

EPFSF Lunch Discussion

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MiFID Implementation – A practitioner’s view of MiFID

Speech from Phil Allison

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Introduction

- Good afternoon Madam Chair, other Members of the European Parliament, Ladies and Gentlemen. May I begin by thanking the EPFSF for inviting me to speak today and more broadly for your interest in engaging with practitioners following the initial implementation of MiFID, a key Directive which MEPs did so much to shape.
- It is my intention to describe some of the new technologies and market initiatives, in particular in the equity trading area, to provide some illustration of “MiFID in action”.
- My focus reflects in part my role as head of the client trading and execution business for European Equities at UBS, the number 1 in Global Cash Equities Trading (Financial News Buyside Trading poll 2008), as well as one of the leading Equities and Fixed Income traders in and across the European domestic markets.

To start with key elements of MiFID

- I would first note that it enables firms to provide services across the EU based on broadly the same rules. It is therefore an important step to a fully integrated financial services market in Europe.
- It thus allows new technologies and ways of trading to be used across European markets, increasing the incentive for innovators to launch new services and products and enabling greater economies of scale since its implementation is not limited to a single Member State.
- Furthermore, MiFID removes the concentration rule, which forced trading on to a limited number of national exchanges, and it imposes pre-trade transparency rules and post-trade reporting for OTC trades, thereby establishing an appropriate regulatory framework for off-exchange trades. It thus encourages the setting up of new trade reporting platforms as well as Multilateral Trading Facilities (MTFs).
- Taken together, these and other MiFID provisions should result in deeper, more efficient European capital markets, which better serve the needs of issuers and investors.

Turning to its overall impact to date

- We see the market responding to MiFID by spawning a range of initiatives and new technologies.
- This innovation has led to both lower fees and differing market structures to the benefit of investors and the market as a whole.

- Together they have led to more participants being able to interact more effectively than previously. This has reduced costs of trading; both explicit costs such as trading fees and implicit costs through greater liquidity. Reduced trading costs benefit all end investors whether directly investing in equities or through pooled vehicles such as mutual funds or pension schemes.
- Retail investors have far greater assurance that the price they receive will be fair across all jurisdictions with the implementation of best execution.
- Low cost, high speed new venues have brought new high volume trading participants, helping to minimise the market impact of large trades, increase liquidity and improve investment performance.
- Institution to institution large block trades can happen more effectively through so called “dark pools”, – a sinister term for undiscovered liquidity which helps to minimise information leakage that could be used to the detriment of investors. Taken together; these factors should combine to provide deeper, more efficient European capital markets to better serve the needs of issuers and investors.

Specific examples

I would now like to focus on the technology that has enabled specific initiatives to be developed, enhancing competition in equities especially.

- Central to innovative trading platforms being successful is “smart order routing”, allowing orders to be rapidly disseminated in an intelligent and dynamic way to the venues most likely to provide the best possible result.
- Many previous attempts to compete in European equity markets had been thwarted in part by the lack of such technology at most executing brokers
- In MiFID we saw a directive that made it clear competitive markets were the way forward for Europe, and at UBS built a smart order router to handle our clients’ orders.
- Smart routers are not commoditised, as we work commercially and in a tailored way to achieve high quality execution for our clients by understanding each venue, but at a basic level they are now widely available and widely used.
- The broad usage of smart order routing has allowed the success of new platforms such as Chi-X, the first order driven, pan-European central limit order book regulated as an MTF.
- Originally wholly owned by Instinet, Chi-X now has a large group of shareholders engaged in developing the platform further.
- The Chi-X model supports full anonymity of trading and a single pan European Central Clearing Counterparty, Fortis’ European Multilateral Clearing Facility
- Compared with the exchanges, the fee structure is substantially less, the functionality rich and the performance of the technology at least as good.
- Chi-X has steadily gained traction in European markets. Last week UBS executed, on behalf of both itself and its clients, over €2bn on Chi-X, and for example, Chi-X achieved market share of greater than 13% in 7 stocks within the Dutch AEX index for the same period.
- Interestingly, our institutional client base all over Europe and the world have encouraged our increased interaction with a platform both we, and they, see as providing new, different and efficient liquidity.

- The next large MTF to launch will be Turquoise in September this year. Initiated by nine banks including five from Europe, Turquoise is now an independent company.
- Turquoise hopes to be the first platform to effectively combine both open order book and a dark pool of liquidity, providing optimum transparency for the needs of market users.
- Many new venues have now been announced or launched. Encouragingly these have come from small innovative companies, consortia of banks and incumbent exchanges and often combinations thereof.
- For example in the last month we have heard of the development of Burgundy from a consortium of brokers in Sweden and Baikal brought by the London Stock Exchange and Lehman Brothers. Both are expected to launch in H1 2009.
- The landscape of European capital markets will doubtless continue to evolve rapidly over the coming months as we see more new entrants as well as further initiatives from exchanges. All of which should increase competition in the Exchange space and be conducive to improved service at reduced cost to both intermediaries and investors.
- It will take some time for brokers and clients to adapt to these and take optimal advantage of the new market structure. It does seem that there will be some diversification and then, most likely, a subsequent period of consolidation of trading venues. This is an inevitable part of making EU markets more competitive and responsive to user needs.

To conclude

- It is too early, in my opinion, to make an overall assessment of MiFID's success as the landscape continues to settle down.
- But there is clear evidence of progress, in large part from regulators providing a framework within which market participants can innovate around commercial solutions.
- In this regard, the success of Chi-X alone is sufficient, for me, to prove that there were blocks to competition, at least some of which are effectively addressed by MiFID
- As a result, we are already beginning to see more liquid markets and therefore implicitly lower costs of capital.
- The best execution framework has raised the bar for executing brokers but still allows firms to compete effectively to achieve the best possible result for their clients.
- Even in the very volatile markets of the past eight months, the transparency of the European equity markets has allowed them to operate effectively.
- Inevitably there are legitimate questions which will need to be reviewed, and some additional guidance may be necessary particularly around clearing and settlement.
- In summary, the progress since November 2007 has been substantial. Many felt that the industry would take a long time to move to change, but in fact innovation has been quite rapid.
- I, for one, am excited by the change we will see in the coming months as more venues appear for trading European equities, allowing more of our clients, both retail and institutional, to access these markets effectively.

- You along, with the other main EU institutions will have an important role in ensuring that the resulting gains from such competition are reaped to the benefit of the EU economy.
- We are keen to work with you to ensure that the EU regulatory framework based on MiFID continues to cater for market users worldwide and thus the well being of the EU economy.

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