VERBAND DER AUSLANDSBANKEN IN DEUTSCHLAND E. V.
ASSOCIATION OF FOREIGN BANKS IN GERMANY

INTERESSENVERTRETUNG AUSLÄNDISCHER BANKEN, KAPITALANLAGEGESELLSCHAFTEN, FINANZDIENSTLEISTUNGSINSTITUTE UND REPRÄSENTANZEN
REPRESENTATION OF INTERESTS OF FOREIGN BANKS, INVESTMENT MANAGEMENT COMPANIES, FINANCIAL SERVICES INSTITUTIONS AND REPRESENTATIVE OFFICES

Committee of European
Securities Regulators
11-13 avenue de Friedland

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March 16, 2007\SN

Response to the CESR Consultation Paper "Best execution under MiFID"

Dear Madam, dear Sir,

The Association of Foreign Banks in Germany very much appreciates the possibility to respond to the CESR Consultation Paper "Best Execution under MiFID" (hereinafter referred to as "the Consultation Paper").

We represent more than 150 foreign banks, investment management companies, financial services institutions and representative offices in Germany, among them several entities belonging to the leading institutions world-wide. The activities of our members involve to a large extent the provision of banking and financial services in Germany, but due to their international structure they are also facing the typical cross-border problems that arise when being integrated in the actions of a globally positioned group.

Our answers to the Consultation Paper are as follows:

Q 1 Do respondents agree with CESR´s view on:

- **the main issues to be addressed in an (execution) policy? Are there any other major aspects or issues that should ordinarily be included in an (execution) policy?**
- **the execution policy being a distinct part of a firm´s execution arrangements for firms covered by Article 21?**
- **the execution policy under Article 21 being a statement of the most important and / or relevant aspects of a firm´s detailed execution arrangements?**

CESR seems to imply that the policy of RTOs and portfolio managers pursuant to Art. 45 Implementing Directive and the execution policy pursuant to Art. 21 MiFID are to a large extent similar and should contain similar elements. This view, however, does in our opinion not sufficiently reflect the differences between RTOS and portfolio managers on the one hand and investment firms actually executing clients´ orders. A policy pursuant to Art. 45 Implementing Directive cannot contain similar elements as the execution policy according Art. 21 MiFID, since different issues are at stake and in the case of RTOs and portfolio managers, no actual execution is undertaken. In fact, policies pursuant to Art. 45 Implementing Directive and execution policies

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pursuant to Art. 21 MiFID as well as the corresponding duties and obligations of investment firms are quite distinct.

As Recital 75 of the Implementing Directive sets out, "a duplication of effort as to best execution between an investment firm which provides the service of reception and transmission of order or portfolio management and any investment firm to which that investment firm transmits its order for execution" is neither required nor intended. Portfolio managers and RTOs do not "execute" orders, since execution can only be carried out by the last link in a chain of intermediaries between the client order and an execution venue. The investment service provided by RTOs and portfolio managers is the mere transmission of orders to another investment firm which executes the transmitted orders. In this respect, they cannot be the last link in the chain. Furthermore, Art. 45 Implementing Directive expressly states that RTOs and portfolio managers do not have to comply with Art. 21 MiFID but rather with Art. 19 (1) MiFID and thereby simply have to take into account the factors referred to in Article 21 (1) MiFID.

Therefore, the duties and obligations of portfolio managers and RTOs to act in their clients´ best interest and to obtain the best possible result for them should only tie up to the service they actually provide, i.e. the transmission of orders and the choice of the investment firm to which they transmit the orders and not to the actual execution of their clients´ orders. As regards the actual execution of their clients´ orders, their duties should simply amount to ensure (contractually or by other means) that the firms to which the orders are transmitted or with which they are placed have execution arrangements (and not necessarily execution policies) in place which permit best execution. If this is the case, RTOs and portfolio managers should restrict themselves to control whether these execution arrangements are adhered to and not be obliged to control best execution. Otherwise, there would be a doubling of best execution duties.

We would appreciate if CESR more clearly emphasised these differences between policies within the meaning of Art. 45 Implementing Directive and execution policies within the meaning of Art. 21 (1) MiFID and made clear that no doubling of efforts to achieve best execution is required.

