29 July 2004

Mandate to CESR for technical advice on possible implementing measures on the Directive on Markets in Financial Instruments

Response of Euronext to CESR's call for evidence dated 29 June 2004
(Ref. CESR/04-323)

Euronext appreciates the opportunity given by CESR to contribute to its call for evidence dated 29 June 2004, on implementing measures concerning some key provisions of the Directive on Markets in Financial Instruments (MiFiD). Nevertheless, it seems quite difficult to provide the regulators with full comments within the very short deadline set up for sending responses.

The call for evidence indeed addresses a number of major topics such as transparency, best execution and client orders handling rules, which would need more detailed comments that we will be able to provide only later this summer.

As a general consideration however, we do share the view that those issues constitute important regulatory challenges in the implementation of a competitive and safe integrated financial market. Implementing measures, when giving effect to core principles of the general framework for the establishment and the functioning of the European integrated financial market, will have to induce the practical benefits awaited by the rule makers and the industry.

Best execution/ Transparency

Euronext endorses the concern of the Commission that it is "necessary to ensure the overall coherence between the different rules that are designed to ensure (…) competition and efficiency in European markets and in particular between the transparency and best execution provisions of the MiFiD".

We therefore welcome the extension of the time limit granted to CESR for establishing its advice since it is important to be able to consider all provisions relating to transparency and best execution at the same time.
Concerning **best execution**, we consider that it should be both practical for investment firms to be applied and sufficiently easy to control to be respected. In this context we consider that amongst the different factors to be taken into account for best execution, price and costs are particularly important: overall costs including price and other services' costs (such as search cost for instance) are indeed a major concern for all types of investors. We also think that order execution policies should be subject to overview from competent authorities to ensure that they truly include "those venues that enable (them) to obtain on a consistent basis the best possible result for the execution of clients orders" as stated in article 21.3. Moreover, we believe that investment firms should be in a position

to document at any time the consent of investors to such execution policies as well as any significant change to them.

Best execution cannot function properly without strong transparency requirements, since firms will only be able to deliver the best result to their clients if they know what can be offered on the various venues where execution is possible.
Relatively to **transparency**, the MiFiD has set up a general framework of obligations, aiming to provide a "comprehensive regime in order to avoid (…) negative effects that fragmentation of trading could cause to the efficient functioning of the market".
Pre-trade and post-trade transparency provisions have thus been set up in the Directive, applicable to investment firms and market operators; such rules have been conceived with specific and limited exemptions.
CESR, when giving its advice to the Commission, should respect the balance reached at Level 1. If flexibility is necessary in some instances, it is nevertheless clear that the balanced transparency requirements as established in the MiFiD are fundamental in order to maintain a level playing field between all execution venues, and that exemptions should be applicable to all of them in the same proportion. In that respect, the Directive has already taken provisions (article 27) to ensure that systematic internalisers (defined as investment firms "which, in an organised, frequent and systematic basis, deal on own account by executing client orders outside a regulated market or an MTF") are submitted to pre-transparency requirements. In our view, CESR's advice should ensure that the criteria to define systematic internalisation activity (i.e. execute clients' orders for own account on an organised, frequent and systematic basis/ standard market size/ liquid market in an individual share) are not interpreted too narrowly, since precise limits have already been foreseen by the article 27 addressing the transparency obligations. Furthermore, waivers to transparency obligations (i.e. waivers to quote firmness, distortion between retail and professional orders…) should not be interpreted extensively.
On the specific point of defining "systematic internalisation" criteria, following the definition given in the Directive that stipulates it covers execution of "clients' orders for own account on an organised, frequent and systematic basis", we would tend to consider as a first assumption that: an "organised" system would imply the existence of procedures settled to execute those orders (i.e. clients' information, execution…); the "frequency" should be interpreted as the availability and consistency of the service of execution of clients' orders for own account; as for the "systematic" criterium, we believe it is more or less a combination of both former ones (i.e. organised & frequent).

Conduct of Business Rules (Article 19)

The MiFiD poses a general obligation for an investment firm to "act fairly, honestly and professionally and in accordance with the best interests of the client" (article 19.1). As regards CESR's mandate to determine the content of this obligation concerning the provision of services other than the execution of orders on behalf of clients, we consider "commercial best practises and lex mercatoria" as a good basis for discussion.

"Eligible counterparties" have been excluded from the scope of article 19 of the MiFiD. We nevertheless consider this exoneration as inappropriate: why should professionals be exempted from acting "fairly, honestly and professionally"? Consequently, we draw

CESR's attention on the need for taking into account such obligation wherever possible at Level 3 or in relation to the conditions of extension of the concept of eligible counterparty. In particular, regarding the advice relative to the procedures that counterparties have to follow to obtain a more protective treatment (cf. article 24 of the Directive), we believe they should be very easy since those eligible counterparties do not even benefit from any "fair, honest and professional acting" requirements. In our view, a simple notification should be considered as sufficient.

Limit orders display (Article 22.2)

Article 22.2 of the Directive aims at increasing price competition at the marketplace, providing that investment firms should, in case limit orders that they received from their clients are not immediately executed, disclose those orders in a way easily accessible to other market participants (unless clients expressly instruct otherwise).
With respect to the advice to be given to the Commission, we draw CESR's attention that any procedure to be used by investment firms to disclose such orders should ensure that not only the information on the prices should be easily accessible, but also the client limit orders themselves. It is this element that gives grounds to the possibility for Member States to decide that such obligation may be complied with by routing such orders to a multilateral execution venue (either RM or MTF), so to render those orders accessible to other market participants. The principle of best execution should dictate which of these venues would be most appropriate, taking notably into account liquidity and accessibility criteria.

List of Financial Instruments (Article 4 – Annex I Section C)

The MiFiD establishes a list of the instruments considered as "financial instruments" for the purpose of the Directive. Such list includes two open categories: commodity derivatives that can be physically settled and non financial-non commodity derivatives.
The Commission has called CESR's technical advice in order to "allow for a harmonised and uniform definition of the financial instruments that fall under the scope of the Directive", provided that the Directive should apply to "derivatives which are constituted and traded in such manner as to give rise to regulatory issues comparable to traditional financial instruments". The list of financial instruments given in the MiFiD is already very specific and quite exhaustive, especially concerning commodity and other assets related derivatives. Nevertheless, and should further precisions/complements be added to these definitions at Level 2, Euronext shares the opinion that it is essential to have/keep a common and fully harmonised definition of financial instruments falling under the scope of the Directive.

We hope that those general views are nevertheless of interest for CESR's work, and that you understand our concern in coming back to you with further detailed remarks on this call for evidence.