

Response to

CESR’S second CONSULTATION PAPER

**Draft Technical Advice on Possible Implementing Measures
of the Directive 2004/39/EC on Markets in Financial Instruments**

Ref: (CESR / 05 – 164)

Following the Lamfalussy process, CESR published a second Consultation Paper (Ref: CESR/05 - 164) covering the following areas: the application of the general obligation to act fairly, honestly and professionally in the best interest of the client where an investment firm grants a credit or loan of money to a retail client; whether the definition of “investment advice” should be limited to recommendations relating to specific financial instruments or should be extended to cover more generic recommendations; best execution; market transparency for Regulated Markets, MTFs and investment firms, including systematic internalisers.

We are thankful for the opportunity to comment on the CESR’s second consultation paper and we are pleased to contribute to the discussion. We hereinafter survey the issues that can have a major impact on the framework of the Regulated Markets and on their competitive environment.

In our discussion we fundamentally refer to the issues raised as well as to the suggestions proposed by FESE in response to the current consultation. In addition we would like to underscore the following:

A. Best Execution

1. On the issue of inducements and execution venues/intermediaries whose fees and commissions include payment for goods or services other than execution (reference to question in paragraph 30 of the Consultation Paper on page 19): we think that this matter is more related to questions of conflicts of interest, which already deal with the issue of provision of execution services that are bundled with other services, such as research. In particular, we believe that venues/intermediaries shall give a **clear and full disclosure** of their fee structures, in order to facilitate investors allowing them to compare among venues/intermediaries that offer inducements and those that do not;

Relative importance of factors

2. On the relative importance of the different factors to be taken into account for best execution, we definitely agree with CESR's statements in par. 39 and in par.1 of Box 4, for which "in the case of a service provided to a retail client, if the investment firm gives or might give a factor other than price or cost more importance than any of price or cost for the purposes of article 21(1)" it shall give "an explanation of why this is in the best interest of its retail clients". As we already pointed out in our response to Consultation Paper CESR/04 – 261b, we **underline here again the importance of focusing on the net price** as the indicator to be considered for determining the best possible result referring to retail clients, and also for achieving the goal of reaching "best execution through transparency".
3. We reaffirm here the principle for which a wide disclosure of bid/offer prices for transactions is fundamental in order to assure the most complete information as possible and to strengthen the price discovery process as well as to assure that competition among different trading venues is carried out within rules which are the same for every operator. This means that, if transparency is considered as a mean to reach best execution, **prices have to be comparable among different venues.**
4. Firstly we would like to underscore that the most effective way to assure such comparability is to use **net prices**, which are the prices which do not include commission or any other type of cost and which do not take into consideration trading capacity (own account versus third party account). Such prices should therefore be considered as the primary guide for determining best execution, especially when referring to retail clients.
5. However costs are also a critical element for venue selection: on the issue we firmly believe that the **amount finally paid by the client shall be the most important factor that determines best execution** since the best execution must be judged from the viewpoint of the client. Consequently, each investment firm shall fully and clearly disclose its fee structure to clients, in order to allow them to make an informed choice and compare among different intermediaries and different venues. For example, if a venue consistently has the best price, the investment firm will have to consider using it; if access to that venue is particularly expensive for the firm, this would have to be included as an element of its fee structure, thus providing ex-ante clarity that after all commissions a trade executed on that venue would turn out to be less favourable to its client.

Execution policy

6. On execution policy and in particular on the possibility for a firm to satisfy the requirements of article 21 while using only one execution venue (reference to question in par. 56 on page 23), we firmly believe that **a firm that uses only one execution venue may very well be compliant with the best execution requirements when such venue is one that is known to provide best results**

on a consistent basis (also in terms of liquidity), e.g. the local Regulated Market.

7. On information on execution policy, we are convinced that **only a full and complete information about the execution policy** of an investment firm (ex ante on each of the venues accessed) **enables the client to make an informed choice**. In addition we believe that statistical (ex post) information about the direction of client's orders to venues is also a valuable element for the client to use in judging the service she receives from the investment firm.

B. Market transparency

Definition of Systematic Internaliser

8. With respect to this issue, we subscribe with the views put forward by FESE in its response and we underline here again that **CESR should not establish quantitative/numeric criteria to define the term “frequent”**.
9. Moreover it does not appear obvious to point out that if an investment firm includes internalisation (or any market practice that might substantially amount to an internalization) as a possible venue among its order execution policies, that would also be clear evidence of internalisation.

