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The Committe of European Securities Regulators
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30th April 2010

Micro-structural issues of the European equity markets

CFA Institute is pleased to comment on the Committee of European Securities Regulators' (CESR) call for evidence on micro-structural issues of the European equity markets (the "call for evidence").

CFA Institute, through its members' experience in international markets and different investment disciplines, represents the interests of investors and investment professionals to standard setters, regulatory authorities, and legislative bodies worldwide. CFA Institute promotes fair, open, and transparent global capital markets, and advocates for investors' protection.

We welcome the opportunity to comment on certain structural aspects of the European equity markets which have come to prominence since the implementation of the Markets in Financial Instruments Directive (MiFID) in November 2007. CFA Institute recently published its own report on equity market microstructure in Europe and our comments herein draw from and supplement the empirical findings of that report[1].

CFA Institute believes that the efficient functioning and integrity of the equity secondary markets is of utmost importance to serve investors' needs. In this respect, CESR's work streams related to the MiFID review will play a critical role in shaping the evolving market structure. CFA Institute is committed to providing input into the MiFID review and trusts that the interests of investors are fully recognised and considered throughout that process.

Executive Summary

The call for evidence seeks information on high-frequency trading; sponsored access; co-location services; fee structures; tick size regimes; and indications of interest. We offer comments specifically on those areas where we are able to draw from the expertise of our membership and our Capital Markets Policy Council (CMPC)[2]. Our main observations on the call for evidence are as follows:

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[1] See CFA Institute, 2009, *Market Microstructure: The Impact of Fragmentation under the Markets in Financial Instruments Directive*, available at http://www.cfapubs.org/toc/ccb/2009/2009/13

[2] The CMPC is comprised of investment professionals with extensive expertise and experience in the global capital markets. In this capacity, the CMPC provides analysis and practitioner expertise on issues affecting the integrity of global capital markets.

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- High-Frequency Trading (HFT) strategies include passive market-making activities and arbitrage. Data presented in figures 1 to 4 in our response, though not isolating causality, suggest that the growth in HFT is consistent with a larger number of trades being executed on electronic order book markets and a reduction in average transaction sizes. These trends are particularly pronounced for dark order book trades.

- HFT is thought to have a broadly positive effect on market liquidity and efficiency. The immediacy supplied by high-frequency traders strengthens liquidity by increasing the speed of execution and fill rate of asynchronous order flow. Similarly, the speed and frequency by which HFT passively 'makes' liquidity is thought to contribute to narrower bid-offer spreads and greater market resiliency by increasing the number of pricing points at which liquidity demanders can trade. Data presented in figure 5 in our response, though not isolating causality, indicates a decline in average bid-offer spreads amongst European stocks.

- HFT improves price discovery across multiple platforms and enhances the informational efficiency of markets. However, HFT can present certain risks to the operational efficiency of the markets. We are concerned that high-frequency traders have become the primary source of liquidity in many markets even though they often have very little capital to support their activities. Accordingly, the liquidity they provide may disappear in a down market. Our view is that HFT firms should be appropriately capitalised to support the proprietary nature of their activities. We also highlight the need for robust internal risk management procedures and controls over the algorithms and strategies employed by HFT firms.

- CFA Institute concurs with CESR's analysis of the potential risks posed by Sponsored Access (SA) arrangements. These risks are heightened by the highly automated nature of equities trading, which increases the propensity for large erroneous trades. Accordingly, we are of the view that sponsoring firms should implement robust risk management procedures and retain adequate oversight of the activities of clients utilising SA arrangements to route orders directly to trading venues. Such controls would also allow for better monitoring by supervisors of the types of equity market participants and their level of activity.

- CFA Institute believes that co-location is a legitimate commercial arrangement between trading firms and exchanges/market centres. Provided that the service is made available to all market participants wishing to pay for it, and that the service is offered on non-discriminatory commercial terms, we do not see any issues with regards to the efficiency and fairness of the markets, nor with regards to market access.

- The most common fee structure utilised by trading venues, as CESR notes, is the 'maker/taker' structure, which involves charging a fee to those participants who 'take' liquidity from an exchange/MTF and rebating part of that fee to 'makers' of liquidity. The incentive of a rebate to liquidity 'makers' has been a primary tool utilised by MTFs and other new trading venues to attract order flow away from the incumbent exchanges. The competition induced by such fee structures has fuelled the

fragmentation of liquidity, which has contributed to narrower spreads but poses challenges for market transparency.

- The benefits of smaller tick sizes are narrower pricing differentials and bid-offer spreads. However, smaller tick sizes may reduce the depth of liquidity amassed at each pricing point as order flow is dispersed over a greater range of points in the order book. Reducing tick sizes by ever smaller increments can also disadvantage investors if certain market participants obtain execution priority by merely posting infinitesimally smaller increments for only nominal price improvement on those orders. Such circumstances could discourage investors from posting limit orders to the detriment of liquidity.

