

CALL FOR EVIDENCE

CESR Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets



Contribution from Crédit Agricole Cheuvreux

31 May 2010

About Crédit Agricole Cheuvreux

CA Cheuvreux is **Crédit Agricole Group's European pure agency equity broker**, offering its clients extensive, high value-added services in **Equity Research, Sales** and **Execution**. CA Cheuvreux's specialists are located close to clients and offer in-depth expertise out of its **15* offices worldwide**.

www.cheuvreux.com

**Amsterdam, Athens, Frankfurt, Istanbul, London, Madrid, Milan, Paris, Stockholm, Vienna, Zurich, Dubai, New York, San Francisco, Tokyo*

CA Cheuvreux is a member of almost every venue in Western Europe and in the US, including Regulated Markets and MTFs, without being a shareholder of any Regulated Market or MTF. CA Cheuvreux is a leading agency broker in Europe. We service our clients on a pure agency basis (except facilitation), and have no conflicts of interest due to any proprietary business.

Executive summary – main answers to the Call for Evidence

- CA Cheuvreux supports CESR's proposals to improve the quality of post-trade transparency.
- CA Cheuvreux is in favour of a European mandatory consolidated tape. It would give an easy overall view of the market and would allow for easier control of post-trade market data.
- Regarding pre-trade transparency, CA Cheuvreux is not in favour of any change in the current calibration for large in scale orders. We believe that the current thresholds were already set at a very low level.
- CA Cheuvreux does not believe that the reference price waiver should be amended to include minimum thresholds. Furthermore we would like to stress that the mid-point is not the only reference that should be allowed to benefit from this waiver. Any price inside the European BBO or the Reference BBO should be allowed as it improves the price for both counterparties.

Responses to CESR's specific questions

2. Transparency

2.1 Pre transparency

Question 1: Do you support the generic approach described above?

Crédit Agricole Cheuvreux supports the approach described in the CESR consultation. Crédit Agricole Cheuvreux is in favour of rules that set a single level playing field at the European level.

Question 2: Do you have any other general comments on the MiFID pre-trade transparency regime?

Pre-trade transparency is linked to the EBBO (European Best Bid and Offer). For each broker, the EBBO varies according to its own execution policy. For example, if in its execution policy, a broker states that all execution will be carried out on the regulated market, its EBBO will be the BBO of the regulated market. With the increase in the number of execution policies, there is a concomitant rise in the number of EBBOs. Consequently it is impossible to have a common EBBO.

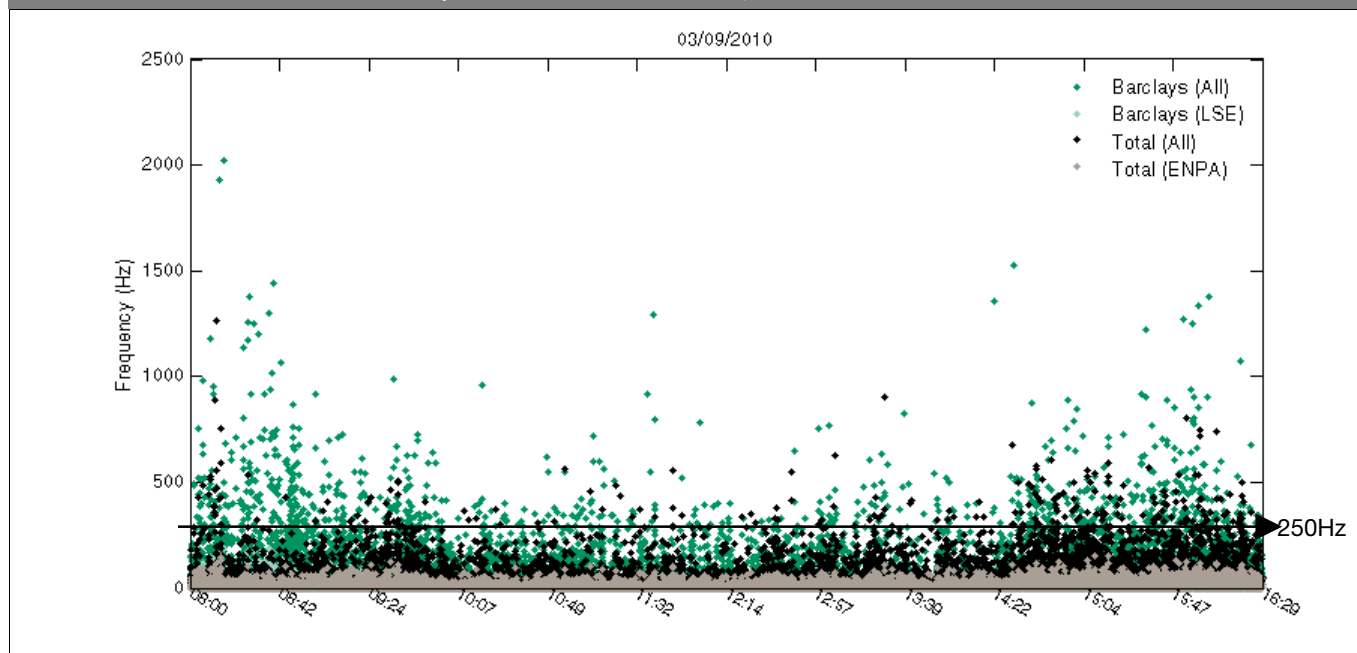
We believe that pre-trade transparency is increasingly less relevant in the price formation process.

