Response to European Commission public consultation

REVIEW OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MiFID)

January 2011

From: Share plc & The Share Centre Limited

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1. CONTEXT

1.1 The Share Centre is one of the UK's leading independent retail stockbrokers. Formed in 1991, its services are offered predominantly online (www.share.com) and its business model is mainly execution-only combined with custodial investment administration. All services are agency-based; there is no principal trading on the Group's own account. On-demand investment advice is provided free of charge. Services are priced very competitively and market research reports that customers are very pleased with the service they receive. We do not provide spread betting or contracts for difference services.

1.2 The Group, which is based in Aylesbury, Buckinghamshire, also operates an MTF (Sharemark) offering trading services for small and medium-sized businesses, and fund accounting services for OEICs (share funds). There are no institutional shareholders of the Share Centre's parent company, Share plc, which is quoted on the AIM market, and which has c. 60,000 personal investor shareholders. The Share Centre looks after c. 220,000 personal investor customers.

1.3 At present almost all investment activities are UK-based. The Share Centre had hoped to use the opportunity offered by MiFID to offer cross-border services, particularly to expatriate UK nationals living in other EU countries. However the absence of cross-border electronic identity verification for anti-financial crime purposes has made this impractical at present. We would prefer to see EU effort being directed to this end in order to create a genuine single market for investment services, particularly in the retail field where this is proving so difficult.

2. GENERAL COMMENTS

2.1 As stated above, greater competition has not yet been achieved across Europe in the field of retail investment. However from other regulatory perspectives MiFID is generally working satisfactorily. There
are some areas, such as fragmentation of information, where improvements are needed; but the extensive consultation and debate which accompanied MiFID's initial introduction have proved successful in enabling an acceptable regulatory environment.

2.2 However several of the proposals included in the current public consultation are not helpful in achieving the objectives of:

- contributing to deeper, more integrated and liquid financial markets
- driving down the cost of capital for issuers
- delivering better and cheaper services for investors

Indeed they are likely to have the opposite effects. The worst examples of these are in the field of so-called investor protection, where the proposed measures would remove choice from people and drive up costs as a result of a 'nanny state' attitude which is at best sanctimonious and at worst patronising.

"Investor Protection"

2.3 The proposed emasculation or abolition of execution only investment services is the worst example in this respect. For personal investors, it would deter or exclude ordinary people from owning shares directly, thus necessitating institutional intermediation on a scale that would drive a wedge into the heart of European democratic capitalism.

2.4 It has recently been shown that over a quarter of all UK quoted companies are owned by personal investors, and this rises to over a third when the share ownership of individual directors is taken into account. Much of the rise in individual share ownership in the UK is directly attributable to execution only retail stockbrokers. We know this because their shares are held in identifiable pooled nominees. The investors who have chosen these shareholdings have done so using online research and media providing a quality of content which is now
of institutional investor standard. They are people who are fully capable of assessing the appropriate level of risk and reward themselves, but they are also not generally from a wealthy or privileged background. They have access to a practice account and the e-learn section on our website, www.share.com, if they wish to develop their familiarisation at any stage, but they would not welcome the imposition of an appropriateness test before they were allowed to open an account or to deal in ordinary shares or funds; in fact this would substantially reduce the number of people who engaged in personal share ownership. I attach a wholly unprompted letter from one of our customers, with his permission, to this effect (Appendix 1), together with an example of another customer’s views in response to our report on your consultation (Appendix 2). You may also be receiving a large amount of direct contact on this issue.

Hence our comment about driving a wedge into democratic capitalism, at the core of which is personal share ownership.

2.5 These individuals also invest in companies that they research and get to know quite deeply, and these include many smaller and medium-sized businesses which are traded on AIM and other non-regulated markets. As your proposal states in section 2.6, such businesses contribute significantly to economic growth, employment, innovation and social integration across Europe. A high proportion of the capital which drives such companies comes from personal investors trading on an execution-only basis. Yet these are the very investors that you seek to irritate or exclude by virtue of either option A or option B in section 7.2.1. Indeed your proposals would purport to prevent many of our own shareholders from dealing in our own shares, since Share plc is AIM quoted.

