

NIEDERER KRAFT & FREY

Niederer Kraft & Frey Ltd
Bahnhofstrasse 13 · CH-8001 Zurich
Telephone +41 58 800 8000 · Telefax +41 58 800 8080
nkf@nkf.ch · www.nkf.ch



IBA - 28th International Financial Law Conference

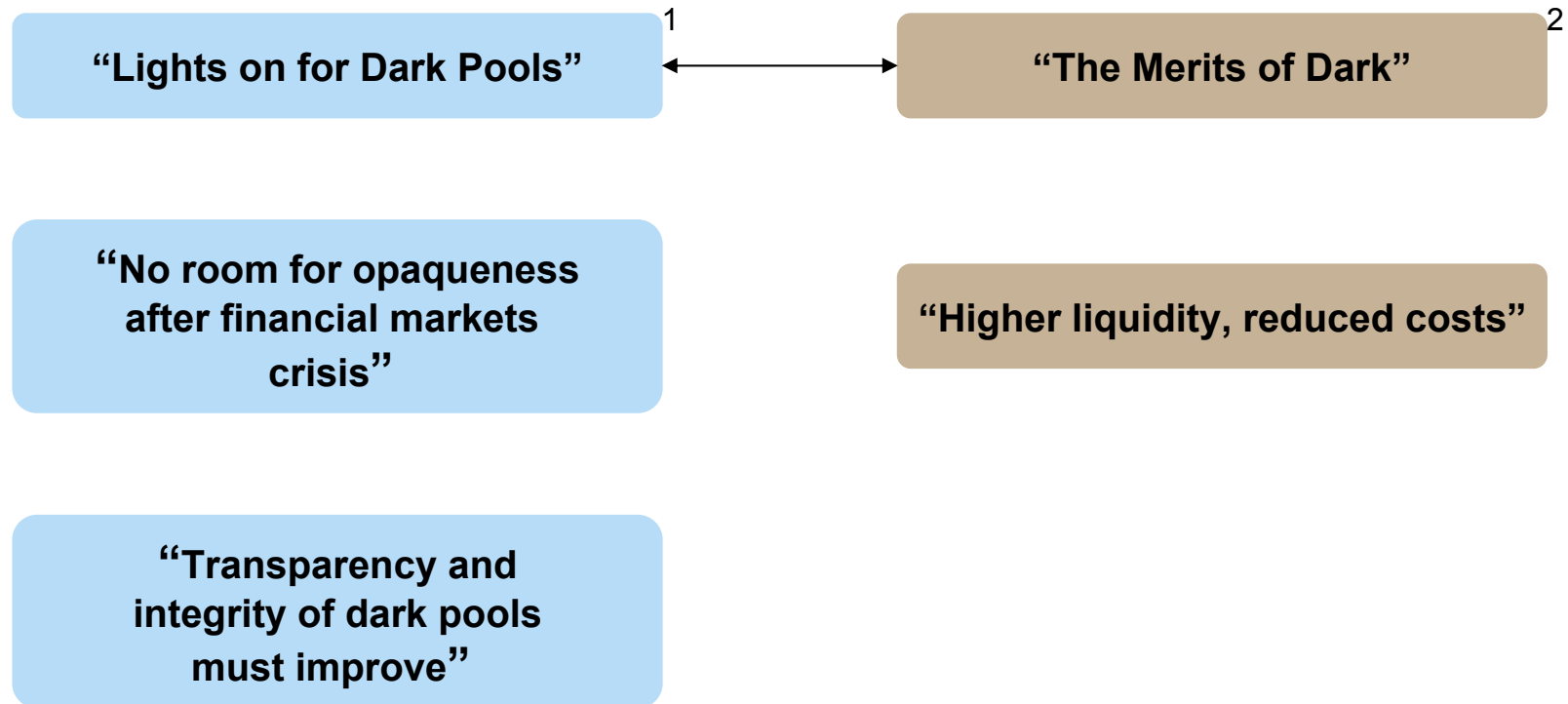
Fragmentation – Dark Pools – Transparency

