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## **REPORT**

on regulation of trading in financial instruments – 'dark pools' etc. (2010/2075(INI))

Committee on Economic and Monetary Affairs

Rapporteur: Kay Swinburne

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## PR\_INI

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#### MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

# on Regulation of trading in financial instruments – 'dark pools' etc. (2010/2075(INI))

The European Parliament,

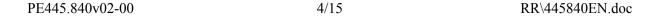
- having regard to the Directive 2004/39/EC on markets in financial instruments (MiFID)<sup>1</sup>,
- having regard to Directive 2003/6/EC on insider dealing and market manipulation (market abuse)<sup>2</sup>,
- having regard to the G20 declarations of 2 April 2009 in London, of 25 September 2009 in Pittsburgh and of 26 and 27 June 2010 in Toronto,
- having regard to the CESR technical advice to the European Commission in the context of the MiFID Review – Equity Markets (Ref.: CESR/10-394),
- having regard to the CESR technical advice to the European Commission in the context of the MiFID review –Transaction Reporting (Ref.: CESR/10-292),
- having regard to the CESR technical advice to the European Commission in the context of the MiFID review – Investor Protection and Intermediaries (Ref.: CESR/10-417),
- having regard to the CESR call for evidence on micro-structural issues of the European equity markets (Ref.: CESR/10-142),
- having regard to the Report to the French Minister of Economy, Industry and Employment on the revision of the MiFID from February 2010,
- having regard to the IOSCO consultation report on 'Policies on direct electronic access' of February 2009,
- having regard to the CPSS and IOSCO recommendations for central counterparties of November 2004,
- having regard to the concept release of the Securities and Exchanges Commission on Equity Market Structure (No. 34-61358; File No. S7-02-10),
- having regard to the CESR technical advice to the European Commission in the context of the MiFID review and responses to the European Commission request for additional information (Ref: CESR/10-802, Ref: CESR/10-799, Ref: CESR/10-808, Ref: CESR/10-859, Ref: CESR/10-860),

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<sup>&</sup>lt;sup>1</sup> OJ L 145, 30.4.2004, p.1.

<sup>&</sup>lt;sup>2</sup> OJ L 96, 12.4.2003, p.16.

- having regard to Rule 48 of its Rules of Procedure,
- having regard to the report of the Committee on Economic and Monetary Affairs (A7-0326/2010),
- A. whereas the G20 set out that no financial institution, no financial product and no territory should remain outside the scope of intelligent regulation and effective supervision and agreed that all standardised OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate,
- B. whereas the lack of transparency and the accompanying opacity of risk patterns in the financial system was an aggravating factor in the financial crisis, facilitating the spread of general distrust and thereby contributing to drastically reduced liquidity flows,
- C. whereas consumer protection, transparency, particularly as regards the price formation process, efficient and liquid markets and competition on a level playing field were the key objectives when MiFID came into force, but have not yet been achieved and must therefore remain a priority; whereas, following the financial crisis, limiting systemic risk must also be prioritised in the review of MiFID,
- D. whereas changes to MiFID should always take into account its importance in governing capital flows into the real economy and therefore the potential impact on jobs, investments and pensions,
- E. whereas up to 40% of trading volume is still carried out OTC; whereas market participants should be encouraged to transact more on organised trading venues,
- F. whereas the inclusion in the MIFID of waivers to pre-trade transparency requirements and the establishment of MTF and dark pools were intended to facilitate a shift towards more regulated and transparent venues,
- G. whereas MiFID defines OTC trading as having the characteristics of being ad hoc and irregular, carried out with wholesale counterparties, and being part of a business relationship which is itself characterised by dealings above standard market size and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser,
- H. whereas despite the provision in MiFID of waivers to allow dark trading on organised markets, the establishment of MTFs and Systematic Internalisers (SIs) and the definition of OTC trades as being irregular and ad hoc, OTC trades not carried out on an SI basis continue to account for a high proportion of equities trading at 38% of all reported trades according to CESR/10-394, and whereas this proportion has not declined since the implementation of MiFID; whereas tighter and more effective enforcement of MiFID rules and waivers should therefore be ensured.
- I. whereas market fragmentation in equities trading has had an undesired impact upon liquidity and market efficiency owing to a decrease in transparency based on an increase in dark pools and crossing networks, the effect of an increased number of venues both in the on-exchange and off-exchange space, and increasingly technology-driven trading, and