As stated in our "Navigating Liquidity 4" publication, we think that:

The trading activity of HFT updates limit order books at a higher rate than the round trip for any non co-located observer. The snapshot of the limit order books you take into account to make decisions does not, in most cases, reflect the state of the book when your order actually reaches it. This can be taken into account using real-time estimates of the quantity that is really available in the books at each price. **This is a shift in the paradigm:** a few years ago, one could send an order to a market knowing that it would be a liquidity provider or a liquidity consumer. **Now, when an order is sent to the market, the present information only gives an estimate of its probability of capturing aggressive or passive flows.**

FIGURE 1 shows the variations of the number of updates of the order book (five limits) per second (i.e. frequency in Hertz) for two liquid stocks (one listed in London, and the other in Paris) during the day. It is greater than 250Hz during most of the day, which implies a Nyquist-Shannon latency bound of 2ms.

FIGURE1: INTRA-DAY FREQUENCY OF UPDATE OF THE FIRST FIVE LIMITS FOR TWO LARGE CAPS IN EUROPE (ON THEIR PRIMARY MARKET AND ON A CONSOLIDATED TAPE): 250HZ IS A COMMON VALUE, ITS ASSOCIATED LATENCY BOUND IS 2MS



Source: Crédit Agricole Cheuvreux Quantitative Research

Dark pools also contribute to this blurring of definitions: on sending an order to such a liquidity pool, the only information you have is the probability of being a liquidity provider or liquidity consumer.

The European Commission could set a Reference BBO (RBBO). However, at the present time, we do not see an immediate need for such a solution. We believe that a significant improvement in post-trade transparency would sort out the issue.

2.1.1.2 Large in scale waiver

Question 3: Do you consider that the current calibration for large in scale orders is appropriate (Option 1)? Please provide reasoning for your view.

Question 4: Do you consider that the current calibration for large in scale orders should be changed? If so, please provide a specific proposal in terms of reduction of minimum order sizes and articulate the rationale for your proposal?

The size of a market order should not be the only relevant criterion to determine if an order is Large In Scale or not. The calibration should be theoretically determined, taking into account the arbitrage between market impact and volatility risk. Even though the terms of this arbitrage have deteriorated, as large orders are generating a higher market impact than prior to MiFID, we consider that the current thresholds were already set at a very low level and we believe there is no need for a review of these thresholds.

2.1.1.3 Reference price waiver

Question 6: Should the waiver be amended to include minimum thresholds for orders submitted to reference price systems? Please provide your rationale and, if appropriate, suggestions for minimum order thresholds.

