22 September 2004

CESR'S ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS (CESR/04-261B)

RESPONSE OF EURONEXT TO CESR CONSULTATION PAPER DATED JUNE 2004

SUMMARY OF COMMENTS

Euronext is again grateful for the possibility to comment on CESR's advice on implementing measures for the Markets in Financial Instruments Directive since such instrument is the backbone of our business.

As a general comment, we would like to draw the attention of CESR to the fact that implementing measures should remain flexible enough to take into account the diversity of European markets, future innovation as well as the need for practical and cost efficient solutions. As developed below and in the attached paper, we have indeed identified a real need for a more differentiated approach in respect of several issues and in particular, for avoiding unnecessary changes when the current arrangements are widely recognized as satisfactory.

The comments we make in the attached paper, of which the most important items are summarized below, concern primarily the proposals contained in sections III (markets) and section IV (cooperation and enforcement).

CESR's advice raises a number of important issues with respect to market transparency and admission of instruments to trading.

Concerning market transparency, we consider that the proposed approach on **pre-trade transparency** for regulated markets and MTFs is too rigid since it seems to limit the number of possible market models to only three and we feel it should be made more flexible in order to allow for future innovation. We are also concerned by the requirement to disclose the full depth of the order book. Euronext currently does provide the full depth of the orderbook, but we feel that we should not become subject to an obligation to do so. A requirement to distribute this information to all market participants does not take into account the limited added value for the general public nor the complications in ways for making such information available. Regarding the method to calculate the block size thresholds we are in favour of the so-called "average size orders method", which seems to us consistent with the level I provisions regarding the determination of the standard market size. Again in this particular area, we think flexibility is needed and we believe that the block size thresholds should not necessarily be the same in the pre-trade and post-trade environments.

In relation to the **post-trade transparency** requirements for regulated markets, MTFs and investment firms, it is our opinion that the "one minute" requirement is too rigid. Although it can be met in most cases, it may prove difficult for more complex transactions. The obligation for firms to have a post-trade disclosure mechanism available all the time the firm is actively trading, even if occasionally and including during the night, seems also too prescriptive.

As for the **admission to trading**, we support CESR's proposal to only retain a limited number of criteria and not to set quantitative requirements. Admission criteria should indeed mainly remain a tool for

innovative approaches as well as competition between markets. Among the proposed criteria, we disagree on the relevance of the criterion of the expected trading activity / expected holders of the instruments since any anticipation in this respect is always very difficult and trading may indeed be very limited for certain instruments. In relation to the issuer's compliance with disclosure obligations, level II measures should make clear that the primary responsibility for monitoring and enforcing such compliance lies with the competent authorities. It should also be clear that market operators can satisfy themselves that such obligations regarding approval or exemption of a prospectus have been met on the basis of information provided by issuers (except in case of admission to trading without the consent of the issuer). It is not the role of regulated markets to check whether the conditions for an exemption from prospectus requirements have been met: issuers should be in a position to demonstrate that in the particular case at hand their competent authorities agree to an exemption. Concerning the obligation imposed on regulated markets to facilitate information flow on initial disclosure, we disagree with the proposal that prospectuses and annual information documents should be put on the website of the regulated market concerned. This requirement goes well beyond the level I provision which concerns only members and participants and not the general public.

An important part of CESR's advice is also devoted to provisions on **cooperation and enforcement.** Euronext can support most of the proposals put forward by CESR in this field, including the proposal to use proxies in order to determine the most relevant market in terms of liquidity. However, we wish to underline, for the sake of reducing costs, that CESR should consider the possibility for remote members of regulated markets or MTFs to report trades to their home competent authority via the home competent authority of such regulated market or MTF. If such provision is not put into place, each national regulator could potentially need to have links with all regulated markets and MTFs in Europe to receive transaction reports of trades done on such markets. On the cooperation between host and home competent authorities, we also wish to underline the need to adopt practical approaches ensuring that cross border operators can operate in several jurisdictions without undergoing inconsistent requirements or duplication of administrative tasks as a result of their cross-border operations. In this context, we wish to draw CESR's attention to the benefits that could be derived from the appointment of a "coordinating" regulator in respect of such entities.

As concerns the part of the consultation paper dedicated to **intermediaries**, "best execution" constitutes a key issue. We reiterate here our view that the main parameters to be taken into account as concerns execution would be price and costs, even if other criteria may also be of relevance for particular transactions. In relation to the execution policy, we agree with the views expressed by CESR in this respect.

We will be happy to discuss any of the comments contained in this document and provide you with additional information.

