

MiFID – into the unknown?

In the last few days before the Directive comes into effect Trading Places asked some key players to share their expectations, hopes and fears.

The London Stock Exchange Positioning the exchange for MiFID

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On 1 November 2007, the Markets in Financial Instruments Directive (MiFID) will be implemented in the EU. Undoubtedly a bold piece of regulation, it is ambitious in its scope and its desire for change in the European equity markets, and forms part of the EU's wider push towards the creation of a true pan-European market subject to the same rules and regulations.

There has been no lack of commentary or of predictions covering a multitude of eventualities. But the question still being asked by many as the Directive finally takes force is: "What is actually going to happen?" The short answer is no one knows for sure. While competition has existed in some markets for some time, notably the UK, an apparent release of competition on the scale of MiFID represents uncharted territory for trading across European equity markets. We will only find out what it really means as we live it over the coming months.

Some have predicted that Europe will be transformed overnight to resemble the US equity market, where trading is very fragmented and smaller technologically focussed providers have competed successfully with established exchanges. But this assumption fails to recognise the significant structural and regulatory differences, and investment attitudes, that still exist between different European countries, as well as the web of clearing and settlement providers. Moreover, it also ignores the very real differences between European exchanges today and US exchanges at the time that market fragmented. The electronic, order-driven trading which transformed the US markets has been a key part of European exchanges for the last decade, while the largest US exchange only introduced a public limit order book in 2006.

While trading fragmentation may be a harmless by-product of competition in

the US's more structurally unified markets, in Europe, it could have the less happy effect of adding to the total cost of trading through an increase in data charges for investors and traders, and through impacting the quality of execution as liquidity is spread more thinly. The investment industry's vigilance against the dent this could make in investment returns is one reason why the trading landscape in Europe does not look likely to resemble the US any time soon.

By contrast, Exchange-led developments that could ease post-trade costs, such as fully competing, interoperable clearing services, as well as our continued drive to reduce spreads, are far more certain to deliver cost savings to the market than fragmentation.

Although the US experience is not a blueprint for what will happen in the EU post-MiFID, it does underline the fact that success as an execution venue is inextricably linked with growing liquidity and delivering efficiency wins for the market. Market participants are not loyal to execution venues, but to liquidity, so the test for all venues is whether they can continue to grow the depth of their liquidity pool. Those that do grow are likely to be amongst the winners.

Technology is a key part of our strategy to deepen liquidity, and is already central to what we do. We have just completed a four year investment programme in new technology which has culminated in the introduction of our world-leading TradElect trading system and Infolect, the high performance information delivery system. In addition to serving as the platform for our new MiFID services, TradElect has made our flagship trading service, SETS, faster with even greater execution certainty and with capacity nearly ten times its previous levels. The introduction of Infolect, and the formation of partnerships with a range of information providers has helped us to broaden the reach of our data, so that it is now received in real-time by more than 100,000 professional users across the world.

Faster trading times, greater capacity on the trading system and faster information are resulting in greater volumes as these factors all widen the scope of algorithmic trading strategies. The scale of the change is demonstrated by the fact that the average daily number of trades on SETS has increased to 576,157 in September 2007 compared with 313,303 in September 2006.

Algorithmic traders, like all traders, are also sensitive to cost, which is why we have worked with the market to create new efficiencies. The result of these collective efforts has been reduced cost of trading and enhanced liquidity. Tariff reductions combined with our volume discount scheme mean that the average Exchange charge portion now typically represents less than 4p per £1,000 traded. More significantly, since we demutualised in 2000, spreads have also declined from an average of over 107bps to 10 bps, a reduction of over £10 to £1.20 per every £1,000 traded on the market on a round-trip basis - a huge benefit to investors, while reducing the cost of capital for companies.

Of course, creating liquidity is the very basis of a stock exchange's most fundamental activity; bringing companies and prospective investors together. This is why the Exchange is committed to attracting more issuers to our markets; we had the highest number of IPOs of any major Exchange globally in 2006 and are continually expanding the market for trading products such as ETFs and securitised derivatives. We lobby for regulatory and policy developments that will benefit our market, and make London a more attractive place to do business. As a result of London's success, the number of firms wanting to play a part in our markets has grown and we now have over 385 member firms from nearly twenty countries.

Our merger with Borsa Italiana should significantly amplify the benefits that the combined exchanges are able to offer to the advantage of all, from high velocity algorithmic traders, to niche houses specialising in international equity, or retail investors trading on the order book. Our interests lie with those of the market as a whole. We believe that those interests are best served by price transparency, independent ownership and neutrality clear of any bias. This is what all market participants can and should expect of a strong, credible and trusted market.