

# Priorities for ensuring the stability and efficiency of cash markets



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## Main document

### 1. Widespread algorithmic (algo) trading and High Frequency Trading (HFT) stimulate market activity but pose market dislocation risks in exceptional circumstances as demonstrated by the May 6<sup>th</sup> 2010 flash crash

#### Background of algo trading and HFT:

In the context of increasingly fragmented trading venues and dispersed liquidity across lit and dark venues (ie with and without pre-trade prices), algorithms help market participants to search for the best options to execute their trades taking into account factors such as liquidity, price and timing. This may be done by using algorithms to slice up orders and distribute them across different venues both dark and lit. Algorithms (algos) are often developed by sell-side brokers and banks and made available to their clients to help fulfill best execution obligations and trading objectives.

HFT is an activity which makes use of algo trading and usually refers to the practice of computer-assisted trading with a high rate of portfolio turnover (at least daily and most often the turnover rate is a few minutes or hours). Different strategies are used, mostly capturing transitory opportunities which come and go in a fraction of a second<sup>1</sup>. HFT is primarily a proprietary activity with traders posting a large number of small in size orders with a view to earn a small return per order. It is believed that HFT now represents a very large segment of the market: around 40% of exchange volumes in Europe and up to 70% in the US.

The development of algo trading and HFT techniques was facilitated by IT innovation, the electronification of trading venues, increases in pre-trade transparency. This has driven a reduction in trading costs, and resulted in new services being offered by trading venues to encourage HFT volume onto their platforms, for example: tick-size reduction introduced by exchanges (ie by regulated markets and multilateral trading venues), co-location (ie location of servers as close as possible of execution venues) and direct market access<sup>2</sup>.

#### Main concerns relating to algo trading and HFT:

Proponents of HFT believe that it brings liquidity to the market, reduces bid-offer spreads and hence execution costs, helps the price formation process, ensures price consistency across multiple venues, increases market efficiency and reduces volatility in normal market conditions<sup>3</sup>. With regard to the recent emergence of HFT and its significant market share in many exchanges HFT traders often point out that short term trading has always existed and

<sup>1</sup> HFT strategies exploit pricing differentials between correlated securities and markets (statistical arbitrage), temporary supply and demand imbalances before equilibrium is restored, market making strategies which profit from rebates and the spreads between the bid and the offer...

<sup>2</sup> Direct market access (DMA) through which brokers allow clients access to their order routing infrastructure and which allows the buy-side to issue their electronic orders almost directly to the exchanges or Sponsored access enabling clients to connect directly to the market using the broker's trading identifier. These services help HFT to react faster but do not however give them front-running advantage since the information is already available on the exchange

<sup>3</sup> since most HFT strategies are arbitrage or correlation related and that HFT traders often accumulate and liquidate relatively small positions during the same day resulting in limited market impact in normal conditions

that HFT is simply a computerized implementation of normal trading strategies.

Opponents question the resilience and depth of the liquidity created by positions being passed back and forth between HFTs and are of the view that this type of liquidity would quickly dissipate in times of market stress when it is most needed. HFTs are also considered as driving smaller transactions and tick sizes and increasing the cost for institutional investors – particularly asset managers and pension funds - to execute large orders<sup>4</sup> on lit venues, resulting in the shift of some liquidity to dark venues.

The SEC / CFTC and the EU Commission analyzed the consequences of the May 6<sup>th</sup> 2010 flash crash, which ultimately resulted in many trades executed at erroneous prices on US cash markets and triggered massive disinvestment from individual investors for several weeks. They concluded that although automated trading is probably not a permanent threat and was not at the origin of the flash crash<sup>5</sup>, it creates risks to the orderly functioning of markets in certain circumstances – eg an automated execution of a large sell order when the execution algorithm does not take prices into account, as was the case for the May 6<sup>th</sup> flash crash. Similar risks were highlighted in the MiFID review consultation paper of the EU Commission and the Commission is investigating how to more appropriately regulate this market segment. One potential approach being investigated would be to introduce governance requirements for HFT firms and harmonise risk controls at the point of market access that would prevent disruptive behavior caused by algorithms over-reacting to market events

Concerns have also been raised by some commentators with HFT practicing “quote stuffing” or “spoofing” (ie strategies in which traders submit and then cancel thousands of orders in milliseconds) which can be used to try to trick other computers into making decisions that can be exploited for profit or attempt to move the market temporarily at their profit. Market players however point out that such practices are considered as market abuse and do not need to be addressed by rules specifically targeted at algo trading and HFT.

