

# The insider

Judith Hardt, secretary-general of the Federation of European Securities Exchanges, understands Europe's policy-making systems better than most. But can she persuade MEPs to see the exchanges' point of view as MiFID II takes shape?

Chris Hall

If you want to know where power lies in Europe, ask a lobbyist. As secretary-general of the Federation of European Securities Exchanges (FESE), Judith Hardt is charged with ensuring that Europe's power brokers understand the views of her constituents, operators of the continent's regulated markets across multiple asset classes. So how does Hardt split her lobbying efforts between the three main power centres of the European Union? Perhaps surprisingly, she spends significantly more time with the members of the European Parliament (MEPs) than with the bureaucrats of the European Commission or with the ministers of member states that sit in the Council of the European Union.

Given her track record at FESE and previously at

the European Mortgage Federation (see outbox), other parties interested in influencing key pieces of European legislation impacting the finance sector, should take note of Hardt's approach to time management.

## Balance of power

Some professional influencers have been slow to recognise this shift in the balance of power in Brussels, according to Hardt. Twenty years ago, Parliament was all but irrelevant, she says, but gradual changes in how European legislation is framed – notably those contained in the Lisbon treaty of 2007 – have now placed MEPs in a much more central role. Moreover, as Hardt observes, this generation of MEPs was elected after the financial crisis and comes with a much stronger mandate from their national

electorates to “stand up for the rights” of EU taxpayers.

Drafted by the Commission, subject to amendment and review by the Parliament and the Council, there is today considerably less scope for interpretation of European laws at the national level, with the decline in scrutiny by national parliaments offset by increased influence by MEPs. In the case of financial services directives such as the current review of the Markets in Financial Instruments Directive (MiFID) and its accompanying regulation, separate versions of new laws are approved in parallel by the Parliament and the Council, then reconciled by a ‘trilogue’ process overseen by the Commission. After this, the European Securities and Markets Authority drafts the Level 2 rules that underpin



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Photos: Muriel Vandersmissen



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the legislation, and monitors their implementation by national regulators, a process that binds market practice together across European markets more closely than under the original MiFID.

Hardt welcomes the close involvement of democratically elected politicians in financial regulation, but suggests that many are still adjusting to the new status quo.

“The new European Parliament has become a stronger voice which argues in favour of EU integration and the protection of the interests of European consumers, investors and taxpayers. For instance, the European Parliament has pushed successfully for a stronger and integrated financial supervisory architecture,” she says. This more assertive stance by Parliament has become a source of tension, Hardt admits, particularly when the integrationist tendencies of the Parliament conflict with the desire of member states in the Council to protect their own supervisory turf. “It has become more difficult to find common agreements across the different institutions in triologies,” she notes.

Securing the attention of MEPs is a challenge, in part because of the sheer range

### MiFID Review timeline

- Oct 2011 – EC unveils initial MiFID II draft.
- Nov 2011 – Rapporteur Markus Ferber MEP issues a questionnaire based on the EC proposals.
- Dec 2011 – ECON committee holds first MiFID II meeting.
- February 2012 – ECON meets again to review 4,000 pages of questionnaire responses.
- March 2012 – Ferber tables his own amendments to MiFID II.
- May 2012 – Other MEPs table their MiFID II amendments.
- May 2012 – Council of the European Union begins its review of MiFID.
- July 2012 – ECON meets to finalise amendments.
- 2014 – Planned adoption of MiFID II.

and complexity of regulatory proposals affecting the finance sector. And while the typical Commission official is both expert and static, MEPs are generalists and mobile, splitting their time between multiple topics and locations. Tactics need to adjust accordingly. The lobbyist succeeds by “boiling down the issues to the most relevant problems and by illustrating how the proposal could affect the real economy and, ultimately, the voters back home,” says Hardt. “You need to build credibility with MEPs and to give them the information that they need when they need it.”

Another consideration is that the desire of MEPs to fight for their constituents’ rights is often accompanied

by the tactics of the underdog, which can lend an element of unpredictability. Hardt notes the Parliament can adopt extreme positions as their starting point in anticipation of tough negotiations with member states in the Council.

### Dawn of the dark

Some brokers and dark pool operators have accused FESE of similar methods. At an early stage in the MiFID review process, FESE estimated that as much as 40% of European equity trading was being conducted on an over-the-counter basis. The sense that MiFID had, in introducing trading venue competition, unleashed new forces in Europe’s equity markets, was amplified when some branches of the media – and not a few politicians – mistakenly reported that four in ten trades were being conducted on private, elite platforms called dark pools.

While some considered the figure alarmist, it was very hard to disprove. It served FESE in that it sparked a debate about the nature of fragmentation in the post-MiFID European equity markets but it also served the industry in that it invigorated efforts to bring greater clarity to the trading

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decisions being made by market participants across the continent. According to data from Thomson Reuters and Markit, dark trading on MiFID-regulated multilateral trading facilities (MTFs) now represents around 4% of European equity trading volumes with leading broker crossing networks (BCNs) – which mainly fall outside the scope of the directive – accounting for a similar amount. The total amount of OTC trading in European equities still remains hard to gauge.

The Federation puts the share of European equity trading conducted on transparent regulated markets (i.e. those operated by its members, plus the London Stock Exchange Group) at 47%, less than 10 percentage points more than the total traded over the counter (37.8%).