We do not believe that the waiver should be amended to include minimum thresholds for orders submitted to reference price systems.

A threshold would prevent clients sending small orders from using the venues or crossing engines applying this waiver. Then these clients would no longer benefit from the low execution cost (explicit and implicit) such venues or crossing engines allowed. It would go against the MiFID objective to enhance competition in order to lower not only explicit cost but also and mainly implicit execution costs.

Furthermore, pre-trade information for passive price-taking orders does not add value to the market's price formation process and may encourage detrimental activity by other market users.

Question 7: Do you have other specific comments on the reference price waiver, or the clarifications suggested in Annex I?

We would like to stress that the mid-point is not the only reference that should be allowed to benefit from this waiver. Any price within the spread enhances the price for both parties (seller and buyer) and is thus cost effective in terms of both price and cost of execution. Any price inside the EBBO or the Reference BBO should be allowed as it improves the price for both counterparties.

As stated in our answer to Question 2 above, every market participant should establish its own EBBO. As each market participant will be responsible for justifying its own Best Execution policy, it should also be allowed to use the latter as the reference price for its crossing activities. This is the only reference price on which a market participant could ensure that latency concerns are handled systematically and that prices are given on a consistent reference base.

2.1.1.4 Negotiated trade waiver

Question 8: Do you have any specific comments on the waiver for negotiated trades?

We would encourage regulators to look in depth at the true nature of the negotiated trades. The very small size of a large portion of negotiated trades may hide a use of this waiver that does not match with the initial aim.

2.1.1.5 Order management facility waiver

Question 9: Do you have any specific comments on the waiver for order management facilities, or the clarifications provided in Annex I?

No

2.2 Post-trade transparency

2.2.1 Quality of post-trade information

Question 17: Do you agree with this multi-pronged approach?

Yes. We consider it to be very important as pre-trade transparency is blurred by High-Frequency orders. The main source of information for market participants is the trades that actually occurred on the market.

2.2.2 Timing of publication of post-trade information

Question 18: Do you agree with CESR's proposals outlined above to address concerns about real-time publication of post-trade transparency information? If not, please specify your reasons and include examples of situations where you may face difficulties fulfilling this proposed requirement.

CA Cheuvreux is in favour of a publication "as close as to instantaneously as technically possible". In our view, this should be the standard applied and enforced for all participants. We are convinced that post-trade transparency will gradually replace the pre-trade as the reliable information on the Price Formation Process (PFP).

Question 19: In your view, would a 1-minute deadline lead to additional costs (e.g. in terms of systems and restructuring of processes within firms)? If so, please provide quantitative estimates of one-off and ongoing costs. What would be the impact on smaller firms?

We do not believe a 1-minute deadline (versus a 3-minute deadline) would lead to additional costs.

Question 20: Do you support CESR proposal to maintain the existing deferred publication framework whereby delays for large trades are set out on the basis of the liquidity of the share and the size of the transaction?

Yes

Question 21: Do you agree with the proposal to shorten delays for publication of trades that are large in scale? If not, please clarify whether you support certain proposed changes but not others, and explain why.

CA Cheuvreux considers that it is necessary to maintain a differed publication regime in order to limit the risk taken by investment firms. The first priority should be to enforce the good application of the rule, that is to say to verify that the investment firm publishes its transaction as soon as the risk is already unwound and not at the end of the delay.

We consider that the re-calibration of the differed publication thresholds and delays should be assessed by the CESR/Industry Working Group.

Question 22: Should CESR consider other changes to the deferred publication thresholds so as to bring greater consistency between transaction thresholds across categories of shares? If so, what changes should be considered and for what reasons?

No

Question 23: In your view, would i) a reduction of the deferred publication delays and ii) an increase in the intraday transaction size thresholds lead to additional costs (e.g. in ability to unwind large positions and systems costs)? If so, please provide quantitative estimates of one-off and ongoing costs.

It would increase the price of transactions facilitated to clients. This would bring a new equilibrium that may prove costly to reach.