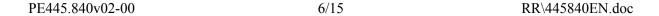




- has decreased average transaction size from EUR 22 266 in 2006 to EUR 9 923 in 2009, increasing the total cost of transactions for some users,
- J. whereas the decrease in transaction size has led to a reduction in the capacity of market participants to instantly execute large orders on a particular market and the desire to prevent market impact for large orders has encouraged the expansion of dark-pool trading; whereas less than 10% of all trading in EEA equities shares on organised markets use the MiFID pre-trade transparency waivers (CESR/10-394), whereas these MiFID waivers allows for dark-pool trading as a more transparent and better regulated alternative to dark trading in the OTC space but whereas the absence of sufficient regulation for OTC transactions, including Broker Crossing Networks, provides a competitive advantage to the OTC space and encourages an increase in trading in the dark, undermining market transparency in general; whereas in total around half of trades are currently not covered by pre-trade transparency requirements, but half of OTC transactions are below market size and therefore do not require protection against market impact,
- K. whereas, to ensure a level playing field, broker crossing networks (BCNs) should be subject to an in-depth investigation of their business models, to ensure that where they provide services which mean they are essentially functioning as regulated markets (RMs), multilateral trading facilities (MTFs) or as Systematic Internalisers they are regulated as such,
- L. whereas the benefits of competition in terms of more competitive and innovative trading infrastructure has not been proved, as the total transaction costs have not been reduced, and opacity has increased, while at the same time it is clear that quality and integrity for all participants in a more fragmented market are not properly guaranteed,
- M. whereas given that HFT claims to provide liquidity to financial markets it would be useful to determine whether there are risks associated with electronic order systems and the significant share of trading volumes attributable to HFT strategies, estimated at 70 % in the US, particularly in view of the conclusions of the Securities and Exchange Commission concerning the US 'flash crash' on 6 May 2010 when HFT liquidity providers exited the market,
- N. whereas HFT strategies are a relatively new phenomenon in Europe and are now estimated to make up 35% of the market by volume,
- O. whereas greater transparency via pre- and post-trade reporting of trading activity across all asset classes should be established in order to provide improved early warning of the build-up and scale of developing problems, as well as to improve the efficiency of the price formation process and foster trust between market actors,
- P. whereas the G20 decisions of 24 and 25 September 2009 in Pittsburgh stated that 'all standardised OTC derivative contracts should be traded on exchanges *or* electronic trading platforms',
- Q. whereas divergence of implementation between Member States has led to an incomplete application of the MiFID framework,

#### **MIFID Trading Venues**

- 1. Recognises that market infrastructures have been resilient throughout the crisis and calls upon the Commission to nonetheless strengthen market infrastructures across all trading venues and clearing systems to enable them to cope with future risk through enhanced transparency, improved resilience and regulatory oversight of all aggregated trades;
- 2. Welcomes the Commission's proposal for a Regulation on OTC derivatives, central counterparties and trade repositories as a necessary prerequisite for increasing transparency and safety within the markets in financial instruments and regards it as the first step towards shifting the significant proportions of OTC trade to trade venues subject to MIFID regulation;
- 3. Suggests that, in the interests of equitable treatment, MTFs should be subject to the same level of supervision as, and therefore regulated in a comparable way to, competition between MTFs and that RMs should happen on a level playing field, while noting the important role of MTFs for market entry;
- 4. Asks for ESMA to conduct an investigation into the functioning and purpose of the Systematic Internaliser (SI) regime and the bringing forward of improvements to the way in which this category is regulated in order to ensure that this regime is used for execution of orders on a bilateral basis with the financial counterparty;
- 5. Demands that investment firms which provide a portfolio management service and act in a portfolio management capacity must be provided with best execution by the investment firms with whom they place orders, notwithstanding the fact that the portfolio manager is categorised by MiFID as an eligible counterparty;
- 6. Calls for ESMA to conduct a review of whether order-by-order best execution needs to be better served by regulation in relation to the availability of data, both post-trade and in relation to execution quality, and in relation to market technology, such as order routers and venue connections;
- 7. Calls for thorough enforcement of the provisions in MIFID in order to ensure that BCNs that are carrying out activities equivalent to an RM, MTF or SI are regulated as such, and, in order to facilitate this enforcement, insists that all BCNs should be required to submit to the competent authorities all necessary information including:
  - a) a description of the system, ownership and clients,
  - b) details on access to the system,
  - c) orders matched in the system,
  - d) trading methodologies and broker discretion,
  - e) arrangements for immediate post-trade reporting;
- 8. Asks for an investigation into OTC trading of equities and calls for improvements to the way in which OTC trading is regulated with a view to ensuring that the use of RMs and MTFs in the execution of orders on a multilateral basis and of SIs in the execution of orders on a bilateral basis increases, and that the proportion of equities trading carried out OTC declines substantially;