- We fully support harmonisation of tick size regimes across Europe and the establishment of minimum tick sizes. We commend the self-regulatory initiative between certain MTFs and the Federation of European Securities Exchanges (FESE), noted by CESR, to align certain tick size regimes and to restrict further tick size reduction. It is sensible for regulators to monitor developments on tick sizes and consider action if self-regulatory initiatives fail to achieve adequate tick size harmonisation and stabilisation at appropriate minimum levels.

- With are not positioned to offer specific comments on Indications of Interest, however, CFA Institute takes the position that all market participants and trading venues should have to abide by the same rules. Therefore, in principle, we are against the development of two-tiered markets and market structures that benefit certain classes of market participants over others.

We attach our response that addresses the questions of the call for evidence. Please do not hesitate to contact us should you wish to discuss any of the points raised.

Yours faithfully,

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With headquarters in Charlottesville, VA, and regional offices in New York, Hong Kong, London and Brussels, CFA Institute is a global, not-for-profit professional association of more than 100,000 investment analysts, portfolio managers, investment advisors, and other investment professionals in 135 countries, of whom more than 88,000 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 137 member societies in 58 countries and territories.

CFA Institute develops, promulgates, and maintains the highest ethical standards for the investment community, including the CFA Institute Code of Ethics and Standards of Professional Conduct, Global Investment Performance Standards ("GIPS®"), and the Asset Manager Code of Professional Conduct ("AMC"). CFA Institute is best known for developing and administrating the Chartered Financial Analyst® curriculum and examinations and issuing the CFA Charter.

Specific Comments

I. High Frequency Trading

Questions:

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

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.

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

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.

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

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?

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

elaborate.

8. How do you see HFT developing in Europe?

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?

High Frequency Trading (HFT), though difficult to explicitly define, is typically thought to imply the utilisation of ultra-fast electronic connections and computer algorithms to execute trades within milliseconds or microseconds. Such high speed (or low latency) trading is designed to extract very small profits from a very large number of transactions, typically executed through electronic order books[3]. Positions are held for a very short time span and high frequency traders typically do not carry significant un-hedged positions from one trading day to the next. As CESR notes, HFT can be considered as distinct from algorithmic trading, in which the use of computer algorithms to determine the parameters of order submission (such as where and when to submit orders, and in what size and price) is the primary characteristic as opposed to speed.

HFT is dominated by two strategies: passive market-making and arbitrage[4]. Passive market-making involves the posting of two-sided quotes, often earning the HFT firm a rebate from the trading venue for the supply of liquidity (or immediacy). The passive market maker earns the bid-ask spread when liquidity 'takers' (demanders of immediacy) hit the market maker's resting two-sided quotes.

Arbitrage strategies are designed to exploit pricing differentials across markets/venues, or to anticipate changes in price or direction of the market, such as when prices deviate from 'fundamental' values. The latter strategy may utilise sophisticated algorithms to anticipate the direction of a stock or the market more broadly. Such strategies may be seen as 'aggressive' (in contrast to passive market making) and involve 'taking' liquidity (hitting resting limit orders) compared to the passive activity of 'making' liquidity.

We are not furnished with statistical information on the market share of HFT in European equity markets. However, it is clear that HFT has advanced significantly in recent years as high-speed technology has become increasingly more important and prominent in the functioning of equity markets.