Defining the scope of the quoting obligation for systematic internalisers

10. We agree with the CESR's choice to use pre-defined criteria in order to determine the shares for which there is a liquid market for the purpose of article 27. Specifically, on free float we are of the opinion that the use of such an indicator, although methodologically correct, can create problems in its definition, that mainly arise from the divergence across Member States in the characteristics of the stakes that are outside the free float as determined. Accordingly **the introduction of an additional definition of ‘free float’ might create confusion** which in turn **might create uncertainty** around the internalisers' quoting obligation. As a result **we suggest that CESR considers the alternative of the total market capitalisation** as an appropriate and straightforward criterion and propose to fix the threshold at € 1,5 billion;

Definition of liquid shares

11. In general, on the criteria proposed by CESR and their application, we presume that the smaller markets will have no shares declared “liquid” after the application of the criteria proposed by CESR. We would therefore suggest CESR to reconsider the possibility of providing for an opportunity for **the competent authorities of such markets to ‘declare’ in any case a certain number of their “top” companies’ shares as ‘liquid’**. Moreover, we would suggest CESR to give the proposed criteria a different priority, so that a share should be

deemed to have a liquid market for the purpose of article 27 when: (1) the share is traded daily and; (2) any of the following three are verified: (i) the market capitalisation of the share is € 1,5 billions or more; (ii) the daily average number of trades is 500 or more; (iii) the daily average turnover is more than € 2 millions.

C. Pre-trade transparency

Standard Market Size (SMS)

12. With regard to the definition of the number of SMS classes, in our response to Consultation Paper CESR/04 – 562 we trusted CESR could find an appropriate number of classes that could balance the need for proper differentiation with the call for a certain practicability. In general we agree with the approach of identifying several SMS classes. In particular we need to underscore that the SMS might very well fluctuate during any given amount of time. Instead, we are not sure about the implications of the € 5,000 SMS' value established for the lowest class and we would propose for such a class a different treatment. In fact, the average order values for the shares in this class would not be equally distributed. As a matter of fact there are very few shares with order sizes close to 0 and shares will be more concentrated in the upper part of the € 0 – 10,000 range. Consequently and accordingly to the proposed regulation, orders whose sizes are higher than € 5,000, which typically involve the majority of shares belonging to this class, would completely “escape” the quotation obligation under article 27.

On a different note we are fully aware that the scope of article 27 is to try to find a balance between the central role of pre-trade transparency (which will guarantee and integrate liquidity pools and aid competitive price formation) while also taking into account the risks born by systematic internalisers which have to display quotes in the shares for which they are internalisers. As a matter of fact we observe that the value of € 5,000 for the lowest SMS does not reach an acceptable balance between the abovementioned opposing interests since does not seem to guarantee the integration of liquidity pools or aid a competitive price formation while does not represent a significant source of risk for internalisers. The € 5,000 limit is so low that might effectively and entirely deprive the marketplace from the necessary minimal liquidity with disastrous effects on the price discovery function of the market.

Moreover, the value of € 5,000 is not significant also because it is even lower than the threshold of € 7,500 fixed for the purpose of art. 27, par. 3, subpart 4 (on price improvement).

Finally our data shows that the average contract size last year for some of the largest exchanges in the EU was between € 21,713 to € 46,870. The numbers

prove again that the € 5,000 SMS is not in line with the average market contract sizes.

As a result we strongly recommend that CESR **merges the two bottom classes, establishing the lowest class at € 0 – 20,000 with the related SMS value at € 10,000**. This solution would contribute significantly to market liquidity and price discovery without increasing the risk born by the internalisers to unacceptable levels.

Size customarily undertaken by a retail investor

13. With regard to the size customarily undertaken by a retail investor for the purposes of article 27.3 (reference to par. 105 of the draft advice), we are of the opinion that the threshold of € 7,500 is definitely not representative of the “retail size” since, from our calculations, this value is lower than 1/5th of the average European size and lower than 1/3rd of the average Italian size. **We therefore would recommend CESR to consider fixing this value at least at € 10,000.**

Post-trade transparency

14. We generally agree with the method proposed by CESR: however on the content of post-trade information we underline here again the importance of giving **complete and detailed disclosure of the net price** (as pointed out in the previous paragraphs, while commenting on the best execution’s issue) in order to assure comparability.

Transactions large in scale compared to normal market size

15. On the issue of maximum permitted delay for trade publication (detailed on Table 2 on page 73 of CESR’s consultation paper), we agree on the proposed delay of maximum 60 minutes for trades exceeding 10% of the Average Daily Volume (or exceeding 5% in the case of less liquid shares) and of maximum 120 minutes for trades exceeding 20% of the Average Daily Volume (or exceeding 15% in the case of less liquid shares). **However we do believe that the maximum permitted delay should never exceed the beginning of the next trading day.** In fact we are convinced that in order to ensure fair price formation, transparency and an adequate price discovery process, all information of trades should be available at the beginning of the next trading day.

We hope that CERS finds our comments useful and we remain at your disposal for further explanations and details. Moreover we look forward to further cooperate with the activities of the CESR. With our best regards.

Milan, April 6th, 2005