Finally, for issues that are not dealt with in this contribution, we refer to the reply of the FESE that we fully support.

PROVISIONS ON INTERMEDIARIES

INFORMATION TO CLIENTS

We consider that the provisions on information to clients about risks should be reviewed in order to concentrate on the most relevant items. In particular, we feel that the indications on information to be provided about "risks associated with clearing house protections" are misleading. Instead of a reference to "risks", CESR advice should more appropriately refer to "limits" to clearing house protections.

BEST EXECUTION

Reply to CESR's questions Q1 to Q3 (page 73):

As we have already mentioned in an answer to a call for evidence, regarding the criteria for determining the relative importance of the different factors to be taken into account for best execution, price and costs are indeed the main features. Other factors are also to be considered in so far as they have an influence on the price (size, speed, likelihood of execution or settlement). We share CESR's view on client, order and venue characteristics to be taken into account for assessing the relative importance of the factors mentioned above. We believe that the more complex the situation will be, the more factors will have to be taken into account. In other words, for "plain vanilla" transactions, price and costs should remain the main factors.

Reply to CESR's questions Q3 and Q8 (page 75):

With respect to the determination of the execution venue providing on a consistent basis the best possible result, we agree with CESR's view expecting firms to use the same factors as those used in selecting the best execution venue for the purpose of executing orders but focusing on longer period of time and not for a particular trade. In this context, we endorse the indicative list of factors drawn up by CESR: price; liquidity; fees, commissions and explicit costs; average size of orders; types of market participants; settlement capabilities; trading capabilities.

Moreover, we endorse CESR's acknowledgement that the business model of the investment firm must not be used to justify the exclusion of a venue that will enable the firm to achieve the best possible result on a consistent basis. We are of the opinion that this statement should be expressly included in CESR's advice.

Regarding the information to clients on the execution policy of the firm, we endorse the items identified by CESR as having to be included in such document: trading venues; procedures for the selection of trading venues and their periodic review; conflict of interest; and procedures to obtain client consent and for communicating material changes.

PROVISIONS ON MARKETS

CONSOLIDATION OF INFORMATION

CESR is of the opinion that pre- and post-trade information need to be consolidated, which supposes common data standards. We believe that CESR might promote the use of standards and/or practices in order to facilitate such consolidation of information but ways to achieve such consolidation should be left at the discretion of trading venues and market users.

PRE-TRADE TRANSPARENCY REQUIREMENTS FOR REGULATED MARKETS AND MTFS

Reply to CESR's questions Q12.1 to Q12.3:

In specifying the "pre-trade" transparency provisions of the Directive, CESR's approach limited to three market models seems to us rather restrictive. Considering indeed the possibility of existing or future "hybrid" market models, we would urge CESR not to take too narrow a view in that respect, as making specific references to certain types of market models would create uncertainty as to the rights and obligations of other market models and possibly lead to inconsistencies with the regimes applicable to other trading venues. We therefore propose that the cited market models be presented as examples, rather than as an exhaustive list.

Furthermore, we disagree with CESR's provision requiring operators of electronic order driven systems to disclose the full depth of their order books on a continuous basis. We consider more appropriate to limit the pre-trade information obligation to the 5 best bid/offers. Indeed, whereas the full depth of the order book is available to all against subscription, we question the interest and relevance of such information for the general public. Although exchanges may provide the data vendors with the full depth of the order book, the latter re-disseminate such information to the public in a format over which exchanges have no control. It would be impossible for technical reasons to oblige them to publish the whole depth of the order book, as well as disproportionate in consideration of the public's needs.

Moreover, we think that CESR's level II advice should not give any definition of the "indicative theoretical equilibrium price", since such notion should be adaptable over time. It should thus be left to market forces.

Concerning CESR's intention to impose monitoring requirements in order to ensure the information's reliability, which we endorse in principle, we think that the wording used in specifying that "regulated markets and MTFs' arrangements should be capable of monitoring correctness of the information" might be misleading: it is in practice more a technical monitoring of the "consistency of the information", rather than a control of the content of such information. Market participants are indeed responsible for the prices or quotes that they enter in the systems. CESR should take this element into consideration in the drafting of its advice.

Reply to CESR's questions Q12.4 to Q12.7:

Regarding the cases of exemptions to pre-trade transparency requirements laid down by CESR, based on market model issues, on types of orders, and for large trades, we agree that crossing systems should be exempted from pre-trade transparency requirements, as it is one of the essential elements of such market model.