3. Application of transparency obligations for equity-like instruments

Question 24: Do you agree with the CESR proposal to apply transparency requirements to each of the following (as defined above):

- DRs (whether or not the underlying financial instrument is an EEA share);
- ETFs (whether or not the underlying is an EEA share);
- ETFs where the underlying is a fixed income instrument;
- ETCs; and
- Certificates

If you do not agree with this proposal for all or some of the instruments listed above, please articulate reasons.

We agree with this proposal.

Question 25: If transparency requirements were applied, would it be appropriate to use the same MiFID equity transparency regime for each of the 'equity-like' financial instruments (e.g. pre- and post-trade, timing of publication, information to be published, etc.). If not, what specific aspect(s) of the MiFID equity transparency regime would need to be modified and for what reasons?

Yes

4. Consolidation of transparency information

4.1 Regulatory framework for consolidation

Question 27: Do you support the proposed requirements/guidance (described in this section and in Annex IV) for Approved Publication Arrangements (APA) ? If not, what changes would you make to the proposed approach?

Regulators must ensure that post-transparency quality is faultless. APA status is one of the possible ways to achieve this purpose.

Question 30: In your view, what would be the benefits of multiple approved publication arrangements compared to the current situation post-MiFID and compared to an EU mandated consolidated tape (as described under 4.1.2 below)?

CA Cheuvreux is in favour of a European mandatory consolidated tape, as we believe that this is more likely to offer a timely solution than leaving market forces to reach an agreement.

Question 31: Do you believe that MiFID provisions regarding cost of market data need to be amended?
 Question 32: In your view, should publication arrangements be required to make pre- and post-trade information available separately (and not make the purchase of one conditional upon the purchase of the other)? Please provide reasons for your response.

We agree that the cost of European data is too expensive and should be reduced.

We support the proposals to make pre- and post-trade information data available separately and to provide post-trade data more than 15 minutes old free of charge.

Question 34: Do you support the proposal to require RMs, MTFs and OTC reporting arrangements (i.e. APAs) to provide information to competent authorities to allow them to prepare MiFID transparency calculations?

Yes, we support this proposal.

Question 34: Do you support the proposed approach to a European mandatory consolidated tape?

Question 35: If not, what changes would you suggest to the proposed approach?

Question 36: In your view, what would be the benefits of a consolidated tape compared to the current situation post-MiFID and compared to multiple approved publication arrangements?

Question 37: In your view, would providing trade reports to a MCT lead to additional costs? If so, please specify and where possible please provide quantitative estimates of one-off and ongoing costs.

CA Cheuvreux is in favour of a European mandatory consolidated tape.

It would give an easy overall view of the market and would allow for easier control of post-trade market data. Well managed, it should also be a factor of lower costs for Investment Firms.

Only good-quality post-trade transparency will compensate for the lack of visibility from pre-trade transparency.

5. Regulatory boundaries and requirements

5.1 Regulated markets vs. MTFs

Question 38: Do you agree with this proposal? If not, please explain.

Question 39: Do you consider that it would help addressing potential unlevel playing field across RMs and MTFs? Please elaborate.

Question 40: In your view, what would be the benefits of the proposals with respect to organisational requirements for investment firms and market operators operating an MTF?

Question 41: In your view, do the proposals lead to additional costs for investment firms and market operators operating an MTF? If so, please specify and where possible please provide quantitative estimates of one-off and ongoing costs.

We agree with this proposal. The impact is likely to be low. In our experience most MTFs already comply with such requirements.

5.2 Investment firms operating internal crossing systems/processes

Question 42: Do you agree to introduce the definition of broker internal crossing process used for the fact finding into MiFID in order to attach additional requirements to crossing processes? If not what should be captured, and how should that be defined?

Yes, we agree.

Question 43: Do you agree with the proposed bespoke requirements? If not, what alternative requirements or methods would you suggest?

We agree.