2.6 Finally, in the field of personal investment we are drawing the conclusion from your proposal that the EU regards mixed portfolio investment to be the preserve of the wealthy; ordinary people would
only have access to lowest common denominator funds of a 
• stakeholder• variety. This conclusion relates not only to the 
execution only proposals but also to the proposed exclusion of on- 
demand investment advice. Having spent the past two decades in 
opening up investment opportunities for all comers, we find this 
approach deeply patronising. The exclusion of on-demand free 
investment advice would be necessitated by the requirement for 
regular reports and written reasoning, whose cost would have to be 
factored in. Services would inevitably be restricted to discretionary 
wealth management, inaccessible by ordinary people.

Regulation drawn up to deal with the complexity and conflicts inherent in dual capacity financial institutions

2.7 it is also our view that much of the complexity and rigour of the 
further proposals to change MiFID are a direct result of your having to 
deal with businesses who deal both on their own account and as agent 
for their customers. We recognise this challenge, and consider that it is 
time to roll back the move towards dual capacity in two respects:

- to reduce the systemic risk to the financial system so graphically 
illustrated in the credit crunch and banking crisis;
- to allow businesses to be certified as • agency only • investment 
businesses, and therefore be subject to a lighter and more 
appropriate level of regulation.

The conflicts in dual capacity investment banks were brought into 
sharp relief for us recently in a • think tank • discussion on the quality 
of investment research provided by such institutions. Several analysts 
from these businesses accepted that the order of priority given to this 
information was:

1. Their proprietary trading desk (principal capacity);
2. Their corporate advisory department
3. Their investment client advisory business, including fund management (agency).

This priority sequence explains why the quality of investment bank research can be seriously compromised, such that their active fund management businesses provide very poor investment performance when compared to their benchmarks.

We consider that there is scope for significant simplification of the proposals for MiFID if some measures are restricted to dual capacity (principal and agent) businesses, and if pure agency investment businesses are clearly identified. These apply particularly to the trading and information parts of the proposal (sections 2, 3, 5, 7, 8, and 9).

3. SPECIFIC COMMENTS

3.1 Section 2 - Developments in Market Structures

Q1: The definition of admission to trading is satisfactory provided that the definition of organised trading facility is not drawn up in such a way as to treat instruments trading thereon as complex; this has particular reference to the LSE AIM market and similar UK markets.

Q2/3: we are supportive of the "catch-all" definition of organised trading facility subject to the following:
- There are certain trading venues which are quasi systematic internalisers and should be dealt with elsewhere (perhaps by way of extending and clarifying the definition of a systematic internaliser), with particular reference to our general comments on dual capacity firms.
- There should be no bar on bilateral trading between two principals.
- There should be no association between organised trading facilities and the definition of a financial instrument traded thereon as 'complex'.

- We are concerned that this new category may complicate the operation of Retail Service Providers (RSPs), which are vital for the efficient operation of UK retail investment in shares of ordinary companies. It is not appropriate to categorise RSPs as Systematic Internalisers, MTFs or organised trading facilities.

Q4: We agree that it is necessary and appropriate to create a separate investment service for operating an organised trading facility. However, given the lighter regime attached to this investment service, we would question whether it should be possible to passport the facility.

Q5: We would support the conversion of all alternative organised trading facilities to MTFs above a threshold. There are other national considerations to be borne in mind (e.g. taxation status), and there are many different types of facility which need separate treatment. There should be no global capping of activity outside regulated markets and MTFs. This would handicap EU businesses against overseas competitors.

Q6/7: The proposed sub-regime for crossing networks is potentially problematic, in that this could create regulatory arbitrage between organised trading facilities seeking to de-classify themselves as crossing networks in order to benefit from a more proportionate regime. It will also add a further level of complexity.