We also endorse the exemption of iceberg-type orders and block size trades. Nonetheless, the possible cases of exemptions should be widened in relation to order types (e.g. cross-trades…).
In defining block trades, our preferred option would be the "average size orders" method since it seems the more stable one over time (as the standard/normal market size will be determined for half a year or a year) and the most simple one (the market impact method seems indeed quite complex to apply in practice). Moreover, we agree with CESR that whatever the method, calculations should be done on overall trading activity in the EU, even though some data may be difficult to obtain.

We also agree with the intention of CESR to gathering shares into different groups in order to make the method more practical. This could in particular be relevant if the average size orders method is chosen since shares will have to be grouped in different classes for which a standard market size is determined.

On the issue of whether there should be one or different block size(s) for the purpose of waiving transparency pre-trade or delayed publication post-trade, we are in favour of adopting different sizes, taking into account market impact and market risks borne by participants.

Finally, we would like to underline the fact that, should those pre-trade transparency requirements be extended to other financial instruments than securities, the relative rules will have to be adapted in the light of the specific features of such other instruments.

POST-TRADE TRANSPARENCY REQUIREMENTS FOR REGULATED MARKETS AND MTFS AND FOR INVESTMENT FIRMS

Reply to CESR's question Q13.1:

First of all, and as concerns the disclosure of post-trade information, we support the approach chosen by CESR, that foresees the information should be made public "trade by trade" for every trade regardless of whether it was executed on an regulated market, MTF or outside them.

On the contrary, we consider as over-prescriptive the provision imposing that the reporting mechanism for investment firms shall be available all the time the firm is "actively" trading. Indeed, it might not bring a real benefit in practice, compared with the costs that would imply for investment firms the obligation to potentially have a post-trade mechanism running all the time, including at night… When transactions are not done during "normal trading hours" (or just after), it would probably be more appropriate to request publication in the morning of the following trading day (especially anticipating the marginal number of trades that would be done during the night…).

Reply to CESR's question Q13.2:

CESR requires that post-trade information shall be provided at the end of the day by regulated markets, MTFs and systematic internalisers "in an aggregated manner", as for opening price, closing price, maximum and minimum price during the session, weighted average price of the session, and total traded volume. Whereas this may be best practice on a number of markets, we are of the opinion that this should be left to market forces to decide and not imposed by implementing measures.

As already mentioned regarding pre-trade transparency, post-trade information can be made available through various arrangements including those of regulated markets and MTFs. CESR foresees imposing monitoring requirements in relation to arrangements of regulated markets, MTFs and investment firms. We believe high standards on quality control will be positive, provided there is a level playing field in that respect between all publishing systems. Therefore all such systems, including third parties systems, should also be imposed this type of monitoring. It seems to us essential, in order to maintain fair and orderly markets, that none of post-trade disclosure services be exempted from monitoring. Beyond this type of monitoring, the same concern arises in relation to market abuse prevention and detection.

Reply to CESR's question Q13.3:

We consider that, beyond a delay of one trading day, the availability of historical data as well as conditions for it should be left to the discretion of the venues or service providers concerned.

We fully support CESR's assumption that "publication just on the firm's own website or on a third-party website where only one or a few firms' data is published is unlikely to meet the "easily accessible" test, in so far as investors are unlikely to be able to search through all websites. Investment firms should thus choose a publication mechanism, which publishes the post-trade information in a form easily consolidatable. We think this assumption should be expressly included in the advice.

Reply to CESR's question Q13.4:

We do not think that minor trades should be exempted from publication, as it remains important that investors can see their trades published, whatever the size of the trade.

Reply to CESR's question Q13.5:

As regards the delay of post-trade publication, we would be in favour of using a more general wording at level II: such information should be made public "as soon as possible" after the transaction took place, rather than in a determined time limit. The "one minute" requirement proposed by CESR seems indeed too rigid.

This would be consistent with the spirit of the level I text, which is that publication of the transaction has to be done without any delay ("as close to real time as possible"). In addition, the "one minute" deadline may prove impracticable for some complex transactions and could actually be counterproductive as rushing may imply more mistakes and corrections...

Reply to CESR's question Q13.6:

We agree with CESR that intermediaries who take a risk position to facilitate the trade of a third party should definitely benefit from deferred publication.

Reply to CESR's question Q13.7:

As for the securities identifiers, we agree they should be harmonised for more consistency and efficiency of consolidation throughout Europe. In this view, extension of the use of the ISIN code, which is already a recognised standard in that respect, could be considered. At the minimum, reference should be limited to two or three standards.

Reply to CESR's question Q13.9:

Answering CESR's question on whether it should initiate work, in collaboration with the industry and data publishers to determine how best to ensure that post-trade transparency data be disseminated on a pan-European basis, we would like to express our trust in market forces' initiative in such developments.

