



By email to:

The Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
FRANCE

CESR Ref: 08-872

9 January 2009

Dear Sir,

Call for Evidence on the Impact of MiFID on Secondary Markets Functioning

Instinet Europe Limited (Instinet) welcomes the opportunity to contribute towards the development of the secondary equity markets, in particular to ensure that the benefits initially intended by CESR are fully realised.

Instinet is Europe's largest pure agency brokerage, and is an electronic trading pioneer, having established the world's first significant electronic trading venue in 1969, one of the first recognized U.S. ECNs in 1997 and the first pan-European MTF in 2007.

Instinet Europe helps both buy-side and sell-side professional clients lower overall trading costs and improve investment performance through the use of innovative electronic trading products, including smart order routing, algorithms, direct market access, dark pools and execution management system platforms.

Instinet is a subsidiary of Nomura Holdings, Inc.

Benefits

- 1. What do you think are the key benefits for yourself or the market more generally that have arisen as a result of MiFID provisions relating to equity secondary markets?*

The key benefits for Instinet and its clients have been the reduced trading costs, increased competition and tighter spreads. Instinet, using its Smart Order Routing (SOR) technology has been able to trade at improved prices for our clients on the new MTFs compared with prices available at the primary exchanges. As an agency broker our clients gain the full benefit of these improved prices. Instinet has been one of the few brokers to publish the results of its three monthly Best Execution Policy review throughout the first twelve months since MiFID. The latest review (see Appendix 1 for tables and figures) showed that we delivered average savings of 6.06 basis points when trading on the new execution venues for the period 1st August until 31st October 2008.

- 2. Do you consider that there are any remaining barriers to a pan-European level playing field across trading venues? If so, please explain.*

Yes, unfortunately there are still barriers to a pan-European level playing field. Despite the EU Investment Services Directive (ISD) of 1995 which was supposed to allow for remote

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membership of the primary exchanges there is still one notably large market, Spain, and particularly the systems of compensation, settlement and registration, that has not yet embraced the ISD let alone the intentions of MiFID. Instinet is disappointed that action has not been taken to remedy this situation. Instinet feels that investors and investment firms would benefit from the same competitive forces which MiFID has created in the other European markets.

Instinet notes and welcomes the recent innovation from the MTFs to work around these issues but the cost savings will not be fully realised until the recommendations put forward by the Spanish National Securities and Exchange Commission (formerly CNMV) and Bank of Spain's joint report (ISBN: 978-84-87870-75-0) of December 2007 are finally implemented.

3. Do you think that MiFID has supported innovation in the equity secondary markets? Please elaborate.

Yes, Instinet has been a positive advocate of MiFID and the intended consequences of allowing competition among trading venues and the resulting price improvement for customers. However, whilst there is now competition amongst trading venues, the competition between execution brokers is still hindered by bundling execution commissions with research payments. Also, Instinet feels that the regulation could have more been more clear with respect to pre-trade transparency in so far as how very similar liquidity pools exist today under differing regulations. Some are under the regulatory remit of a Systematic Internaliser (SI), others as Dark Pools with neither the SI nor the MTF "badges" and others are regulated as MTF Dark Pools. Instinet operates a Dark Pool called BlockMatch, but has chosen to apply and enforce the MTF regulation for this offering to provide our clients with increased confidence on the operation of the MTF. Instinet could have chosen the easier route of running BlockMatch as a dark pool without the MTF or SI regulation and its resulting obligations.

Downsides

4. Have you faced significant costs or any other disadvantages as a result of MiFID relating to equity secondary markets? If so, please elaborate. Have these been outweighed by benefits or do you expect that to be the case in the long run? If so, please elaborate.

In attempting to bring increased market competition and to drive down costs through MiFID, not enough planning and preparation was given to the complexities that would be created in the post execution space.

The creation of new trading venues has indeed been revolutionary in bringing down execution costs and reducing latency. However, the creation of new CCPs has led to increased complexity and more cost in the post execution space. There are now more CCPs now than ever before, to whom margin needs to be posted, and this inevitably creates more cost.

Additionally, there are more net settlements being created adding another yet another layer of cost.

Trades are being sliced into smaller sizes as smart order routers look for best execution and this has added further cost by increasing OTC and market settlements, as well as all the resulting transaction reporting costs, even before adding in the system overheads.

True interoperability can only be achieved across the market through intervention by CESR to create a central fund for margin for all CCPs leaving them to charge for the novation and netting of trades but not as the recipient of cash margin.

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We would also suggest that it is opportune to look at the cost of OTC settlements between the large volume players and for a competitive environment to be encouraged that builds OTC netting facilities. There is some progress here with sub custody agents such as Citi and Paribas, who are investing in products but more could be done. Such a product would not novate risk but further net the number of physical settlements that occur at clearing securities depositories.

