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WIRTSCHAFTSPRÜFER
IDW

Committee of European
Securities Regulators
11 – 13 avenue de Friedland
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06 October 2004
449/541

Dear Sirs

Re.: Consultation Paper- Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

We would like to thank you for the opportunity to comment on the above-mentioned document, and to apologise for the delayed submission of this letter. Firstly, we address matters of a general nature, before considering specific sections in more detail.

General Matters

The Directive already specifies very detailed regulations in respect of certain matters. In our opinion the implementing measures should therefore be limited to those areas where the need for further regulation remains evident. Since the Directive applies to a wide group of service providers and intermediaries ranging form large banks or investment firms to self-employed individuals a flexible approach should be adopted to the application at level-2, in order that the features specific to the various jurisdictions of each Member State and of the type of investment firms can be taken into consideration, as appropriate. As an example, we suggest that the regulations to apply Article 13, (6) in Box 4, or Article 19 (7) in Box 9 appear to be partly redundant.

Measures in some Member States, following the transposition of ISD at the start of 1995, for example Germany, where the Rules of Conduct and organisational duties

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for investment firms are subject to an annual audit carried out by an auditor or an audit firm, or a similar external audit which includes reporting to the relevant authorities, have demonstrated that this type of flexible application can offer high quality investor protection without burdening the investment firms with excessive costs in respect of organisation and audit which would otherwise have resulted form rigid standardised requirements.

We would like to stress that it is imperative that a satisfactory balance between the mandatory minimum requirements for small investment firms and self-employed individuals operating as financial advisors and the detailed regulations to which an investment firm offering a wide range of investment services in all business segments must adhere.

If examples of appropriately graduated categories (calibration) of investment firms were to be provided a suitably balanced application could be achieved at Level-2. Section 3.1. of the Guidelines Further Specifying the Organisational Requirements of Securities Firms pursuant to Section 33 (1) Securities Trading Act[1] of the German "Bundesanstalt für Finanzdienstleistungsaufsicht" [Federal Financial Supervisory Authority (formerly Bundesaufsichtsamt für den Wertpapierhandel)] provides criteria which are potentially suitable for this purpose. These are, for example, an investment firm that:

- has members of its corporate agents and/or employees who are member of a supervisory body of issuers of securities that are approved for trading in a regulated market in a Member State or a comparable capital market of another country,
- trades itself on the stock/ commodities exchange,
- operates an analysis or research operation, either directly itself or outsourced by the firm,
- is engaged in the development of its own financial-instrument products.

In addition, we would like to suggest that further effort be made to establish standardised terminology in the various EU Directives and implementation measures relevant to the capital markets. For instance, the above-mentioned consultation

[1] Guidelines of 25 October 1999

paper refers to “Investment research” whilst the most currently issued Directive implementing the Directive on Market Abuse refers merely to “Research”.

Specific Matters

Section II – Intermediaries

Compliance and personal transactions (Article 13 (2), Question 1.1.)

The nature, scale and complexity of the investment business, rather than merely the size of the investment firm, should form the basis for the independence requirements in respect of the compliance function. This would preclude disproportionate demands being established. Size alone should not be a criterion.

- We suggest, as noted above, that, in principle calibration could be used to distinguish between:

    - Entities, which due to the nature, scale and complexity of their investment business regularly receive information on compliance-relevant facts and

    - Entities to which this does not apply.

Therefore, in our opinion, the requirements proposed by CESR in Box 2 (d) should definitely include the wording “where appropriate and proportionate in view of the nature, scale and complexity of its business”. As a minimum, any form of self-review should be precluded.

Record keeping obligation (Article 13 (6), Question 4.1.)

We consider the regulations determined at level 1 to be sufficient, as Box 4.4. merely reiterates the basic principle deriving from Article 13 (6) (“An investment firm must be able to demonstrate that it has not acted in breach of its obligations under the Directive and the internal code of conduct”), this is superfluous and should be deleted.

However, we suggest that further consideration should be given to introducing a requirement for the records retained pursuant to Article 13 (6) to be subject to an appropriate regular audit by an auditor.

Safeguarding of clients' assets (Article 13 (7) and (8))

According to point 7 of Box 5 those investment firms which use client money in their own name and on third-party account and which are not deposit-taking credit institutions must deposit client funds immediately into accounts of a deposit-taking credit institution. According to this proposal such accounts can be either individual accounts or omnibus accounts.

We do not regard such omnibus accounts as acceptable, as this option cannot ensure the investors' ownership rights for their funds and prevent the investment firm from using investors' funds on account of another client.

Conflicts of interest (Article 13 (3) and Article 18)

We regard limiting the exchange of information between research analysts and other divisions that receive compliance-relevant facts as referred to in Box 6, question 6.3 as well founded. We also consider that a separation by means of information barriers is necessary in respect of information that has relevance in the compliance function, and to all other departments where such a transfer of information could occur. These should not only include corporate finance departments, but also proprietary trading and credit business divisions.

Box 6, question 6.4.:

CESR does not provide any grounds to justify why it would be necessary to deviate from the IOSCO principles and to accept exceptions from the organisational requirements. We contend that, it is necessary for investor protection, for all the criteria in Box 6 no. 16 (f) (II) to (v) to be fulfilled by an investment firm.

Should CESR adhere to its proposal to permit exceptions, we favour the first option in No. 17 i.e., the application of Nos. 17 to 19. However, we consider the requirements of No. 17 (b) "the conflicts of interest potential within the particular business of the investment firm is of a minor nature" to be somewhat removed from practice, since research may well also include potential conflicts of interest and be of relevance to the capital markets when, for instance, rather than an investment firm, a large credit institute is concerned, which does not provide investment services. Precisely for this reason, the Directive on Market Abuse has established minimum requirements for all financial analysts.

