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FEEDBACK ON CESR CFE – MICRO STRUCTURE EUROPEAN EQUITY

HFT

Burgundy Answers to CESR Questions

1. Please describe trading strategies used by high frequency traders and provide examples of how they are implemented.

No comment.

2. Please provide evidence on the amount of European trading executed by HF traders (including the source(s) of that information). CESR is particularly interested in statistical material on: a) market share of HFT in orders/trades in Q1/2010 (and, if possible compared to 2008 and 2009), b) average trade size in Q1/2010 (and, if possible compared to 2008 and 2009), c) market participants, d) financial instruments traded (including cash vs. derivatives). If possible, please distinguish between HFT on transparent organised trading platforms and on dark pools of liquidity.

No comment.

3. What are the key drivers of HFT, and (if any) limitations to the growth of HFT?

Mainly related to technological improvements in the way equities are traded – a natural step similar to automatisisation of other industries.

4. In your view, what is the impact of high frequency trading on the market, particularly in relation to:

- market structure (eg. tick sizes);
- liquidity, turnover, bid-offer spreads, market depth;
- volatility and price formation;
- efficiency and orderliness of the market?

Please provide evidence supporting your views on the impact of HFT on the market.

No comment.

5. What are the key benefits from HFT? Do these benefits exist for all HFT trading strategies?

We believe that HFT has unfairly been blamed for creating unwanted volatility and lack of transparency in equity markets. On the contrary, Burgundy welcomes HFT firms as they are a natural development in the automatisisation of markets. We believe that HFT's are vital part acting as providers of liquidity or arbitrageurs facilitating trade for investors. We see scope for further growth from HFT firms and also that HFT already exists among prop trading desks of banks and investment firms. However, any automatic trading participant present potential new risks that need to be monitored carefully as outlined further below;

6. Do you consider that HFT poses a risk to markets (eg. from an operational or systemic perspective)? In your view, are these risks adequately mitigated?

Although not particularly related to HFT's, we see an increasing risk in automated trading applications going wild and potentially flooding trading venues with data affecting the market with negative consequences for all participants and ultimately end investors. This puts increased demand on each venues capability to mitigate this risk by being able to throttle flow or disconnect such members in extreme circumstances. Trading rules for electronic venues should therefore contain rules on capacity limitations and trade cancellation rules as there is a clear risk of mass outrades that needs to be cancelled or rectified.

7. Overall, do you consider HFT to be beneficial or detrimental to the markets? Please elaborate.

See above.

8. How do you see HFT developing in Europe?

We foresee increased volume growth in Europe as market technological readiness evolves and becomes more mature.

9. Do you consider that additional regulation may be desirable in relation to HF trading/ traders? If so, what kind of regulation would be suitable to address which risks?

We do not see any need for specific HFT firm regulation. It is also difficult to define exactly what is an HFT and any attempts to try to define this are futile in our view.

As most of the European liquid universe is now cleared we do not see significant systemic risk added due to more HFT firms being active in the market. As some of these firms are MIFID-exempt, there is possible risk added for any such firm being allowed to trade on a bilateral basis as there is inevitable counterparty risk involved in need of mitigation. Regulators may want to ensure that there are certain standards regarding the above mentioned capacity issues and trade cancellation rules for RM;MTF and SI's who are open for HFT firms to access. MIFID-exempt firms should also have more stringent capital requirements and additional reporting obligations to both trading venues and clearers/guarantors compared to ordinary firms in order to minimize any system-wide risk they might add.

SPONSORED ACCESS*Burgundy answers to CESR Questions - Sponsored access*

1. What are the benefits of SA arrangements for trading platforms, sponsoring firms, their clients and the wider market?

We believe that controlled SA i.e. an “enhanced DMA” service, where all communication between the client and the trading venue is done in a “filtered” way, i.e. pre-trade controls is fine and could be offered to clients. We see risks in allowing clients direct access without the necessary controls and ultimately this could jeopardize the stability of a marketplace. Therefore, unfiltered SA arrangements should not be allowed on exchanges or MTF's.

2. What risks does SA pose for the orderly functioning of organised trading platforms? How could these risks be mitigated?

See above.