5. *Have you seen/experienced any unexpected consequences in terms of level playing field arising from the implementation of MIFID provisions relating to equity secondary markets? If so, please elaborate.*

Our response to Question 4 also covers this unexpected consequence. Naturally the cost of borrowing capital to fund our margin calls has also risen in recent months somewhat outweighing the benefits of any improvement in trading prices. However as an Agency broker our clients get all the benefits of price improvements when trading. Instinet bears all the increased costs associated with our increased margin payments.

Trading Costs

6. *What impact do you consider that increased competition between equity trading venues is having on overall (i.e. implicit and explicit) trading costs? Please elaborate.*

Increased competition between execution venues is leading to improved prices for investors where these are passed on. As an agency broker, Instinet always passes on all price improvement to its clients. The increased costs for margin payments are covered in our answer to 4 & 5 above.

The increased costs of transaction reports, due to the number of trades, could be dramatically simplified if CESR were to encourage all execution venues to offer the reporting of the "market side" of all transactions directly to the member firm's Competent Authority (CA). This would be a simple step for the execution venues who all already possess sufficient information to allow for the market side reporting. This would also strengthen the quality of the existing reporting and no doubt be welcome by all the CAs. The brokerages would then just have to transaction report the "client side" of their business which accounts for a much smaller portion of the entire set of transaction reports. It is also clear that there are different interpretations of the transaction reporting requirements within the industry.

Potential fragmentation

7. *Do you think that there has been significant fragmentation of trading and/or liquidity in European equity markets? If so, please elaborate. Do you think that such fragmentation raises concerns (for example, does it impact on the price formation process, the overall efficiency of the markets, search costs, best execution requirements)? If so, please elaborate on those concerns.*

There has been significant fragmentation of trading since the introduction of MiFID with the introduction of new (and proposed) Regulated Markets and Multi-Lateral Trading Facilities (MTFs) to the market. We see this as a continuing trend and one welcomed by Instinet. By way of comparison, we note that the systematic internaliser status does not appear to have been adopted uniformly, possibly as a result of the available opt-outs, or interpretation thereof. We believe that uniform adoption of the status and/or clarification of the available opt-outs e.g. whether the activity represents a material commercial role, would benefit from clarification.

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Instinet has yet to be convinced that the best execution provisions of MiFID are delivering the intended benefit to investors. Insetnet has made significant investments in its technology in order to be able to achieve the best possible result for clients and is committed to being as transparent as possible about where and how we execute client orders.

Instinet's experience in the first 12 months of MiFID is that when trading on new execution venues an average 4.91 basis points in price improvement (see Appendix 1) was achieved for clients.

We are fearful, however, that our approach has not been uniformly adopted by all firms. We believe that asset managers could do more in this area to demand greater clarity and transparency from the broker community on how orders are managed and executed. We are seeing signs that this is starting to happen but believe that there is much more to be done.

8. Do you think that MiFID pre- and post-trade transparency requirements adequately mitigate potential concerns arising from market fragmentation?

Yes, although as mentioned in response to questions 3 & 7 and as elaborated further below there needs to be more clarification on when a liquidity pool is a SI, when it's a MTF and when it needs neither the SI nor MTF status.

Transparency

9. Is the categorisation of shares appropriate in relation to: the definition of liquid shares; 'standard market size'; 'orders large in scale'; and 'deferred publication'? If not, please elaborate.

As an agency broker and one that wishes only to encourage further transparency we have no requirement for standard market size requirements and deferred publication. We also feel that the "orders large in scale" requirement for dark orders is unnecessary.

The US markets have had over 10 years of experience since the initial ECN order display rules of 1997 and the ATS rules of 1998. Iceberg orders (or reserve orders) can have as little as one share displayed with the rest remaining dark from the market. We would prefer the abolition of the large in scale rules and allow MTFs to innovate with new order types that balance pre trade transparency and price discovery. The large in scale requirement has meant there is almost no dark liquidity on any MTF that has "light" liquidity today. Concerns over small hidden orders breaking up potentially larger trades can be mitigated by minimum trade size order types etc. The US marketplace should be a useful reference.

10. Do you see any benefits (e.g. no market impact) to dark pools of liquidity (to be understood as trading platforms using MIFID pre-trade transparency waivers based either on the market model or on the type or size of orders)? If so, what are they?

Instinet welcomes dark pools and we are happy to route some or all of our client orders to executing brokers operating dark pools if they can offer price improvement and/or reduced market impact. Dark pools and completely dark MTFs mainly trade at the mid price so the spread savings can be significant. Post trade transparency is sufficient for price discovery on dark pools.

11. Do you see any downsides to dark pools of liquidity (e.g., impacts on the informational content of light order books)? If so, what are they?

No, we don't see any significant downside to dark pools of liquidity.

