

# Executive Summary

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The purpose of this paper is to compare the EU and U.S. securities regulations. In November 2007, the Market in Financial Instruments Directive 2004/39/EC (MiFID) came into force in the EU, and brought about deep changes in the market infrastructure. The same year Regulation NMS in the United States was fully enacted and reformed equities markets. This study compares MiFID with the corresponding U.S. regulations, and primarily focuses on the regulatory and supervisory framework, trading venues, and the provision of investment services. Implementation of the rules, enforcement, and right to redress are beyond the scope of this paper. Likewise, the paper does not intend to judge the effectiveness of the two regulatory systems.

The international financial crisis evidenced some gaps in securities regulations. Main issues have focused on the imperfect oversight of large interconnected institutions, the low transparency of OTC markets, especially derivatives, and the insufficient liquidity and capital across financial institutions. Regulators on both sides have announced plans to address them:

- **A better supervision of large and interconnected institutions:** Under the U.S. regulatory reform plans, the Federal Reserve would have the power to conduct consolidated supervision and regulation of all large interconnected financial firms. These firms will be subject to the non-financial activities restrictions of the Bank Holding Company Act, regardless of whether they own insured depository institutions. In the EU, a Systemic Risk Council would be established to identify systemic risks to the financial system, and the European System of Financial Supervisors would enhance the supervision of cross-border institutions. One substantial difference remains the plan to separate financial and commercial activities in the United States, while this is not currently considered in Europe.
- **Increase market transparency:** In the United States, the Treasury unveiled a comprehensive reform of OTC derivatives in May 2009: all “standardized” OTC derivatives would be cleared, dealers and firms who create large exposures to counterparties would be subject to tough regulation (with conservative capital requirements, business conduct standards, margin requirements), and un-cleared trades would be reported to a regulated trade repository. The EU Commission is examining several courses of action for OTC derivatives: standardization, central data repository, central counterparty clearing and moving trading to more public venues. In both regions, there is a risk of adding carve-outs to the regulation of derivatives as industrial firms claim that the clearing would incur significant costs. As regards OTC equity markets, the SEC and CESR are currently investigating whether dark pools should be subject to stricter regulation.
- **Enhance capital and liquidity requirements:** The U.S. draft systemic risk legislation proposes to raise capital and risk management requirements for all

Financial Holding Companies. In the EU a comprehensive reform of the Capital Requirement Directives is currently under review. Both approaches consider stricter capital requirements to address the exposure to securitized products.

The paper argues that rules in the current securities regulations may differ on both sides of the Atlantic, but objectives and some of the outcomes are comparable. Differences are related to:

- **The scope of trading venues:** MiFID is not currently applied to dark pools, while in the United States, dark pools are considered as ATS and register as broker-dealers. They have to make their quotes available to the public above a certain trading volume threshold.
- **EU regulators have more discretion in authorizing investment firms** and intervening in their management since they can judge whether the managers of investment firms or Regulated Markets are sufficiently experienced and reputable, while the U.S. regulator can only control their reputation and competences. The EU regulations go one step further in allowing supervisors to control the integrity of ultimate controllers of Regulated Markets regardless of their ownership, while the U.S. rules generally base the notion of control on ownership.
- **Organizational requirements** are broader in scope for exchanges in the United States and focus on disciplinary powers, which is explained by the self-regulatory role of exchanges in the United States versus a more limited role in the EU.
- **Capital requirements** are risk-based in the EU and based on the concept of maintaining a highly liquid core of capital in the United States.
- **The mitigation of conflicts of interest** is a broad and general obligation for investment firms in Europe while it is focused on more specific situations in the United States.
- **Investor protection rules** in Europe are two-tiered between retail and professional investors (client categorization is binding), while the U.S. regulatory scheme protects all investors, with some carve-outs for institutional investors.
- **Best execution** in the United States covers a number of factors, with price being typically the most important; in Europe price is one factor among others to assess whether the client has obtained the best possible result for the execution of its trade.
- **Data consolidation on equity trades:** in the United States, quotes and transaction data reported by national exchanges and associations are consolidated into a single system and disseminated to market participants, whereas in Europe, quotes and trades are fragmented between multiple trading venues and no consolidation is required.

However, the objectives of the securities regulations are similar, and some outcomes are comparable:

- Both regulatory systems aim to maintain fair and orderly markets, protect investors, and provide price transparency.
- **Equity securities are subject to more scrutiny** and transparency requirements than bonds or derivatives. In the two regions, pre and post-trade transparency requirements apply to equities while there is no or limited transparency regime for derivatives and bonds.
- **Investor protection regimes are broad** and offer better protection to individual investors, whether the rules to achieve such protection are strictly tiered or not.
- **Competition has increased in Europe**, but trading has become more fragmented and liquidity has moved from exchanges, raising the concern of “fragmented liquidity” that led *inter alia* to the adoption of Reg NMS in the United States. In both regions consolidation between exchanges stepped up and it seems that an increasing share of equity trading moved to dark pools.
- **There are concerns on both sides regarding the fragmentation of oversight.** The U.S. SEC does not oversee futures and government bonds; it shares supervisory responsibility with the banking supervisors which oversee commercial banks dealing with securities. In Europe, MiFID is implemented by 27 national supervisors which may lead to different interpretations.

A discussion on the outcomes cannot really be achieved without looking at the implementation of the securities regulations. Thus, the study suggests some directions for future research:

- Assess enforcement on both sides, at the SEC and SRO level in the United States, and at the level of the 27 supervisors in the EU;
- Deepen the knowledge of dark pools on both sides and examine how to improve disclosure and price discovery;
- In Europe in particular, examine ways to achieve quotes and trades consolidation.