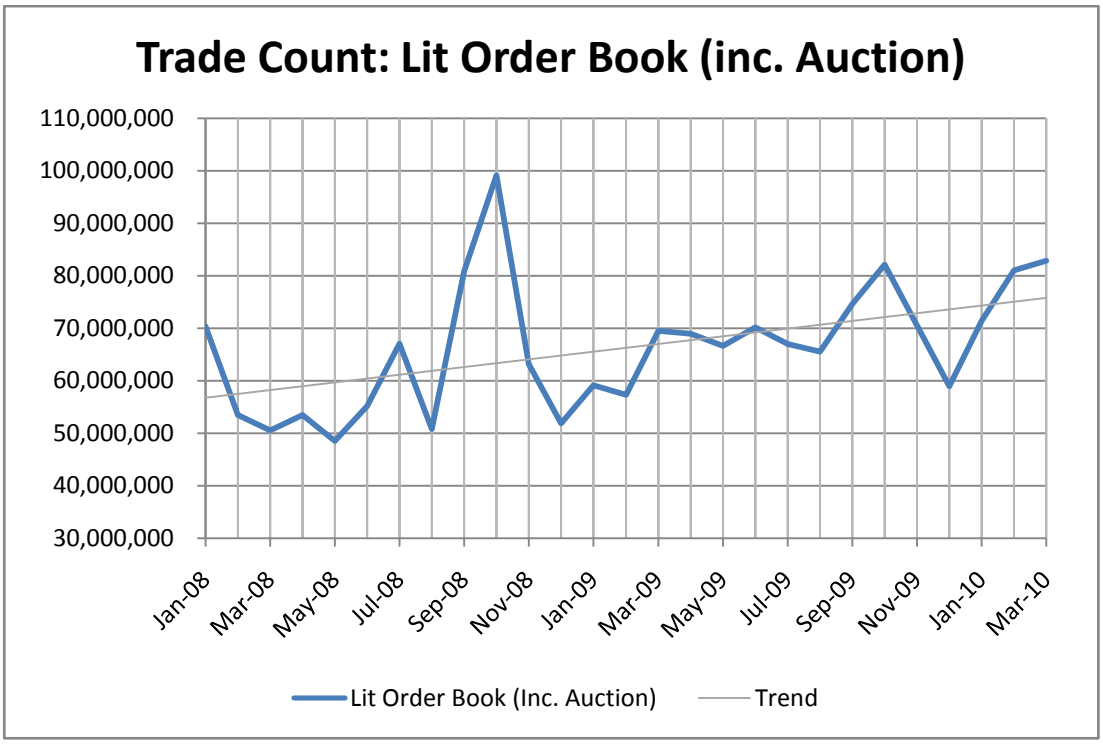
Figures 1 and 2 below show the monthly number of trades executed on lit electronic order books (including auction trades) and on 'dark' or un-displayed electronic order books[5], respectively. The data comprises trades executed in all EU markets plus Switzerland. In all cases, the trade count has risen over the past two years. The trend is particularly pronounced for dark order book trades, which have grown significantly (albeit still at a small proportion – less than 2% - of overall equity trading).

[3] HFT is thought to account for a significant proportion of equity trading volume on the primary exchanges. In the United States, HFT is estimated to account for the majority of on-exchange trading volume.

[4] A good overview of HFT trading strategies is also provided in the U.S. Securities and Exchange Commission's *Concept Release on Equity Market Structure* (January 2010).

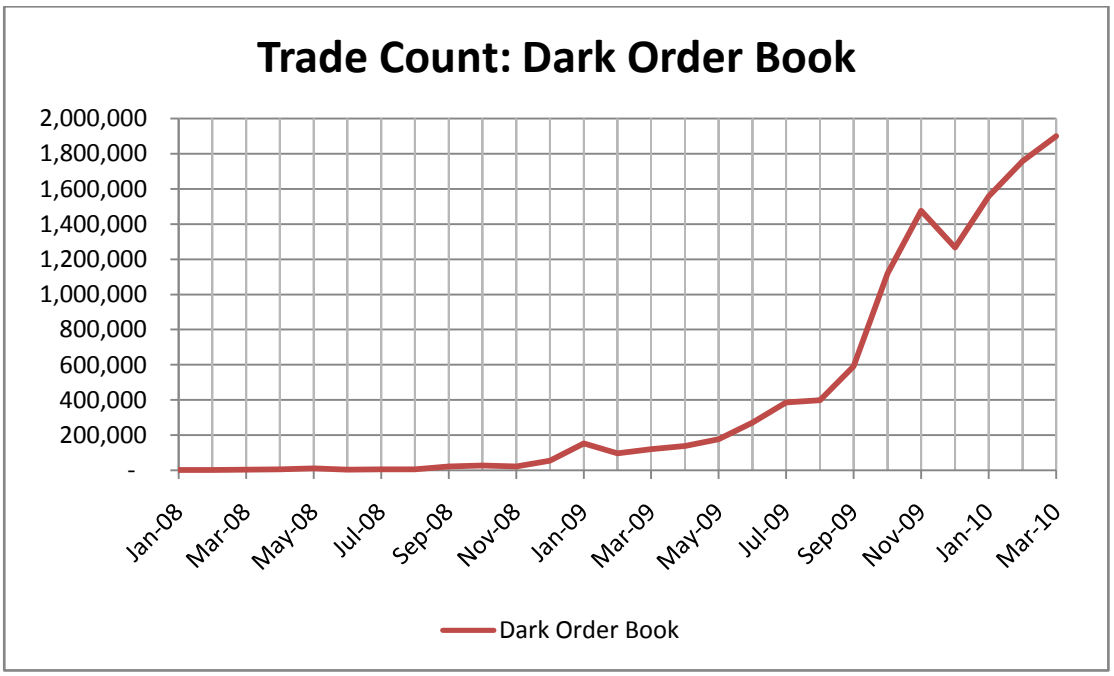
[5] Un-displayed order books are commonly referred to as 'dark pools' run by market operators.

