5 April 2005

CESR'S DRAFT ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE 2004/39/EC

SECOND CONSULTATION PAPER
(REF. CESR/ 05-164)

Reply of Euronext

Introduction

At this stage of the consultation process, Euronext focuses its contribution on chapter four of the consultation paper dealing with market transparency.

We note that CESR has taken into account certain of the comments made in our reply to the prior consultation paper on such topics. We do appreciate the modifications and are grateful for them, in particular as regards additional flexibility in the treatment of the pre-trade transparency. There are nonetheless a number of points on which the proposed advice still does not appear fully satisfactory. Comments on such points are developed below.

Market Transparency

1. *Definition of the systematic internaliser (BOX 1)*

As mentioned by some participants in the hearing of 23 March, the two elements of the first criterion (§11a): (1) separate business model in which internalisation has a commercial role and (2) the existence of non-discriminatory rules (etc.) may be cumulative since a separate business model will probably also have non-discriminatory rules.

However, we agree with CESR that it is important to keep the possibility for these two criteria to be alternative: if systematic internalisation should have a commercial role in all business models it will not necessarily be through a "*separate*" business model.

Therefore, we would be in favour of clarifying that the first element of criterion 11(a) (i.e. a separate business model) is not a necessary condition to be considered as a systematic internaliser, whereas the second element of such criterion (i.e. non-discriminatory rules) may apply in addition to the first one (i.e. "or" could be replaced by "and/or" in criteria 11(a)).

In order to keep things simple, it seems important to avoid using too many criteria. In our opinion, no more criteria should be added. We are not in favour of quantitative thresholds.

Moreover, in any instances and in order to ensure a level playing field throughout Europe, we believe that such criteria should not be optional but, if retained in the final advice, should be made obligatory in all Member States.

2. *Defining liquid shares (BOX 2)*

There are four criteria to determine liquid shares: (a) the share is traded daily, (b) the share has a free float of at least 1 billion euros, (c) the daily average number of trades per day of the share is more than 500 and (d) the average daily turnover of the share is more than 2 million euros. CESR foresees that the two first criteria be mandatory, sort of pre-requisite conditions whereas Member States would choose one of the two last criteria alternatively but consistently for all shares in that Member State.

In order to avoid issues of definition and problems in calculation, we propose to replace the criterion of free float by market capitalisation.

If the criterion of free float is to be retained, we consider it more appropriate that the calculation of the free float be made on the basis of the proposed interim proxy i.e. by using a widely accepted /used EU-wide index calculation. We have indeed some reservations on the calculation method proposed by CESR, especially regarding the exclusion of holdings exceeding 5% of the voting rights, as defined in the Transparency Directive, in view of the fact that these holdings may be held by investors who are willing to sell them at any time without restriction (e.g. investment funds).

In our opinion, criteria (d) average daily turnover in a share and (c) average number of trades per day are both relevant criteria to measure liquidity. We do not really see what justifies the possibility of choice by Member States of one of the two criteria. We believe that comparable shares should be treated equally for the purpose of determining whether or not they are liquid. The possibility left to states to choose between criteria (c) or (d) does not achieve this goal. It appears key to us that all Member States have the same rules to select liquid stocks. Therefore, we propose that shares meeting any of the criteria (c) or (d) be considered as "liquid" in all Member States.

3. *Content of pre-trade transparency (BOX 3)*

We would have preferred an advice based on high level principles rather than a list of market models. We nevertheless appreciate the effort of CESR to open up such a list and can live with such proposal.

The developments relative to the updating and withdrawal of quotes on a RM or MTF have to be reviewed considering the following: on Euronext markets, the obligations of market makers, and consequently the withdrawal of their quotes, are only partially covered by market rules. The contractual agreement they have with the market operator are also relevant in that respect. In our opinion, such issue should either not be dealt with at level II or the advice should be made more flexible.

Regarding the condition of price control of negotiated trades, we do not quite get the intention of CESR stated in § 84a: does the transaction need to be in all instances within or at the current best bid/offer of the order book or can it at a weighted average spread if a transaction is for a size bigger than the one of the current best bid/offer price?

As concerns the calculation of the Standard Market Size, we would like to highlight an issue relative to the “mid-point” method chosen by CESR as the proposal is not quite in line with level 1 (art. 27.1.4). As concerns the first class of shares, the SMS should be higher than the mid-point to be relevant and to reflect the true distribution of shares within such first class.

Concerning the withdrawal and updating of quotes by internalisers, CESR’s advice indicates in §99 that internalisers *may* withdraw quotes when trading is suspended on a RM. A level playing field between execution venues requires that they should be obliged to do so and not be offered a mere possibility.

4. Display of clients limit orders (BOX 4)

The statement made by CESR that the order should be made “visible to other market participants” is not precise enough in our view. It should be clearer that the notion of “market participants” refers to the wider market.

Furthermore, the possibility to transmit orders on other types of venues should only be foreseen when investment firms “cannot” execute on a multilateral execution facility. In that respect, §128 that states “*does not*” should read “*cannot*”.

In addition, an explicit reference to best execution should be included in §129, that states that the firm may “either transmit the limit order to the most appropriate venue directly or route the order via another investment firm provided that a similar end result is achieved”.

5. Post-trade transparency requirements (BOX 5)

Relatively to the explanatory §137, we are wondering, and would therefore call for precision, on who should “flag/mark” post-trade information that could be misleading because the transaction would be subject to conditions other than price.

6. Transactions large in scale compared to normal market size (BOX 6)

Given the fact that there are sufficient waivers in box 3 and assuming that such waivers will be interpreted in a flexible manner, we can agree with the pre-trade waiver thresholds established by CESR in table 1 p.73.

As regards the deferred publication arrangements in table 2, we ask CESR to simplify its proposal by using fixed numbers instead of percentage of the ADV with limits. We underline however that with such an approach using fixed numbers the revision process must be possible on a yearly or half yearly basis and that the thresholds for less liquid shares should be higher.

In §172 of CESR's advice, the drafting should make clear that the "lead Regulated Market" is the "most relevant market in terms of liquidity" referred to in Article 5 of the Directive, in order to avoid any ambiguity in this respect.