The competitive advantages in terms of speed provided by co-location, sophisticated algos and direct market access are also considered to be unfair by some players although HFT traders and trading venues point out that they can be accessed freely by all market participants ready to make the related financial and IT investments and that technological differentiation is not specific to financial markets.

Regulators at this stage are mainly concerned by the potential disruptions that algo trading and more specifically HFT can cause to the market in exceptional circumstances, both from a market efficiency and a market integrity perspective.

Issues raised by certain commentators regarding the possible longer term impacts of widespread and potentially dominant computer-based trading in major exchanges on market efficiency and investor confidence have not been specifically addressed at this stage.

### **Measures opened for discussion regarding algo trading and HFT:**

Some measures have been adopted or are being tested particularly in the US to limit the potential risks posed by automated trading. Among these, circuit breakers, which were in place on US futures markets but not on cash markets, seem to be the most consensual solution:

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<sup>4</sup> HFTs may detect for example so-called “iceberg orders” which are large orders sliced up in smaller ones and try to benefit from this knowledge in their strategies

<sup>5</sup> The flash crash was triggered by a mutual fund using algo trading and not by a HFT trader

- Circuit breakers are pauses to provide time for market participants to reassess their strategies in case of significant price change – the SEC conducted between September and December 2010 a pilot programme<sup>6</sup>. Circuit-breaker systems also exist in several EU trading venues and in India and have recently been implemented in Brazil for example.
- Anonymous naked or unfiltered sponsored access through which a broker allows trading firms to use their access to exchanges and trading platforms without any pre-trade controls or check by the broker has been banned by the SEC<sup>7</sup>.
- A “limit up-limit down” rule is also being considered which would prohibit trades a certain distance away from the market price in addition to circuit breakers<sup>8</sup>

Other measures are being discussed in the EU in the context of the MiFID review (Markets in Financial Instruments Directive)<sup>9</sup>:

- Possible authorisation of HFT participants and related organizational requirements (risk controls, notification and testing of algorithms employed, stress testing)
- Possible market making requirements for HFT players with obligations to provide bids and offers throughout the trading day in order to prevent dramatic price drops and spikes caused by participants withdrawing the market at the same time
- Possible requirement to ensure that orders should rest on an order book for a minimum period before being cancelled to curb “quote stuffing”
- Possible minimum tick sizes.

IOSCO and the FSB should give further guidance on these issues and proposals in the report on technological developments due for June 2011.

## **2. Short selling regulation which has a number of objectives including prevention of market abuse, settlement discipline and retarding price declines is being reviewed**

### **Main issues regarding short selling:**

Short selling (ie the sale of a security the seller does not own with the intention of buying it back at a later point in time) enables investors to profit from the decline in the price of a security. The benefits short selling brings to the market put forward by the industry are widely recognized by regulators. IOSCO for example points out in its consultation report (March 2009) that “short selling plays an important role in the market for a variety of reasons, such as providing more efficient price discovery [by allowing investors to act when they believe a security is overvalued<sup>10</sup>], mitigating market bubbles, increasing market liquidity, facilitating

<sup>6</sup> whereby trading across the US markets is paused for 5 mn in a given security if that security has experienced a 10% price change over the preceding 5 mn (applied to securities included in the S&P 500 index, the Russell 1000 index and certain ETFs)

<sup>7</sup> Firms are now required to put identifiers in place and brokers providing market access are asked to put in place risk management controls and supervisory procedures to help prevent erroneous orders, ensure compliance with regulatory requirements and enforce preset credit or capital thresholds