Figure 1



Sources: Thomson Reuters Equity Market Share Reporter; CFA Institute calculations

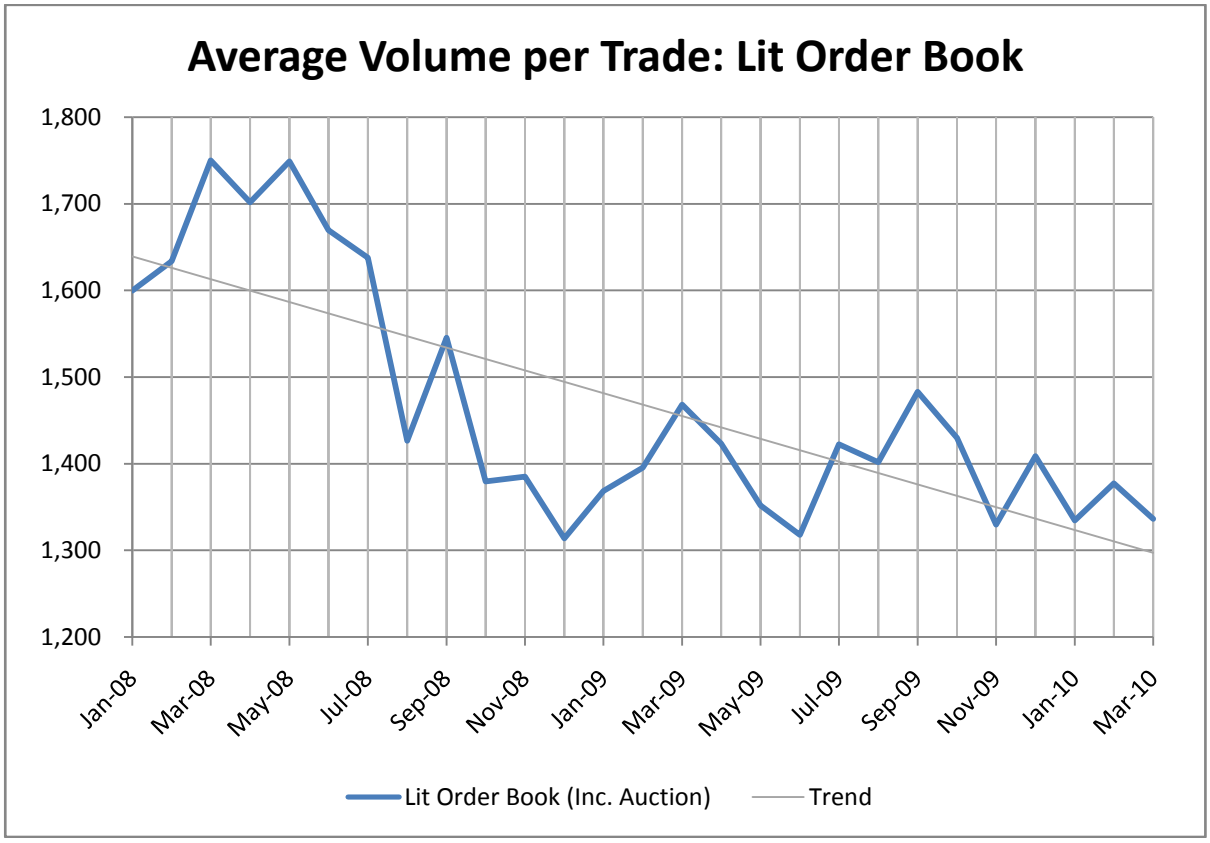
Figure 2



Source: Thomson Reuters Equity Market Share Reporter

Secondly, average volume per trade is illustrated in Figures 3 and 4 for lit and dark order book trades respectively. Average volume per trade has been obtained by dividing monthly trading volumes (in shares) by the monthly trade count. Both charts illustrate a fall in average volume per trade. Again, the trend is striking for dark order book trades, suggesting that such platforms are not typically being used for execution of large block orders[6].