Question 44: Do you agree with setting a limit on the amount of client business that can be executed by investment firms' crossing systems/processes before requiring investment firms to establish an MTF for the execution of client orders ('crossing systems/processes becoming an MTF)?

a) What should be the basis for determining the threshold above which an investment firm's crossing system/process would be required to become an MTF? For example, should the threshold be expressed as a percentage of total European trading or other measures? Please articulate rationale for your response.

b) In your view, should linkages with other investment firms' broker crossing systems/processes be taken into account in determining whether an investment firm has reached the threshold above which the crossing system/process would need to become an MTF? If so, please provide a rationale, also on linking methods which should be taken into account.

If regulators wish to implement such a threshold, we consider that it would be inappropriate to set it any lower than 0.5% of the total average daily turnover of a stock.

Question 45: In your view, do the proposed requirements for investment firms operating crossing systems/processes lead to additional costs? If so, please specify and where possible please provide quantitative estimates of one-off and ongoing costs.

Investment Firms will need to review their execution policies and will have to implement a declutching system in their crossing engine.

6. MiFID options and discretions

a) Waiver of pre-trade transparency obligations

Question 46: Do you think that replacing the waivers with legal exemptions (automatically applicable across Europe) would provide benefits or drawbacks? Please elaborate.

Yes, we are in favour of a single set of rules across Europe.

b) Determination of liquid shares

Questions 47: Which reasons may necessitate the application of both criteria?

Questions 48: Is a unique definition of liquid share for the purposes of Article 27 necessary?

Questions 49: If CESR were to propose a unique definition of 'liquid share' which of the options do you prefer?

a) apply condition a) and b) of the existing Article 22(1), or

b) apply only condition a), or

c) apply only condition b) of Article 22(1)?

Please elaborate.

Any definition based on the average daily number of transactions is so dependent on the trend in frictional costs that setting a threshold based on current market conditions may soon prove to be outdated and irrelevant. Any definition based on average daily turnover is so dependent on the proportion of HFTs (which in turn depend on frictional costs) that setting a threshold based on current market conditions may soon prove to be outdated and irrelevant.

ANNEX II – PROPOSED STANDARDS FOR POST-TRADE TRANSPARENCY

Question 1: Do you agree to use ISO standard formats to identify the instrument, price notation and venue? If not, please specify reasons.

Yes. We would also be in favour of a standard format to identify a stock's place of listing.

Question 2: Do you agree that the unit price should be provided in the major currency (e.g. Euros) rather than the minor currency (e.g. Euro cents)? If not, please specify reasons.

Yes

Identification of dark trading

Question 5: Would it be useful to have a mechanism to identify transactions which are not pre-trade transparent?

Yes. For a venue with multiple pools of liquidity (MTF lit + dark, etc.), it is important that these different pools can be identified by regulators (via the transaction reporting and a MIC code per venue). The market may need to know in which kind of venue the transaction took place. But the MTF dark and crossing networks should be given the freedom to disclose their specific identities via their MIC codes.

Question 6: If you agree, should this information be made public trade-by-trade in real-time in an additional field or on a monthly aggregated basis? Please specify reasons for your position.

On a trade-by-trade. A monthly aggregate would not have added value.

Question 7: What would be the best way to address the situation where a transaction is the result of a non-pre-trade transparent order executed against a pre-trade transparent order?

We do not believe dark books should interact with lit books in any situation, as this would be misleading for clients that have asked for execution on a dark venue.

Unique transaction identifier

Question 8: Do you agree each transaction published should be assigned a unique transaction identifier? If so, do you agree a unique transaction identifier should consist of a unique transaction identifier provided by the party with the publication obligation, a unique transaction identifier provided by the publication arrangement and a code to identify the publication arrangement uniquely? If not, please specify reasons.

Yes

Cancellations

Question 9: Do you agree with CESR's proposal? If not please specify reasons.

Yes, the information should be sent to the market as soon as the need for cancellation is identified. We do not believe that setting up a specific 90-second deadline would be useful. The principle of it being done "as soon as possible" is strong enough.

