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International Organization of Securities Commissions (IOSCO)

C/Oquendo 12

28006 MADRID

SPAIN

Consultation Report

Regulatory Issues Raised by Changes in Market Structure
IOSCO/CR03/17 May 2013

General remarks submitted by:

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(Dutch Shareholders' Association)

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Introduction

Beleggersvereniging VEB (*the Dutch Shareholders' Association*) was founded in 1924 with an objective to represent the interests of retail and institutional investors. Nowadays, VEB is the largest association representing investors in the Benelux with 50.000 members. VEB is also a founding member of EuroInvestors (now: EuroFinuse) and EuroShareholders, pan-European organisations which represent retail investors and shareholders.

Financial Markets are constantly changing because of new legislation, the ongoing financial crises and innovation. Unfortunately, not all changes benefit retail investors. Recent changes in the market structure results in more uncertainties for retail investors. However, this issue is very complex and therefore does not have the attention of individual retail investors, in this respect a sense of urgency lacks. Therefore the VEB actively participates in debates, consultations and legislative procedures to make sure that the investors' interest are taken into account.

The VEB favours more transparency on the financial markets and trading platforms, more clarity about where responsibilities lie and more opportunities for investors and shareholders to use their own responsibilities carefully and effectively.

VEB has read with interest the consultation paper prepared by IOSCO. VEB finds it important to present its view, as the topic of said consultation paper is important.
make sure that the investors' interest are taken into account.

1. General remarks

VEB believes that fragmentation of multiple trading spaces (also known as facilities, venues or places) within the global financial market has led to more competition but has negative impact on transparency and investor protection. The evolving globalisation of the financial market urges for stronger regulatory requirements which are consistent between countries, economic regions and worldwide.

To realise better protection of retail investors, VEB is in favour of improvements to pre and post trade transparency in equity and non-equity markets. As mentioned in VEB's Position Paper of March 2011 'Review of the Markets in Financial Instruments Directive (MiFID)', VEB strongly advocates a mandatory consolidated tape on pre and post information. The same pre and post trade information should be provided to retail investors on all trading venues, and this information should be accessible at the same time.

To summarise our point of view, in situations where investment firms offer their clients the possibility to trade on multiple trading platforms, retail investors in general end up not knowing on which venue their trades eventually take place. It can even be said that – again, in general – retail investors are indifferent as to the question on which venue their trades will take place, as long as they receive clear and accurate information with regard to (i) the current bid and ask quotes in the order book of the financial instruments they wish to trade in, (ii) the costs of trading involved and (iii) pricing, timing and volume information of earlier trades in the same instruments. Post-trade, investors are mainly interested in receiving information with regard to the execution of their order, to be more precise whether (and in which way) the involved investment firm has applied Europeans best execution rules with regard to their trade. In our view, investment firms should be able to show why they have chosen to execute a certain order on a certain trading venue. For retail investors it is very important to determine if his advisor or investment firm actually have applied to 'best execution'-rules.

Furthermore VEB would like to point out that all market participants benefit from more transparency and well endorsed regulated markets. VEB therefore supports the shift of trades towards innovative, transparent and regulated organised trading venues and calls a level playing field for different trading spaces so that different venues are subject to the same rules.

VEB also supports a global system of (i) clearing and settlement and (ii) service of corporate actions such as dividend payment and voting. Retail investors invest and trade more and more outside their domestic markets, exchanges and trading spaces. This leads to complex issues such as reliable custody chains, access to international depositories and questions about responsibility and accountability for international transfers by investment firms, advisors and investors.

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2. Questions and answers

VEB wants to answer all questions expressed by IOSCO.

Recommendation 1

1.1 Regulators should regularly monitor the impact of fragmentation on market integrity and efficiency across different trading spaces and seek to ensure that the applicable regulatory requirements are still appropriate to protect investors and ensure market integrity and efficiency, including with regard to price formation, bearing in mind the different functions that each trading space performs.

1.2 Regulators should regularly evaluate the regulatory requirements imposed on different trading spaces and seek to ensure that they are consistent (but not necessarily identical) across spaces that offer similar services for similar instruments.

Questions:

(1)1. Does the evolving market fragmentation challenge the relevance, effectiveness or implementation of current regulatory requirements? If so, which ones and how are they impacted?