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12. Do you consider the MiFID pre- and post-trade transparency regime is working effectively? If not, why not?

Yes it is working effectively. However we would welcome any further improvement in reducing the number of trades eligible for deferred publication and would recommend the abolishment of the large in scale requirement for completely hidden orders on light MTFs.

Data

13. What MiFID pre- and post-trade transparency data do you use, and for what purpose? Does the available data meet your needs and the needs of the market in general?

We take market data feeds directly from the continuously traded MTFs and use their data in both our SmartRouter and Algorithms. From a smart order routing and an algorithm perspective the available data meets our needs.

14. Do you think that MiFID pre- and post-trade transparency data is of sufficient quality? If not, please elaborate why and how you think it could be improved.

We believe the data is of sufficient quality to allow commercial forces to provide competing smart order routing and algorithmic trading offerings.

15. Do you think that there has been significant fragmentation of market data in the EEA equity markets? If so, please elaborate. Do you think that such fragmentation raises concerns (for example, does it impact on the price formation process, the overall efficiency of the markets, search costs)? If so, please elaborate on those concerns.

Instinet launched the first pan-European MTF, Chi-X Europe Limited which has been encouraging external investment that could ultimately result in ownership away from Instinet. Instinet also operates another MTF, BlockMatch which is a dark liquidity pool. Instinet has been operating ATSS globally for many years and as such are strong proponents of creating competition in the marketplace. Fragmentation and competition are essential to allow the European markets to innovate and most significantly to reduce trading costs for investors.

16. Does the current availability of data facilitate best execution? If not, please elaborate.

Yes the current market data from the primary exchanges and the new MTFs creates significant price improvement opportunities as previously mentioned and as shown in detail in Instinet's most recent best execution review in Appendix 1. Instinet is committed to join each of the new credible MTFs from day 1 in order to continue to offer such price improvement opportunities to clients.

17. Do you think that commercial forces provide effective consolidation of data? If not, please elaborate.

Yes, allowing commercial forces to naturally develop and innovate around the usage of MiFID data should certainly be the way forward in the medium term although ultimately some form of consolidated tape will either emerge or be required.



General

18. Do you think that the implementation of MiFID is delivering the directive's objectives in relation to equity secondary markets (e.g., fostering competition and a level-playing field between EEA trading venues, upholding the integrity and overall efficiency of the markets)? If not, why do you think those objectives have not been met?

We absolutely agree that the directive's objectives have been met in the majority of the EEA. Instinet's clients have benefited from the price improvement when trading on the new execution venues. This amounted to over 6 basis points in the review period, August through October 2008 and averaged just under 5 basis points in the first year post MiFID. Please see Appendix 1 for further detail.

Investors have thus benefited from improved trading prices, the costs of trading have been reduced, new and cheaper CCPs have emerged, and new liquidity has entered the market from the statistical arbitrage firms among others who were previously shut out of the European marketplace due to the high costs of trading, clearing and settlement. We encourage CESR to take further steps, for example, in Spain to ensure that the full benefits are available throughout the EEA.

19. Do you see any other impact or consequence of MiFID on equity secondary markets functioning?

Whilst there are many benefits which have resulted from the MiFID, most notably the fact that competition amongst trading venues is now working, it is clear that competition between execution brokers is sub-optimal. This defeats the purpose of MiFID and prevents clients from getting the full benefit of price improvements available on the new execution venues. In particular, Instinet remains frustrated at the slow progress within the asset management community towards the unbundling of commissions. Instinet competes solely on the quality of the execution products it offers to its clients but continues to compete for order flow from asset managers who remain restricted, in terms of where their flow is directed, by the payments the asset manager wishes to make for access to research.

I would be delighted to expand on any of the above comments or to discuss further.

Yours faithfully

Richard Balarkas
CEO, Instinet Europe Limited



Appendix 1

Instinet Europe Releases Results of MiFID Best Execution Policy Review for August – October 2008 and Full 12 Months Since Introduction of MiFID

Firm finds Smart Order Routing to new venues has delivered clients average savings of 4.91 basis points over the 12 months since the introduction of MiFID on 1 November 2007; During the final 3 months (August – October 2008) Instinet Europe delivered average savings of 6.06 basis points

LONDON – 10 December 2008 – Instinet Incorporated, a global leader in electronic trading and agency-only brokerage services, today announced that its European agency brokerage subsidiary, Instinet Europe, has published the key findings of its Best Execution Policy Review, conducted in accordance with MiFID regulations. The review covers Instinet Europe's trading performance from 1 August 2008 through to 31 October 2008 (months 10-12 of MiFID).