ADMISSION OF FINANCIAL INSTRUMENTS TO TRADING

Reply to CESR's question Q14.1:

We are supportive of CESR's approach, especially of the fact that level II does not set any quantitative criteria in relation to the admission to trading. We indeed believe that those criteria have to be determined by the regulated markets' rules, that are subject to the Directive's requirement of being "clear and transparent" and that are in any case approved by the regulators. Indeed, those "admission" criteria are a key element of a sound competition between regulated markets, and thus shouldn't be settled at a legislative level.

As regards the regulated market's responsibility for maintaining "fair and orderly trading" for instruments admitted on its markets, we can endorse CESR's requirements that the market should in that respect take into account the free float, as well as the appropriateness of the trading mechanism for the considered instrument (even though an oversight of the appropriateness of certain mechanisms for certain types of instruments is also exercised by regulators in the scrutiny of the trading rules). On the contrary, we are opposed to the criterion of the "expected trading activity of the instrument" as well as of "expected holders". We are aware that such provision is currently laid down in the Directive 2001-34 on the

"admission of securities to official stock exchange listing", but we would not want it to be extended to all regulated markets. Indeed, the trading volume of a financial instrument can never be precisely anticipated, and may always be different from any previous expectation done… In addition, there may be cases where listing is necessary but trading is limited in practice (e.g. government bonds); in such cases, appropriate trading mechanisms are implemented (fixing…).

As concerns the transferability and the fungibility of the securities admitted to trading on a regulated market, we consider that the relevant criteria to be taken into account would rather be, in our opinion, "negociability" and "transferability" (as clearly stated in the Directive, which says that the "rules shall ensure that…in the case of transferable securities, (they) are freely negotiable"). Indeed, securities need to be both negociable and then transferable to be admitted to trading on a regulated market. In particular, securities could be considered as "transferable" if there is neither statutory nor legal "blocking conditions" attached to them. On the contrary, fungibility is not a relevant criterion and is out of the scope of admission to trading: factually, fungible securities will be listed on the same "line" on a regulated market, whereas not fungible ones will be listed on different lines; but this is not a requirement for admission to trading.

Regarding the requirements for admission to trading for derivative products, the reference made by CESR to the "reliability" of the price of the underlying seems hard to implement in practice for certain instruments. This would especially be the case for physical commodities or certain money market instruments, where the price of the underlying is not transparent because the underlying market is an OTC one.

Reply to CESR's question Q14.2:

As concerns the issuer's compliance with their disclosure obligations, CESR should make clear in its advice that the primary responsibility for monitoring and enforcing such compliance lies with the competent authorities. It should also be clear that market operators can satisfy themselves that such obligations regarding approval or exemption of a prospectus have been met on the basis of information provided by issuers (except in case of admission to trading without the consent of the issuer). Indeed, it is not the role of regulated markets to check whether or not the conditions for an exemption from prospectus requirements have been met: issuers should be in a position to demonstrate that in the particular case at hand their competent authorities agree to an exemption.

The level II measures should moreover not create a situation where a regulated market could come to different conclusions than a competent authority on whether or not an exemption should be granted. We believe that the regulators' authority should not be "challenged" by regulated markets through the proposed "verification" procedure, thus we disagree with the proposed advice. In order to reduce potential difficulties in this area, in particular having in mind admission to trading on a cross border basis, it would be important that competent authorities have to make public their decisions regarding exemptions to publish a prospectus.

Concerning the regulated markets' obligation to facilitate information flow on initial disclosure, CESR's requirement that regulated markets shall provide on their website links to prospectuses and annual information documents, or when they do not exist in an electronic format indicate where they can be found, broadens the provisions of the level I text, which imposes that information has to be given to members and participants. In our view, regulated markets should not be obliged to establish links to prospectuses and annual documents since this service implies investment and liability, as well as operating costs to maintain updated information. We consider that this requirement should be limited to an obligation to have an internal procedure in place whereby members and participants may obtain information on the instruments and issuers in a timely manner. In addition, we think CESR's requirement regarding initial disclosure should be aligned with the one concerning ongoing and ad-hoc disclosure,

which is drafted in a more relevant manner. In any case, both requirements should be limited to members and/or participants.

PROVISIONS ON COOPERATION AND ENFORCEMENT

TRANSACTION REPORTING

Reply to CESR's question Q15.1:

CESR has evoked the possibility for competent authorities to waive the requirement for investment firms to report transactions in electronic format. We think this should be limited to very exceptional cases since it can prevent comparability of data, which is an essential element of the harmonization process.