Yes. Regulators should guarantee retail investors that they not only focus on market efficiency and transparency but also on fair and timely information. As time is the only unbiased measurement to trade at a certain price based on biased information, real time pre en post trade information about all trades on all trading spaces is crucial.

(1)2. Are you aware of material differences in regulatory requirements between different trading spaces that from your point of view are not justified and create regulatory risks and unfair competition? For example, are there regulatory requirements that apply to one type of trading space in your jurisdiction and currently do not apply to others but, in your view, should apply to others that offer similar services? Please describe.

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In Europe the cost of retail data is excessively high, and retail investors must pay to access each Member State's market. Retail investors pay a similar fee to access the much larger US market, which is why this market is often the second most active market for retail investors behind their domestic market. A low cost standardised view of the market data will increase cross-border investment in Europe to the benefit of all. The excessive cost of pre-trade data is a key barrier for retail investor access to European Capital Markets. Trading venues should provide separate retail pricing structures for market data in order to remove fragmentation and improve retail participation in European Capital Markets. To improve a single European market for retail investors, regulators should discuss the possibility for retail investors to pay one fee to view all data of markets in the Eurozone or all European exchanges.

(1)3. Do you think that the price formation process has been deteriorated or has been improved as the result of market fragmentation? If so, please explain how.

As stated above, VEB notes that results of the price information process differs for types of investors. Professional and institutional investors may have benefit of the fragmentation of trading. Retail investors face new challenges to access all relevant information at higher costs. If retail investors demand sufficient, reliable and timely information, these are currently provided only at extremely high costs.

<u>Recommendation 2</u>

In an environment where trading is fragmented across multiple trading spaces, regulators should seek to ensure that proper arrangements are in place in order to facilitate the consolidation and dissemination of information as close to real time as it is technically possible and reasonable.

<u>Questions:</u>

(2)1. What options are available to manage the issues associated with data fragmentation in a competitive environment?

In our view, the pre and post trade information provided should be consistent, regardless of the venue on which the trading takes (or took) place, and without regard of the financial instruments traded in, be it equity, equity-like, bond, bond-like instruments or derivatives thereof.

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Harmonisation of pre and post trade information across trading venues globally and indifferent of the type of financial instruments traded in, would lead to a more level playing field and a better protection of investors. Currently, the cost of this market data is excessively high in Europe; without access to this data, European retail investors are denied access in equal terms to investment opportunities. The standard practice in de United States of the consolidated tape should apply for all multiple trading spaces. If necessary the consolidated tape should be compulsory.

(2)2. What conditions, if any, should govern access by investors to consolidated market data?

None.

(2)3. Are there other challenges (technical, regulatory, prohibitively high costs) with regard to creating and/or accessing consolidated market data? What if anything, should be done to address these challenges?

The costs for collecting consolidated market data are much too high for retail investors. There is still no initiative of commercial market participants that creates reliable and consistent consolidated data at reasonable price. If available, retail investors have to pay high fees to collect sufficient, reliable and timely market data. The reason for these high cost is not the cost of collecting and publishing the data, but blocking of the data for all investors because of the interest to maintain the fragmentation of the markets and data. It's in the interest of issuers, brokers and liquidity providers to maintain the fragmentation of trading spaces. These market participants earn fees on every trade investors make. If it is impossible to oversee all market data, more trades will be placed against higher spreads or lower prices. Therefore, regulators should introduce a mandatory consolidated tape. It is preferable that the regulators open a public tender for markets participants to build, maintain and distribute the consolidated tape. Regulators have to put forward strong requirements for composition of the consolidated tape. Under question 1 and in the general remarks VEB pointed out some first requirements for a consolidated tape.

(2)4. What views do you have on the relative merits of a single consolidated tape mandated by the regulation versus multiple competing tape providers? Please elaborate.

Please see above under question (2)3.

Recommendation 3

Where markets are fragmented, regulators should consider the potential impact of fragmentation on the ability of intermediaries to comply with applicable order handling rules including, where relevant, best execution obligations, and take the necessary steps.

Questions:

(3)1. Should existing order handling rules, such as best execution, be re-examined in the context of fragmented markets? If so, in what way?