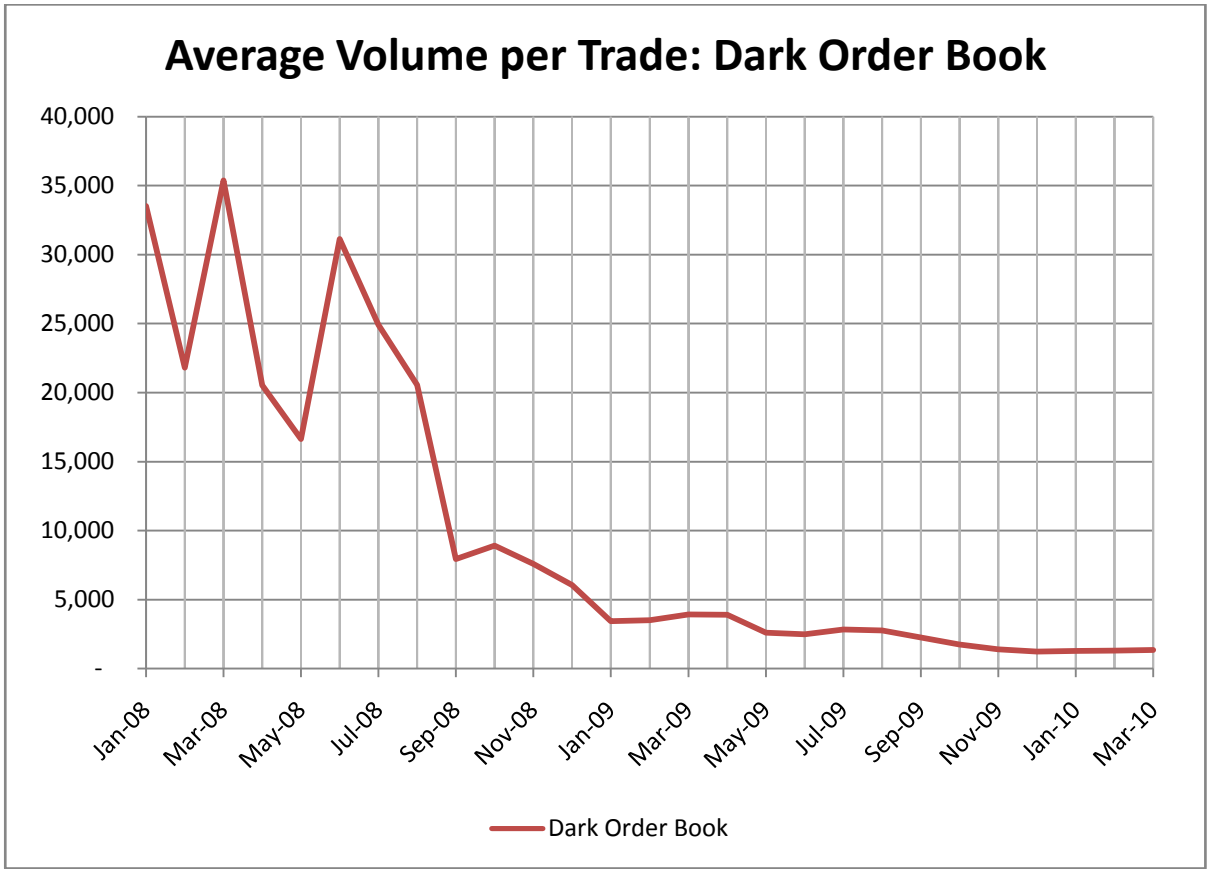
Figure 3



Sources: Thomson Reuters Equity Market Share Reporter; CFA Institute calculations

[6] This raises a separate issue for the applicability of the MiFID pre-trade transparency waivers. The data suggests that dark pool platforms are not being used for their original intention, namely execution of large orders without pre-trade transparency in order to minimise market impact.

Figure 4



Sources: Thomson Reuters Equity Market Share Reporter; CFA Institute calculations

It is difficult to isolate causality, and we do not have data on the proportion of HFT executed on lit and dark exchanges. However, the overall trends observed from Figures 1 through 4 are certainly consistent with the notion that HFT leads simultaneously to a larger number of trades being executed and smaller average transaction sizes.

The key drivers of HFT are technology and competition. Most exchanges and multilateral trading facilities (MTFs) are structured as electronic limit order book markets whose trading systems and matching engines facilitate high-speed connectivity and low latency trading. Competition between trading venues since the implementation of MiFID has spurred more rapid technological innovation, primarily based on speed. Such competition has continued to reduce latency as trading venues seek to attract order flow. This in turn has facilitated the growth of HFT as well as other algorithmic trading strategies. It is difficult to firmly identify limitations to the growth of HFT, as HFT itself is driven by technological innovation, the form of which is difficult to predict.