Q8: No comment – we do not trade in derivatives.
Q9: No comment.

Q10: No comment.

Q11: No comment.

Q12: No comment.

Q13: No comment • We do not conduct algorithmic trading.

Q14: Generally positive.

Q15/16/17: No comment.

Q18: No, provided that best execution arrangements are not made more prescriptive.

Q19: Generally positive.

Q20: We would prefer the alternative ratio basis.

Q21/22: This is a particularly relevant area so far as our general comments on dual capacity are concerned. We support the general principle here that systematic internalisers should contribute to price formation. However, we are concerned that in the pursuit of more dual capacity firms being categorised as systematic internalisers, the net will be cast too widely and could damage RSP services in the UK. As with many of these proposals, there is a thread of ‘one size must fit all’ philosophy which may undermine the variety and flexibility of investment services throughout the EU; there should be more provision here and elsewhere for subsidiarity.
Q23/24: Whilst the suggestions appear sensible in theory, this will narrow the differentiation between regulated markets and MTFs. In practice, regulated markets and MTFs will require similar systems and controls needed to ensure similar regulatory standards. However, MTFs will lack the kudos of regulated market status and domestically will be unable to classify themselves as exchanges, or have their admitted securities given the status of being listed.

Q25/26: The key to improving the processes for raising finance for SMEs through capital markets (the issue of shares) is to enable, so far as possible, unfettered access to personal investors; these are the principal suppliers of capital for SMEs, and make possible relatively liquid secondary markets. We have no objection to defining an SME market and support the criteria suggested for its definition (although 35% looks high in relation to the UK market), provided that this is a subset of regulated market or MTF status. However the proposals in section 7 run directly counter to the objectives behind the proposals in section 2.6.

The UK has one of the most effective SME markets in the EU in AIM, yet even this market is plagued with inadequate liquidity and inappropriate valuations in the secondary market as a result of a placing mechanism which leaves the control of shareholdings in the hands of a pitifully small number of micro-cap institutional investors and discretionary high net worth private client brokers.

There are a great many execution only personal investors who would apply for shares in SME primary offers if restrictions were lifted and the market mechanisms improved. Firstly, the new thresholds for the Prospectus Directive (€5m and 150 investors) should be lifted significantly. The argument that a
higher threshold would render all issues in certain East European countries as falling below the catchment area for the Prospectus Directive is unacceptable and discriminatory against the UK.

Secondly, a clear statement should be made that all ordinary share capital (equity shares) in conventional trading companies will continue to be treated as non-complex. Any attempt to place an appropriateness test in front of personal investors' access to SMEs will significantly damage their capital raising capacity and it should be borne in mind that many local personal investors know far more about the characteristics of their preferred SME than they do, for example, about safety standards on drilling rigs operated for BP.

Thirdly, there are corporate finance quasi-cartel arrangements in SME markets which need to be challenged. This is the role of competition authorities, not MiFID. Improved competition will result in lower issuer costs for SMEs as a result of a more standard approach to corporate advice, due diligence and distribution.

Finally, some thought needs to be given to the much lower levels of trading liquidity in relation to SMEs, such that there is some regulatory proportionality in being able to admit securities to trading, where liquidity may result in infrequent transactions amongst smaller numbers of shareholders.

3.2 Section 3 - Pre- and Post-Trade Transparency

Q27-31: it is not appropriate that market orders of a size capable of moving a market price should be permitted to use "dark pools" of liquidity and therefore remain hidden while all limit orders
arising from personal investor business – most of which cannot by themselves move market prices – are required to be published. We therefore support the pre-trade transparency of actionable indications of interest and all subsidiary questions regarding publication of institutional orders or post orders.