As mentioned in the IOSCO consultation report, trading systems are generally required to handle orders in a fair and non-discriminatory manner. Price and time priority are the two most important factors guiding how orders should be handled. Investment firms acting in Europa which have to apply to the MIFID-regulation, have the obligation to apply 'best execution' principles to trades executed for retail investors. The many benefits of competition between trading venues and trading systems are not being passed through to the retail investor, as an case Study of our international organization EuroFinUse will show (see Annex I). Currently, it is not completely clear what 'best execution' entails. The additional Order Protection Rule in Canada and the US is beneficial for retail investors who doesn't have direct access to a regulated market or multiple trading space.

In our view, the principles should be more concrete and combined. VEB thinks that applying combined 'best execution' and 'order protection' principles should entail at least two things: (a) investment firms should check and compare prices of the financial instruments an order relates to, not only on the regulated home market but also on at least two other - international - trading venues (if possible), and they should subsequently execute the order on the trading venue where the total cost of trading (thus: a combination of trading costs involved + best price of the financial instrument the order sees to) is lowest; applying best execution principles also means that (b) investors can check (post trade) why an investment firm has executed their order on a certain trading venue. The latter can be done by providing retail investors post trade with pricing data at the time of their order. To clarify the latter point: after execution of an order an investment firm should send retail investor a confirmation of the execution of their order and provide him (at the same time) with three pricing numbers: the total costs of trading on trading venue 1, on trading venue 2 and on trading venue 3, all at time X.

(3)2. Do you think that rules relating to the disclosure of order handling practices by investment firms are appropriate to facilitate compliance with and evaluation of 'best execution'?

No. There should be a dramatic changes in disclosure of order handling practices, best execution policies and evaluation. See VEB response under question (3)1.

(3)3. Are there any other appropriate 'order handling' tools that should be considered in the context of fragmented markets?

Please note VEB response under question (3)1.

Recommendation 4

Regulators should regularly monitor the impact of fragmentation on liquidity across trading spaces. Regulators should seek to ensure that applicable regulatory requirements provide for fair and reasonable access to significant sources of market liquidity on the exchange and non-exchange trading market systems.

Questions:

1. Do you have views on regulatory mechanisms and specific arrangements that might be needed to help ensure that investors have an appropriate, fair and reasonable access to liquidity in both exchange and non-exchange trading market systems? If yes, please elaborate.

The focus on competition and market efficiency by legislators and regulators created more trading opportunities for investors, a decline in cost of trading and – on first sight – more liquidity. The introduction and growth of High Frequency Trading ('HFT') and Algorithmic Trading ('AT') is a direct consequence of the structural change of significant trading on multiple trading spaces. The dominant view on HFT and AT is that it provides liquidity and higher volumes and therefor is positive for the financial markets. On the contrary, some experts argues that these kinds of innovative trading created phantasm liquidity or at least false liquidity in the order book by positioning and removing the same orders within milliseconds. VEB has a nuanced view on this topic. We agree that HFT and AT as a trading strategy can be very positive but if HFT and AT are used wrongly and in a manipulative mandate, they would have an enormous negative impact on transparency and investor protection.

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Especially retail investors can be harmed by these kinds of trading strategies because there is a lag in time, information and opportunities for retail investors compared to professional investors and HFT and AT traders.

Furthermore, in the Over-The-Counter market ('OTC') for warrants and certificates and regulated markets this problem also occurs. This because of the shift of brokers away from regulated markets onto OTC markets without giving retail investors the opportunity to trade on one of the two venues. As mentioned earlier, this threatens the best execution of orders and trades of retail investors. National regulators should ensure that brokers or issuers provide venue choice to retail investors. At the very least regulators should ensure that if retail investors does not have the venue choice, they can switch easily and without any administrative burdens and cost to another broker which gives retail investors this venue choice.

2. Are there any other issues resulting from the market fragmentation that should be addressed with respect to access to liquidity on exchange and non-exchange trading market systems?

VEB wants to address the general concern that market fragmentation and the lack of a consolidated tape on pre and post trade information, has been contributing to further marginalize retail investors and discriminate them versus institutional and professional investors.

If necessary, the VEB remains open for any further comments on this issue.

