transparency regime

The post-trade transparency issue emerged mainly as a consequence of the fragmentation of the information, following the multiplication of the trading venues.

In general, Italian operators consider the provisions of the current MiFID regulation on the subject sufficiently valid and adequately implemented.

Recently, ABI carried out a survey (with the National Authority - CONSOB) on the implementation of the MiFID regulations on post-trade transparency, specifically focused on the method of publication of post-trade information, which revealed a satisfactory level of compliance by intermediaries with these obligations.

More in detail, it emerged that nearly all the sampled intermediaries make information on closed transactions available, free of charge, on their own website or on their Holding Group's. This information includes the identification of the financial instrument in transaction, the date and time of the transaction, price, currency and quantity of the securities traded and the identification of the trading venue (minimum disclosure requirement prescribed by EU Regulation No. 1287/2006/EC implementing the MiFID). This information is made public and usually kept for a period between 1 and 3 months (51% of the sample), while a third of the sample (36%) maintains it for more than a year. Only a low percentage (3.5%) keeps it for less than one week.

Furthermore, Italian operators are aware that the quality of the post-trade information could be improved, by means of standardization and improvement of its availability, particularly in relation to OTC transactions. The approach proposed by CESR is therefore looked at positively, with the ultimate goal of increasing the comparability of the information and its reliability.

ABI takes the opportunity to express its commitment to participate in a joint CESR/Industry work group for the definition of the information communication standards. Indeed, ABI is convinced that any intervention in this area should be implemented by means of a self-regulation activity able to ensure the necessary adaptability of the solutions identified to various contexts and in relation to different kind of brokers.

With specific reference to the timeliness of post-trade transparency information, CESR suggests to reduce the deadline for publishing such information from three to one minute.

On this regard, ABI underlines that the current regulations require that "pre-trade information and post-trade information relating to transactions taking place on trading venues and within normal trading hours, shall be made available as close to real time as possible. Post-trade information relating to such transactions shall be made available in any case within three minutes of the relevant transaction" (Article 29 of EU Regulation No. 1287/2006).

Post-trade information on transactions executed on trading venues should therefore be made public in real time and <u>only under exceptional circumstances</u> close to the maximum deadline of three minutes, when the systems available on the market do not permit publication within a shorter time span.

In light of the above, ABI does not consider appropriate to change the current regulatory provision, as any shortening of maximum publication delay would not by itself lead to an increase in the efficiency of information publication (as, under normal circumstances, brokers publish the information in real time), but would make it more difficult to meet the fulfilments.

That said, it should also be taken into account that there are certain transactions, such as OTC transactions taken over the telephone, for which this obligation is definitely more difficult to be accomplished in real time, as they cannot be completely automated and require manual intervention.

Finally, acknowledging that every deferral of publication by itself represents a reduction in the significance of the information published, it is necessary to take into account also the activity of intermediaries of smaller dimensions, which (partly in relation to their volume of transactions) are equipped with systems proportioned to their operations. These systems often do permit them to fulfil the obligations within the deadline set. For these intermediaries, keeping the current 3 minutes maximum deferral, would represent a greater guarantee that the obligations are observed by small brokers and would not force them into investments too large relatively to their volume of executed transactions.

Transparency obligations for equity-like instruments

Generally, ABI supports CESR's proposal to provide a transparency regime for equity-like instruments. This should be appropriately calibrated on the basis of the characteristics of the financial instruments to which it relates and should be implemented gradually, in order to facilitate operators to adapt and adjust their systems.

Consolidation of transparency information

With regard to the consolidation of the pre-trade transparency information, a regulatory intervention aimed at making it mandatory is not deemed appropriate.

Indeed, ABI considers that valid arguments against this choice exist. Specifically, if the consolidation only concerned the first level of the various market books, the aggregation would not give significant indications, because it would favour less liquid trading venues. These venues, in fact, would not expose quantities for the subsequent levels, against orders entered at the first level of the consolidated book. Furthermore, compulsory consolidation would not be useful for guaranteeing the best execution, since it is not possible to execute the orders on all the execution venues which the consolidated book refers to.

What is more, it is recognised that this initiative could lead to significant costs for the brokers which, eventually, would affect (negatively) the cost of every transaction.

With regard to post-trade transparency, which could actually be of value for the market, a general agreement is reached on the fact that the industry of info-providers has not, so far, offered effective solutions for the consolidation of the information.

Moreover, to-date, consolidation of the information relating to orders/contracts concluded on different execution venues is left to the market's free initiative and there is no provision indicating its obligatory nature. In this regard, there would still be obstacles to the actual possibility of consolidating information, such as, for instance, the low degree of standardization of information and its relevant costs.

In relation to the question of standardization, it is considered advisable an intervention of the regulators aimed at making more standardized and traceable the information on trades published by the various trading venues and by authorized operators. Therefore, in this way it would be easier to consolidate such information, as already mentioned above.

Standardization of the post-trade information could, in fact, effectively lay the foundations of a more reliable and comprehensive consolidation system, usable by both brokers and investors. This consolidation system should concern just listed equity instruments (possibly just those considered liquid), given that the system relating to post-trade information publication envisaged by the MiFID does not apply to instruments other than shares.

With reference to the cost of the information, it might be useful to clarify and detail the meaning of publishing the information under “reasonable commercial conditions”.