3. What risks does SA pose for sponsoring firms? How should these risks be mitigated?

n/a

4. Is there a need for additional regulatory requirements for sponsored access, for example:

- a. limitations on who can be a sponsoring firm;*
- b. restrictions on clients that can use sponsored access;*
- c. additional market monitoring requirements;*
- d. pre-trade filters and controls on submitted orders.*

Burgundy allows member firms clients to connect and trade via a member firms application. There are no special rules/member classes that allow a non-member firm to connect directly to trade on Burgundy with the financial support of a member.

Burgundy does not support the view of allowing naked/unfiltered access to markets. This is mainly because of the risk aspect, even though in a CCP-world, this can now be mitigated. A real-time pre- and post-trade monitoring of any DMA or SA client is in Burgundy's view an absolute minimum requirement. Given that this is not waived for the latter category of firms, we suggest that there is little need of any special rules regarding SA from a venues point of view. In Burgundys opinion, they should be treated as any DMA client of a participant, subject to the appropriate filters and controls. Regulators should ensure that there are no venues who allow direct, unfiltered access to venues, regardless of client type, through any member.

5. Are there other market wide implications resulting from the development of SA?

In the extreme, members may opt out of trading at certain platforms who allow SA due to the above risks.

CO-LO SERVICES

Burgundy answers to CESR questions:

1. What are the benefits of co-location services for organised trading platforms, trading participants and clients/investors?

The purpose is to minimize latency between members equipment and a venues central server in order to maximize the potential of members trading strategies and order execution capability which requires ultra-fast access to the marketplace server. We believe that using such service is beneficial for both member firms and their clients since the speed of execution is becoming increasingly important when selecting both broker and execution venue.

2. Are there any downsides arising from the provision of co-location services? If yes, please describe them.

Not having full overview on what members have better access to a venue, for example by co-lo, could mean that a client is getting slower executions without knowing about this when selecting broker.

Co-lo and proximity services should be offered to all participants on an equal basis, i.e. pricing should be fully transparent and available to participants. Burgundy notes that co-lo and proximity hosting services are offered by several MTF's and incumbent exchanges – however, the pricing and possible conflict of interests are not easily understood by looking at publicly available information.

A trading venue may have a commercial interest to offer co-lo services to its members, for example as part of a rebate package. If third party providers are offering kick-backs to trading venues related to co-lo or proximity services, this should be made known to participants and interested parties.

3. What impact do co-location services have on trading platforms, participants, and the wider market?

Co-lo will create greater demand on platform capacity, message handling and technological capacity as there is an increased demand for faster access and ability to push more quotes on each venue.

Co-Lo also provides a new source of income to venues which may compensate for some of the revenue losses seen by competition on trading fees.

4. Does the latency benefit for firms using co-location services create any issues for the fairness and efficiency of markets?

Yes, this is not a problem itself as long as this is openly disclosed to all participants and clients.

5. In your view, do co-location services create an issue with the MiFID obligations on trading platforms to provide for fair access?

Co-lo and proximity services should be offered to all participants on an equal basis, i.e. pricing should be fully transparent and available to participants. Burgundy notes that co-lo and proximity hosting services are offered by several MTF's and incumbent exchanges – however, the pricing and possible conflict of interests are not easily understood by looking at publicly available information.

6. Do you see a need for regulatory action regarding any participants involved in co-location, i.e. firms using this service, markets providing the service and IT providers? Please elaborate.

No, but transparency is important when addressing the fairness issue raised above, of course – the ability to get better access to the venue's server must be made fully clear to participants in order for them to make a commercial choice. Burgundy would welcome a special mark-up by trading venues themselves, indicating which participants are co-located or proximity hosted – this would enable clients to make a more informed choice. As long as this is an open process, we do not see any issue affecting fairness and efficiency of markets. Regulators should ensure that venues price lists, marketing material and documentation is precise and transparent about costs and possible conflict of interests, perhaps even including expected latency improvement figures for the different options offered.

FEES

Burgundy answers to CESR Questions

1. Please describe the key developments in fee structures used by trading platforms in Europe.

Burgundy is an adopter of the maker-taker pricing model. We believe that this facilitates competition between venues and a greater choice between platforms. Although fees are important to members, we do not see this as being a key element in selecting venue – price and liquidity is in our view are the most important ones.