Amendments

Question 10: Do you agree with CESR's proposal? If not please specify reasons.

Yes, the information should be sent to the market as soon as the need for amendment is identified. We do not believe that setting up a specific 90-second deadline would be useful. The principle of it being done "as soon as possible" is strong enough.

Negotiated trades

Question 11: Do you agree with CESR's proposal? If not please specify reasons.

Yes

RECHERCHE & VENTE INSTITUTIONNELLE

ALLEMAGNE

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU DE FRANCFORT
Taunusanlage 14
D-60325
Frankfurt am Main
TEL: +49 69 47 897 100
FAX: +49 69 47 897 530

AUTRICHE

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU DE VIENNE
5th floor, Opemring 3-5
1010 Vienna
TEL: +43 1 22 712 70 00
FAX: +43 1 22 712 70 01

BENELUX

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU D'AMSTERDAM
Honthorststraat 9
1071 DC Amsterdam
TEL: +31 20 573 06 66
FAX: +31 20 672 40 41

EMIRATS ARABES UNIS

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU DU MOYEN-ORIENT
702, 7th Floor,
Precinct Building #2,
The Gate District
Dubai International
Financial Centre
P.O. BOX 506611
Dubai, UAE
TEL: +971 4 428 3600
FAX: +971 4 428 3644

ESPAGNE

CRÉDIT AGRICOLE
CHEUVREUX ESPAÑA S.V. S.A.
Paseo de la Castellana 1
28046 Madrid
TEL: +34 91 495 16 48
FAX: +34 91 495 16 60

FRANCE

CRÉDIT AGRICOLE
CHEUVREUX S.A.
9, quai Paul Doumer
92400 Courbevoie
TEL: +33 1 41 89 70 05
FAX: +33 1 41 89 70 05

GRECE

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU D'ATHENES
1 Korai street (3rd floor)
10564 Athens
TEL: +30 210 373 4000
FAX: +30 210 373 4001

ITALIE

CRÉDIT AGRICOLE
CHEUVREUX - BUREAU DE MILAN
Via Brera 21
20121 Milan
TEL: +39 02 80 62 83 00
FAX: +39 02 86 46 15 70

ROYAUME-UNI

CRÉDIT AGRICOLE
CHEUVREUX
INTERNATIONAL Ltd
12th Floor
Moorhouse
120 London Wall
London EC2Y 5ET
TEL: +44 207 621 5100
FAX: +44 207 621 5101

SUEDE

CRÉDIT AGRICOLE
CHEUVREUX NORDIC AB
Regeringsgatan 38
10393 Stockholm
TEL: +468 723 5100
FAX: +468 723 5101

SUISSE

CRÉDIT AGRICOLE
CHEUVREUX
BUREAU DE ZURICH
Bahnhofstrasse 18
8001 Zurich
TEL: +41 44 218 17 17
FAX: +41 44 212 25 50

TURQUIE

CRÉDIT AGRICOLE
CHEUVREUX
MENKUL DEGERLER A.S.
Buyukdere Cad.
Yapi Kredi Plaza
C Blok Kat:15
Levent 80620 - Istanbul
TEL: +90 212 371 19 00
FAX: +90 212 371 19 01

VENTE INSTITUTIONNELLE

JAPON

CHEUVREUX
CREDIT AGRICOLE SECURITIES
ASIA B.V., TOKYO BRANCH
Shiodome Sumitomo
Building, 15th floor
1-9-2 Higashi-Shimbashi
Minato-Ku
Tokyo 105-0021
TEL: +81 3 4580 8522
FAX: +81 3 4580 5534

ETATS-UNIS

CRÉDIT AGRICOLE
CHEUVREUX NORTH
AMERICA, INC.

NEW YORK

1301 Avenue of the Americas
15th floor
New York, NY 10019
TEL: +1 (212) 492 8800
FAX: +1 (212) 492 8801

SAN FRANCISCO

388 Market Street; Suite 960
San Francisco, CA 94111
TEL: +1 (415) 255 9800
FAX: +1 (415) 956 9940