9. Asks for an investigation by the Commission into the effects of setting a minimum order size for all dark transactions, and whether it could be rigorously enforced so as to maintain adequate flow of trade through the lit venues in the interests of price discovery;

#### **Pre-Trade Transparency Waivers**

- 10. Calls on the Commission to conduct a review of the existing MiFID pre-trade transparency waivers to:
  - (a) consider whether a suitable minimum threshold should be introduced for the Reference Price waiver to encourage the use of lit venues,
  - (b) consider broadening the Reference Price waiver to include trades that fall within the current spread in the reference market
  - (c) introduce a maximum volume of transactions that could use pre-trade transparency waivers in order to guarantee efficient price discovery,
  - (d) give ESMA the possibility of adapting and restricting pre-trade waivers as necessary, taking into account the impact of dark trading on the efficiency of markets;
- 11. Asks for a uniform application of pre-trade waivers across Member States to limit implementing differences that can lead to uncertainty, regulatory arbitrage and an uneven playing field; suggests that technical standards *defined by ESMA* could be an appropriate way of achieving this, in keeping with the concept of a single rule book for financial services;

#### **Consolidated Tape**

- 12. Welcomes the recent announcement by market participants that they will be unbundling their pre- and post-trade data, and calls for further efforts towards common data standards and better availability of data;
- 13. Calls on the Commission to establish a working group to overcome the difficulties preventing the consolidation of market data in Europe and particularly the poor quality of reporting data across all transactions;
- 14. Calls upon ESMA to draw up common reporting standards and formats for the reporting of all post-trade data, both on organised trading venues and OTC, to aid in data consolidation;
- 15. Asks that all reporting venues be required to unbundle post-trade data from pre-trade data so information can be made available to all market participants at a commercially reasonable and comparable cost; further, asks the Commission to consider the introduction of Approved Publication Arrangements (APAs) in order to introduce quality standards for trade publication and reduce the number of venues that trades can be reported to, as well as the use of internet pages, which are an obstacle to consolidation;
- 16. Calls for a reduction in the time limit for deferred publication so transactions are reported to the regulators within twenty-four hours of taking place; takes the view, with regard to publication of transactions, that in ordinary circumstances delays of more than one minute should be considered unacceptable;

17. Deems that it is essential to analyse the breakdown and business models of OTC trading, and therefore calls for the introduction of specific flags in pre- and post-trade transparency for OTC trades with a view to further understanding the characteristics of such OTC trades and assessing which types of transaction can legitimately be done OTC owing to their specific characteristics;