<sup>8</sup> requiring that prices be maintained within a certain band proposed at 8% on either side of the current price – ie best bid and offer - for all securities subject to circuit breakers

<sup>9</sup> Additional suggestions have also been made: that regulators should have the power to suspend HFT trading in exceptional circumstances, as is the case for short selling during severe market turbulence, have also been made; regulating latency speeds or volume incentives in tariffs. Banning market makers from using “stub” quotes (ie quotes at levels far away from current market prices used sometimes to fulfill a market making requirement) which is not specifically related to HFT was also approved in November 2010.

<sup>10</sup> Industry players also point out that the presence of short sellers in the market means that over-priced securities are likely to revert to a more appropriate value more quickly to the benefit of less sophisticated market participants who would otherwise over-pay

hedging and other risk management activities". These views are however not unanimously shared among market commentators, some of whom consider that short selling, which benefits from the fall of prices of securities, goes against the normal interest of investors with long positions and of issuers, (for whom markets were developed in the first place) possibly reducing prices and their liquidity potential<sup>11</sup>.

The concern generally expressed by regulators is that in extreme market conditions, short selling may contribute to disorderly markets causing excessive downward spirals in prices<sup>12</sup>. Short selling is indeed considered by many observers to have amplified artificially the fall of certain stocks in 2008 – particularly financial ones – and became a sensitive issue in the EU in the context of market volatility in euro denominated sovereign bonds. Short positions created through related CDS contracts have been accused of contributing to a decline of sovereign bond prices and increasing borrowing costs. Industry players argue however that there is no evidence to date that CDS trading has a material impact on prices and point out that there are legitimate reasons for the increased use of sovereign CDS both as a hedging tool where a party has significant exposure either to the sovereign itself or to a correlated portfolio and as a tool to aid liquidity in sovereign bond auctions.

Moreover insufficient transparency about short positions can prevent regulators from being able to monitor the implications for the market or the possible abusive use of short selling.

### **Existing short selling legislation:**

Short selling regulation exists in many countries but varies to a large extent (source IOSCO report). Some jurisdictions such as Hong Kong allow short selling of stocks which meet certain eligibility criteria. Short selling in Canada, Hong Kong and Japan is subject to trading controls such as price restrictions. Some jurisdictions like Australia, Canada, Japan, the US and Hong Kong require the "flagging"<sup>13</sup> of short sales. Margin requirements are also employed as a tool to control short selling in jurisdictions like Japan. In certain jurisdictions, for transactions where stocks are not delivered within the standard settlement cycle, there is some form of mandatory buy-in or close-out requirement designed to cover the risk of failed delivery of the stocks.

### **Measures proposed to tighten short selling rules:**

Sharp falls in securities prices during the financial crisis led many regulators to adopt temporary emergency measures in Autumn 2008 (restricting or banning short selling in some shares). This has since encouraged a push for strengthening short selling regulation in many countries following the principles proposed by IOSCO in 2009:

- a) Short selling should be subject to appropriate controls to reduce or minimise the potential risks that could affect the orderly and efficient functioning and stability of financial markets.
- b) Short selling should be subject to a reporting regime that provides timely information to the market or to market authorities.

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<sup>11</sup> See for example Steven Pearlstein on unfairness of short selling – The Washington Post – Dec 1 2010

<sup>12</sup> Other possible concerns refer to abusive behaviour in the short selling context, which are prohibited by market abuse rules

<sup>13</sup> "Flagging" refers to the system that requires putting a marker on each short sale that a broker sends to the exchange or alternative trading facility for execution.

- c) Short selling should be subject to an effective compliance and enforcement system.
- d) Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development.

Short selling regulation is however complicated by the fact that it carries different meanings in different jurisdictions and different approaches to regulation have been adopted. So far, IOSCO has not provided a common definition of short selling. The existence of different settlement cycles among countries also makes harmonization of short selling regulation difficult.

The SEC adopted a 'circuit-breaker' rule in February 2010 that restricts short sales of a share whose price has fallen by more than 10% compared to its closing price the previous day.

