

## REVIEW OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID)

### Reply from the European federation of Investors (EuroInvestors)

2 February 2011

#### EuroInvestors

*EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on investments, savings, borrowings and Personal Finances of individuals in Europe, by grouping the organisations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.*

#### Executive Summary

##### • Capital markets structures

The Markets in Financial Instruments Directive (MiFID) came into force on 1 November 2007. In the name of a quite theoretical notion of “competition”, it allowed and promoted the fragmentation of European equity markets: “MTFs” were created in addition to the existing “regulated markets” (“RM”); OTC trades were also encouraged and could represent today about 40 % of the trades, although no one really seems to know for sure. The results are quite damaging for investors, especially individual ones<sup>1</sup>:

- Order (“pre trade”) and trade (“post trade”) data transparency has deteriorated considerably, as small investors do not usually get the data from the new market venues, i.e. they now probably miss about 50% or more of the data;
- The costs for collecting consolidated market data are now much too high for small investors. MiFID has ignored the nature of capital markets data as a public good.
- The average size of disclosed trades has collapsed, but certainly not the orders’ size from end investors, and studies on the impact of the markets fragmentation on liquidity are contradictory at best.
- The “best execution” of retail orders - especially in terms of best price - is simply not the case according to a recent study<sup>2</sup>.
- The cost of shares’ trading for small investors (transaction and information costs) has not decreased.

<sup>1</sup> See for example the European Investors Working Group (EIWG) report “Restoring Investor confidence in European Capital Markets”, February 2010, pages 5 and 13:  
<http://www.ceps.eu/book/restoring-investor-confidence-european-capital-markets>

<sup>2</sup> See Annex 1: Equiduct study for EuroInvestors, January 2011

Overall, MiFID has helped to further marginalize individual investors, despite the fundamental economic purpose of the capital markets (as opposed to intermediated finance) which is to connect directly end investors and issuers of capital. MiFID facilitated the re-intermediation of equity markets to the benefit of financial intermediaries - especially the big ones who could invest enough in information technology to profit from the fragmentation – and to the detriment of non financial issuers as well as end investors, pushing those further to “packaged” – i.e. high embedded commissions - products.

This marginalization of small investors has continued in the MiFID revision process which has largely ignored their complaints:

- The CESR technical advice to the Commission barely takes EFI’s requests into consideration if any (we refer to our replies to CESR’s consultations on secondary equity markets<sup>3</sup>, on investor protection and intermediaries<sup>4</sup> and on non equity markets transparency<sup>5</sup>).
- This European Commission consultation paper claims that “*the Directive has driven ... better protection and services for investors*” and that “*positive feedback has been received from market participants*”, while retail investors’ feedback has been mostly negative, in particular, at the Commission’s Public Hearing on the Review of the MiFID (20 September 2010)<sup>6</sup>.

EFI is also surprised by the lack of evidence produced in the Commission’s consultation document to support these assertions.

Small and medium size end investors ask urgently for:

- A fact-finding study being conducted on the impact of MiFID -induced changes on small and individual investors, and the consequences on the economic and social value of the now largely “re –intermediated” European capital markets;
- a publicly enforced and controlled “consolidated tape” both for pre- and post-trade data, which must be easily and freely accessible by all investors in the equity market at least as before the introduction of MiFID;
- The actual enforcement of the “best execution” duty;
- The reduction of “dark” and OTC trading to more acceptable levels, certainly less than 10% of total market activity;
- The thorough improvement of pre- and post –trade transparency of fixed income products sold to retail investors;
- A minimum liquidity level of these fixed income securities sold to retail investors on the secondary market.

<sup>3</sup> [http://www.esma.europa.eu/popup\\_responses.php?id=5550](http://www.esma.europa.eu/popup_responses.php?id=5550)

<sup>4</sup> [http://www.esma.europa.eu/popup\\_responses.php?id=5562](http://www.esma.europa.eu/popup_responses.php?id=5562)

<sup>5</sup> [http://www.esma.europa.eu/popup\\_responses.php?id=5627](http://www.esma.europa.eu/popup_responses.php?id=5627)

<sup>6</sup> See

[http://ec.europa.eu/internal\\_market/securities/docs/isd/20100920/euroinvestors\\_euroshareholders\\_g\\_prache\\_en.pdf](http://ec.europa.eu/internal_market/securities/docs/isd/20100920/euroinvestors_euroshareholders_g_prache_en.pdf)

• **Investor protection**

Investor protection is one of the key objectives of the MiFID Directive.

EFI welcomes several proposals from the Commission such as:

- The better identification of “complex” investment products which would require an “appropriateness” test from the intermediaries before any selling to non –qualified investors;
- The incompatibility between getting paid by providers on product sales (“inducements”) and using an “independent advice” label, with some qualifications.

But some **critical issues for investor protection are unfortunately not addressed** by the consultation document:

- **The insufficient enforcement of the fair information rules<sup>7</sup>**: we have evidence of widespread misleading information to retail investors that is persisting year after year<sup>8</sup>. It is unfortunate that the Commission seems not to have investigated the actual implementation of this key provision of MiFID over the last three years.

- **The widespread and misleading use of the “advice” and “advisors” words in MiFID:**

As long as financial intermediaries’ remuneration is mostly coming from the investment products providers, these intermediaries should not be allowed to label themselves as “advisers”: they are not advisers but sales people. Why do regulators allow and promote such a misleading labeling of sales professionals as “financial advisers” in the retail investments area that is so critical to the future well –being of EU citizens?

- The necessity for **unbiased, competent and knowledgeable advice** and in the interest of the client: *“recent developments in financial markets have highlighted how the sale of financial products to retail consumers has been influenced by unbalanced fee structures and compensation mechanisms. In some cases, such compensation mechanisms compromise the ability of investment advisors to uphold the primacy of customers’ interests.”*<sup>9</sup>
- The actual **justification and disclosure of the so –called “inducements”** and sales –based remuneration of “advisors” by product providers: this key investor protection feature of MiFID is not properly enforced in Member States and is even ignored by CESR’s “Consumer guide to MiFID” despite the requests from investor and consumer advocates<sup>10</sup>.
- The necessity for MiFID investor protection provisions to **cover all retail financial investment products** offered to EU citizens, and not only – as it is currently the case – about only one fifth of them (securities and funds). The “PRIPs” initiative is unfortunately unlikely to meet this objective because of its now too narrowed scope (we refer to our reply to the PRIPs Consultation<sup>11</sup>).

<sup>7</sup> Article 19.2 of the Framework directive and article 27 of the Implementing directive

<sup>8</sup> See case study attached as annex 2

<sup>9</sup> The European Investors Working Group (EIWG) report “Restoring Investor confidence in European Capital Markets”, February 2010:

<http://www.ceps.eu/book/restoring-investor-confidence-european-capital-markets>

<sup>10</sup> See FIN-USE 2008 report, page 9:

[http://ec.europa.eu/internal\\_market/fin-use\\_forum/docs/annualrep\\_2007\\_en.pdf](http://ec.europa.eu/internal_market/fin-use_forum/docs/annualrep_2007_en.pdf)

<sup>11</sup> <http://euroinvestors.org/upload/positions/EFI%20PRIPs%20reply%20to%20EC%20%202011%2001311296556000.pdf>