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Annex

Annex 1

The "best execution" of retail trades

European equity trades execution
Cost of opportunity analysis[16]

Methodology

- The following statistics are based on full depth order book data prices across 7[(1)] European venues: ***Xetra, Euronext, Chi-X, Turquoise, BATS, Borsa Italiana and Equiduct HybridBook.***
- Only order books trades from continuous trading phases on one specific day: **Thursday January 13th 2011** are considered in the analysis.
- The analysis does not include a UK stock as the UK retail market is different from continental Europe. It is based on the Retail Service Provider (RSP) model: it is a quote driven share dealing: the retail investors will send to the Retail Service Providers a request for quote. The RSPs will provide a quote for the deal. The UK retail investors have no access to the LSE order book.
- Our algorithm compares the real traded price of all trades with the prices available on each of the different venues at the precise point in time for each trade of the day.
- A trade is considered to have missed a better price if:
  - In the case of a buy order, the VWAP[(2)] available on the consolidated market is strictly lower than the real traded price,
  - In the case of a sell order, the VWAP available on the consolidated market is strictly higher than the real traded price.
- For all trades missing the best price, we calculate the optimal split of the traded volume across the relevant venues, prioritising venues accordingly to prices and volume.
- The price improvement is calculated as the difference between the real traded price and the VWAP of the consolidated book i.e. the best available price across all different venues.

(1) : In the fragmentation and Best Execution analytics provided regularly by Equiduct, the venue Tradegate is not part of the reference markets selected by Equiduct. The reasons are linked to the market model and the access to this liquidity as well as a market share below 0.5% on the main European indices which does not qualify it to be in the Equiduct's European consolidated book. European Systematic Internalisers are also not in this panel of reference markets for the same reasons.

(2) Volume-Weighted Average Price - represents the total value of shares traded in a particular stock, divided by the total volume of shares traded in that stock.

[16] This analysis was provided by Equiduct for EuroInvestors

AGEAS

- Number of venues where the stock is tradable during continuous : 5
- Executed value: 32,143,828 €
- # trades: 7,123
- Executed value missing the best price on another venue: 2,853,521 € - **8.9%**
- # trades missing the best price on another venue: 612 – **8.6%**
- # trades executed on the home market missing the best price on another venue: **9.2%**
- Total Value Improvement for January 13th : 1,788 €
- Average Price Improvement for trades missing the best price: **2.9 € - 7.5 Bps per trade**
- Average Price Improvement for trades executed on the HM missing the best price: **3.2 € - 7.6 Bps**
- If we extrapolate for a whole year (~250 days of trading), then the Total Value Improvement for a year would be: **447,000 €**
- Total Value Improvement for a year for trades executed on the Home Market missing the best price: **392,000 €**

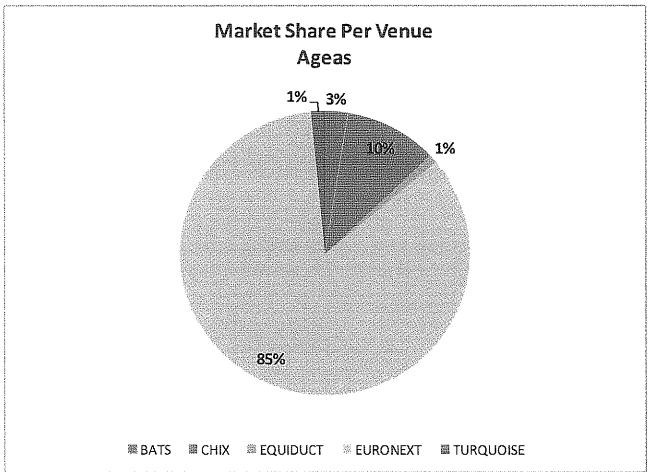

Chart 1: Market Share per venue
It is based on trades occurred during continuous trading only.
It shows that for Ageas, the Home Market only has 85% market share. So when a retail broker sends his clients' orders on the Home Market only, it misses the prices available on the other venues which represent all together 15% of the market for Ageas.