#### Micro-structural issues

- 18. Insists that post-'flash crash', all trading platforms must be able to demonstrate to national supervisors that their technology and surveillance systems are able to withstand the kind of barrage of orders experienced on 6 May so as to ensure that they could successfully deal with the activity associated with HFT and algorithmic trading in extreme circumstances and show that they are able to re-create their order books by end of day so that causes of unusual market activity can be pinpointed and any suspected market abuse identified:
- 19. Calls on ESMA to conduct an examination of the costs and benefits of algorithmic and high-frequency trading (HFT) on markets and its impact upon other market users, particularly institutional investors, to determine whether the significant market flow generated automatically is providing real liquidity to the market and what effect this has on overall price discovery, as well as the potential for abuses by manipulation of the market leading to an uneven playing field between market participants, and its impact on overall market stability;
- 20. Calls for the practice of 'layering' or 'quote stuffing' to be explicitly defined as market abuse:
- 21. Calls for an investigation into whether to regulate firms that pursue HFT strategies in order to ensure that they have robust systems and controls with ongoing regulatory reviews of the algorithms they use, the capacity for intra-day monitoring and interrogation about real-time outstanding positions and leverage, and the ability to demonstrate that they have strong management procedures in place for abnormal events;
- 22. Calls for an examination of HFT's challenges in terms of market monitoring; recognises the need for regulators to have the appropriate means to detect and monitor potential abusive behaviour; with this in mind, calls for the reporting to the competent authorities of all orders received by regulated markets and MTFs, as well as of trades done on these platforms;
- 23. Calls for all trading venues allowing co-location of servers, whether directly or through third-party data providers, to ensure that equal access for all co-located clients is maintained and where possible under the same infrastructure latency arrangements in order to comply with non-discriminatory practice outlined in MiFID;
- 24. Calls upon regulators to monitor and regulate the provision of sponsored access and upon the Commission to consider additional measures including:
  - (a) expressly prohibiting unfiltered sponsored access to companies, regardless of

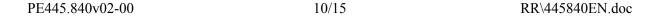


- whether they belong to the same corporate group as the sponsor,
- b) requiring broker-dealers and investment firms to establish, document and maintain a system of risk-management controls, pre- and post-trade, and supervisory procedures to manage the financial, regulatory and other risks related to its market access;
- 25. Calls, notwithstanding the necessary application of safeguards, for ESMA to further investigate whether sponsored access crosses the threshold of non-discriminatory access;
- 26. Calls on the Commission to adopt the principles being developed by the Technical Committee of IOSCO on direct electronic access, including sponsored access, which will cover the criteria for selecting clients who can be given sponsored access and the contractual relationship between the platform, the member and the client and will outline their respective responsibilities regarding their use with suitable controls and filters;
- 27. Takes the view that, in order to comply with the principle that all investors should be treated equally, the practice of flash orders should be explicitly ruled out;
- 28. Calls for an investigation by ESMA into fee structures to ensure that execution fees, ancillary fees, investment firms' commission fees, and any other related incentives are transparent, non-discriminatory and consistent with reliable price formation and are designed and implemented so as not to encourage trading for improper purposes and to assess whether a minimal charge should be paid by users posting orders, whether these orders are executed or not, as these orders need to be processed by the market infrastructure;
- 29. Suggests ESMA conduct a study of the maker/taker fee model to determine whether any recipient of the more favourable 'maker' fee structure should also be subject to formal market maker obligations and supervision;
- 30. Asks for ESMA supervision and definition by implementing acts of robust volatility interrupts and circuit breakers which operate simultaneously across all EU trading venues in order to prevent a US-style 'flash crash' event;

#### Scope

- 31. Requests that no unregulated market participant be able to gain direct or unfiltered sponsored access to formal trading venues and that significant market participants trading on their own account be required to register with the regulator and allow their trading activities to be subject to an appropriate level of supervision and scrutiny for stability purposes;
- 32. Calls for proprietary trading activities conducted via algorithmic trading strategies by unregulated entities to be transacted solely through a regulated financial counterparty;
- 33. Calls for the extension of the scope of the MiFID transparency regime to all 'equity-like' instruments including depository receipts (DRs), exchange traded funds (ETFs), exchange traded commodities (EDCs) and certificates;

