

ZENTRALER KREDITAUSSCHUSS

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Comments of the Zentraler Kreditausschuss (ZKA)¹

CESR Work Programme on MiFID Level 3 Work (CESR/06-413)

11 September 2006

¹The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,300 banks.

General remarks

We welcome the fact that now, once the legislative process at Level 2 under the Lamfalussy procedure has been completed, CESR looks into the issue of how to handle the upcoming work at Level 3 and that – in its brainstorming exercise – it seeks timely involvement of market participants. As has already become evident with regard to the February 2005 Level 3 recommendations published by CESR concerning the Prospectus Directive: the decisions which CESR adopts at Level 3 concerning the various interpretation issues incur major implications for market participants. In order to pre-empt any potential conflicts with the supervisory practice of Member States' competent authorities, directly after its adoption, each and any of banks' implementation measures are directly geared towards CESR's recommendations.

At present, banks are already doing their utmost in order to prepare MiFID compliance as of 1 November 2007. Already at this point in time, it has become clear that – provided this will be feasible at all – meeting the deadline will require the greatest effort. Here, one critical key for successful MiFID implementation consists in timely planning reliability as regards supervisory requirements. In the absence of such a clear idea of the road ahead, banks will not be able to prepare the necessary safeguards for an appropriate implementation as per 1 November 2007. Unfortunately, the CESR road-map for its Level 3 work between 2006 and 2009 does not meet these requirements. The deadlines for the adoption of Level 3 interpretations contained thereunder are almost exclusively too late (i.e. there is not enough lead time before the implementation date scheduled for 1 November 2007) or, moreover, said deadlines expire so shortly after 1 November 2007 that short-term system adjustments after MiFID's first-time implementation scheduled for 1 November 2007 would become necessary. From our point of view, this is neither acceptable nor feasible. Instead, we would welcome it if CESR's Level 3 work was already finalised by the beginning of 2007. Yet, more likely than not, already due to the mandatory consultation deadlines which CESR has to observe, this will not be a realistic option.

In view of the apparent time pressure under which all stakeholders have to operate, CESR might want to focus on those implementation aspects where a clarification at the European level is a *conditio sine qua non* for timely implementation. Therefore, those areas should receive the highest priority where the specific form of the cooperation between authorities amongst themselves will have an impact on market participants and their actions. This, for instance, is the case when it comes to the implementation of reporting obligations; yet it also applies generally as regards the issue of the home/host relationship.

A limitation to those aspects which are absolutely essential for timely implementation also appears possible on the grounds that CESR's Work Programme includes numerous aspects which do not require CESR to take any action at Level 3. We equally propose abandoning any plans to re-launch requirements which have already been discussed by CESR in the past but which were subsequently abandoned during the drafting process of MiFID and the Level 2 provisions. There is a clear expectation on the part of the market that such provisions shall and must not be reintroduced into the political agenda. Generally, with regard to the Level 3 work, great care is required so as to ensure that this level shall and must only deal with the interpretation of the provisions adopted at Level 1 and Level 2; in other words Level 3 must not impose any additional requirements upon investment firms.

Please find our more detailed comments concerning the Consultation Paper in the following paragraphs.

I. Work in connection with upcoming Commission's Reports

- *Possible extension of the pre- and post-trade transparency obligations to transactions in classes of financial instruments other than shares. The Commission's report is due by October 2007. (Article 65 of the Level 1 Directive)*