19 May 2011

Urs Pulver / Petra Ginter

NKF

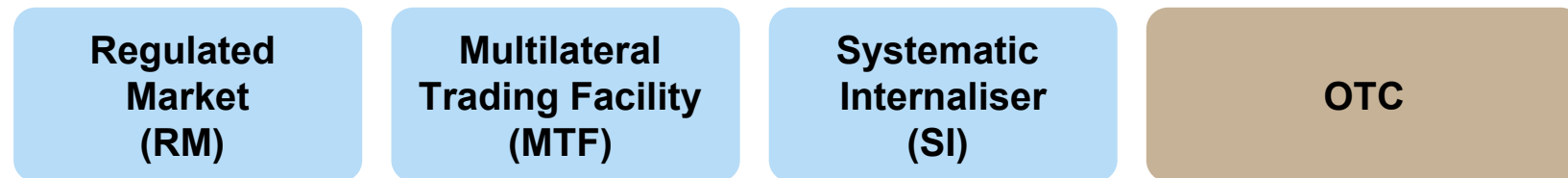
Lit or Dark? – Clash of Controversial Views



¹ Sabina Salkic (Deutsche Börse AG), in Deutsches Aktieninstitut, Finanzplatz, Jan 2011 Nr. 1, p.16

² Linn Karstadt (Citi Global Markets), loc. cit., p. 19

Regulatory Background Trading Venues



Regulated Markets / Multilateral Trading Facilities

RM	MiFID Definition	MTF
✓	multilateral system	✓
✓	operated/managed by a market operator	✓ or an investment firm
✓ or facilitates the bringing together	brings together multiple third-party buying and selling interest in financial instruments	✓
✓	in the system and in accordance with its non-discretionary rules	✓
✓	⇒ results in a contract	✓
✓ ✓	system is <ul style="list-style-type: none"> • authorised • functions regularly 	

Systematic Internaliser (SI)

Executing customers' orders against the own account

- Investment firm
- deals on own account
- by executing client orders
- outside a Regulated Market or a MTF
- **on an organised, frequent, systematic basis**
 - commercially material
 - by automated technical system or dedicated personnel
 - under non-discretionary rules/ procedures
 - on a regular or continuous basis

OTC Transactions

➤ **on ad-hoc and irregular bilateral basis**

➤ **with wholesale counterparties**

➤ **dealings above standard market size**

➤ **outside the systems used for business as SI**

Transparency Requirements

	Regulated Market (RM)	Multilateral Trading Facility (MTF)	Systematic Internaliser (SI)	OTC
Pre-Trade Transparency	✓	✓	(✓) (not if > standard market size)	✗
Post-Trade Transparency	✓	✓	✓	✓
Venue Identification	✓	✓	✗ (anonymous "SI")	✗ (anonymous "OTC")

