

**Response of the AMF “Retail Investors” Consultative Commission to the
Consultation organised by the Committee of European Securities Regulators
(CESR) on the review of the Markets in Financial Instruments Directive with
regard to equity markets**

The main task of the Retail Investors Consultative Commission (“Commission”) is to issue a consultative opinion on issues being debated by the AMF Board concerning retail investors and their investments. The members of the Commission are either individual investors or representatives of associations of retail investors or individual shareholders.

* *

*

In connection with the review of the Markets in Financial Instruments Directive (MiFID), the Commission welcomes with great interest the consultation organised by CESR on equity markets (*CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets – CESR/10-394*), with particular reference to:

- issues linked to improving pre-trade and post-trade transparency in equity markets;
- conditions for fair competition;
- developments in market technology.

The Commission notes firstly that changes resulting from MiFID implementation in these three areas have a particular impact on retail investors. Therefore, rather than simply reviewing the Directive, consideration should be given to completely overhauling its provisions where necessary.

1/ Improving market transparency

• **Pre-trade transparency**

The Commission notes that, with the development of dark pools and crossing networks, around 40% of transactions currently take place outside regulated markets and multilateral trading facilities (MTFs).

Concerning **MiFID’s pre-trade transparency waivers**, the Commission stresses that the waiver based on order size should not be changed and recommends a narrower interpretation of the waiver for negotiated transactions. The Commission notes that both waivers, which existed pre-MiFID, are now the most widely used form of exemption, applicable to 9.5% of trades on regulated markets and MTFs. Furthermore, the method for implementing the waiver for orders held in an order management facility needs to be clarified so as to set a minimum size for the publicly displayed portion of “iceberg” orders.

The Commission finds that **the main issue is with the “imported reference price” waiver**. Under the terms of this exemption, an MTF may be “dark” if its trades are executed based on a price imported from a transparent market.

The Commission notes that the main risk at present is that volumes traded¹ under this waiver may increase considerably, creating a vicious circle that undermines the price formation mechanism and leads to wider spreads on transparent markets and a greater incentive to trade on dark pools. Accordingly, a threshold should be set for trading volumes on a dark pool, beyond which the facility would be required to operate with pre-trade transparency. This threshold could be set by the European Securities and Markets Authority (ESMA).

The Commission also considers that the very limited pre-trade transparency requirements currently applicable to **systematic internalisers** should be tightened. For equities considered liquid under MiFID criteria, this would entail publication of bid and ask prices for a minimal amount.

Concerning the MiFID pre-trade transparency waivers, the Commission recommends making no change to the waiver based on order size and adopting a narrower interpretation of the waiver for negotiated transactions.

The Commission notes that the main issue is with the “imported reference price” waiver under which an MTF may be “dark” if trades executed on it are based on a price imported from a transparent market.

Concerning systematic internalisers, the Commission recommends strengthening the very limited pre-trade transparency requirements currently applicable to them. For equities considered liquid under MiFID criteria, this would entail publication of bid and ask prices for a minimal amount.

- **Post-trade transparency**

The Commission recommends implementing a single centralised system of data dissemination, or consolidated tape.

As CESR has proposed, the Commission considers that trades made on dark pools and crossing networks should be identified.

The Commission also notes the need to better identify – notably through a system of flags – over-the-counter (OTC) trades which, because of their characteristics, are unlikely to be included in the price discovery process. It also calls for a better definition of the concept of OTC, which is currently defined by default only (i.e. any trade that is not executed on a regulated market or an MTF).

The Commission recommends:

- **implementing a single, centralised system of consolidated data dissemination in the form of a consolidated tape;**
- **identifying trades made on dark pools and crossing networks;**
- **identifying OTC trades more precisely, in particular using flags, and establishing a better definition of the concept of OTC.**

¹ Volumes executed under this waiver have tripled in the past two years but, at end-2009, still accounted for only 1% of total trading on regulated markets and MTFs, according to CESR figures. However, they apparently continued to grow considerably in the first quarter of 2010.

2/ Restoring conditions for fair competition

The Commission notes that the rules currently applicable to regulated markets, MTFs and crossing networks are asymmetrical.

The Commission considers that MiFID review should be seen as an opportunity to ensure fair competition between execution venues, based on developments observed in the initial years after the directive came into force.

Thus, the Commission recommends creating a clearly defined status for crossing networks and setting a maximum market share above which they would be required to adopt MTF status. This would address concerns about the absence of pre-trade transparency and the privatisation of liquidity. The threshold could be set by CESR/ESMA according to the characteristics of European markets.

Finally, the Commission recommends strengthening the requirements applicable to MTFs, especially with regard to trade reporting and market surveillance, under the same conditions as for regulated markets, to ensure market integrity and fair competition between execution venues for the same security. Drawing inferences from the recent incident in the New York market, the Commission stresses the need for coordinated management of technical measures to interrupt trading in the event of a sudden, large price discrepancy among regulated markets, MTFs, systematic internalisers and crossing networks.

The Commission calls for fair competition between execution venues to be restored by:

- creating a clearly defined status for crossing networks and setting a maximum market share above which they would be required to assume MTF status. This threshold could be set by ESMA;
- strengthening the requirements applicable to MTFs, especially with regard to trade reporting and market surveillance, under the same conditions as for regulated markets.

3/ Keeping abreast of developments in market technology

The Commission observes that, in these fast-changing areas, it would be pointless setting precise rules through Level 1 measures. It therefore recommends giving ESMA the authority to intervene as required through Level 3 binding measures, on the basis of a jurisdiction established by MiFID.

Specifically, as indicated in its 23 April 2010 response to CESR's call for evidence on "micro-structural" issues, the Commission finds that the contribution of high-frequency trading (HFT) to improving market liquidity and lowering transaction costs for final investors (though narrower spreads) has yet to be proven, since there is no research on the subject nor even an agreement on the concepts (how is a market's liquidity defined?)

However, HFT also presents serious drawbacks, which must be mentioned:

- it diminishes market transparency since order transmission and execution times on the markets, and hence price change intervals, are far shorter than investors' potential reaction times;
- it reduces average trade size, leading to order fragmentation and higher overall execution costs;
- it increases the risk of market abuse through price manipulation.

The Commission therefore believes that ESMA should be given the authority to intervene to set a frame for HFT, in particular by setting minimum tick sizes for markets.

For all these reasons, the Commission considers that ESMA should be granted the power to set a frame for HFT by adjusting market rules. In particular, it could determine a minimum latency period for orders to remain in the order book, or regulate tick sizes, or apply markets' fee-setting policies that take account the use of IT system capabilities (e.g. higher billing above a certain number of orders or order cancellation rate).

The Commission also stresses that a very high level of vigilance is needed to ensure that sponsored access and fee structures do not bias the choice of trading methods. Finally, the Commission recommends prohibiting indications of interest when they are really firm orders disclosed only to selected members of a dark pool, thus transforming the trading venue into a “grey pool.” It emphasises that, under MiFID, an order must either be visible to all market participants or invisible to all of them.

For all these reasons, the Commission believes that ESMA should be given the power to intervene to set a frame for HFT, in particular by setting minimum tick sizes for markets.