The EU Commission put forward harmonized rules for EU countries in September 2010 with proposals to flag orders which involve a short sale and requirements for investors to disclose significant net short positions to regulators and to the market beyond defined thresholds<sup>14</sup>. The proposal that EU regulators should have the power to restrict or ban short selling on a temporary basis in exceptional situations was also made. These proposals are being reviewed at present. Some industry players are concerned in particular that disclosure to the market of net short positions exceeding 0,5% of the relevant issued share capital would impact investors and point out that flagging requirements may be redundant with the other requirements.

Japan has recently tightened short selling rules for new equity issues.

### **Measures targeting 'naked short selling':**

Specific measures have been proposed in many countries to ban or restrict 'naked' or 'uncovered' short selling (ie when a short seller sells a financial instrument short without first borrowing it). Naked short positions in sovereign CDSs (in which insurance is taken on the default risk of bonds without owning them and which is a way of shorting them) have also been accused of causing or amplifying the speculative attacks Greece suffered from at the beginning of 2010, although the European Commission Task Force report on sovereign CDS following the Greek crisis concluded that there was no evidence that development in the CDS market caused higher funding costs for Member States.

Many regulators believe that the risks of totally uncovered short selling – when an investor puts himself voluntarily in a situation of not being able to deliver the securities in due time - could expose the financial system to settlement risks<sup>15</sup> and should be therefore avoided. These risks are considered to outweigh the possible benefits brought to the market – ie increasing the flexibility of hedging and increasing liquidity.

Naked short selling is already banned in some countries such as Australia, Norway and Hong Kong or strictly regulated (eg with a 'locate requirement' as in the US).

- Temporary bans have been extended in Japan and Germany
- Measures have been proposed by the EU Commission to introduce limitations to this practice by imposing that investors, in order to enter a short sale, must either have borrowed the instrument concerned, entered into an agreement to borrow them,

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<sup>14</sup> Disclosure to regulators once these amount to 0.2% of the issued share capital of a company, and to the market at a higher 0.5% threshold

<sup>15</sup> with an unlimited number of shares allowed to be sold in a short space of time

or have an arrangement with a third party to locate and reserve them for lending so that they are delivered by the settlement date (i.e. a 'locate' rule).

### **3. The impact of 'dark trading' (ie with no pre-trade transparency) on price formation is being closely analyzed by regulators**

#### **Background:**

Alternative multilateral trading venues called Multilateral Trading Facilities (MTFs) in the EU and Alternative Trading Systems (ATs) in the US and Canada have developed alongside traditional regulated exchanges following regulatory reforms to foster competition in the trading space. They provide multilateral trading<sup>16</sup> in the same way as regulated markets (as opposed to bilateral OTC trades). In Europe these platforms share other features with regulated exchanges: particularly pre and post trade transparency and an order driven market model<sup>17</sup>. They now represent a significant part of the market: MTFs account for 25% of equity trading in the EU for example.

OTC trades are the traditional alternative to multilateral platforms for executing bilateral trades with no pre-trade transparency and lighter regulatory requirements. OTC transactions are normally characterized by large order sizes involving wholesale counterparties or that cannot be executed on stock exchanges or alternative lit platforms without market impact or by their ad hoc nature (eg trading customized products which are not sufficiently liquid). Some regulators however consider that OTC has expanded to include retail order flow and has also moved from bilateral ad hoc transactions to organized trading, either bilateral (systematic internalisers) or multilateral (broker crossing networks). OTC trades can be executed by voice orders or electronically on platforms run by investment firms..

Brokers also operate their own dark pools referred to as Broker Crossing Networks ("BCNs").<sup>18</sup> BCNs have been created by sell-side institutions who have enough "internal liquidity" to create an efficient matching engine by combining all their order flows. In some regions (eg the EU) most BCNs are not regulated at present as trading venues but the investment firms managing BCNs are subject to authorization as investment service providers under MiFID involving notably compliance with the conduct of business rules.