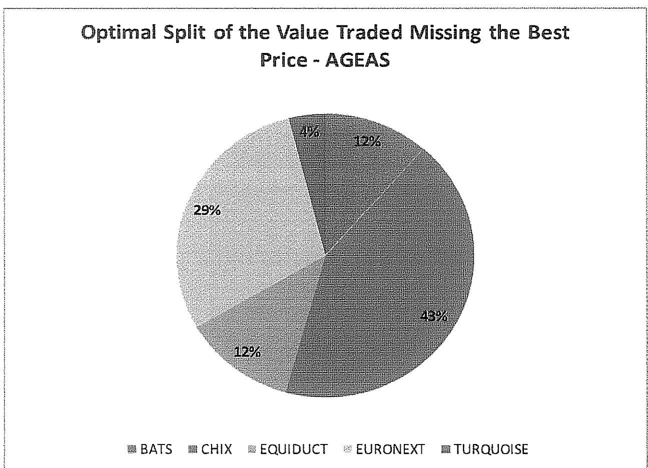

Chart 2: Simulated optimal Split
8.9% of the value traded on all the venues missed the best price available on another venue.
The chart 2 shows how it should have been split to achieve the best price.

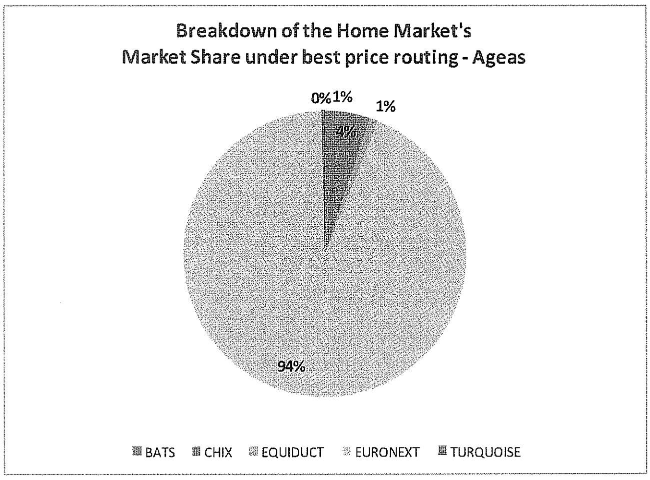

Chart 3: Breakdown of the Home Market market share
It shows that only 94% of the trades occurred on Euronext should have been done there, 6% should have been executed on another venue.

ENI

- Number of venues where the stock is tradable: 6
- Executed value: 417,418,135 €
- # trades: 28,769
- Executed value missing the best price on another venue: 41,900,083 € - **10.04%**
- # trades missing the best price on another venue: 2,930 – **10.2%**
- # trades executed on the home market missing the best price on another venue: **16.3%**
- Total Value Improvement for January 13th : 12,895 €
- Average Price Improvement for trades missing the best price: **4.4 € - 3.5 Bps**
- Average Price Improvement for trades executed on the HM missing the best price: **4.3 € - 3.2 Bps per trade**
- If we extrapolate for a whole year (~250 days of trading), then the Total Value Improvement for a year would be: **3,223,750 €**
- Total Value Improvement for a year for trades executed on the Home Market missing the best price: **2,455,500 €**

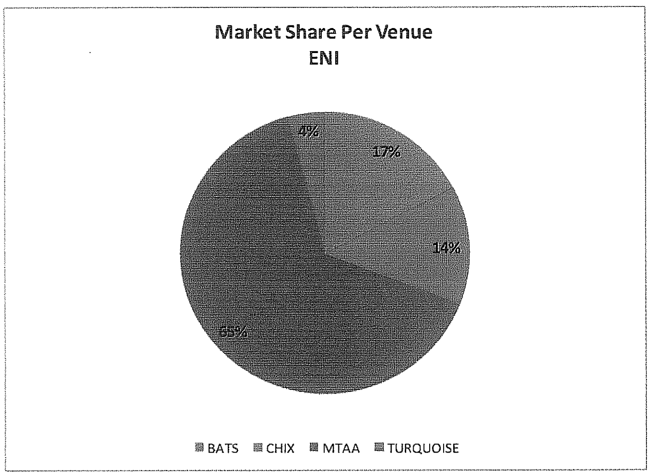

Chart 1: Market Share per venue
It is based on trades occurred during continuous trading only.
It shows that for ENI, the Home Market only has 65% market share. So when a retail broker sends his clients' orders on the Home Market only, it misses the prices available on the other venues which represent all together 35% of the market for ENI.