- 34. Asks the Commission and ESMA to consider introducing a transparency requirement, preand post-trade, on all non-equity financial instruments, including government and corporate bond markets and CCP eligible derivatives, to be applied in a manner that differentiates across asset classes where appropriate and at the same time combines with measures that bring about further standardisation of OTC derivative products in order to enable greater application of transparency;
- 35. Takes the view, taking into account the issues that have been experienced in relation to data quality and consolidation of post-trade data for European equities, that the Commission should ensure that post-trade data for non-equity products are provided in a form which is readily consolidated;
- 36. Supports the Commission's intention to apply a wider range of MiFID provisions to derivative instruments, as the trading of such products moves increasingly to organised trading venues and is subject to increasing standardisation and central clearing requirements;
- 37. Calls for a proposal from the Commission to ensure that all OTC derivative contracts that can be standardised are traded on exchanges or electronic trading platforms, where appropriate, in order to ensure that the price of such contracts is formed in a transparent, fair and efficient manner, free from conflict of interest;
- 38. Requests a review of the IOSCO standards for clearing houses, securities settlement systems and systemically important payment systems with a view to improve further market transparency;
- 39. Believes that it is necessary for regulators across the different physical and financial commodities markets to have access to the same data in order to identify trends and cross linkages, and calls on the Commission to coordinate efforts both within the EU and globally;
- 40. Instructs its President to forward this resolution to the Council and the Commission and to the European Central Bank.



#### **EXPLANATORY STATEMENT**

The European capital markets have undergone a period of unprecedented change, both due to a changed regulatory environment, post MiFID implementation, and due to the technological advancements over the same period. The introduction of MiFID has also overlapped with a period of externally imposed volatility due to the financial crisis. As a result, even if reliable market data were available across all trading venues, the quantitative data does not solely reflect the regulatory impact.

In the last five years, the monopoly position of primary exchanges has been transformed. Less than 60% of trading volume in the UK FTSE 100 takes place on the LSE, whereas 30% of the CAC40 now takes place outside Euronext in Paris and 25% of the DAX30 trading takes place outside the Deutsche Bourse in Frankfurt. It seems that across all players there is recognition that the abolition of the single primary venue for equities trading has secured greater competition between trading platforms.

This key objective of MiFID, to promote competition between trading venues for execution services, has led to increased investor choice, lowered transaction costs and has helped increase the efficiency of the price formation process. There are now 136 MTFs operating in the EU, as well as the primary exchanges which collectively make up the organised trading venues. These organised venues account for some 60% of the trading volume with the remainder being carried out by broker-dealers, collectively termed OTC. Bilateral trades, where the client gives the broker an order and he finds a match, have migrated from mainly verbal orders to predominantly electronic orders. Although by definition there is no pre-trade transparency for OTC trades they are still required under MiFID rules to be reported.

Market fragmentation has however led to poor post-trade transparency as a result of spreading trading over various venues and in particular on the quality of the post-trade data. A more effective regulatory framework for consolidated post-trade information is required which encompasses new technical codes in the settlement process to better reflect an environment where traders can execute on multiple venues. Regulators need to ensure that they can, at any time, recreate the order book in order to understand the market dynamics and participants involvement. Regulatory intervention also seems necessary to remove the outstanding barriers to the consolidation of post-trade data in order to establish a privately run European Consolidated Tape system.

Data costs in the US are significantly lower than in the EU and can be as low as \$50 dollars per month for all platforms while running to \$500 in the EU. This is primarily due to the bundling of pre and post trade data by the trading venues, hence the need to unbundle these data sources and thereby lower costs significantly. Inconsistent trade data quality and lack of common data reporting formats have further compounded the problems and can be resolved by drawing up common reporting standards and formats for the reporting of post trade data.

MiFID also detailed a permissible delay in post-trade reporting and, given the increased use of technology, it seems appropriate for price formation purposes that this limit be reduced so no

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transaction can be reported later than 24 hours after it took place and, with regards to most electronic transactions, delays of more than 1 minute should be considered unacceptable.