No one really disputes that MiFID's equity trading venue categorisation framework of regulated markets and multilateral trading facilities (MTFs) and systematic internalisers (SIs) has failed to capture much of the trading activity that brokers conduct on behalf of clients off exchange. The bone of contention is, what to do about it? The Commission's approach was to regard



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BCNs as a subset of a new category – organised trading facility (OTF) – initially designed to describe and regulate the new electronic platforms for trading centrally cleared OTC derivatives, similar to the swap execution facilities established by the Dodd-Frank act in the US.

Markus Ferber, the rapporteur for MiFID, i.e. the MEP responsible for guiding the legislation through its parliamentary stages, questioned the need of the new category, and in March the Parliament's Economic

and Monetary Affairs Committee tabled an amendment that effectively pushes all OTC activity into SIs. But MEPs on the committee reflect a spectrum of views. “Investors use BCNs because they want choice on order flow,” acknowledged Kay Swinburne, a UK MEP, speaking to The TRADE in May.

### Greater good

For FESE and Hardt, OTFs are a “fudge” that compromise MiFID's distinction between bilateral and

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multilateral venues, while current levels of OTC pose a threat to effective price formation, the core task of any market. Hardt accepts that trading in institutional size should be protected and suggests that regulators define OTC trading as this would bring greater clarity than the current system of pre-trade price transparency waivers that allows retail-sized orders to be executed in the dark. But she insists that the benefits for which buy-side traders prize BCNs – e.g. discretionary access and ability to select trading counterparties to limit signalling risk – must be sacrificed to the greater good.

“All operators of multi-lateral platforms must comply with non-discretionary execution when executing the orders entered into their systems so as to provide a predictable outcome and fairness to all investors,” she says. “It is very important to protect investors from arbitrary prices, to ensure that all investors have access to all liquidity pools directly or indirectly and to ensure proper price formation.”

For many, arguments over the wording of MiFID are part of a wider battle over the nature of Europe’s financial markets. “Do we

### Hardt to avoid in Brussels!

- Member of ESMA’s Securities and Markets Stakeholder Group, the ECB’s Advisory Group on Target 2 Securities and the Commission’s expert group on market infrastructures
- Former chair, European Parliamentary Financial Services Forum
- Awarded ‘Lobbyist of the Year’ for role in adoption of European Code of Conduct on Clearing and Settlement
- Previously head of European Mortgage Federation

want to preserve an equity market where we have liquidity and transparency and price formation or a market that would be to a very large degree, less liquid with market makers deriving prices by other models?” asks Hardt. Though quick to rule out a path that would lead back to exchanges as monopolies, she suggests the tide has been turned by the global financial crisis, following a period in which achieving price discovery was a secondary regulatory goal to competition. “The G20 has recognised that there is a need to mandate both CCP clearing and trading on electronic platforms to make our markets safer. Regulators across the board have recognised that there is merit in forcing investors to participate in a public market model even if this is not always in their own short-term interest.”

Hardt recognises the

tensions that the debate is causing, between banks and exchanges, between and within European institutions, and between member states, notably the UK and the rest of Europe. “In this regard, the views of the UK and its supervisors are particularly relevant because, following the deregulation triggered by MiFID, a lot of trading is happening in the UK,” she says.

### Beyond equities

But MiFID II is not just about equities. Though inherent in the original directive, the MiFID review has taken on wider significance in the context of the global financial crisis. The extension of MiFID’s nostrums to other financial instruments was always intended, but the review explicitly became part of the European Commission’s response to the crisis. Hardt welcomes proposals for greater pre- and post-trade transparency for fixed income and derivative markets under MiFID II.

“Had such transparency been in place prior to the crisis, we would have avoided to a large extent the amplification and acceleration of the turmoil following the Lehman

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bankruptcy,” she argues.

Hardt expects the reforms to offer new business opportunities for exchanges but recognises that the differences between traditionally high-volume equities markets and other asset classes can require a combination of approaches, as exemplified already on a number of regulated markets across Europe. Nasdaq OMX Copenhagen already trades Danish covered bonds for example, while Spanish sovereign bonds are traded on Bolsas y Mercados Españoles. The LIFFE options market combines voice brokerage and electronic trading and the London Metal Exchange combines open outcry floor, voice brokerage and an electronic order book.

“There are limits to transparency, especially for instruments where the liquidity is very thin,” says Hardt. “There is a need to find the right calibration for bond markets in particular.”

### Back to their roots

As part of the financial sector, Hardt admits that exchanges are under almost as much suspicion and scrutiny as banks and brokerages, and acknowledges that



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bourses too have allowed themselves to be swept along by an ethos that has seen “a much stronger pre-occupation with trading and technology, with less time and energy spent on the listing side”.

The fight for market share with MTFs has taken its toll, with many exchanges desperate to maintain their grip on trading in their blue-chip names.

Hardt notes that less than 15% of listed companies

have market capitalisation above €1 billion, but these are the main revenue drivers for equity exchanges, accounting for over 93% of market capitalisation, 85% of trades and over 95% of turnover. “MiFID allows MTFs to cherry pick these shares,” says Hardt. “For exchanges that are not diversified, losing the blue-chips is very painful.” Attempts by some European exchanges to compensate by raising listing fees have had a negative impact on local financial markets. Hardt nevertheless sees a major role for Europe’s domestic exchanges in supporting the financial ecosystem of countries hit hard by ongoing euro-zone government debt crises. She welcomes in principle the fact the policy makers have recognised the part exchanges can play, though is cool on Commission proposals for lighter listing rules for small- and medium-sized enterprises on grounds that they could cause investors to step back from smaller issuers who will be perceived as more risky.

“For us as a community, we need to go back to our roots. There is need to look after all issuers and to grow our companies for tomorrow,” says Hardt. ■