

**Mr. Michel Barnier**  
**Commissioner for Internal Market and Services**  
**European Commission**  
**Rue de la Loi 200**  
**B-1049 Brussels**

Brussels, 4<sup>th</sup> April 2011

Dear Commissioner Barnier,

I am writing to you on behalf of the 46 member exchanges of FESE to highlight a major concern we have with regard to the MiFID Review. Europe's exchanges are concerned that **the current EU efforts to close the regulatory loopholes in the EU trading environment will not bear fruit without a significant re-orientation in the policy options under consideration.** We fear that a failure in this area – despite significant successes in others - would cast a shadow on the legacy of this Commission in making European markets safe again for all investors.

FESE members provide more than 9,000 companies from all over the world with access to European capital markets. They enable investment opportunities for European investors of all types. Through the transparent, systemically robust, well-monitored trading environments they operate, European exchanges perform a fundamental role in the European economy, providing a reliable price formation process for companies' shares, thereby enabling them to raise capital on a sound basis, with benefits for the wider economy in wealth and job creation.

Because of this responsibility, we support the speed and substance of your key reforms in the financial sector. We agree with you that the lessons from the financial crisis have to be implemented without losing momentum. Bold decisions are needed– such as the consideration of the introduction of pre-trade transparency for bond markets or the strengthening of equity transparency rules—even when some of these reforms might be unpopular among those benefiting from opaque markets. **'Business as usual' cannot be allowed to continue if we want to protect our investors and create a sound, resilient EU Single Market.**

From the start, we have supported the goals of MiFID – improving transparency and increasing competition. Our members face competition from a multitude of new trading venues active in Europe, which they welcome. However, our members are concerned that all these venues are operating in an environment that is turning increasingly less transparent, more fragmented and less regulated:

**Europe has essentially become a marketplace where some of the world's largest investment banks are running exchange-like platforms for their own private (wholesale and retail) clients, without providing these clients and the wider investor community with any of the protections of a MiFID-regulated trading environment.**

This has happened because regulatory flexibilities originally designed for very limited kinds of wholesale trading ('OTC') are being used for wide segments of the equity trading business. As an illustration, recent independent research shows that less than a quarter of all trades executed by brokers without trading venue rules are actually 'large' in the MiFID sense. Half of all such trades are retail investor size and smaller. Setting aside truly large and technical trades, a large portion of orders that should contribute to generating the true price of assets are being kept away from the public eye. These are not the kind of trades that should be subject to private negotiation regimes. These trades should be subjected to MiFID rules.

The above facts are not fundamentally contested by anyone: the only thing contested is what the MiFID Review should do about it.

In our view, **these broker platforms are exactly what MiFID was designed to regulate, and so they should be considered as a trading venue according to MiFID** – with the Review providing the necessary clarifications to ensure that all supervisors interpret MiFID in the same way. We propose to go to the root of the problem and to close the loophole. The current framework is perfectly suitable to capture all trading types in equities but needs to be implemented forcefully and consistently throughout Europe. The Review can and should reinforce clear rules by removing the legal ambiguities in the existing definitions that permit the abuse of MiFID flexibilities. This would be the simplest, surest and most efficient way of removing the loopholes. We must ensure that everyone follows all of the MiFID venue rules (and not a sub-set) when running trading venues ('same activity, same rules').

In contrast to the above view, certain parties believe that brokers should be allowed to run trading platforms without being subject to the same rules that govern the activity of other market operators. In our view, this fundamentally violates the functional approach of EU regulation in the financial sector. Specifically, there is a heated debate about the current plans under consideration to create a new trading venue type ('Organised Trading Facility'). The European Parliament soundly rejected this idea in its December 2010 Own-initiative Report on MiFID. Similarly, FESE members also fear that, despite the good intentions behind it, this proposal will not fix this problem, and will actually make it worse, because of the following reasons:

- 1) **A new category will create a significant scope for regulatory arbitrage, worsening the current situation.** Without clarity on what rules apply to what activity, everyone acting in self-interest would choose the lightest possible regulation. The existence of a separate (by definition less regulated) category would create major incentives for the currently regulated operators of venues (eg MTFs) to abandon their licenses and to become an OTF. Equity trading platforms would be significantly less well regulated in the EU as a whole.
- 2) **Transparency is the core of efficient and sound financial markets.** There are currently no transparency requirements in the OTF proposals. At best, it would provide regulators with some basic figures about brokers' private exchanges. But it would never serve the purpose of imposing the necessary public safeguards on their trading.
- 3) **The real issue is regulating appropriately dark trading and OTC markets.** The MiFID Review should clearly define and enforce the circumstances under which opacity is acceptable. Except for well-defined cases meriting OTC flexibilities, the entire core MiFID protections (transparency, fair access, equal treatment, predictable execution, and market surveillance) should apply to equity trading. OTC should no longer be a default category into which it is easy to opt.

In conclusion, **Europe is in danger of turning into a network of private markets.** The key question to be resolved in the MiFID Review is how to ensure that all share trading happens with the rules designed to protect the EU markets. Getting this question right determines everything else. If the rules do not apply to the right activities, the result will be a badly regulated marketplace, no matter how good the rules might be. **Instead of closing the loophole that has allowed large parts of equity trading to go unregulated, the current plans would create incentives for all to pursue lighter treatment, starting an irreversible race to the bottom.** Investors investing in Europe and companies raising capital here need to be reassured that when shares are traded in Europe, this trading will always be properly regulated and supervised. We ask that the MiFID Review meet this vital challenge.



Hans-Ole Jochumsen  
FESE President



Judith Hardt  
FESE Secretary General