



EU LIAISON OFFICE
Regentlaan 53
1000 Brussel
Belgium
Tel: +32 2 546 03 96
Fax: +32 2 546 04 24
CONTACTS:
Wim Mijs
Malgorzata Pulkownik

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CESR LEVEL 2 Directive on Markets in Financial Instruments Response to Consultation Paper

I. INTRODUCTION

We welcome the opportunity to provide comments to CESR's consultation paper on the second mandate from the European Commission on the implementing measures of the Directive on Markets in Financial Instruments (MIFID).

As a financial institution with operations in almost all EU Member States, we are directly concerned by the MIFID and its future implementing measures. Subject to a short consultation period and an important number of new proposals on which CESR did not consult before, we have carefully studied the proposed implementing measures and provided comments taking into consideration our experience in different markets as well as our own systems and procedures.

In general, we noted improvements compared to CESR's previous consultation paper like for example the high-level approach adopted by CESR in relation to reviewing the best execution policy or the criteria of best execution. The definition of systematic internaliser also positively changed even if some basic improvements still should be done.

It would be appreciated if CESR could make the same effort in relation to other broadly contested issues:

In relation to the suitability test when lending to retail clients, not only this requirement has no legal basis in the level 1 text, but above all it should not be included in CESR's final advice because it was introduced at the very late stage of the consultation process.

We think that the majority of CESR's proposals on the information to be disclosed to clients under the article 21 exceeds the scope of the Directive since it is not an "appropriate information" for the clients.

In relation to the market transparency issues, CESR introduced a number of new quantified proposals which are not based on any explanation on the method of calculation. We also invite CESR to give a particular consideration of our comments concerning the following issues:

- The obligation to have a third party or proprietary arrangement in place for trading that takes place outside the market's opening hours.
- The threats of the deferred publication arrangements for our less- and mid liquid segments.
- The obligation to include an indicator explaining the reason for the deviation from the current market price in case of transactions made outside the RM or MTF subject to other conditions than the current market price of the share.

In general, we would like to stress that firstly the MIFID is the maximum harmonisation Directive and thus not allowing Member States to impose further measures beyond what is agreed in the Directive and its implementing measures and secondly, the costs of implementing the overprescriptive requirements will ultimately filter through our clients.

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I. INTERMEDIARIES: - LENDING TO RETAIL CLIENTS - INVESTMENT ADVICE DEFINITION

1. BOX 1 - General Obligation to act fairly, honestly and professionally and in accordance with the best interests of the client – lending to retail clients

We do not agree with the requirement in BOX 1 imposing on investment firms the obligation to ensure that the credit is suitable for the type of transaction in financial instruments that the retail client is likely to enter into for the following reasons:

- Firstly, the suitability test would introduce on investment firms the obligation to verify the purpose of every credit granted to the retail client, which is prohibited by the Dutch law.

- Secondly, article 19.1 of the Directive does not provide any legal basis (explicitly or implicitly) for introducing such a suitability test. The latter is envisaged only by the article 19.4 of the Directive and applies only in relation to investment advice and portfolio management services, whereas lending to clients is an ancillary service (Annex 1 Section B of the Directive). In our opinion, if it had been the intention of the level 1 text to impose the suitability test on firms when lending to retail clients, it would have been clearly stated under article 19.4 as in case of investment advice and portfolio management. Therefore we believe that there is no mandate for CESR to introduce such a suitability requirement.

- Finally, from the clients' perspective, we do not see any reason for introducing separate rules on such loans since they do not entail more risks than loans granted for other purposes. Clients when contracting loans with the view of investing in any financial instruments will already be covered by the suitability test under the investment advice.

Therefore, we suggest deleting the whole BOX 1.

2. Definition of Investment Advice– generic and/or specific advice

We do not agree with the inclusion of the generic advice in the definition of the investment advice. We believe that CESR's assessment saying that the exclusion of the generic advice from the definition of the investment advice would enable investment firms to circumvent the suitability requirement (article 19.4 of the Directive) is not correct for the following reasons:

- When receiving generic advice, clients do not need the protection provided by the suitability requirement of article 19.4 of the Directive because no concrete action can be undertaken on the basis of the general advice which is not followed by any specific advice. Any concrete action can be undertaken only after specific advice and in relation to a specific financial instrument. Therefore, the whole advice composed of generic and the subsequent specific advice should of course be covered by the definition. Nevertheless, given that no damage can be caused by generic advice only, investment firms would be deprived of legal certainty if they could be sued for non applying the suitability test at the stage of the generic advice.