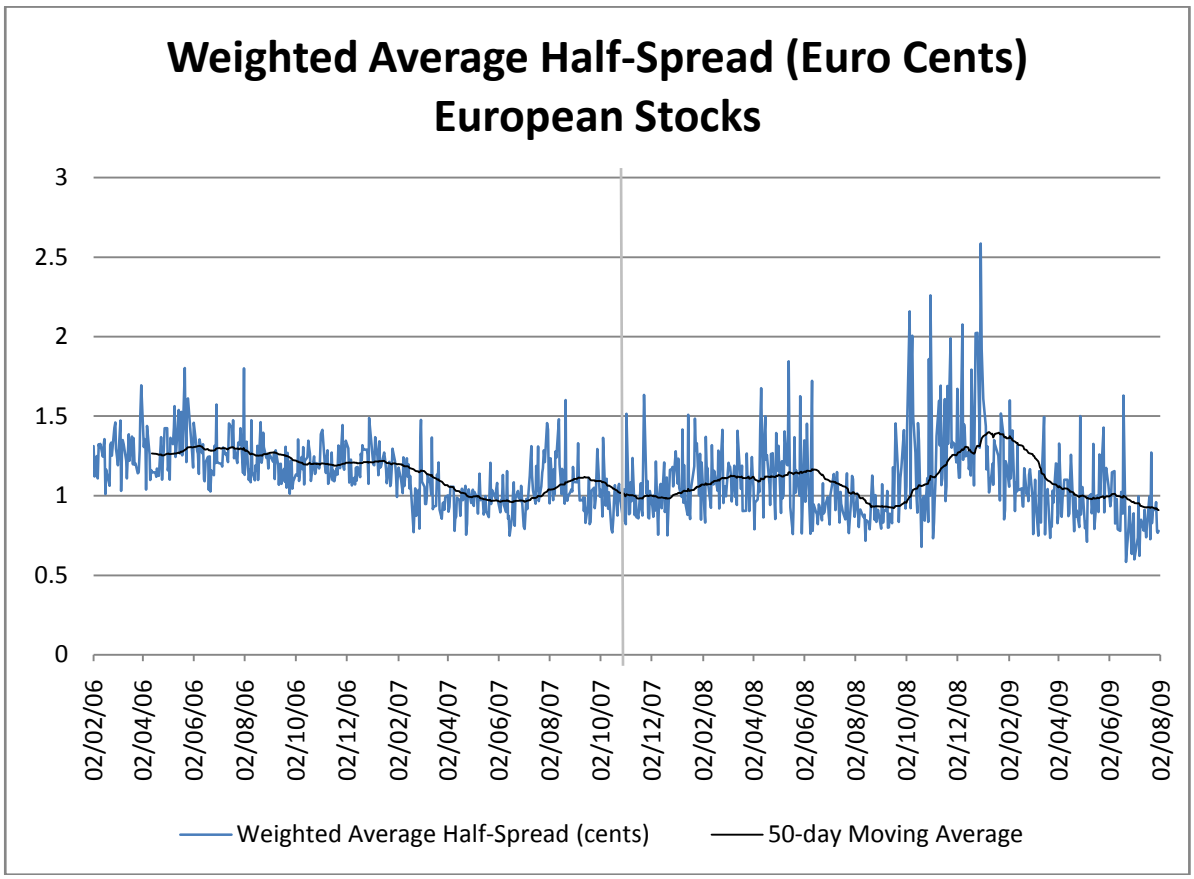
HFT is thought to have a broadly positive effect on market liquidity and efficiency. The immediacy supplied by high frequency traders helps to strengthen liquidity by increasing the speed of execution and fill rate of asynchronous order flow. Similarly, the speed and frequency by which HFT passively 'makes' liquidity is thought to contribute to narrower

bid-offer spreads and greater market resiliency by increasing the number of pricing points at which liquidity demanders can trade.

At the same time, however, it is uncertain how HFT affects market depth (a further component of liquidity). If order flow is dispersed over a greater number of pricing points, the depth of liquidity amassed at each point could (theoretically) be shallower. A related issue is the apparent reduction in average transaction sizes, which can increase the indirect cost of filling client orders if a greater number of transactions are necessary to complete an order.

Data on bid-offer spreads is presented in Figure 5 below. The chart shows the weighted-average quoted half-spread for a portfolio of 44 large European stocks. The dividing line represents the implementation of MiFID. The average half-spread of 1.08 cents taken over the post-MiFID period is 6 percent lower than for the preceding period (the trend would be more pronounced were it not for the impact of systemic events in the fourth quarter of 2008). Though it is not possible to isolate causality, the overall decline in spreads is at least consistent with the notion that HFT is associated with narrower bid-offer spreads.

Figure 5



Source: "Market Microstructure: The Impact of Fragmentation under the Markets in Financial Instruments Directive," CFA Institute (2009).

It is difficult to discern the impact of HFT on market volatility. Systemic market events towards the end of 2008 and into 2009 coincided with a sharp increase in volatility, although this has since subsided. However, the significance of recent market events is such that it is difficult to cleanly evaluate the impact of HFT on the variability of prices.

HFT is considered to be beneficial for market efficiency because it facilitates price discovery across multiple platforms. It also promotes the law of one price as participants arbitrage away price differences. This has the effect of improving the informational efficiency of markets.

