

European Commission
Mr Emil Paulis
Director
Director G – Financial Markets
Office SPA2 03/203
1049 Brussels
Belgium

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Dear Mr Paulis,

First of all, I would like to thank you for the interesting exchange of views that we had on the occasion of the panel discussion regarding the MIFID review during the last EUROFI conference in Copenhagen.

One of the points made during the debate was that the discretion that the OTF operator will have in executing client orders will not be a problem in view of the protection offered by the best execution rules.

I would in fact like to challenge this assertion as my experience is that banks are pretty relaxed in the way they fulfill measures aimed at protecting investors, including best execution. For instance, recently my bank changed the way they execute transactions I do through them without even asking whether I would consent to the new execution mode. I incidentally found out about it due to a message posted in the web interface to the bank. This may only be an issue with my bank but I have the feeling it is more than that.

In the same manner, I believe that best execution rules will not protect investors, especially retail investors, against abusive discretion in the execution of their orders by OTF operators. The possibility to exercise discretion with respect to order execution will allow the OTF operator to choose who he wants to match against who. This is dangerous as it builds a system where the operator of the OTF, by exercising discretion, may favor certain investors to the detriment of others i.e. allow some informed investors to gain from being matched with uninformed (retail) investors.

The best execution framework is difficult to apply and therefore to control. Rules around best execution are very flexible as many different factors enter into the determination of what is best execution. For instance, speed and likelihood of execution can be used to justify a worse price. Moreover, best execution is evaluated in relation to the execution policy offered by the firm, which can be restrictive provided that the client receives information about what is offered. One should keep in mind that it is these shortfalls that have facilitated the execution of retail orders OTC. Will these rules now be a protection in the case of OTF? I have serious doubts. In addition, the more orders are withdrawn from venues with non-discretionary execution (RMs and MTFs) the less relevant will be the price on these venues which is nonetheless suppose to be a benchmark in assessing best execution on other venues.

It is also uncertain whether investors, in particular retail, will understand the implications of discretion, even if they are informed. In this respect, the express prior consent of investors, which is asked in a number of cases by the present MIFID rules, does not ensure in practice that the investor gives its consent (as mentioned above) since many regulators have considered that mere information is sufficient.

Also, according to the Commission's proposal, the prior express consent of the investor will not even be necessary to execute its orders on an OTF as OTFs will be considered as regulated venues.

My view is that it is essential to set a market organization allowing that as many investors as possible see and access the trading interests expressed by other investors and that orders are matched in a fair manner i.e. on a non-discretionary basis.

The best solution to limit the amount of OTC trading and make sure such trading is properly regulated would be to clarify the MTF definition and introduce an OTC definition in the corpus of the legislation (not a recital –we have already sent to you and your services a proposal to this effect) as well as specifying the requirements applying to them. The internal crossing networks which have all characteristics of MTFs should be classified as such and discretion not allowed. It is important to have a definition of what can be OTC and what should be executed on trading venues. In this respect, it appears appropriate to maintain an OTC space where only some selected bilateral trading interests interact with one another, but it needs to be better controlled to make sure that OTC transactions are carried out bilaterally and only when justified (i.e. large sizes).

For the reasons listed above, creating an OTF category, allowing execution of orders on a discretionary basis will undermine further the fairness and efficiency of financial markets in Europe. In addition, introducing yet another category of execution venue will increase market fragmentation and pose further challenges in terms of market surveillance.

It is also important that the prior express consent of client prior to execution of orders outside a RM or an MTF is really express. Some jurisdictions consider as express consent when the client does not reply. This should not be accepted, when the client does not reply the firm should consider that the client has not agreed.

In any instances, should the OTF category remains for equity instruments I believe that retail order flow should stay out of OTFs in consideration of the above.

I hope you will find this information useful and will be happy to complement it as necessary, including with a follow-up meeting.

Yours sincerely,



Hans-Ole Lachumsen
President NASDAQ OMX Nordic