- We noted CESR's concern expressed during the hearing that in practice there may be cases in which the distinction between generic and specific advice is not as clear as in some academic cases like those exposed in CESR's Consultation Paper and therefore any potential loopholes should be covered. However, we think that those fears are not founded since specific advice should be interpreted as the one directly linked to the client's purchase of financial instruments.

- Moreover, articles 19.4 and 19.5 refer clearly to "the specific type of product or service". Investment advice definition in the level 1 text refers to "one or more transactions relating to financial instruments". Therefore it is not the intention of the Directive to apply the suitability test to generic advice. Investment advice definition should be restricted to recommendations of specific financial instruments. According to our previous comments, if any client were advised to invest a certain amount in a very specific market (e.g. Finnish Telecom), this could fall indeed within the current scope of the Directive's definition. Therefore, extending the scope of investment advice to generic information will not improve the definition, but only increase confusion.

II. INTERMEDIARIES: BEST EXECUTION OBLIGATION

We approve CESR's high level approach adopted in BOXES 2 and 3 which is in accordance with the investment firms' need for flexibility when implementing the best execution obligation. Given the fact that the application of the best execution obligation to non-equity markets is a very complex issue and therefore need a particular attention, we also welcome CESR's decision to work on this issue at level 3.

However, we have some important concerns in relation to BOX 4 on the information that should be disclosed to the clients:

Article 21 of the directive is rather detailed and does not need any further detailed rules at level 2. Therefore, most of CESR's provisions under the BOX 4 are particularly and unnecessarily overprescriptive.

CESR should consider that the over prescriptive requirements would not help us to act in the best interests of our clients. It is indeed in investment firms' own interest to deliver to their clients the best execution of their orders. The concept of the best execution is very broad and CESR should not make proposals when there is no specific market failure. For those reasons, the adoption of a principles-based approach relying in a more extensive way on the firms' duty of care is preferred (see our comments under BOX 4).

1. BOX 1 – Application of the best execution obligation to portfolio managers and/or firms transmitting and receiving clients' orders

We would like to ensure CESR that it is not our aim to avoid a duty of best execution by imposing an additional party into the chain of execution. We agree with CESR that all clients should benefit from the protection offered by the best execution obligation whether clients have a contractual relationship with a portfolio manager or with the firm executing orders. Therefore the obligations under article 21 should indeed apply to the investment firms executing clients' orders literally, as well as to those that provide the services of portfolio management and /or order reception and transmission. This interpretation is indeed aligned with the recital 33 providing that "the best execution obligation should apply to the firm that has the contractual or agency obligations to the client".

However, we ask CESR to consider the distinction between 1) the fact that portfolio managers bear the final responsibility towards their clients for the best execution of their clients' orders and 2) the content of this obligation.

Hence, we agree with the general principle of application of the best execution obligation to portfolio managers, receivers and transmitters of orders, nevertheless we invite CESR to take into account the following remarks when drafting its advice:

- Even if an investment firm using execution intermediaries should take all reasonable steps to select intermediaries that are most likely to deliver the best possible result for the execution of its clients' orders, its task is not to execute directly an order because the activities of portfolio managers and firms executing orders do not have the same nature. The content of the best execution obligation should therefore be adapted to the specific business of portfolio managers, as well as to the specific agency and contractual obligations they are subject to.

- For the above reasons, CESR's pure and simple transposition of concepts applying normally to the firm executing orders to portfolio managers, receivers and transmitters of orders may reveal not correct and going too far. After all, we do not see any added value from the clients' protection point of view since in any case they benefit from the best execution obligation.

2. BOX 4 - Information to the clients on the execution policy of the firm

Paragraph 1 a) ii)

This paragraph requires that where the investment firm gives or might give a factor other than price or cost more importance, an explanation to retail clients should be provided on why this is in their best interests.