Best Execution (Article 21)

The criteria identified in the consultation paper, namely: “client characteristics”, “order characteristics” and “venue characteristics” help put the meanings of the factors referred to in Article 21 (1) into context. We suggest that “venue characteristics” should also include:

- The jurisdiction of the place of business (laws, Stock / Securities exchange regulations, conditions for participation on MTF etc.);
- The market model (market maker system, brokerage system, hybrid model etc.);
- The potential or the Pressure/compulsion to cancel specific erroneous trades (mistrade handling);
- The technical design of the IT system operating in the market place (real-time and slot system);
- The treatment of risks from the contracting party (involvement of a central counterparty) and the connected issue of trading anonymity.

In addition to those factors listed on page 75 of the consultation paper, factors such as the clearing capabilities, and particularly in relation to electronical trading systems, the IT system availability (system failure rate) and the integrity (miss-processing rate) of the IT system should be considered in selecting the venue for trading.

In respect of the issue of “best execution” in the second part of the first question to section 3.4.1 (page 73 of the consultation document) “How do you think the advice should determine the relative importance of the factors in Article 21 (1)?” we suggest that the criteria could be weighted in the following order; share price, market depth, speed, and likelihood of execution and settlement before the issue of incidental costs is considered, in order to optimise investor protection, whilst at the same time, preventing cut-throat price competition. This would have the additional benefit of allowing trading the necessary flexibility. Incidental costs are partly determined by external factors; for instance, the custody fee. It is not always possible to change the contractual terms of trading in such a short period of time.

Client order handling (Article 22 (1))

In respect of the issue concerning the aggregation of trading orders from clients with those from the firm itself, we would like to make the following point. Aggregation can be advantageous for the client, as in some instances, an aggregation may facilitate trading that would otherwise not be possible, or it may also result in a better price being obtained for the client.

However, the potential for aggregation increases the risk of front and parallel running. It would be necessary to introduce additional measures to ensure that other requirements of the Directive, notably those of Article 13 (2) (in Box 1 No. 7) were not undermined.

Section III – Markets

Pre-trade transparency

We support the suggestion in respect of the scope of pre-trade transparency and depth of trading interests whereby all offers to buy and sell as well as quotations are to be disclosed. In our view, wide ranging pre-trade transparency will counteract the risk of manipulative behaviour far more effectively than transparency rules or regulations, which simply prescribe publication of, for example, the five best offers. Requests specify, that by these means, circumvention of this transparency can be prevented.

The regulations suggested in respect of “updating and withdrawal of quotes” are suitable to guard against market abuse. It should however be made clear that the definition of “orderly market” and the introduction “market abuse provisions” is to be undertaken by the market operators of the RM or MTF and not at the discretion of the participants (refer to Box 12, No. 4 on page 87 of the consultation paper). The market operators should likewise be obligated to publicise the rules and regulations which they have set on the acceptability of updating and withdrawal of quotes (including sanctions for non-compliance) and to monitor compliance with these rules and regulations.

In our opinion, in establishing the criteria for determining the market models for which pre-trade transparency obligations may be waived CESR should bear in mind that those market models, where the price of the transaction is not exclusively determined within that trading system, but by reference to the lowest and highest prices on other

markets, should not be included as an exemption. This relates to No. 13 in Box 12 “Based on market model”.

In respect of the proposed exemption of “iceberg”-type orders from pre-trade transparency obligations under the heading “Based on type of order”, we would like to point out that the market operators of RM or MTF should be obligated to define and publicise the prerequisites for an order to be treated as an “iceberg”-type order on that particular market.

In considering how the term “block size” should be best defined under the heading “Large trades”, the document appears to favour the “method based on the average size of orders” as this is already set out in the level 1 text of Article 27. However, we are of the opinion that impact on the market constitutes the most preferable criterion and therefore favour the “market impact method”.

The Directive requires that Post-trade transparency measures are undertaken as close to real-time as possible, regardless of whether an individual transaction is completed on a regulated market or outside a regulated market. The time limit proposed by CESR for making this information public (1 minute) constitutes a reasonable limit, in particular for those markets that are not IT supported. However, we recommend that CESR should clearly state that the prescription of a time limit does not absolve any party from the obligation to make post-trade transparency disclosures as close to real-time as possible. This is particularly relevant to those cases where the technical IT environment does not preclude real-time disclosure.

According to the consultation paper transactions are not to be disclosed unless a “transfer of economic risk” has occurred. This regulation (see Box 13, No. 28 on page 93 of the consultation paper) is not sufficiently specific and therefore there is a danger that it will not be uniformly applied. The scope of information disclosed as post-trade transparency should be widened to include “type of transaction“. In this way, lending transactions could be distinguished from purchase/sale transactions. We therefore concur with the proposal for deferred publication. We do, however, recommend that CESR categorically state that the term “third party” as used in Box 13, No. 31 on page 93 of the consultation paper does not include any relationship to the entity whose shares are concerned.

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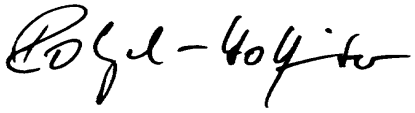
We hope our comments will be useful to CESR in finalising its Advice on Implementation Measures of the Directive 2004/39/EC on Markets in Financial Instruments. Please do not hesitate to contact us, should you require clarification of any matters raised in this letter, or if we can be of further assistance.

Yours faithfully



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