2. What are the benefits of any fee structures that you are aware of?

Maker-taker fees are important for liquidity providers as they are able to price stocks even better when taking this negative transaction cost into the picture – this is ultimately to the benefit of the end investors who get even lower bid-ask spreads, thereby reducing their total cost of trading.

3. Are there any downsides to current fee structures and the maker/taker fee structure in particular? If yes, please describe them.

Clients best interest could also be compromised if a firm systematically directs an order to a super-granulated venue, which is paying for orderflow, with very low price improvement potentials and higher all-in costs and/or increased cost of execution when taking the clearing and settlement charges into consideration.

4. What are the impacts of current fee structures on trading platforms, participants, their trading strategies and the wider market and its efficiency?

Traditional fee structures (both sides pay, large volume discounts for biggest clients) currently in use by several incumbent exchanges, have lately tried to keep clients and trading volumes by introducing very large volume-based rebates for certain members. We believe that such pricing practice is detrimental to competition and that further information on actual rebates given should be made public in order for participants and interested parties to make an informed choice, for example by semi-annual disclosures.

5. How important is the fee structure of a trading platform in determining whether to connect or not to it for trading. Please elaborate.

We believe that this is not the most important when selecting venue for firms with client orderflow. For HFT and Algo firms the case is different and the fee structure can be a major factor for participating or not.

6. Do you consider that the fee structures of trading platforms should be made public to all market participants? Please provide a rationale for your answer.

Yes, in the same way that conflict of interests are handled today, exchange fees and any incentives and discounts given (not only obtainable) should be disclosed regularly.

7. Is there a role for regulators to play in the fee structures? If yes, please describe it.

We believe more could be done on transparency and disclosure of rebates and market-maker incentives, but the industry should be allowed to try and resolve this on its own.

TICK SIZE

Burgundy principle is to adopt the primary market tick size, in order to prevent too much granularity and unwanted competition between venues which would risk a negative impact on available liquidity on exchanges. We believe regulators should not intervene in tick sizes regimes, but instead rely on FESE and MTF's to solve this matter.

Burgundy answers to CESR Questions

In your view, what has been the impact of smaller tick sizes for equities in Europe on the bid-ask spreads, liquidity, market depth and volatility of these markets? Are there any spill-over effects on derivatives markets?

We see that in general and for CCP cleared instruments, retail investors have benefited from smaller spreads, thereby reducing their all-in trading costs. Larger players have seen the opposite in Nordic markets, i.e. less liquidity and wider spreads for large orders.

2. What are the benefits/downsides of smaller tick size regimes for shares in Europe?

Benefits: see above.

Disadvantage: there is a trade-off between tick size and post-trade clearing and settlement cost that needs to be respected. The last tick size harmonization in the Nordics (October 2009) has had a negative effect on overall liquidity for the most liquid names. Too fine tick sizes may also not be in a clients best interest as there will be a risk for constant price improvement to get ahead in the queue, without getting any significant volume done. This puts the client order at risk.

3. Is there a need for greater harmonisation of tick size regimes across Europe? Please elaborate.

No, we believe that MTFs and exchanges should not compete on TS, but rather work together in order to avoid the negative effects above. The work done so far has been very good for investors.

4. Is there a role for regulators to play in the standardisation of tick size regimes or should this be left to market forces?

No, this should be left to the industry to resolve.

5. Have organised markets developed an appropriate approach to tick sizes?

Yes, we believe that last years work by the MTF's in consultation with FESE is a good way.

6. Should regulators monitor compliance with the self-regulatory initiative of the MTFs and FESE? If this initiative fails, do you see a need for regulators to intervene?

No need for additional regulation, venues who try to compete with too small TS will be automatically excluded by the order routers at members.

7. What principles should determine optimal tick sizes?

No comment.

IOI

Burgundy does not provide an IOI service. No input given.

CESR questions

- 1. Please provide further information on how IOIs are currently used in European markets by investment firms, MTFs and RMs?**
- 2. Which are the key benefits/downsides of such IOIs? Please provide evidence to support your views.**
- 3. Do you consider that MiFID should be amended to clarify that actionable IOIs should be subject to pre-trade transparency requirements?**
- 4. Do you see circumstances where it would be appropriate for IOIs to be provided to a selected group of market participants? Please provide evidence/examples to support your views.**