Pre-Trade Transparency

Pre-trade transparency

exceptionally not applicable in certain circumstances

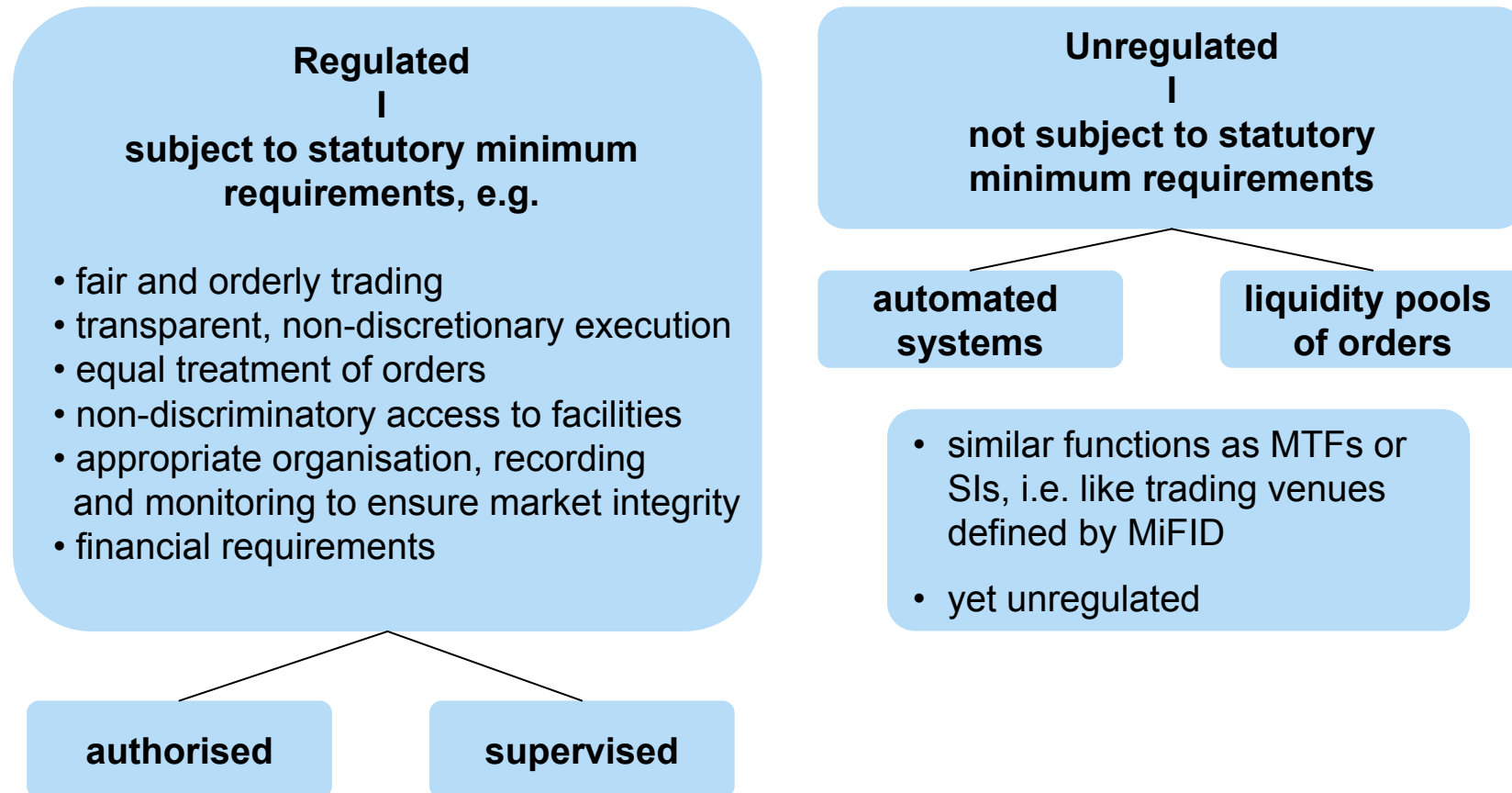
Dark Pools operated by Exchanges and MTFs

regulated markets must submit waiver request, e.g.

- large-in-scale waiver
- reference price waiver

**Unregulated dark pools:
not subject to pre-trade transparency duty**

Regulated/Unregulated Dark Pools – Regulatory Discrepancy



...more about the Controversies

Unregulated Dark Pools

lack of

- transparency
 - no pre-trade transparency
 - post-trade reporting generic, unspecified labeled "OTC"
- venue surveillance
- integrity