We do not agree with this requirement since the level 1 Directive does not impose any obligation (explicitly or implicitly) on investment firms to provide such an explanation to their clients.

Paragraphs 1 a) iv) and v), b), c), d), e)

The level 1 text states clearly that Member States shall require that investment firms provide appropriate information to their clients. We think that disclosing to clients the information on the execution venues, description of the process for obtaining client consent to firms' execution policy, explanation on how the information about the policy on inducements is provided is firstly more than inappropriate for clients and secondly not workable and very difficult to comply with in practice.

We remind CESR that this information is available on client's request.

Paragraph 1 a) v)

Imposing on the investment firms the requirement to provide to each client the information about each execution venue that the investment firm accesses directly should be questioned:

What is the purpose of the information that the firm A has access to only one execution venue and the firm B to two or three execution venues, whereas the firm A can also be linked to a broker who has itself access to a very large number of the execution venues or the broker itself can have relationships with sub brokers who themselves have access to other execution venues? What is the added value from the investors' protection point of view to impose on firms such a requirement?

The client can not make any useful deductions based on this disclosure. There is a risk that the client will be more confused than informed because he will think that this is a relevant information for him.

Question 110 a

It would be very difficult and unworkable in terms of labour and infrastructure costs to comply with the requirement to collect historical information about what proportion of their clients' orders firms directed to each venue.

Again, we remind CESR that the information on individual clients' orders is available on their request.

Question 82

It is difficult to assess that a particular execution intermediary or venue started to offer "better execution" than the one currently used by the firm. The markets' environment is changing constantly and for example shifts to liquidity on a daily or even monthly basis do not allow for considering that "better execution" is offered elsewhere. This assessment is possible to make as far as firms have access to the appropriate information made public by the Regulated Markets and if the firms' system can compare this information.

Question on page 25

We think that the distinction between internal and external costs is relevant. Internal costs like for example operational or infrastructure/connectivity costs should be taken into account by market participants. We also remind CESR that both external and internal costs are interconnected: the external processes used for clearing and settlement influence the workload on operations and therefore have impact on the internal costs.

III. MARKET TRANSPARENCY

1. BOX 1- Definition of the Systematic Internaliser

Although we regret that CESR did not provide us with any explanation on how it came up with the figures concerning the proposed thresholds related to the frequency criteria of the internalisation activity, we acknowledge the improvement of several elements of CESR's definition of systematic internaliser compared to CESR's previous proposal.

We particularly welcome the following:

- CESR's intention in paragraph 8 to introduce an indicative list of factors in order to demonstrate when internalisation activity is carried out on an organised, frequent and systematic basis and the fact that such a solution would accommodate what is already required by the recital 53 of the MIFID.
- CESR's acknowledgement in its paragraph 5 that even if an investment firm is a systematic internaliser both in shares and in other financial instruments, the level 2 text should be understood as referring only to shares. This is literally stated in article 27.

However, we think that some basic improvements should be done in order to make the definition clearer:

- The reference to the recital 53 excluding wholesale transactions carried out on an OTC basis from the scope of pre-trade transparency rules, as well as limitation of the scope of the MIFID only to shares should be explicitly stated in CESR's final advice to the Commission.
- It should also be made clear that the qualitative criteria in paragraph 11 and quantitative criteria in paragraph 12 should be interpreted in a cumulative way.

Introducing at least the above mentioned clarifications would help firms to identify within their off-exchange trading business as a whole, what constitutes systematic internalisation as a separate, identifiable business activity to which Article 27 provisions would apply.

Paragraph 13

CESR considers that a firm will no longer be considered as systematic internaliser in one or more shares when it has ceased the activity having made an announcement of its intention to do so in advance.

We do not agree with the requirement to make such an announcement in advance for the following reasons:

- Firstly, this is a too burdensome requirement which should therefore be based on the Level 1 text, which is not the case here.
- Legal certainty for investment firms is threatened since it is not clarified how much time we need to take into account before switching off the internalising process.