The key findings are as follows:

- Instinet Europe's SmartRouter™ has been enhanced to interact with new trading venues as they have been introduced. The average price improvement¹ when trading on new venues was 6.06 bps for the three month measurement period, rising to 6.58 bps in October 2008, compared to an initial 1.73 bps in November 2007 (the first month of MiFID) and the previous quarter's (May-July 2008) average of 5.32 bps.
- Of the shares traded away from the primary markets on alternative trading venues, Instinet Europe's clients received price improvement 55.4 percent of the time (by value traded) and executed at the same price or better than found on the primary markets 96.2 percent of the time over the three months.
- By value traded, Instinet Europe executions away from the primary markets for UK, French, German and Dutch equities increased to 39.7 percent in October 2008, compared to an initial 11.3 percent in November 2007. For UK equities alone, in October 2008 Instinet Europe executed 45.2 percent of its volume away from the London Stock Exchange, compared to 14.0 percent in November 2007.
- Between August and October 2008, Instinet Europe connected to and began successfully trading on both NASDAQ OMX Europe, launched at the end of September, and BATS Europe, launched at the end of October. Additionally, Instinet Europe expects to continue to link to other new liquidity pools as they become available, including NYSE Arca Europe and NYSE Euronext's SmartPool.
- Instinet Europe's SmartRouter now has access to the following MTFs: BATS Europe, BlockMatch®, Chi-X® Europe, NASDAQ OMX Europe, NYFIX Euro Millennium™ and Turquoise. Instinet also continues to connect to a number of broker dark pools.

¹ Price improvement is defined as the difference between execution price and the best quoted price on the primary exchange at that time. Measurement is based on Instinet Europe Limited's review of all IEL trade executions when removing liquidity from MTFs between 1 November 2007 and 31 October 2008, and does not represent an independent review of execution performance.

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Commenting on the findings of the Best Execution Review, Richard Balarkas, CEO of Instinet Europe said, “We believe that both the new and emerging pools of liquidity offer tremendous opportunities for price improvement. We reported average savings of 6.06 bps for our clients during this review period in large part by delivering on our promise to link our clients to each and every liquidity pool to which we are allowed access, and this rose to 6.58 bps in October 2008 from an initial 1.73 bps back in November 2007. Over the 12 months since MiFID was introduced, this approach has allowed Instinet to pass on the full benefit of price improvement when trading on the new execution venues. This in turn has given our clients significant savings, averaging 4.91 bps, when removing liquidity from MTFs.”

He continued: “As an agency-only broker, our sole aim is to hunt out the best possible execution opportunities for our clients with the continual refinement of our sophisticated smart order router and commitment to connect to new liquidity venues. Next year is going to prove interesting, as we anticipate more new entrants and the quest for liquidity between the MTFs themselves is only set to heighten. Whatever the outcome, we are confident that our smart order router will continue to seek out the best possible executions for our clients.”

Table 1 – Instinet Europe price improvement when trading on MTFs

Review Period	Nov 07 - Jan 08	Feb 08 - Apr 08	May 08 - Jul 08	Aug 08 - Oct 08	Volume Weighted Average
Price Improvement	2.17 bps	3.61 bps	5.32 bps	6.06 bps	4.91 bps
Better prices than Primary market	48.2%	51.2%	54.2%	55.4%	53.4%
Same prices or Better than Primary market	94.1%	94.2%	96.0%	96.2%	95.5%

Table 2 – Instinet Europe percentage of business executed on MTFs by value traded

Review Period	Nov 07 - Jan 08	Feb 08 - Apr 08	May 08 - Jul 08	Aug 08 - Oct 08	Volume Weighted Average
All European stocks	8.9%	17.1%	22.2%	31.9%	21.0%
Dutch, French, German & UK stocks	12.8%	23.4%	29.2%	41.2%	27.9%
UK stocks only	15.6%	31.4%	39.5%	47.4%	35.4%



About Instinet

Instinet Europe Limited is one of Europe's largest agency brokerages and is a top 10 broker by market share ranking on the London Stock Exchange year to date². The firm employs more than 40 sales and trading personnel in four European locations. Instinet Europe provides its clients with a comprehensive suite of trading services that includes agency sales trading, global portfolio trading, algorithmic trading, DMA and commission management.

Instinet is an electronic trading pioneer, having established the world's first significant electronic trading venue in 1969, one of the first recognized U.S. ECNs in 1997 and the first pan-European MTF in 2007. Through its subsidiaries and affiliates, Instinet operates two distinct business lines: a global network of agency-only brokers that seek to help institutions lower overall trading costs and improve investment performance through the use of innovative electronic trading products, including smart-routing, algorithms, DMA, dark pools and EMS platforms, and also provide sales trading, commission management services and independent research; and the Chi-X[®] trading systems, which aim to improve the efficiency of capital markets globally by providing high-performance, low-cost alternative execution venues. Instinet is a wholly-owned subsidiary of Nomura Holdings, Inc. For more information, please visit www.instinet.com.

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² According to the London Stock Exchange Reporting Service.