As regards the content of (execution) policies proposed by CESR in paragraph 22 of the Consultation Paper, we would like to suggest that CESR clarifies its statement in footnote 4, last sentence, according to which a firm must list the execution entities it uses. In view of Art. 21 (3) MiFID and Art. 45 (5) Implementing Directive, investment firms actually executing orders are simply required to list the execution venues they use whereas RTOs and portfolio managers are only required to list the entities with which the orders are placed or to which orders are transmitted for execution. Neither provision requires these investment firms to list any further entities or intermediaries involved in the chain of execution. Since there may be chains of execution involving more than one intermediary and since investment firms making use of an intermediary might not always know if their intermediary will make use of another intermediary and, if so, of which intermediary they will make use, an understanding according to which all execution entities involved in the chain of execution must be listed in the (execution) policies will pose significant practical problems. We therefore strongly recommend that CESR makes clear that, in the case of investment firms executing orders, only the execution venues and, in the case of RTOs and portfolio managers, only those entities with which the orders are actually placed or to which the orders are actually transmitted have to be listed in the (execution) policies. In particular, it should be clarified that other subsequent intermediaries in the chain of execution do not have to be named in the (execution) policies.

We agree with CESR that the execution policy is different from the execution arrangements. The execution policy describes the principles applicable to the execution of orders as well as the execution venues chosen whereas the execution arrangements encompass the means implemented to reach the goal of best execution.

Q 2 For routine orders from retail clients, Article 44 (3) requires that the best possible result be determined in terms of the "total consideration" and Recital 67 reduces the importance of the Level 1 Article 21 (1) factors accordingly. In what specific circumstances do respondents consider that implicit costs are likely to be relevant for retail clients and how should those implicit costs be measured?

We have doubts whether implicit costs should be considered in order to determine the best possible result in terms of total consideration. In particular, it would be difficult to calculate implicit costs which might result in considerable difficulties for investment firms, should they have to consider them in their execution policies.

As regards CESR´s views in paragraphs 28 to 30 of the Consultation Paper on the assessment of best execution for professional clients, we would like to suggest that no weighting of the factors in Art. 21 MiFID is recommended. Investment firms should remain free to decide on a particular business model. Depending on the business model and the type of professional clients investment firms wish to attract, it should be at the investment firms´ discretion to weight the factors as they consider it appropriate.

We would also like to comment on one aspect of CESR´s expositions on the inclusion of a firms´s fees and commissions when deciding between execution venues in paragraph 33 of the Consultation Paper. CESR states that "when choosing a venue [...] to execute a particular client order, the fees and commissions charged to the clients by the investment firm will be a relevant component of the costs". Although we totally agree that the fees and commissions charged to clients by the investment firm are a relevant component of the costs, we object to the assumption that the costs should be established for a particular client order. Order-by-order best execution is not intended by MiFID, on the contrary, it is relevant that the choice of a venue delivers the best possible result on a consistent basis.

Q 3 Do respondents agree with CESR´s views on the use of a single execution venue?

MIFID and Implementing Directive do not require that the best execution policy of a firm is drawn up under consideration of the total market. In order to assess whether best execution is provided, firms have to take into account the venues included in their policies. As Recital 66 Implementing Directive points out, "the obligation under MiFID to take all reasonable steps to obtain the best possible result for the client should not be treated as requiring an investment firm to include in its execution policy all available execution venues".

Therefore, we welcome that investment firms should have the possibility to use only a single execution venue. In particular, we welcome CESR´s view that the costs of accessing alternative venues should also be paid consideration to when setting up an execution policy. An investment firm will have to consider not only the actual prices displayed by the venues but also the costs charged by the venues for the execution of orders which are passed on to the client, when assessing which venues should be included in its execution policy.

CESR states in paragraph 39 that investment firms should consider the advantages of indirect access to a certain venue if they decided against connecting directly to this venue due to the associated costs. We have strong objections against this statement. Such a requirement would mean that investment firms would be forced to consider introducing the investment service of order transmission although their business model might not be directed to the provision of this type of service. Furthermore, it is important to note that indirect access cannot be directly compared to direct access in an execution policy since investment firms would not execute client orders but

rather transmit orders. Requirements for the transmission of orders, however, are distinct from those relating to the execution of orders (cf. in detail our answer to Question 1).