However, CFA Institute believes that HFT can present certain risks to the operational efficiency of the markets. We are concerned that high frequency traders have become the primary source of liquidity in many markets even though these firms often have very little capital to support their activities. Accordingly, we are concerned that the liquidity they provide may disappear in a down market, or even exacerbate the decline in prices given HFTs' exemptions from certain obligations to maintain market quality. Whilst these participants may not be afforded explicit privileges[7] by the exchanges, their technological sophistication places them to benefit most from the highly automated market structure.

Further, high frequency traders often receive a liquidity rebate from trading venues. Accordingly, our view is that HFT firms should be appropriately capitalised to support the proprietary and speculative nature of their trading activities.

HFT may also pose other risks which may have consequences for systemic risk. Firstly, the highly automated nature of HFT is such that broker-dealer control systems may be by-passed in the submission of orders to trading platforms. Accordingly it is necessary for broker-dealers to have adequate risk management procedures and controls in place in order to adequately monitor HFT order flow. Secondly, if the algorithms and strategies employed by HFT are replicated across firms, this could create systemic risk by amplifying market movements. These risks underline the need for robust internal risk management procedures and controls over the algorithms and strategies employed by HFT firms.

Overall, there are both benefits and drawbacks to HFT. A survey of CFA Institute members in the United States reinforces this picture[8], where 49% of respondents believe HFT has a negative impact on markets and market participants. By comparison, 37% believe that HFT has a positive impact, while 14% thought that HFT had some other impact or no impact.

II. Sponsored Access

Questions:

[7] Traditionally, exchange 'specialists', most notably those at the New York Stock Exchange, were afforded certain trading privileges in return for being bound by certain affirmative and negative obligations, for example to provide liquidity and maintain an orderly market.

[8] The survey was conducted in April 2010 and received nearly 400 responses. The results reflect the views of members based in the United States. The results of other global surveys suggest that, typically, the views of CFA Institute members do not vary significantly geographically.

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

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

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

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.

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

Sponsored Access (SA) arrangements enable clients of broker-dealers to submit orders directly to trading platforms, thereby by-passing broker-dealers' internal systems. The broker-dealer effectively sponsors the client to use the broker-dealer's exchange membership / ID to route orders directly into the exchange's trading system.

In the absence of proper controls, CESR notes that SA arrangements could result in an increased risk of error trades and potential for market abuse. CESR comments further that credit risk could also arise from the inability of sponsors to monitor their clients' business and their exposures.

We concur with CESR's analysis of the potential risks posed by SA. The market risks posed by SA arrangements are further heightened by the highly automated nature of equities trading, which increases the propensity for large erroneous trades. Recent instances highlighted in the media of costly and misleading error trades generated by computer algorithms serve to underline the potential risks from SA arrangements.

Accordingly, CFA Institute is of the view that sponsoring firms should implement robust risk management procedures and controls and retain adequate oversight of the activities of their clients utilising SA arrangements. Such arrangements are necessary to protect the integrity and efficient functioning of the markets and to prevent the noted risks developing into systemic threats. Furthermore, such controls allow for better monitoring of the types of equity market participants utilising SA arrangements and their level of activity. This information would assist regulators develop a more thorough understanding of the type and size of participants in equity markets.

III. Co-location

Questions:

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

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

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

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

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

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.

Co-location involves physically locating firms' IT systems in close proximity to the matching engines of exchanges and other market centres. Such physical proximity minimises latency in order submission and connectivity between the trading systems of exchanges and investment firms. Co-location may reduce latency by milliseconds or microseconds, which is often sufficient to enable high frequency traders in particular to profit from those not investing in such services.

CFA Institute believes that co-location is a legitimate commercial arrangement between trading firms and exchanges/market centres. In essence, co-location is akin to any regular commercial service, in that the fee charged for the service is reflective of the benefits offered to subscribing customers.

Provided that the service is made available to all market participants wishing to pay for it, and that the service is offered on non-discriminatory commercial terms, we do not see any issues with regards to the efficiency and fairness of the markets. Nor do we have significant concerns with regards to market access. Accordingly, we do not see any need for regulatory action regarding co-location services.

A related subject is the issue of high speed data delivery to market participants. Our members believe that a trading venue should not give specific trading firms faster access to its data via T3 lines if such access is not available to other entities. Specifically, our concern is that if an exchange/market centre allows a trading firm to access its data via a T3 line, while the public data line is a T1 line, it may create an unfair advantage for the trading firm in question.

However, if CESR and the Commission decide, nevertheless, to permit HFT firms special data access via a faster (T3) line while the rest of the market has access via a T1 line, it also should impose higher obligations on such firms in return for their faster access. Such obligations should include frequently providing financial information to regulators and a commitment to making a market on both sides, irrespective of the size and direction of market movements.

IV. Fee Structure

Questions:

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

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

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

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

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

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.