As well as the crisis, many other changes to the market place have also occurred since the introduction of MiFID, such as the advent of new technology and the now widespread use of electronic algorithmic trading, including HFT. In this new technological era and in recognition of the increased requirement for transparency, it is interesting to note that the volume of trades conducted OTC has not diminished as a percentage of overall trading volume since the increased number of venues has appeared. However, the market has adjusted to the use of dark pools for trading large orders (BCNs) and the use of MiFID exemptions for such actions when they are conducted through organised trading venues (dark transactions).

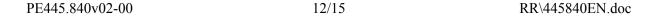
Approximately 10% of all trading in EEA equities shares on organised markets use the MiFID pre-trade transparency waivers and can be considered to be trading 'in the dark'. A balance however must be struck between the need for pre trade transparency to aid price formation and the justified situations where waivers have been granted to prevent undue market movement and aid the functioning of the market. Given that the average trade size has reduced from &22,266 in 2006 to &9,923 in 2009 and only 0.9% of trading is now conducted under the 'Reference Price' waiver there is grounds for a review of the different waivers. Care also needs to be taken to ensure that there is a more uniform application of the pre-trade waivers across Member States to limit implementing differences; technical standards could be an appropriate way of achieving this.

Executing OTC trades through broker-dealer crossing networks existed pre-MiFID but have now predominantly become electronic platforms for clients. BCNs are accepted as a valuable addition to the venues for buy-side orders in particular, and so should be recognised as a category within MiFID and be subject to regulatory oversight in order to monitor their activities.

CESR is currently conducting a data capture exercise in order to correctly assess the volume of trades being conducted in the dark and whether there is a limit as to what volume of the market, trading without pre-trade price disclosure, actually begins to impact the process of price formation itself. The US market for regulating diverse trading platforms is more advanced than in the EU and we need to investigate whether lessons can be learnt from the US on post trade transparency for dark pools, especially as currently the UK FSA estimates less than 1% of equity trading is conducted in the dark by OTC contracts, whereas in the US, dark pools account for closer to 10% of trading volumes.

Since MiFID, market infrastructure providers have increasingly become technology platforms heavily dependent on IT systems, competing to provide the most efficient, rapid and resilient trading facilities. Regulatory changes aside, the impact of new technology and the advent of new market participants has led to faster trading speeds, the growth in HFT and an increase in direct market access by clients of trading platform members and therefore to faster and more dynamic markets.

One of the reasons for the steady decline in the average trade size is that the new market participants place a premium on immediate execution of orders and not on displaying large orders. Any well functioning market requires firms willing to provide liquidity and make



public prices. Traditionally, specialists and market makers have carried out this function by quoting 2 way prices and generating revenue from the spread. As the market has evolved, the way in which the provision of liquidity is implemented has changed. In particular, with the advent of technology, algorithmic trading firms are now providing liquidity in the markets by posting 2 sided orders onto electronic order books and making a public price. Market makers typically do not hold investments for any length of time and therefore HFT strategies have evolved to capitalise on this function. It would seem appropriate that further analysis be done on the obligations and responsibilities that may be required of these informal market makers. If they are benefiting from a market maker pricing structure they should be obligated to provide a market price when required.

HFT is not a trading strategy in itself but can be applied to a variety of trading strategies which all have high portfolio turnover in common; many can process up to 33,000 trades per second, with sub microsecond roundtrip times for trading. They all have a requirement for speed and are therefore latency sensitive, requiring high capacity market data feeds and trade matching and quoting engines. They typically fall into two categories: electronic market making and statistical arbitrage. It is estimated that the volume of trading conducted by HFT traders is in excess of 35% and rising. This is compared to 70% of volume transacted in the US markets where it is less expensive to operate a HFT strategy. It is expected that the costs in the EU of clearing and settlement are a barrier to further expansion and so any reduction in costs is likely to have an additional effect on the market dynamics.

Little data is available for the impact these HFT strategies are having on the market and in particular as to whether the aggregate impact of technology could impact the resilience of the market itself. It would seem that HFT has increased liquidity and has tightened the spreads for investors; however, further investigation needs to be carried out to ascertain whether the quality of this liquidity is useful as often there is little volume at the touch and questions arise over the validity of the depth shown on order books. Analysis also needs to be carried out to determine whether price formation has also been impacted negatively by the increase in HFT.

