

**BME SPANISH EXCHANGES COMMENTS ON THE CESR CONSULTATION
PAPER CESR/04-261 b (JUNE 2004) ON BEST EXECUTION AND
TRANSPARENCY**

This is the second set of comments of BME Spanish Exchanges to the CESR Consultation Paper CESR/04-261b "CESR advice on possible implementing measures of the Directive 2004/39/EC on Markets in Financial Instruments", given the deadline extension to comment on the mandates concerning best-execution and market transparency.

I. BEST EXECUTION (Article 21)

1. Concept of trading venue

The concept of "trading venue" is not defined along the Directive nor within CESR Consultation Paper.

From our point of view, the concept of trading venue in article 21 must refer to regulated markets and to MTFs.

That interpretation is consistent with article 21, as it foresees that each firm's execution policy must include information of the different venues and the factors affecting the choice and, in a different part, that article refers to the possibility of executing orders outside a regulated market or an MTF.

2. The review should focus as well in executions outside RM or MTF

CESR comments focus specially on whether the trading venues are giving or not the best execution when assessing the firm policy. This is probably because CESR discuss the criteria for evaluating trading venues for inclusion in the execution policy together with its revision.

Even though, it seems that the Directive and the Commission mandate are wider: The mandate refers to factors that may be taken into account by an investment firm when adopting and reviewing its execution arrangements so it is not limited to the decision and revision of the trading venues it will belong to.

We miss then a reference to the criteria that the firm must consider when assessing the executions of orders outside a regulated market and MTF: Monitoring the effectiveness of the execution arrangements and policy applies

to all of these arrangements and not only to the trading venues included in the policy.

3. Evaluation of trading venues

CESR makes many references to the capacity or suitability of trading venues to provide with the best execution.

We find that such approach gives too much emphasis to the trading venues evaluation and might weaken the very fact that the execution policy evaluation deals primarily with the investment firm itself. Competition should be produced not only among trading venues but also among investment firms. In fact, given a trading venue that provides the best result in a consistent basis, this does not imply that the firms get the best execution because other factors involved in the firms activities must be taken into account.

Then, we miss references to the investment firm revision and evaluation of its own results managing to get the best execution and not only to the evaluation on how well the respective venue has executed the firm's client orders.

4. Best execution and inclusion of trading venues within the execution policy

The concept of best execution is considered within the Directive as a best efforts provision. This means that it finds its application in the establishment of a policy oriented to obtain that best execution.

The investment firms are not obliged to include every trading venue in its execution policy and we defend that according to its business model certain trading venues could be excluded.

However, we think that clients should have a way to verify that their orders have been traded according with the best execution principle.

5. Criteria for determining the relative importance of the factors

We think that the best execution may be assessed with the following criteria:

First, calculating the best bid-ask price for a standard market size. With this figures we can calculate a selection of venues where the best execution can be found. In all the venues it can be calculated the percentage of times where the best execution is reached. Only venues with a consistent basis or with a minimum percentage of best execution (for example 5%) are the venues that investment firm must have access to.

Second, best execution must include all details for client, order and venue characteristics. It will include for each asset the venues that have passed the first criteria.

6. Conflicts of interest and client's consent

The third paragraph of Article 21.3 requires that investment firms shall obtain the prior express consent of their clients before proceeding to execute their orders outside a regulated market or an MTF. It also states that such consent may consist either in a general agreement or in respect of individual transactions.

It has to be noted that this consent refers, in general, to the execution policy of the investment firm and covers the possibility of executing orders outside a regulated market or MTF.

Therefore, such requisite does not address any eventual conflict of interest that may need specific ways to be dealt with.

This may be the case of orders that are going to be crossed not with other participants but against the firm's own account.

The specificity of that way of trading makes clear that it cannot be covered by a general consent to the investment firm execution policy. Consequently, this consent should be completed with the additional one applicable to solve the conflict of interest that might arise in the own account trader or with specific requirements for some types of dealing.

II. Pre-trade transparency requirements for Regulated Markets (Article 44) and MTFs (Article 29)

1. Content of information

We find that for price discovery mechanisms through auction electronic systems the display of an indicative theoretical equilibrium price with the associated volumes on an aggregate basis gives enough information to market participants. The display of the underlying orders should not be mandatory but optional.

The definition of indicative theoretical equilibrium price should not be detailed in level II regulation in order to make it flexible for future market developments.

Furthermore, we would like to highlight that, from our point of view, the statement of a closed list of market models could hamper innovation in the European financial markets.

2. Depth of trading interests and access to pre-trade information

Even if the idea of providing full order depth would theoretically reinforce the concept of market transparency, from a technical point of view, it would be difficult to be carried out.

In addition to this, we believe that the added value for the general public would not justify all the technical arrangements needed to implement such provision. We would like to underline that the main interest for traders focus in the first five positions. The enquiries referred to the other positions could be considered as mere “curiosity enquiries” and therefore, providing full display of all the positions in the order book would not contribute significantly to market transparency. For this reason, we would propose to limit pre-transparency to the first 5-10 lines of the order book.

Moreover, we understand that the provision of the pre-trade information should be in any case subject to reasonable commercial terms.

3. Effectiveness

The reliability of the information seems to be a question that should be tackled by each trading venue while providing each own data which should comply with the specific regulation applicable.

4. Exemptions from pre-trade transparency

We would like to express our discrepancy with the proposed exemption to pre-trade transparency to the price-taking systems. We would like to point out that price formation results from the price and volume of bids and offers, not only from the

price, and therefore any information about a trading opportunity in those systems, together with the volume information is certainly of relevance to the market. Without such information, investment firms would not be able to fulfil their best execution obligations.

5. Large trades

It is necessary to define what is to be considered an order large in scale compared with the normal market size and to define the SMS for each class of shares as well as the criteria for its revision.

The volume of the large order must be calculated in relation with the daily turnover or with the average order traded. In this concept it is seen as necessary to coordinate and agree the concept of traded order (It is not the same traded order than trade).

We consider that an order of more than 5% of the daily turnover can be considered as a large order. This system should be combined with a minimum amount in euros (i.e. 500.000 €) for less liquid shares.

The Standard Market Size can be 10 times lower than the large order but must also have a minimum level to preserve the concept of pre trade transparency. The system will need to be modified during the periods due to extraordinary events: IPOs, takeover bids, mergers, increases of capital and other events that change dramatically the liquidity of the share.

It is very important to define what is a large order that is not going to be taken into account for the calculation of the average order. It also should be very clear that the volumes have to be calculated single counted.

The competent authorities should coincide in the revision period and publish at the same time the class of share to which each share belongs.

III. **Post-trade Transparency requirements for Regulated Markets (Article 45) and MTFs (Article 30) and for Investment Firms (Article 28)**

1. Arrangements to disclose post-trade information

BME supports the post-trade transparency scheme proposed by CESR. Given the importance of post-trade transparency in avoiding data manipulation and distortion, trade-by-trade information should be applied with no exceptions. We consider that no trade should be excluded from publication and therefore we do not see the justification for the exemption of minor trades.

We find appropriate the two-week period for which the post-trade information should be available. Nevertheless, we assume that these kind of information should be provided under reasonable commercial terms.

Furthermore, when mentioning the issue of the operation of arrangements for trading information, we find that the expression “time when the firm is *actively* trading” could be lax . In order to be more concrete and to avoid misunderstandings, we could refer to European trading hours. In any case, we think that it would be necessary to clarify the exact meaning of the term “actively”.