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

The most common fee structure utilised by trading venues is the 'maker/taker' structure, as noted by CESR. This fee structure involves charging a fee to those participants who 'take' liquidity from the exchange/MTF (by hitting resting limit orders), and rebating part of that fee to 'makers' of liquidity (those posting passive limit orders). An aggressive variant of this approach is to charge liquidity 'takers' a lower fee than the amount paid to liquidity 'makers'. Such inverted pricing structures may be employed on a temporary basis in anticipation that the additional liquidity they attract will persist beyond the immediate term and will more than offset the temporary losses from the inverted fees.

The incentive of a rebate to liquidity 'makers' has been a primary tool utilised by MTFs and other new trading venues to attract order flow away from the incumbent exchanges. The competition induced by such fee structures has fuelled the fragmentation of liquidity that has been witnessed since the implementation of MiFID. In turn, competition has contributed to the narrowing of bid-offer spreads (see Figure 5) and offered investors greater choice for order execution.

At the same time, fragmentation poses challenges for market transparency and the quality of trade data. Most significantly, the diffusion of price data arising from market fragmentation poses difficulties for investors to obtain an accurate consolidated picture of market prices. This issue would be remedied, in large part, through provision of a more accessible and affordable consolidated tape for all market participants in the European Union.

We also believe that trading venues should disclose their fee structure to all market participants. Such disclosure helps investors understand why their trades have been executed through a certain venue, and enables investors to better evaluate whether the intermediary acting on the investor's behalf is achieving best execution for the client. If

the investor discovers that trades are routed to a venue solely on the basis of higher rebates/fees and those fees are not rebated to the client, it might indicate that the intermediary is acting on the basis of interests other than those of the investor's.

We are not positioned to comment further on the specific impact of fee structures on trading platforms and trading strategies.

V. Tick Size

Questions:

1. 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?

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

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

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

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

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?

7. What principles should determine optimal tick sizes?

The benefits of smaller tick sizes[9] are more diffuse pricing and potentially narrower bid-offer spreads. Smaller tick sizes increase the number of discrete pricing points at which investors can submit limit orders, thus minimising the propensity for large swings in prices. Accordingly, smaller tick sizes help dampen volatility.

Smaller tick sizes also minimise dealers'/market makers' inventory risk, since they increase the range of pricing points at which positions can be closed out. Lower inventory risk enables market makers to post narrower bid-offer spreads.

However, smaller tick sizes may reduce the depth of liquidity amassed at each pricing point as order flow is dispersed over a greater range of points in the order book. Secondly, reducing tick sizes by ever smaller increments could also disadvantage investors if certain market participants obtain execution priority ('jump the queue') by merely posting infinitesimally smaller increments for only nominal price improvement on those orders. At

[9] The tick size is the minimum increment by which security prices can change.

the limit, such circumstances could discourage investors from posting limit orders to the detriment of liquidity[10] and price discovery.

As CESR notes, the use by trading venues of different tick sizes for the same share raises additional issues. Specifically, it could distort price discovery and create an uneven playing field between trading venues. Accordingly, we fully support harmonisation of tick size regimes across Europe and the establishment of minimum tick sizes. We commend the self-regulatory initiative between certain MTFs and the Federation of European Securities Exchanges (FESE), noted by CESR, to align certain tick size regimes and to restrict further tick size reduction. We believe that this initiative is the most appropriate approach to the harmonisation of tick sizes at suitable levels and do not foresee the need for regulatory intervention at this stage. It is sensible for regulators to monitor developments on tick sizes and consider action if self-regulatory initiatives fail to achieve adequate tick size harmonisation and stabilisation at appropriate minimum levels.

VI. Indications of Interest (IOIs)

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.

Indications of Interest (IOIs) are messages between trading firms and venues that reveal market participants' willingness to buy and sell securities. Such messages take the form of non-binding commitments that reveal information about a security and the interest to buy or sell. IOIs enable select market participants to gauge the level of interest in a given security without posting firm quotes in the lit markets. As such, IOIs are often utilised by dark pools.

CESR comments that if IOIs were used to provide information to a select group of market participants to the exclusion of others, this may be inconsistent with MiFID's over-arching principles of pre-trade transparency and non-discretionary access to trading on regulated markets and MTFs. In the United States, the Securities and Exchange Commission has already voiced concerns over the potential for IOIs to create two-tiered markets, and has

[10] See also CFA Institute's comment letter on sub-penny trading at https://www.cfainstitute.org/centre/topics/comment/2010/pdf/100106.pdf

proposed measures to amend the definitions of 'bid' and 'offer' in Regulation NMS to incorporate certain 'actionable' IOIs.

We are not in a position to offer specific comments on IOIs. However, CFA Institute takes the position that all market participants and trading venues should have to abide by the same rules. Therefore, in principle, we are against the development of two-tiered markets and market structures that benefit certain classes of market participants over others.

30th April 2010