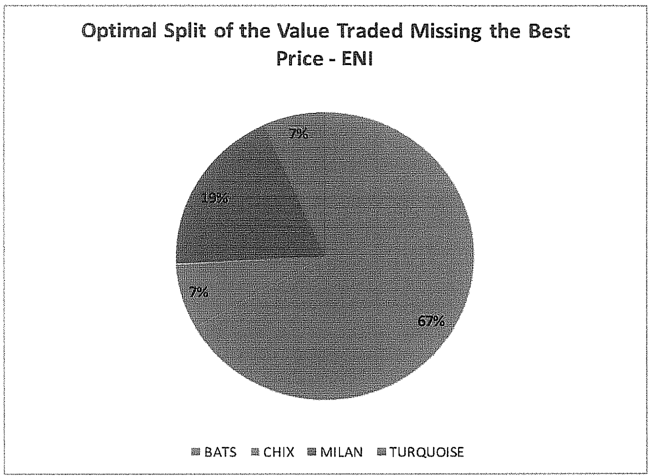

Chart 2: Simulated optimal Split
10.2% of the value traded on all the venues missed the best price available on another venue.
The chart 2 shows how it should have been split to achieve the best price.

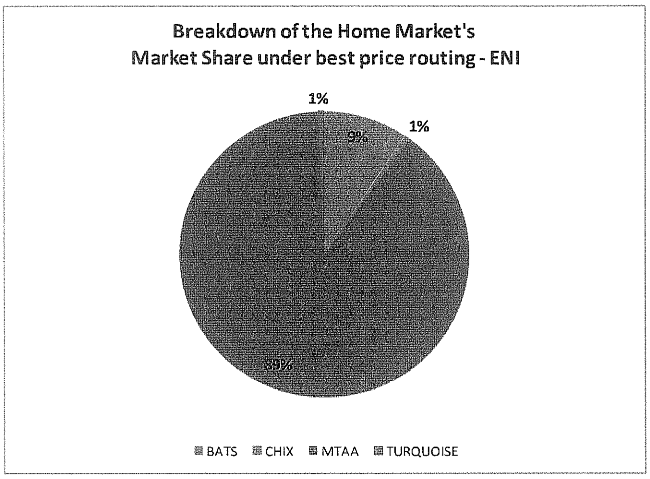

Chart 3: Breakdown of the HM market share
It shows that only 89% of the trades occurred on MTAA should have been done there, 11% should have been executed on another venue.

SIEMENS

- Number of venues where the stock is tradable: 6
- Executed value: 300,797,019 €
- # trades: 24,966
- Executed value missing the best price on another venue: 48,364,237 € - **16.1%**
- # trades missing the best price on another venue: 3,976 – **15.9%**
- # trades executed on the home market missing the best price on another venue: **14.1%**
- Total Value Improvement for January 13th : 7,329 €
- Average Price Improvement for trades missing the best price: **1.8 € - 2 Bps**
- Average Price Improvement for trades executed on the HM missing the best price: **1.9 € - 1.1 Bps per trade**
- If we extrapolate for a whole year (~250 days of trading), then the Total Value Improvement for a year would be: **1,832,250 €**
- Total Value Improvement for a year for trades executed on the Home Market missing the best price: **504,250 €**

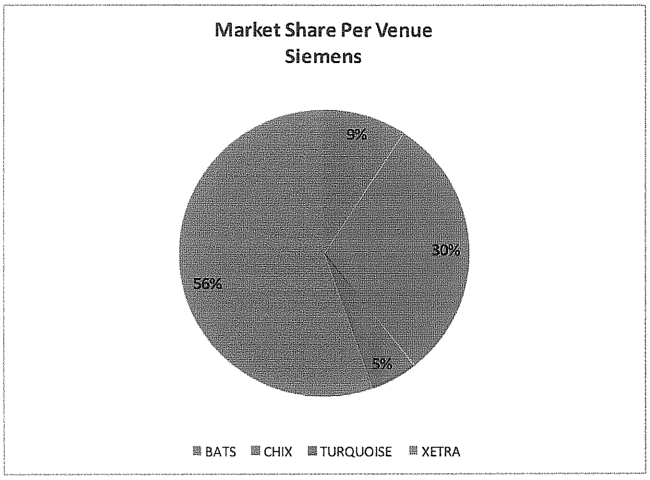

Chart 1: Market Share per venue
It is based on trades occurred during continuous trading only.
It shows that for Siemens, the Home Market only has 56% market share. So when a retail broker sends his clients' orders on the Home Market only, it misses the prices available on the other venues which represent all together 44% of the market for ENI.