impact on price discovery

benefit from unlevel playing field

do not provide open, non-discriminatory access

limited transparency

- protects against negative impact on the market

discretionary execution

- ensures "best execution" – fair value check

brokers are regulated

no negative impact on price discovery

Conventional Exchanges

lack of

- liquidity
- cost efficiency
- anonymity

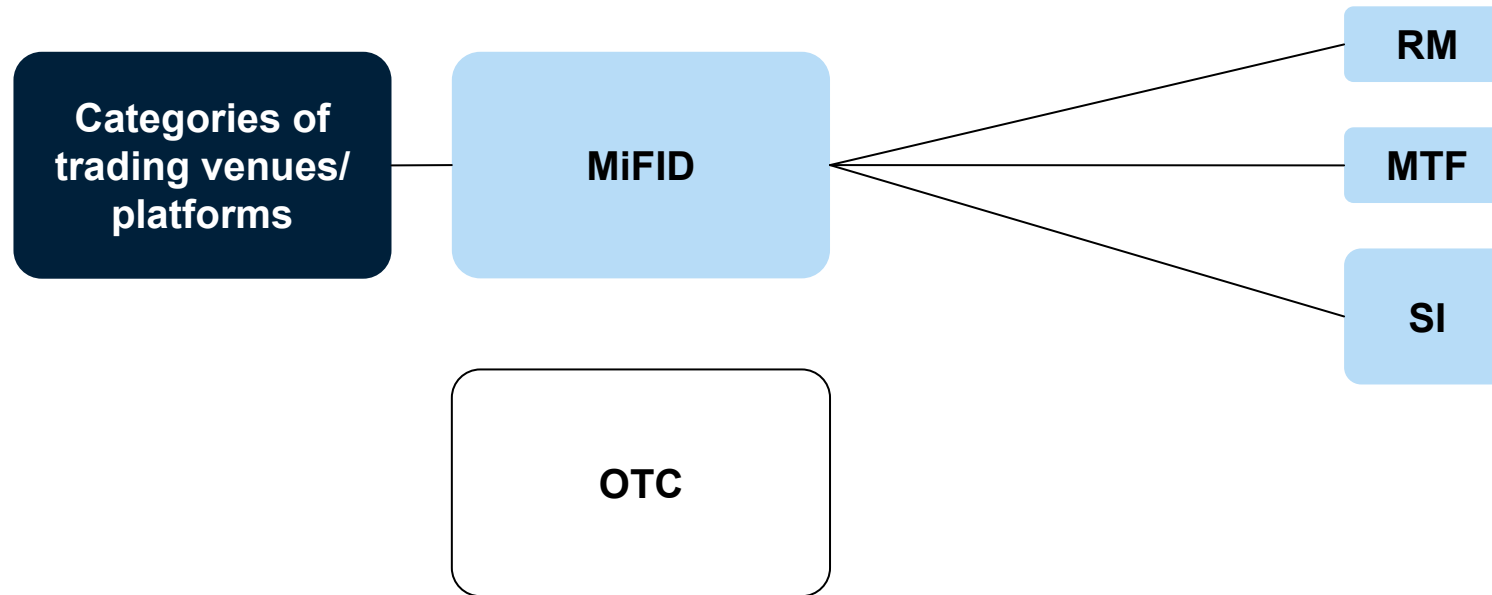
reduced liquidity is due to market fragmentation

unlevel playing field

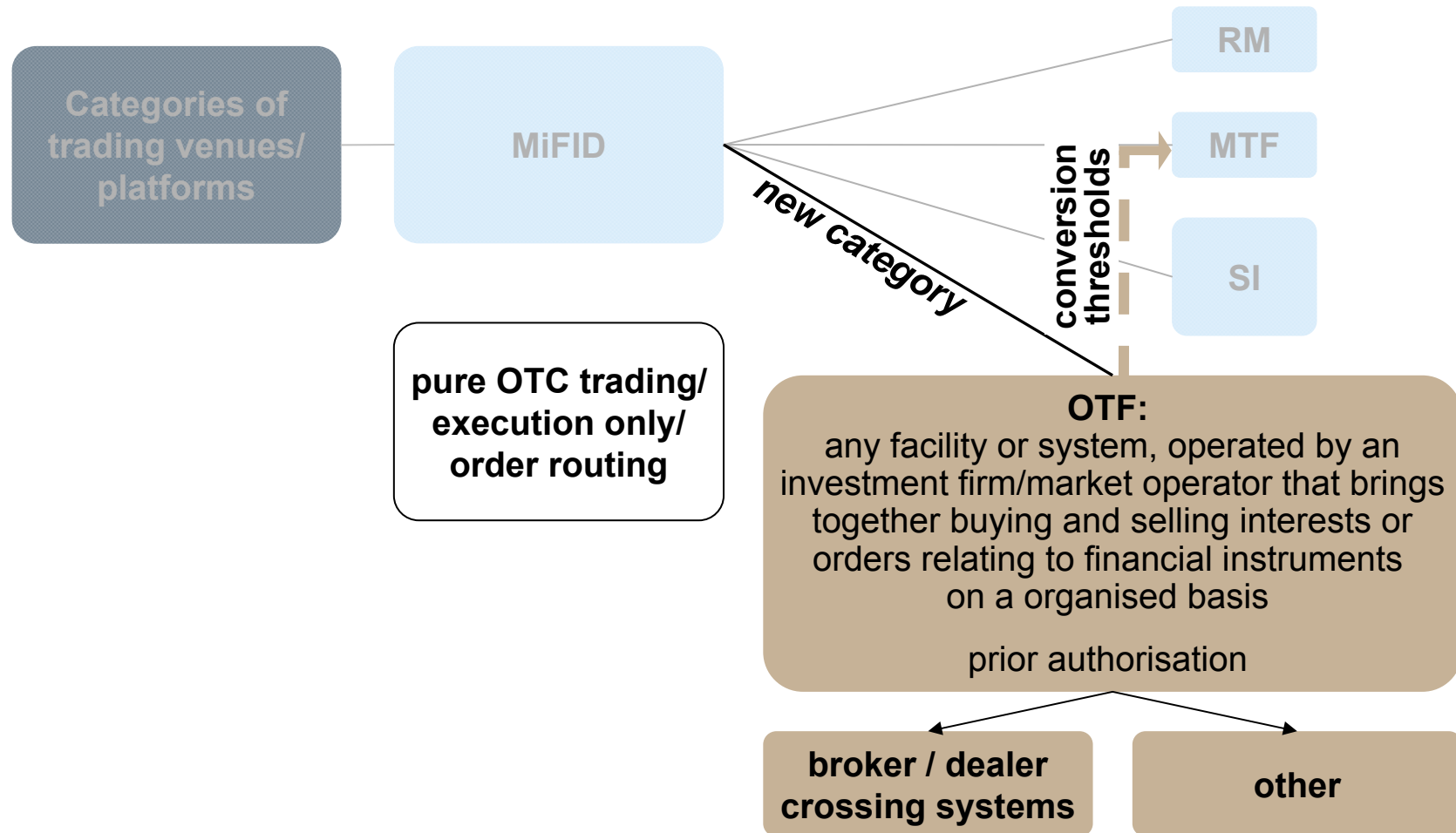
- cost efficiency of regulated/ unregulated venues can not be compared
- regulatory arbitrage