Reply to CESR's question Q15.2:

In respect of bond markets and commodity derivatives markets, we see no objection to CESR's suggestion that market participants should be allowed more time to implement these level II measures, as new systems for reporting transactions will probably have to be put in place in many Member States.

Reply to CESR's question Q15.3:

Concerning the extent to which CESR should investigate the possibility for future convergence between national reporting systems and at EU level, we believe it is quite essential to harmonise these requirements at a European level, in order to ensure comparability of data hence efficient exchange of information between all European regulators.

Reply to CESR's question Q15.4:

As regards the methods and arrangements for reporting financial transactions, we welcome the "general minimum conditions" set out by CESR, with which all reporting channels have to comply in order to be approved, as they meet the essential criteria of reliability, security and comparability of data. Indeed, we think it is important to ensure a level playing field between all reporting arrangements.

Reply to CESR's question Q15.5:

CESR foresees that the reporting mechanism will be approved and monitored by the competent authority to which it reports. We are concerned that this may potentially require for remote members that a regulated market as reporting mechanism be authorised/ monitored by all 25 competent authorities… We would urge CESR to envisage a more simple solution, for example that the reporting system can notify the competent authority of the Member State where the transaction took place and such competent authority would in turn notify the home country of the investment firm and the competent authority of the most relevant market in terms of liquidity (which is likely to be in most cases the market where the transaction has been executed).

Reply to CESR's questions Q16.1 to Q16.3:

To ensure market integrity is maintained and competent authorities can identify any potential cases of market abuse, the competent authority of the most liquid market for each particular financial instrument is entrusted with the responsibility of developing a complete overview of the activity regarding a financial instrument across Europe. In that context CESR provides advice on criteria for assessing the liquidity in order to determine the most relevant market in terms of liquidity for financial instruments. We fully agree with the "proxy" method proposed by CESR, since a pertinent measure of liquidity would be difficult to

define considering the complexity of cumulative criteria to take into account, and the diversity of market structures and trading mechanisms. This proxy method has indeed the advantage of simplicity as it is able to be used over time.

As an alternative to the proxy method, in specific cases where such a method does not apply, we also agree with a method computing turnover and/or volume, and complementary criteria such as number of trades, number of executed orders, bid/ask spread…

We may agree with CESR that the time period to be taken into account when applying the criteria "turnover" and/or "volume" and the definition of such criteria can vary according to financial instruments in consideration. However, it has to be harmonised in relation to a specific type of instruments so that there is a coherent approach among competent authorities throughout Europe.

The conditions of revision foreseen by CESR seem appropriate, and we have noted that they should be finalized at level III, as well as the procedures for updating the list of "relevant markets" for each financial instrument. In view of the fact that such list of the "most liquid markets in term of liquidity" can be misleading in other contexts than reporting or transparency requirements, making public the list does not appear necessary since it is to be used by competent authorities. It would be sufficient if the list could be obtained on request.

We also endorse the principle that it is necessary that the Member State in which the transaction takes place also receives the information about this transaction: hence should be ensured at level III that any competent authority should be able to request transaction data, in accordance with the cooperation arrangements of the Directive.

Reply to CESR's questions Q17.2 and Q17.3:

Regarding CESR's advice on the minimum content and common standards/format of transaction reports, we agree with the minimum information specified. We would be in favour of a standardized approach at a EU level of the format and content of such transaction reports.

COOPERATION AND EXCHANGE OF INFORMATION

Reply to CESR's questions Q19.1 to Q.19.3:

As concerns exchange of information between home and host countries' competent authorities, and regarding the methods and arrangements for exchanging information on transaction reports between competent authorities, the conditions described by CESR that they have to comply with (electronic form, timeliness, safety, correcting mechanisms) seem relevant. It also seems to be the case regarding the conditions of the requests for cooperation and exchange of information between regulators, as well as the execution of these requests.

Furthermore, and considering the development of "multi-jurisdiction" market infrastructures and the growing number of market participants operating cross-border, we support the idea that an efficient framework of cooperation between national supervisors should be established in order to support that evolution. Regulatory cooperation and exchange of information at a European level are indeed essential to ensure both investors protection and market efficiency. On the cooperation between host and home competent authorities, we also wish to underline the need to adopt practical approaches ensuring that cross border operators can operate in several jurisdictions without undergoing inconsistent requirements or duplication of administrative tasks as a result of their cross-border operations. In this context, we wish to draw CESR's attention to the benefits that could be derived from the appointment of a "coordinating" regulator in respect of such entities.