Dark pools have created an alternative to bilateral OTC trades for dark trades. Orders are placed onto a dark pool with no pre-trade visibility (dark pools benefit from transparency waivers usually as defined in the applicable legislation) and if a matching order is found the transaction takes place by an execution of buying and selling interests in a non-discretionary way and the order is reported post-trade. Many dark pools are operated by exchanges and MTFs as a complement to their lit venues.

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<sup>16</sup> Bringing together multiple third-party buying and selling interests in financial instruments in accordance with non-discretionary rules – definition of an MTF

<sup>17</sup> MTFs may have different organizational requirements than regulated exchanges due to proportionality principles in legislation and a different supervision regime due in particular to the fact that some functions such as listing are not performed by alternative venues. Some regulated markets (RMs) however point out that since both RMs and MTFs perform the same function with regard to pure trading, such proportionality principles are not justified in their opinion.

<sup>18</sup> BCNs execute their clients' orders, necessarily in a discretionary manner, as it is their duty to choose, together with their clients, the way the orders will be executed, their limits being the respect of best execution and the management of conflicts of interests. To this extent, BCS optimize the traditional broker's job, by using algorithms, without fundamentally changing the nature of this job.

Dark pools and BCNs are now considered together to represent around 5 to 10% of the market in the EU<sup>19</sup> and around 10% of share trading in the US by some estimates and their proportion is thought to be growing because of the difficulty institutional investors are finding in getting large orders executed on lit venues.

Statistics collected by some analysts<sup>20</sup> in the EU show that the volume of dark trades may have slightly grown as a result of the development of dark pools and BCNs. The market share of OTC trades is indeed found to remain generally stable (ie representing around 40% of the equity market, which would imply, if confirmed, that MTFs have not captured much of the OTC flow in the EU at least). The figure of 40% of trades carried out OTC is also used in the Swinburne report for the EU Parliament. This figure is however disputed by some industry players, particularly from the sell-side, who consider that the 40% statistic is in large part comprised by trades that are reportable under MiFID but form no part of price formation and/or do not represent liquidity available to other market participants and/or are double-counted due to the lack of clarity in the reporting data. As a result only around 10% of trade volumes could be considered to be actual addressable liquidity [that could potentially be executed on a lit venue] according to these players.

Furthermore analyses of trade flows seem to indicate that quite a high proportion of trades currently executed through dark pools and BCN platforms are not large in scale and present no or limited potential market impact (around 40 to 60% of them), which would mean that dark pools and BCNs have probably captured some of the trading flow that normally goes through lit regulated markets and multilateral trading platforms. Possible reasons for this are that dark venues can prove to be more cost effective for traders who may save all or part of the bid / ask spread, since in dark pools or BCNs the price is usually built at the midpoint of the best bid and offer quote on the relevant regulated market. The fact that many trades executed through dark pools and BCN platforms are not large in scale is disputed by some industry players who consider that most of those trades form part of much bigger initial clients' orders and therefore belong to clients' interests which are large in scale.

Where large orders are executed, dark trading provides anonymity and limits information leakage to other participants on the strategies pursued, which is an advantage for institutional investors wanting to execute slices of large orders without being detected by their competitors.

Algo trading has also facilitated the use of dark venues optimizing order execution through multiple venues and reducing the risk of transactions not being executed due to the limited liquidity of some platforms.

### **Main issues regarding dark pools and BCNs:**

With a further increase of transactions taking place in the dark questions are raised as to the validity of the price creation and discovery process<sup>21</sup> on the exchanges, MTFs and ATSS since pre-trade transparency is a key element of this process. This is a major issue both for investors and issuers since market prices are based on the prices used on these platforms<sup>22</sup>. Reducing the reliability of price information could reinforce information asymmetry in the

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<sup>19</sup> Source P. Fleuriot's report on the MiFID review (Feb 2010) In the EU BCNs are estimated in to represent 4 to 5% of OTC trades corresponding to a total market share of approx 1.5%

