Dear Mr. Demarigny,

In response to CESR's request for comments on the proposed ISD 2, Investment Technology Group Limited, would like to offer the following:

Best Execution Obligation

An environment wherein brokers and execution venues compete on the basis of execution quality is essential to the efficiency of European markets and the interests of the ultimate customers of fund managers. Clearly the factors of price and overall execution costs are relatively more important to investors than any other considerations. However, while execution price is easily understood by investors, the complexities of execution costs are often not (eventhough they have an equally large bearing on execution quality). Therefore, investment firms, in the interests of their customers, must be compelled to consider explicit (spread, commissions, taxes etc) and implicit (market impact, delay and implementation shortfall etc). It should be noted that delay can be a benefit as well as a cost, and overemphasising timeliness of execution can create a perverse incentive to execute immediately - for fear of regulatory infringement - even where such could be judged not to be in the best interests of the customer. Best execution regulations that are not sufficiently sophisticated to take account of all market realities breed complacency through artificially low standards. Therefore, the total cost of execution must be emphasised over timeliness.

It must be recognised that without provisions that require investment firms to monitor execution quality and the quality trends of the various execution venues they use, best execution become rather toothless. Technology is available to monitor execution quality effectively and in real time with relative ease. An effective monitoring requirement is a prerequisite to ensuring real competition between execution venues based upon the total cost of trading.

Currently, the criteria used by investment firms in choosing execution venues are overly dominated by commitment ratios (i.e. through bundling and soft commission arrangements). Again, it is possible for investment firms to monitor which venues are providing consistently better execution results through transaction cost analysis tools.

Pre Trade Transparency for MTF's

We agree that the criteria for determining what MTF's should be exempt from the pre-trade transparency obligation should center around whether they are price taking systems. It is universally accepted now that market impact can be a significant transaction cost - and one that must be taken into account for any meaningful definition of best execution. Crossing, for example, by reason of its pre-trade anonymity is the most effective way of eliminating this cost from large orders. If pre-trade transparency were to be applied in any form to crossing networks, they would cease to be a viable business, and transaction costs would increase across the market. Further, the latent liquidity encouraged by the existence of crossing would not emerge in its absence. Clearly this would be at odds with everything the directive seeks to achieve, especially in the areas of improving execution standards and competition.

Furthermore, in respect of price taking systems, the production of pre-trade information would present opportunities for manipulating the reference price. Therefore, in the interests of preventing market abuse, it is essential that no pre trade information be divulged.

Post Trade Transparency for MTF's

CESR should recognise should recognise that many MTF's will not be able to find the most appropriate and cost effective ways of achieving post trade transparency i.e. if an MTF is a member of an Exchange, it may often have reporting obligations to that Exchange in respect of business executed on the MTF (if the Exchange defines such business as on Exchange. Such provisions are also severely anti-competitive: no Exchange should be able to claim a jurisdiction over business executed on a competing execution venue. To explain in further detail:

Currently, "regulated markets" seek to impose rules on and regulate activity carried on outside of their own markets and systems. We think it is wholly inappropriate for Exchanges to be permitted to continue to extend their responsibility and jurisdiction to trading on MTFs once those MTF's are regulated under the new directive.

For example, in the UK, the London Stock Exchange defines any transaction executed outside of its own systems by a member firm as an on Exchange transaction (unless it is concluded under the rules of another "recognised Exchange"). Euronext has a similar provision in respect of so called "block trades". These conditions of market membership effectively enable Exchanges to regulate trading on an MTF, where the investment firm operating the MTF is a member of the Exchange. It also enables them to impose trade and transaction reporting fees on MTF operators for transactions executed on the MTF.

This is a blatant abuse of their position as the dominant liquidity providers. Exchanges and MTFs compete for liquidity: It is clearly anti-competitive for one group of competitors to be afforded an elevated status in the market place that allows them to effectively regulate the other group.

We need to see measures confining the Exchange's supervisory reach and responsibility to their own systems or markets. This will enable MTF operators who are market members to explore other, more cost effective methods of achieving post trade transparency and compliance in other areas of MTF regulation. It will also prevent Exchanges from imposing monopoly prices for their reporting facilities and level the playing field between MTF's and regulated markets.

Should you have any queries regarding any of the above, please do not hesitate to contact me.

Your Sincerely

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