Once an improved standardization of the information has been achieved, the provision of a Mandated European Consolidated Tape, which consolidates the information on all transactions executed across different trading venues, given current market conditions, appears excessively invasive and does not represent a more efficient solution than alternative hypotheses.

One of these could be to foresee a “partial” consolidation regime, based on relevant thresholds representing the trading venues, for example based on significant trading volumes. This is because the trading volumes generated by small brokers would have little relevance with regard to price discovery process.

On the basis of this system, only trading venues and brokers which contribute significantly to share trading would be required to publish their information (in standard formats which permit the information to be traced), so as to be easy to consolidate via authorized channels. Accordingly, the important principle of the proportionality of the regulation would be safeguarded.

With regard to proposal of mandatory publication of the post-trade information via authorized communication channels (regulated market or MTF structures, third party infrastructures with specific organizational requisites, the so-called APA - Authorized Publication Arrangements), it is deemed appropriate to indicate how this provision could lead, for smaller brokers (who might have to abandon the current publication mechanism via proprietary channels, its website), to additional charges, out of proportion relatively to the activities carried out and to the contribution to the price discovery process through their operations.

4. Regulatory boundaries and requirements

Regulated markets vs. MTFs

Given the current regulations, ABI does not recognise elements determining an unlevel playing field between MTFs and regulated markets.

MiFID has identified three types of trading venues – Regulated Markets, MTFs and Systematic Internalisers – with equal dignity, but characterized by different features. It follows that "by definition" regulation must take into account the different profiles attributed to the different venues by MiFID, as established by the principle of proportionality in the identification of applicable requirements.

Besides, the proposed requirements for brokers who organize an MTF do not seem to add much to what is set in the current framework. Indeed, the proposed requirements are not very different from those already set in articles 13, 14 and 18 of the Directive. Therefore, ABI does not consider appropriate to articulate further the requirements proposed by CESR, as this would add no particular value.

Crossing Systems

CESR's proposals aim to understand crossing networks in order to achieve an accurate definition of these trading systems. Since these systems are not contemplated at all by the MiFID, it might be useful to bridge the legislative gap by means of identifying characteristics which can unequivocally define the type of activities of the crossing networks.

Crossing networks are automated systems which cross client orders. These are quite different from both MTFs and Systematic Internalisers.

In detail, ABI does not consider that crossing networks can be led back to the management of a MTF, since they do not present elements of multilateralism (of the purchase and sale interests) and are characterised by the presence of discretionary elements.

Furthermore, ABI does not believe that the crossing networks can be attributed to Systematic Internalisation activity, since they do not have the requirements envisaged by EU Regulation No. 1287/2006, with specific regard to the publication of irrevocable listed prices and own-account transactions.

It is also believed that a qualification of crossing networks cannot disregard a prior analysis of the phenomenon, especially to assess the systematic nature of these structures and the various forms and functioning mechanisms they have adopted. The latter also in consideration of the fact that the significance of the phenomenon is not so far known, nor is evidence available with regard to the impacts on the trading venues regulated by the MiFID, in terms of lower volumes traded.

On the basis of this assessment, it is therefore suggested that a method of intervention by the regulators, if deemed appropriate, could involve creating a new category of trading venue, drawing up ad-hoc regulation, possibly establishing a threshold in terms of operating volumes. This regulation would also make it possible to draw a precise line between crossing networks, MTFs and Systematic Internalisers, observing the principle of proportionality of the regulations and with a view to ensure a level playing field.

Regulatory measures could also point to an improvement in the quality of the post-trade transparency data published by the brokers managing crossing networks. The obligation to publish should regard the information relating to transactions concluded on listed shares. ABI agrees with the CESR that transparency obligations should be envisaged vis-à-vis significant size thresholds, on the assumption that the trading volumes generated by small brokers would be of little significance for the price discovery process.

Finally, when qualifying crossing networks as self-standing trading venues, it would be necessary to pay attention to the regulations on operators/entities carrying a market making activity. Indeed, ABI considers necessary to run further analysis on the opportunity for brokers, which operate crossing networks, to carry out market making activities within these systems and an analysis of any repercussions this might have on the price discovery process.

5. MiFID options and discretions

ABI supports the overall goal of rules harmonization, but it considers also important to pay attention to the need to maintain a certain degree of flexibility.

Thus, with specific reference to the use of pre-trade transparency waivers, ABI considers that translating and transposing the exemptions into mandatory rules would undermine the aforementioned principle of flexibility in the rules. Possibly, a rule-based intervention could be adopted in the second level Directive or at least in any other level of the “Lamfalussy” process.

Besides, as regards the determination of liquid shares, it has to be noted that the notions of liquidity and volatility are not absolute and unique and must be interpreted with reference to specific market conditions, which, in turn, have to be considered case by case.

ANNEX II – PROPOSED STANDARDS FOR POST-TRADE TRANSPARENCY

ABI agrees with CESR’s proposal to use the ISO standard for the standardization of the post-trade information, provided that the standardized communication methods should be left to the self-regulation of the industry, as indicated in the section on post-trade transparency.

ANNEX III – CLARIFICATIONS ON THE POST-TRADE TRANSPARENCY OBLIGATIONS

There are no comments on this Annex.