<sup>20</sup> « MiFID – spirit and reality of a EU Financial Markets Directive” Report by Goethe Universitat and Celent September 2010 based on figures provided by Thomson Reuters 2008 - 2009

<sup>21</sup> Price discovery is the process through which the current market price for a security is established. It is derived from the supply and the demand for the security and information about transactions which have actually occurred – source IOSCO consultation on dark liquidity – October 2010

<sup>22</sup> Dark trades are often accused by regulated markets of freeriding the price discovery service they provide to the market

market, potentially increasing the cost for investors to operate in the market and reducing their confidence in the value of financial instruments, leading in turn to reduced volumes and liquidity and higher transaction costs.

Some market players argue that reference price pre-trade transparency waivers do not negatively impact the price formation process because prices are referenced from the existing lit market price formation process. Other observers however point out that this is only true up to a certain share of trades executed in the dark – which still needs to be determined - beyond which the validity of the reference price determined in lit venues might be diminished.

Questions are also raised in terms of market surveillance – developed further down in section 4.2.

### **Measures proposed:**

Different measures are being considered at present by regulators to ensure appropriate pre-trade price transparency is maintained across trading venues (source MiFID review consultation document of the EU Commission and IOSCO consultation report on dark liquidity) and across asset classes:

- Broadening the scope of pre-trade transparency requirements: enforcing minimum threshold for dark orders and limiting the scope of waivers; introducing a maximum volume of transactions that could use pre-transparency waivers; broadening the scope of instruments that pre-trade transparency requirements apply to
- Ensuring transparent orders receive execution priority over dark orders at the same price within a trading venue in order to incentivize the use of transparent orders

Efficient post-trade transparency is another key element of price discovery. The quality of post-trade information provided by different venues is considered to be quite heterogeneous in many countries with the expansion of data sources and in some cases to have declined (mistakes, delays...). Regulators have proposed (eg the EU Commission) that post-trade regimes should be put in place for each asset class and in some cases for each type of instrument to ensure sufficient post-trade transparency across trading venues<sup>23</sup>. Speeding up the publication of post-trade data to be as close as possible to real time has also been suggested.

IOSCO has also raised fair access issues with regard to dark pools and BCNs particularly in cases where a dark pool has a significant market share and participants cannot access the liquidity within the dark pool. Solutions could be to provide fair access provisions when a threshold market share is reached.

Regulating and supervising BCNs in line with equivalent multilateral trading venues – possibly beyond a certain market share - has also been proposed by the EU Commission.

## **4. Market surveillance needs to face up to risks of increasing fragmentation, complexity and opacity of markets**

With the implementation of regulations to foster competition and the demutualizations of most exchanges, securities trading has become increasingly fragmented in most regions of the world with a multiplication of trading venues: regulated exchanges, alternative multilateral

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<sup>23</sup> In order to minimise information asymmetries and improve pricing, the post-trade transparency regime should be transaction-based and provide data on transactions in terms of price, volume, time of trade, and the main reference characteristics of the traded instrument rather than aggregate data. The transparency regime should be properly calibrated to the class of financial instruments (bond, structured finance product, derivative) and to the type of instrument (option, swap, forward).

platforms, broker networks, dark pools, etc... as well as electronic OTC platforms and request for quote platforms.

This evolution has had some positive results favouring reductions of trading fees per transaction, stimulating innovation in services and platform performance and broadening the geographical scope of order execution but raises transparency and data consolidation issues for investors, issuers and regulators as well as market surveillance challenges (in order to eg prevent market abuse or detect systemic risks). In addition the magnitude of fee reductions for end-investors is questioned, given the investments required in connectiveness to multiple venues, the improvements still to come in the post-trading area<sup>24</sup>, and the focus of alternative venues on blue chip stocks, particularly in Europe. Fragmentation also impacts liquidity although improved IT and algo trading bring solutions at least for the more sophisticated buy-side institutions.

The development of orders executed OTC and through dark pools and BCNs, is another major challenge for supervisors who do not always have access to sufficient data to perform their market surveillance duties.