If this is not adopted, we feel the requirement to publish retail scale limit orders should be removed due to continued exclusion of the larger orders which influence price formation. The requirement appears to deter some retail stockbrokers (not ourselves) from handling limit orders beyond the current day's trading, thereby introducing a handicap to efficient operations. Meanwhile it contributes a negligible amount towards price formation.

The commission should either be taking pre-trade transparency seriously and require publication of all orders, or not mandate something which is little more than a charade.

Q32: we are generally in support of shortening post-trade publication times, although one minute may cause problems for certain market practitioners for technical reasons.

Q33/34: Generally supportive of these proposals.

Q35: Generally supportive.

Q36: While remaining generally supportive, SME provisions should not be too prescriptive for the reasons given in reply to Q25/26.

Q37-41: The proposals in this section appear unduly prescriptive, and we consider it best not to burden market activities with such a level of detail.
Q42: We are generally supportive of identification and flagging of OTC trades, although allowance needs to be made for such trades to be handled by non-regular market participants, without access to immediate reporting technology.

3.3 Section 4 - Data Consolidation

Q43-46: The proposals fail to recognise that the key problem with data consolidation is not the functioning of Approved Publication Arrangements operated by individual regulated markets, MTFs or organised trading facilities, but the lack of aggregated, comprehensive data in a fragmented market. It is MiFID which has encouraged this fragmentation and therefore exacerbated the problem itself.

The obligation to aggregate cannot be on individual market structures but must be on data publishers, including the electronic and printed media. It should not be permitted to publish financial data unless reasonable endeavours have been undertaken to ensure that the data is comprehensive. For example, on Share plc's first day of trading just 4,000 shares were traded on the LSE's AIM market and over 800,000 on Plus Markets Group.

The Financial Times only had a contract with the LSE to provide data, and published just 4,000 shares turnover. When challenged, they said there was no obligation to publish comprehensive data. The same problem applies also to intraday prices and published transactions.

Q47-50: We support these proposals.

Q51-59: From our response to Q43-46 you will see that we do not support monopoly or contrived solutions to the provision of a
consolidated tape, but something which would evolve commercially from the obligations being placed on data publishers. This is more in line with option c, and represents an open market solution to the problem of fragmentation.

it should also apply to non equity trades.

3.4 Section 5 - Commodity Derivative Markets

Q60 66: we have no comment on this section as we do not trade or offer services in commodity derivative markets.

3.5 Section 6 - Transaction Reporting

Q67 83: we are generally supportive of this section, although it does appear unduly prescriptive in parts. The following proposals would not, in our view, be helpful:

- The proposed obligation to transmit details of orders when not subject to a reporting obligation (Q77).
- The suggestion of transaction reporting directly to a reporting mechanism at EU level. All regulatory and supervision arrangements should be applied at national, not EU level (Q80).
- The suggestion of harmonised client identifiers (Q76) for transaction reporting when the EU cannot get its act together for money laundering identity verification. This contradiction demonstrates the inadequacy of regulatory priorities.

3.6 Section 7 - Investor Protection - Investment Services

Q84: we agree with the proposals, as these will also reduce the scope for regulatory arbitrage.
Q85: We can see the logic of including structured deposits by credit institutions. In the UK it is odd that such investments should be included as eligible for cash ISAs, a particularly cautious form of retail service, bearing in mind your draconian proposals so far as extension to complex product definitions are concerned.

Q86: This is a one size fits all approach which merits more detailed explanation. Further details are therefore requested here.

Q87: Our comments on this execution only section are mainly included in the general section of our submission. In particular, we consider that shares in ordinary companies should not be categorised as complex. They are not financial instruments, but simply represent part ownership of a business enterprise.

We do support the logic that specially constructed financial instruments should be assessed for complexity, but there is no reason why simple, conventional investments such as ordinary shares, or straightforward bonds and open-ended funds should require appropriateness tests. People are not required to undergo such tests when, for example, purchasing a motor vehicle at a cost considerably higher than our average transaction size; we see no reason for treating standard investments as if they required a shotgun license.