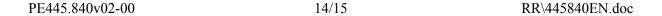
An observation has been made that many of these HFT players are operating as proprietary trading houses and are as such unregulated entities and therefore do not need to comply with MiFID rules. Given that there is a political mood for all significant market participants to be appropriately regulated, we suggest that this should apply to these firms, with the expansion of MiFID reporting rules to cover these entities being required as a matter of urgency. In particular there needs to be oversight of the systems and risk management of these firms as demonstrated by the US 'Flash Crash' on May 6th. Stress testing of platforms should be carried out to ensure that they are capable of dealing with a 'runaway algorithm'. Data capture of all market participants' activity needs to be prioritised to enable regulators to reconstruct order books, when necessary, to monitor the functioning of safe and efficient markets. Given the volume of transactions, it would seem that they may pose a systemic risk to the system which needs to be investigated pan-EU.

The use of co-location is becoming commonplace as placing client servers in close proximity with trading servers enables a trading firm to reduce the time taken to receive market data from the trading venue and to place orders into the market, thus reducing latency and enabling the firm to trade more frequently. This can also be achieved through third party proximity hosting. Although costly, the option to co-locate does not seem discriminatory at this time and

although all users should be treated equally in terms of distance from servers and pricing, a requirement to provide information on how prices are set seems necessary.

Sponsored access permits traders who are not market members to route their orders through a sponsors system such as a broker-dealer or general clearing member (GCM). EU platforms who currently allow sponsored access namely Chi-X, BATS Europe, LSE and NYSE Euronext, have, under the supervision of their regulator, introduced requirements for filters and controls that the member applies before the orders are transmitted. However, unfiltered (naked) sponsored access permits an intermediary's client to connect directly to the platform without any other form of supervision, this practice poses unacceptable risks to the market member and its clearing facility and to the orderly function of the market and should remain prohibited in the EU. It is suggested that proper pre-trade risk controls and post-trade monitoring systems must be established for sponsored access to platforms, especially for those using a 'clearing firm' where sponsored clients can operate in the markets using significant leverage, potentially causing a systemic risk to the system given the potentially large intraday positions across the many strategies.

In conclusion, it seems that a significant consequence of the competition brought about by the implementation of MiFID has been market fragmentation which has in itself encouraged the explosive growth of HFT strategies. Regulation needs to recognise that these technological advances are in need of suitable provisions in the legislation in order that they do not fall through regulatory gaps and inadvertently cause systemic risk to the overall functioning of the markets.



## **RESULT OF FINAL VOTE IN COMMITTEE**

Date adopted	9.11.2010
Result of final vote	+: 43 -: 0 0: 2
Members present for the final vote	Burkhard Balz, Godfrey Bloom, Sharon Bowles, Pascal Canfin, Nikolaos Chountis, George Sabin Cutaş, Leonardo Domenici, Derk Jan Eppink, Markus Ferber, José Manuel García-Margallo y Marfil, Jean- Paul Gauzès, Sven Giegold, Sylvie Goulard, Gunnar Hökmark, Othmar Karas, Jürgen Klute, Rodi Kratsa-Tsagaropoulou, Philippe Lamberts, Werner Langen, Astrid Lulling, Hans-Peter Martin, Arlene McCarthy, Sławomir Witold Nitras, Ivari Padar, Anni Podimata, Antolín Sánchez Presedo, Olle Schmidt, Edward Scicluna, Peter Skinner, Theodor Dumitru Stolojan, Ivo Strejček, Kay Swinburne, Marianne Thyssen, Ramon Tremosa i Balcells, Corien Wortmann-Kool
Substitute(s) present for the final vote	Thijs Berman, Herbert Dorfmann, Sari Essayah, Robert Goebbels, Sophia in 't Veld, Syed Kamall, Arturs Krišjānis Kariņš, Thomas Mann, Sirpa Pietikäinen, Bernhard Rapkay
Substitute(s) under Rule 187(2) present for the final vote	Knut Fleckenstein