market surveillance ⇒ integrity

MiFID Review: Categorisation of Trading Venues/Platforms (1)



MiFID Review: Categorisation of Trading Venues/Platforms (2)



Some Issues Raised in Responses

- Is there a need for new category “OTF”?
- Should BCNs
 - fall into the category OTF
 - or not as they ought be regulated as MTF or SI
- Is there a light touch treatment of cash equity BCNs as compared to non-equity OTFs? Is it appropriate?
- Is a threshold approach appropriate?
 - Conflict with functional approach?
 - Equal treatment as compared to small MTFs?

Data consolidation

Expectation: allow investors to compare prices across different venues

MiFID
Review

Reduction of the cost for post-trade data for investors

Introduction of a **consolidated tape** for the EU market
⇒ to enhance transparency
⇒ to reduce market fragmentation
⇒ to allow for a better oversight



Key Issue: OTC data

Quality
Consistency
Identifiers
Timeliness

centralised

vs

decentralised



“single point of failure ”



reduce latency

- Industry working group established
- Initiatives of Thomson Reuters and NYSE Euronext

...and Switzerland?

Swiss Block – A Regulated Dark Pool

Swiss Block SIX Swiss Exchange

- Electronic trading platform of SIX Swiss Exchange
 - for block trading of Swiss Blue Chips
 - outside of the public order book
 - open to international qualified investors
- No pre-trade transparency
- full and immediate post-trade transparency

A Swiss Government's Statement (2009) on Swiss Block and Unregulated Dark Pools

Swiss Block complies with

- Swiss law; and
- MiFID – makes use of the MiFID reference price pre-trade transparency waiver

as long as compliant with the required transparency and operating within the regulated SIX Swiss Exchange

Concerns regarding dark pools operated by investment banks – considered not to be fully compliant with transparency requirements

Broad Discretion of Swiss Regulator

Broad **discretion** of Swiss Financial Market Supervisory Authority under current legislation (principles-based approach):

- to subject “**organisations similar to an exchange**”
 - to the requirement of prior authorisation,
 - supervision and regulation
- to determine the regulatory requirements

Currently

- Generally speaking: Dark Pools operated by investment banks etc. unregulated
- Negative clearance approach

Tendency of future Swiss legislation:

- Following the international standards of regulation
- Harmonising Swiss regulation with international standards

Consolidated tape: Inclusion of “Swiss” data?

Conclusions

- MiFID ⇒ increase in competition and execution options for market participants
- Clash of interests of different market players
- Need for non-displayed pools of liquidity recognised
- Need for improvement of transparency recognised
- Introduction of investment service “operation of OTF”, subject to prior authorisation, being considered
 - issues: definition
 - applicable transparency regime
 - conversion to MTF
- Consolidated Tape for post-trade data considered
 - broadly supported
 - quality of data = key concern
 - provider

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