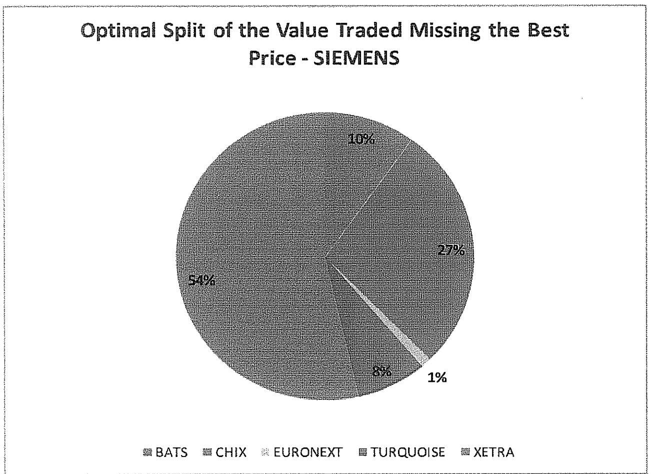

Chart 2: Optimal Split
15.9% of the value traded on all the venues missed the best price available on another venue.
The chart 2 shows how it should have been split to achieve the best price.

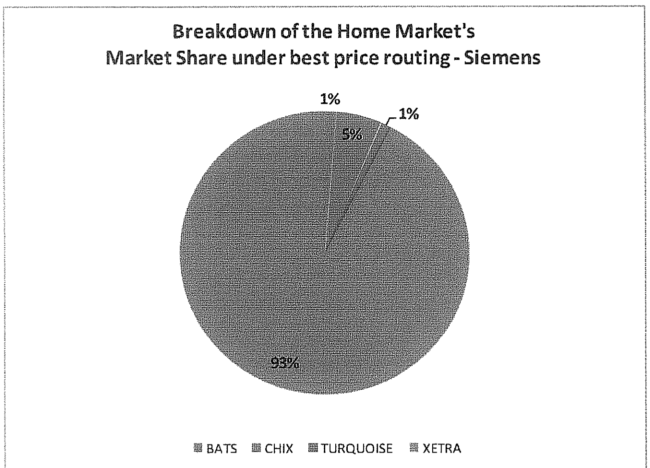

Chart 3: Breakdown of the HM market share
It shows that only 93% of the trades occurred on Xetra should have been done there, 7% should have been executed on another venue.

SOCIETE GENERALE

- Number of venues where the stock is tradable: 5
- Executed value: 468,723,530 €
- # trades: 57,025
- Executed value missing the best price on another venue: 73,864,485 € - **15.8%**
- # trades missing the best price on another venue: 9,418 – **16.5%**

- # trades executed on the home market missing the best price on another venue: **19.3%**
- Total Value Improvement for January 13th : 16,770 €
- Average Price Improvement for trades missing the best price: **1.8 € - 2.5 Bps per trade**
- Average Price Improvement for trades executed on the HM missing the best price: **1.9 € - 2.7 Bps**
- If we extrapolate for a whole year (~250 days of trading), then the Total Value Improvement for a year would be: **4,192,500 €**
- Total Value Improvement for a year for trades executed on the Home Market missing the best price: **3,140,750 €**

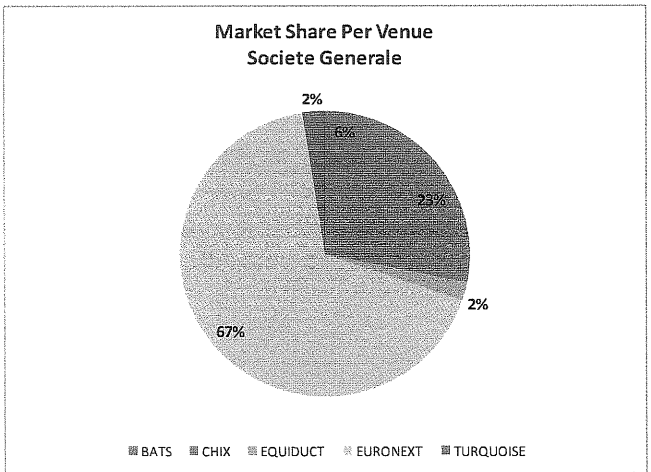

Chart 1: Market Share per venue
It is based on trades occurred during continuous trading only.
It shows that for Societe Generale, the Home Market only has 67% market share. So when a retail broker sends his clients' orders on the Home Market only, it misses the prices available on the other venues which represent all together 33% of the market for ENI.

