

## Multiple venues leave Europe 'open to abuse'

By Jeremy Grant

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"Layering", "spoofing" and "painting the tape" are just some of the underhand practices that crop up from time to time in equity markets.

But regulators could soon be using these terms much more frequently in the wake of fresh warnings about the potential for market abuse in Europe.

A group of consulting groups in Britain has published a study showing that the fragmentation of trading venues as a result of the Markets in Financial Instruments Directive (Mifid) has left Europe open to abuse by traders wanting to manipulate the markets.

They contend that the fragmentation of trading across multiple venues - exchanges, newer platforms and dark pools - means that regulators cannot spot fraud as easily - and may be missing it completely.

That will come as unwelcome news to the architects of Mifid in Brussels who devised it as a way of spurring competition, allowing the emergence of "multilateral trading facilities" and lowering trading costs for investors.

It is also likely to fuel a row between exchanges and their smaller rivals over who is better at keeping tabs on market abuse.

The consulting groups behind the Alliance of Independent Advisors to Financial Markets, or Avenues, argue that the function of ensuring markets are fair - such as the surveillance of bids and offers and executed trades - is "now almost impossible to undertake comprehensively".

It says the potential for abuse has been heightened by the fact that a Market Abuse Directive passed by the European Commission came into force two years before Mifid in 2007, when no MTFs existed and when most trading was done on national exchanges.

Yet with the advent of Mifid, as much as half of trading in some big name stocks takes place away from exchanges, so surveillance staff only see a fraction of activity in many stocks. Last month, the London Stock Exchange's share of trading in FTSE 100 stocks dipped below 50 per cent for the first time.

"No single exchange now sees all the activity on any given stock for which they are responsible. MTFs do not invest in comparable surveillance infrastructures and internal broker-dealer 'crossing networks' [dark pools] are in effect unregulated in Market Abuse Directive terms," Avenues says.

Similar concerns have been raised in the US, where equity markets are fragmented between the New York Stock Exchange, Nasdaq and smaller platforms such as BATS and Direct Edge.

Rick Ketchum, chief executive of the Financial Industry Regulatory Authority, which regulates US brokerage firms, recently acknowledged that "the decline of the primary market concept, where there was a single price discovery market whose on-site regulator saw 90-plus per cent of the trading activity, has obviously become a reality".

Mats Wilhelmsson, chief operating officer at Scila, a Swedish seller of market surveillance systems - and a former head of surveillance at the Swedish markets regulator - agrees with Avenues' conclusions. He says that "some types of market manipulation are much easier to execute in the post-Mifid environment because of [market] fragmentation".

He singles out "front-running", where a broker, knowing a client has a large buy or sell order, will carry out a buy or sell order of its own first, to take advantage of the price movement that the broker knows the client order is likely to have once it is placed in the market.

Layering and spoofing were the focus of a recent warning to the UK markets by the Financial Services Authority, which warned brokers to be aware of such practices, which involve placing orders on an exchange to give an artificial impression of an intention to buy or sell shares.

Avenues says such abuses including painting the tape - involving placing multiple buy and sell orders to artificially move a stock price up or down - are harder for regulators to spot because of the speed of electronic trading and need for sophisticated "real time" systems to spot them.

The ability to police for fraud has become a flashpoint between exchanges and MTFs as the two sides battle each other for a bigger share of trading.

The MTFs deny they are less able to carry out proper surveillance. Alasdair Haynes, chief executive of Chi-X Europe, which offers trading in shares across 14 European markets, says: "We are concerned about unsubstantiated allegations . . . which may seek to characterise MTFs . . . as offering lower standards than incumbent exchanges. We . . . believe that these may be motivated by commercial, competitive objectives," he says.

Joost van der Does de Willebois, chairman of Euronext Amsterdam, the Dutch segment of NYSE Euronext, says Euronext has long been required by regulators to maintain a "market integrity unit" of surveillance staff to monitor markets - not a requirement for MTFs. "We would argue that Mifid has created an unlevel playing field for which we have good evidence. It all comes down to cost, they compete on lower costs," he says.

Brian Taylor, managing director of BTA Consulting, a member of Avenues, argues that industry and

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regulators should come together to create a "utility" to carry out surveillance across Europe, involving all venues and not just exchanges.

Regulators in Brussels are set to review the market abuse directive later this year. Maria Velentza, head of the securities markets unit in the European Commission's directorate-general for the internal market and services, which is reviewing Mifid, says Brussels will study the issue. "We are going to fix this."

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