Q88: It would seem more appropriate to apply the test to the provision of the credit or the loan than to the purchasing of investments. If suitability tests had been required for bank lending, the credit crunch financial crisis might not have occurred in the first place.

Q89: We oppose the exclusion of UCITS, which are a regulated class of collective investment anyway, from the list of non-complex
financial instruments.

Q90: We oppose very strongly indeed the notion that the 'execution only' regime should be abolished. Our reasons are stated in the general section above.

Q91/92: Our style of investment advice is on demand, ad hoc advice on equity shares which is suitable for our customers' KYC information. It is delivered free and with no obligation to follow up; indeed in most cases we do not know whether a deal has been subsequently undertaken, as any such deal would be on an execution only basis.

It is neither necessary nor appropriate to provide either a written explanation of the basis (which, if a regulatory requirement, would be material and costly) or to treat the advice as if it were the selection of a pension product from a range of different providers.

Q93: Not appropriate to our style of investment advice.

Q94: Also not appropriate to our style of investment advice: indeed this would render impossible the provision of a free, ad hoc service.

Q95-100: None of these should be applied to standard investments; that is, ordinary equity shares, units or bonds. These are only appropriate to financial products of a complex nature.

Q101-103: No comment.

Q104-106: No comment.

Q107/108: Generally supportive.

Q109/110: The current regime for execution quality and best execution is working well and should not be changed. We receive a negligible amount of query in respect of these issues, which are
subject to regular compliance review.

Q111/112: No comment.

Q113: within the UK these matters are adequately addressed at present. These concerns may therefore reflect imperfect implementation of MiFID throughout member states.

Q114: we are supportive of the proposals, which will ensure consistency of treatment across the industry.

Q115/116: we are supportive of the proposals, which will provide a more robust, independent check on product and service development, sales and marketing. The modifications mentioned would be necessary.

Q117: No comment.

Q118: Please refer to our opening comments re dual capacity.

Q119-123: current MiFID arrangements are operating appropriately and we do not support further change in this area.

Q124: further work could usefully be done in this area, particularly in the context of dual capacity financial institutions. However we do not support a 'one size fits all' approach.

3.7 Section 8 - Further Potential Convergence

Q125-132/134-140: As a general principle, we do not support further regulatory convergence in these respects particularly in view of the fact that no common electronic identity verification arrangements have yet been set in place to enable cross-
border competition in retail investor services.

Q133: However we welcome the suggestion that member states should not be permitted to add to national provisions. This would preclude UK 'gold plating' of MiFID requirements.

3.8 Section 9 - Supervisory Powers

Q142/143: Generally supportive. However we are very wary of giving outright powers of such scale to any authority without clear rationale and accountability for decisions taken. We believe there should be independent scrutiny of this proposal before continuing.

Q144: No comment.

Q145-148: No comment.
Appendix 1: Unprompted Customer Letter

17 January 2011

Mr. Gavin Oldham
The Share Centre
P O Box 2000
Aylesbury
Bucks
HP21 8ZB

Dear Mr. Oldham,

I was not pleased to read your report of the EU concerning themselves about private investors affairs. The Financial meltdown recently has emphasised just how little the so called experts in Finance know. People who deal execution only do so because they rightly believe their own opinion and analysis is equal to that of financial advisors. The only thing financial advisors get right is the arrangement of their fee income.

How could I invest in companies I have followed over the years and come to trust if my investments were then checked by a third party. One would think people with financial expertise would be managing unit and investment trusts, why then do the majority of these just mirror the general market levels. Hardly any unit and investment trusts outperform the general indices.

There is absolutely no evidence that financial advice will help an experienced private investor. I don’t need any advice at all from the EU, a no growth area of the world economy.

Yours faithfully

Appendix 2: Comment in response to our report on MiFID Review

Customer Services
Share Centre
Aylesbury
Buckinghamshire

29 January 2011

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Yours faithfully