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30 April, 2010

By e-mail

Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris, France

Re: Call for evidence on Micro-structural issues of the European equity markets (Ref: CESR/10-142)

Ladies and Gentlemen:

Liquidnet Europe Limited appreciates the opportunity to comment on the Call for Evidence published by the Committee of European Securities Regulators (CESR) on "Micro-structural issues of the European equity markets" (the Call for Evidence).

Background on Liquidnet

Liquidnet is the number one block trading pool in Europe in terms of both market share and average execution size.[1] The average size of European trades manually negotiated in our negotiation system is €1,177,362. This is 118 times larger than the average execution size on the London Stock Exchange.[2]

Liquidnet currently operates in Europe, the United States, Canada, Asia and Australia. Our primary objective is to reduce trading costs for institutional investors and the tens of millions of individuals who are the beneficiaries of the accounts that they manage. In particular, our primary focus is to reduce the market impact cost for executing block orders. In the United States, for calendar year 2008, Broker Edge™ ranked Liquidnet as the #1 broker overall for equity trade cost performance across all institutional brokers. In this survey, Liquidnet also ranked #1 in 23 of 37 execution performance categories.[3] For calendar year 2009, Liquidnet again ranked #1 in execution performance across all institutional brokers in the annual Broker Edge™ report.[4]

We are grateful for the opportunity to comment on the Call for Evidence. We also believe it is extremely important in connection with any rule proposals relating to market structure that CESR carefully consider

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[1] Thomson Reuters Market Share Reporter, extracted 30 April 2010 for month of April 2010.
[2] Thomson Reuters Market Share Reporter, extracted 30 April 2010 for month of April 2010.
[3] Investment Technology Group "ITG Broker Edge™ Core Broker Report" for U.S. trades for the four quarters ended December 31, 2008, cited in April 30, 2009 press release, "Liquidnet Ranked #1 in 62% of all Execution Categories According to ITG Broker Edge™ Core Broker Report".
[4] Tradewatch, *Pensions & Investments*, 8 March, 2010, http://www.pionline.com/apps/pbcs.dll/article?AID=/20100308/CHART/100309924&crit=liquidnet&template=printart (accessed 22 March, 2010).

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the views of the buy-side institutions, including the managers of UCITs, other investment funds and pension funds, that trade on behalf of tens of millions of European households.

Indications of interest

We are limiting our response to the topic of indications of interest, which is the topic in the Call for Evidence that is relevant to our business.

The U.S. Securities and Exchange Commission has recently issued proposals to amend the Regulation NMS definition of bid and offer to include certain "actionable IOIs". In many cases, these IOIs are similar to orders or quotes because they can be executed without a further affirmative action by the party issuing the IOI. One of the issues being considered by the Commission relates to how much information must be provided in an IOI before we can conclude that an order has been communicated to a third-party. We support the SEC's approach of seeking to better define when a so-called IOI should, in fact, be considered an order, and we would support similar efforts by CESR and the European Commission.

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From our perspective, the most important policy concern is to ensure that the regulations provide appropriate exemptions from pre-trade transparency, specifically for institutions seeking to execute block orders.

Various industry experts have noted the need for institutions executing large orders to maintain the confidentiality of their large order information.

According to TABB Group, a research and consulting firm that conducts extensive research on trading and markets,

> "... institutional investors tend to keep their trades quiet and not telegraph their intentions. Many investors feel that by placing limit orders or showing their hand, they will leak information into the market and invite other traders to take advantage of them."[5]

TD Newcrest, a securities dealer in Canada that provides research reports on the equity markets, similarly reports that institutional traders in Canada "... remain concerned over information leakage that results from sophisticated pattern recognition as well as aggressive strategies utilized

[5] The TABB Group, LLC, "US Equity High Frequency Trading: Strategies, Sizing and Market Structure", September 2009, p. 22.

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by high frequency traders that are able to maneuver in the market much more nimbly than traditional traders."[6]

Quantitative Services Group, a provider of advanced trading analytics and investment consulting services, notes similarly in a recent report:

> "It's well known that sophisticated stat-arb models routinely monitor market data and the depth of limit order books to detect asymmetries in trading interests. The goal is to exploit and profit from them before the flows reverse and larger traders have a chance to finish their orders. These HFT strategies increase the costs of completing institutional trades and often introduce 'adverse selection' as orders are completed in names that are moving contrary to the institutional trader's investment goals."[7]

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In November 2008, CESR published a "Call for evidence on the impact of MiFID on secondary markets functioning", seeking feedback from market participants in Europe on the impact of the Markets in Financial Instruments Directive.[8] As part of this process, CESR solicited feedback from market participants on dark pools.[9]

The significant majority of responding parties, including many buy-side market participants who invest on behalf of tens of millions of European citizens, identified the benefits of dark pools.

The European Banking Federation, whose membership includes approximately 5,000 European banks,[10] wrote:

> "Dark pools have an important role in that they allow the execution of large orders without creating a market impact. Pre-trade transparency requirements for such types of orders would otherwise lead to artificial rice distortion. I.e., without the

[6] The Equity Division of TD Securities, "High Frequency Trading Strikes a Chord with Politicians, Regulators and Market Participants", *S&P/TSX Bulletin*, p. 8.
[7] Quantitative Research Group LLC, "Beware of the VWAP Trap", *Research Note*, November 2009, p. 3.
[8] Ref. CESR/08-872, 3 November, 2008.
[9] While Liquidnet is often referred to as a dark pool, we would describe ourselves as a block order pool because our purpose is to facilitate execution of block orders by institutions with reduced market impact costs. As evidenced by our average negotiated execution size of €1,177,362, our business is more similar to that of an institutional broker than it is to exchanges and dark pools that focus on executing smaller orders.
[10] http://www.fbe.be/Content/Default.asp (accessed 18 December, 2009).

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> possibility of trading in dark pools the investor would be forced to execute the transaction in tranches."[11]

The Association of British Insurers wrote:

> "Our members believe there are benefits to the dark pools of liquidity, namely the reduction of market impact as CESR highlights. Portfolio managers often trade in large sizes so minimising market impact – and thus reducing the cost of trading - is of great importance to them."[12]

The Investment Management Association, the trade body for the UK's asset management industry,[13] wrote:

> "IMA members believe that dark pools are helpful in trading large blocks of stock particularly in minimising market impact and in achieving best execution."[14]

* * * * *

Based on the role that dark pools like Liquidnet play in reducing trading costs for large block orders, we believe that appropriate exemptions from pre-trade transparency should be provided to reduce trading costs for institutions. We will discuss our specific proposals with respect to pre-trade transparency in our upcoming responses to the consultation papers that have recently been issued by CESR.

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We would like to thank CESR for the opportunity to comment on this Call for Evidence. We look forward to participating in this discussion of the current market structure issues. We hope that in this process due consideration is given to the importance of reducing trading costs for the tens of millions of pensioners and other individuals who invest through UCITS, investment funds, pension funds and similar investment schemes. This process has been extremely beneficial so far in creating greater awareness of how the equity markets operate, and we look forward to the ongoing discussion of market structure issues.

Yours sincerely,

Steve Brown
Director
Head of International Operations

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[11] "EBF Response to CESR Call for Evidence on the Impact of MiFID on Secondary Markets Functioning", 9 January, 2009.
[12] "Call for evidence on the impact of MiFID on secondary market functioning - The ABI's Response to CESR 08-872", January 2009.
[13] www.investmentuk.org (accessed 18 December, 2009).
[14] "Call for Evidence on the Impact of MiFID on Secondary Market Functioning", 8 January, 2009.