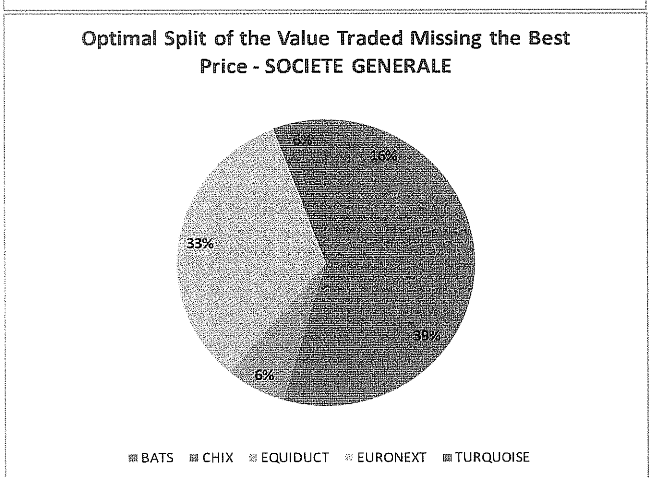

Chart 2: Optimal Split
16.5% of the value traded on all the venues missed the best price available on another venue.
The chart 2 shows how it should have been split to achieve the best price.

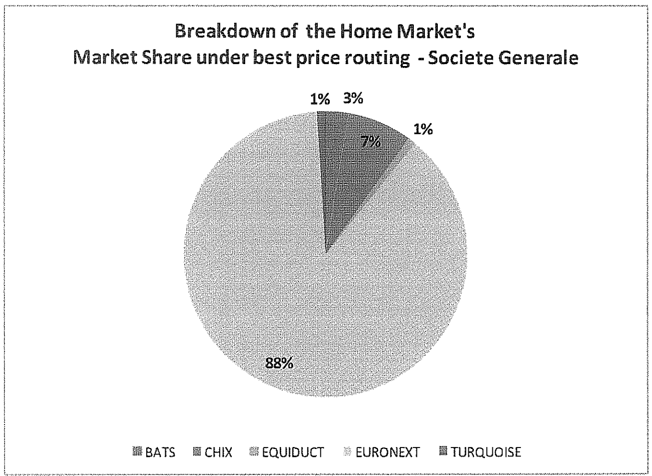

Chart 3: Breakdown of the HM market share It shows that only 88% of the trades occurred on Euronext should have been done there, 12% should have been executed on another venue.

Conclusions

- Brokers only displaying information from the Home Markets would miss between 20 and 40% of the liquidity available on other venues:
  - BEL20: Home Market's market share = 63.2% in December 2010[17]
  - CAC40: Home Market's market share = 61.6% in December 2010[1]
  - DAX30: Home Market's market share = 65.7 % in December 2010[1]
  - MIB40: Home Market's market share = 78.6% in December 2010[1]
- Because the online brokers are often only connected to the Home Markets and because the Home Markets only have ~60% of the liquidity, it results in a cost of opportunity to the investor who has no access to that liquidity and to the better prices sometimes available there.
- **Between 10 and 20% of the trades** executed on the Home Markets could have achieved a better price on another venue.
- The cost of opportunity amounts to a few Euros per trade; in total **6.5M€ per year** for the 4 stocks analysed here only.
- It is most likely that most of the cost of opportunity is supported by the retail investors given that:
  - Retail brokers are mostly only connected to the Home Market
  - They don't have the Smart Order Routing Technology required (for cost reasons) to split the orders and send it where the best prices are.
- MiFID has introduced competition to the equity market but the benefits of that competition are not available to the retail investors

Sources: Equiduct LFA

[17] Source: Thomson Reuters