#### **4.1. Data consolidation across trading venues is needed in order to allow price comparisons**

Besides requiring market data to be reliable, timely and available at a reasonable cost, investors also require the information to be brought together in a way that allows comparison of prices across different venues. The main problems relate to the quality and format of the information, as well as the cost charged for the information and the difficulty of consolidating the information.

Data consolidation is a priority in equity markets where the proportion of trades executed on multilateral venues is the highest, but many consider that it should be extended as far as possible to non-equity instruments.

Different solutions are being examined:

- Improving the quality and consistency of raw trade data and ensuring it is provided in a consistent format (to facilitate consolidation);
- Developing 'consolidated tape solutions (a single database of completed transactions) – which exist at present in the US and are being evaluated in the EU. The US consolidated tape is a mandatory one, and in Europe the debate spins around whether it would be wise to launch a mandatory solution like the US one (taking into account the possible drawbacks that a mandatory approach entails) or rather to allow solutions to consolidation led by the industry taking advantage of the provisions envisaged in the MiFID reform for the harmonization of trading flags and the APAs (Approved Publication Arrangements) regime.
- Reducing the cost of post-trade data for investors and improving its quality are additional objectives.

#### **4.2. Visibility on dark orders is requested by regulators in order to enable them to perform their market surveillance duties**

Insufficient visibility on the activity of dark venues could undermine the surveillance capacity of supervisors. IOSCO indeed argues that having access to accurate, timely and detailed information regarding dark orders, including on the very fact that those orders were dark, is important for regulators to understand the market structure issues posed by dark pools and

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<sup>24</sup> Post-trading is still widely fragmented across Europe. The Target2Securities platform of the ECB is expected to improve the situation in the settlement area. Interoperability is the solution proposed in the clearing space but much progress is still required. Harmonized technical and legal rules are in the process of being defined

to monitor trends in trading and trading behavior for regulatory purposes. Supervisors may also wish to use information on dark trades in order to trace orders for market monitoring and surveillance purposes.

This information should include the price, volume, parties to the trade and the venue upon which the trade was executed.

The EU Commission also suggests that there could be greater granularity of information regarding OTC trades and that OTC trades could be identified and flagged in post trade transparency reports. This would ensure that there is much more granular and accurate information about levels of OTC trading.

#### **4.3. Improving the technical means and resources of supervisors seems necessary as well as achieving coordination of regulatory and supervisory powers on the EU and global levels**

Supervisors need to be able to continuously enhance their capacity to monitor markets in the context of constant market developments (technology, trading techniques, etc...) which requires the appropriate technology and human resources to access and process market data and address market abuse risks, This is particularly true for HFT activities in which market players continuously improve the speed and sophistication of the technology used. As mentioned by P. Fleuriot from Credit Suisse in his contribution to the Eurofi newsletter "supervisors need to improve their ability to detect and deter market abuses by enabling more rapid access to and more sophisticated analysis of the right information, enhancing market participants' and public confidence in the capital markets".

Industry players and regulators also need to work together to "find the right balance between innovation, stability and efficiency in cash markets" as suggested by J. Moulds from Bank of America Merrill Lynch in the Eurofi newsletter, that can best answer the needs of investors, issuers and market players.

The regulations adopted and implemented should also be as consistent as possible in order to simplify their application by global and regional players in market structures which are increasingly similar, increase their legitimacy and avoid creating regulatory arbitrage in activities which have a global dimension and are highly automated (eg HFT). This requires strong coordination by IOSCO in relation with the FSB for market stability and integrity issues and coordination among market supervisors.

The EU has a specific challenge in terms of coordination which the EU Commission and the future EU market authority (ESMA) are attempting to fulfill. Proposals have been made to increase and further harmonize the powers of regulators and supervisors with regard to short selling as mentioned above. Additional proposals have been made on the occasion of the MiFID review to increase and harmonize the surveillance powers of EU regulators in securities markets including the power to ban temporarily certain products or practices or restrict the trading or the distribution of a product in case financial stability or market confidence is threatened.