2. BOX 2 - liquid market in share

This issue is of major importance for firms since the systematic internalisers in shares are to publish a firm quote in those shares where there is a liquid market.

Therefore, we urge CESR to adopt a twofold approach:

- Firstly, given important practical consequences on firm's business, we think that the best solution is to adopt an experimental approach as proposed and exposed by London Investment Banking Association during CESR's hearing. Indeed, starting with a certain number of "obviously liquid" shares would be helpful to make a right, conscious and dutiful assessment of the operation of article 27. Based on that, it would become clearer if the number of the liquid shares should be extended or not. The progressive and empirical approach would have advantage to demonstrate the real result of the operation of article 27.

- Secondly, we are surprised that CESR is considering leaving the choice to the Member States on the criteria for the purpose of calculation of liquid shares. We urge CESR to acknowledge that the MIFID is in general a maximum harmonisation Directive thus not allowing Member States to impose further measures beyond what is agreed in the Directive and its implementing measures. We believe that this is one of the benefits of the revision of the 1993 Investment Services Directive.

Therefore, any national discretion on such an important matter should be based on an explicit provision of the Level 1 text, which is not provided in this case.

3. BOX 3 - Content of pre-trade transparency for Systematic Internalisers

Paragraph 95

We do not agree with CESR's proposal on the method to define the Standard Market Size for shares admitted to trading for the first time. We think that this would be premature to fix an initial SMS from the first day of trading of a share admitted to trading for the first time. This method risks to not to reflect the SMS corresponding to reality. Therefore, the assessment of the SMS should be made after a certain period of trading. A three- months trading period seems to be a more acceptable solution.

4. BOX 5 - Content of the post-trade information

Paragraph 141

We do not agree that in case of transactions made outside the RM or MTF that were subject to other conditions than the current market price of the share, the information published should include an indicator explaining the reason for the deviation from the current market price. In practice, it would be almost impossible to comply with this requirement because of the amount of labour and costs this would entail (firms would have to go manually into the system) and the fact that this information should be provided within 3 minutes.

5. BOX 6 – Table 2 Deferred publication arrangements

The most serious threat for our secondary business arises in relation to the trades over 100% of the ADV in the Less- and Mid Liquid segments: In the current situation in the Netherlands we can choose for non-transparency by reporting direct to AFM only (not through facilities of Euronext). The risk of losing money on these high-risk trades increases by an earlier time of publication. Eventually this will force us and other brokers/banks to behave more "risk averse" towards our clients. This is neither good for us, nor the end-investor. It will decrease liquidity in the Mid/small Cap segment which we think is not the intention of the Directive. Suggested changes in the matrix are put in red and underlined.

Minimum qualifying size of trade (and cash ceilings)

Maximum permitted delay for trade publication	High liquidity shares e.g. Eur 50 m+	Mid-liquidity shares e.g. Eur 1-50m	Less liquid shares e.g. less than Eur 1m
60 minutes	More than 10% of ADV or more than Eur 10m	More than 10% of ADV or more than Eur 3.5m	More than 5% of ADV or more than Eur 10.000
120 minutes	More than 20% of ADV or more than Eur 20m	More than 15% of ADV or more than Eur 5m	More than 15% of ADV or more than Eur 30.000
End of day (+roll-over to close of next trading day if undertaken in final 2 hours of trading)	More than 30% of ADV or more than Eur 50m	More than 25% of ADV or more than Eur 10m	More than 25% of ADV but at least Eur 50.000
End of next trading day	More than 100% of ADV	More than 50% of ADV	More than 50% of ADV
End of second trading day following trade		More than 100% of ADV	More than 100% of ADV but at least Eur 1m
End of fifth trading day following trade		More than 250% of ADV	More than 250% of ADV

6. BOX 7 - Publication of transparency information

Paragraph 196, 3rd sentence

We would have problems with complying with the obligation to have a third party or proprietary arrangement in place for trading that takes place outside the market's opening hours since in the Netherlands, the AFM does not provide us with such a possibility. During trading hours we do need to go via Euronext. However, would be very happy if the AFM allowed us to report all off- exchange trades directly to them via a third party or proprietary arrangement.