As regards the RTOs and portfolio managers, we welcome that they, too, should be permitted to select one particular investment firm for their policy.

Q 4 Do respondents agree with CESR´s views on the degree of differentiation of the (execution) policy?

We welcome that CESR does not require a specific degree of differentiation. It is important that investment firms have the possibility to choose the level of differentiation that they deem to be appropriate in view of their services provided, their business model and their clients.

Q 5 Do respondents agree that the `appropriate´ level of information disclosure for professional clients is at the discretion of investment firms, subject to the duty on firms to respond to reasonable and proportionate requests? On the basis of this duty, should firms be required to provide more information to clients, in particular professional clients, than is required to be provided under Article 46 (2) of Level 2?

We agree that it should be at the investment firms´ discretion what the appropriate level of information disclosure for professional clients should be. However, the maximum level of information that investment firms are required to provide to any client should be the level of information which is to be provided to retail clients. Requests for more information should only be regarded as reasonable and proportionate if the additional information does not exceed the information which would have to be provided pursuant to Art. 46 (2) Implementing Directive. Of course, investment firms are free to provide further information on a voluntary basis if they consider this to be appropriate. Consequently, retail clients should not be granted a right to claim further information. Art. 46 (2) Implementing Directive seems to be concluding as regards the scope of information and the level of disclosure to be provided to retail clients. Otherwise, said provision would contain the words “at least”.

In paragraph 54 of the Consultation Paper, CESR states that firms need to ensure that the execution policy disclosure is sufficient for client consent to be valid. In view of Recital 44 and the fact that the prescribed contents of the execution policy disclosure in Art. 46 (2) Implementing Directive only apply to retail clients, it is important to differentiate between the retail clients and professional clients. Disclosure to retail clients should always be sufficient for client consent to be valid if it encompasses the contents required according to Art. 46 (2) Implementing Directive. As regards professional clients, consent should be considered as valid if these clients do not require further information after the investment firm has disclosed to them the information on its execution policy it deems appropriate. In any case, consent should be valid even if the information provided to professional clients does not completely encompass the contents required under Art. 46 (2) Implementing Directive.

Q 6 Do respondents agree with CESR on how “prior express consent” should be expressed? If not, how should this consent be manifested? How do firms plan to evidence such consent?

We agree with CESR´s proposals on how prior express consent should be expressed. As regards prior consent, we feel that evidence that such consent has been obtained as well as the rights of the competent supervisory authorities in this respect should depend on the requirements under the respective national civil law.

Q 7 Do respondents agree with CESR´s analysis of the responsibilities of investment firms involved in a chain of execution?

We agree with CESR that requirements for firms to obtain the best possible result for their clients should be applied as necessary to take account of the particular function performed by each firm in the chain and that these requirements vary depending on the investment service a firm is actually providing. As regards the obligations of RTOs and portfolio managers transmitting their clients´ orders to another investment firm or placing these orders with another investment firm, we would like to refer to our answer to Question 1.

We do not share CESR´s understanding of what the duties of RTOs and portfolio managers are in respect of the monitoring of the execution quality. CESR states that this encompasses the quality of the results that the intermediary has delivered in comparison to the results that were possible. RTOs and portfolio managers should, in our opinion, be restricted to monitor whether the intermediary has adhered to its best execution policy and / or has complied with its best execution arrangements. Art. 45 (6) Implementing Directive only requires RTOs and portfolio managers to monitor the effectiveness of their own policy established in accordance with Art. 45 (5) Implementing Directive which simply requires them to ensure that the entities to which orders are transmitted or with which the orders are placed have execution arrangements in place. If they were required to check whether these execution arrangements actually deliver the best possible result, there would be a doubling of best execution obligations which MiFID does not intend.

Furthermore, RTOs and portfolio managers should not be obliged to check whether the results from firms they use achieve a better result than the results that are being delivered by other firms in the market. This would involve enormous burdens and would not reflect the fact that they are permitted to rely on the best execution policy of the firm they use.

Q 8 What core information and / or other variable do respondents consider would be relevant to evaluating execution quality for the purposes of best execution?

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Should you have any queries or wish a personal discussion, please do not hesitate to contact us.

Best regards,

Wolfgang Vahldiek Sabine Nachtsheim