We will submit our comments during the European Commission's public consultation on "Pre- and post-trade transparency provisions of the Markets in Financial Instruments Directive (MiFID) in relation to transactions in classes of financial instruments other than shares". Our comments will also and especially cover the envisaged time-line. In this context, we would like to question whether it makes sense to conclude the consultation process prior to the deadline for national implementation of MiFID's market transparency provisions, i.e. before the first practical lessons learnt from the implementation of the forthcoming provisions, can be incorporated into the debate. We see the need to wait for the first stock market results to come in, which then may be analysed further. Yet, at the same time we should also be mindful of the fact that these results cannot be transferred to other areas on a 1:1 basis. Notwithstanding its limited transferability, the impact on share markets may also provide pointers as to a potential roll-out to other areas. Currently, there are preparations underway for an implementation of the relevant provisions under MiFID as well as the Implementing Regulation. This process has highlighted a strong need for clarification on the ground. After all, Germany is not the only country where this implementation process ventures into largely uncharted territory. Furthermore, the European legislator obviously hoped for positive effects on market transparency as regards share

trading in Europe – and it still remains to be seen whether these hopes will come true in practice. In view of the foregoing and before having even tackled the first stage, we feel that any decision on a potential extension of the scope of such provisions would be premature.

On a more general note, in this context, we would like to point out that – already on the grounds discussed in the context of the CESR wholesale day – we are unwilling to accept an expansion of MiFID's market transparency provisions to other securities.

II. Work in connection with other Level 3 Committees

- *Substitute products*

This point is unclear. Besides, any CESR treatment of this issue after the second quarter, 2008 would be too late, anyway.

III. Other Areas of Work

- *Aspects related to the functioning of the passport of investment firms and regulated markets (where relevant), including home/host relationships in the phases of authorization, free provision of services/activities, establishment of branches, crisis management; it also covers transitional provisions around the passport, and issues regarding the provision of cross border business by tied agents. (Articles 31 and 32 of the Level 1 Directive)*

Banks engaged in cross-border transactions take a vital interest in the forthcoming clarification of the home/host relationships. The issue of the competent authority for a dependent branch abroad (i.e. which authority shall be specifically responsible for such dependent branch) is in need of unambiguous clarification by January 2007. Hence, we feel that starting the work only after the first quarter, 2007 would be too late.

- *Best Execution*

From our point of view, at Level 3, there is no compelling need for a further interpretation of the best execution provisions which, already, feature a high amount of details. Furthermore, based on MiFID and due to the Level 2 provisions, item 2 has become obsolete; hence, this is an issue which should not be pursued any further. The rationale behind item 3, 4 and 6 still remains unclear and it also remains unclear whether these issues are covered by MiFID and the Level 2 provisions. At any rate, a start of the work in the

second or third quarter, 2007 would clearly be too late. Banks need to know the general parameters of the forthcoming specifications by January 2007. Otherwise it will become unfeasible for them to set up the necessary IT infrastructure in time.

- *Record keeping*

In our view, the minimum list of records merely serves clarification purposes. At most, and subject to the conditions contained in Article 4 of the Level 2 Directive, Member States could provide for additional record keeping obligations. Furthermore, under the provisions of Article 51 (3) of the Level 2 Directive, the competent supervisory authority of each Member State shall prepare and maintain a list of the minimum requirements. Hence, in this context, it remains highly questionable whether CESR shall and may become involved.

- *Execution only*

We do not perceive any need to draw up a list of non-complex instruments. However, the indicated timing, i.e. as of the second quarter, 2008 would be too late. The requirements contained in Article 19 (6) of the MiFID need to be clear by January 2007.

- *Inducements*

The issue of "softing and bundling" has already seen sufficient coverage at Level 1 and Level 2. Hence, there is no need to investigate this issue any longer in a separate manner. At any rate, by January 2007, in order to prepare their distribution infrastructure in a timely manner, banks need to have a clear idea of the legal requirements.

- *Marketing communications*

The items listed under marketing communications are not sufficiently justified by the Level 1 and Level 2 provisions. More likely than not, these will be identical with earlier CESR requests – requests which were either abandoned in the course of MiFID's legislative process or, if they were not abandoned altogether, they were at least not incorporated in the form in which they are currently included in the present proposal. Hence, reintroducing a re-launched version of such provisions at Level 3 is not an option; after all, they are not covered by Article 19 (2) of the MiFID. Having said this, any CESR treatment of this issue after the second quarter, 2008 would be too late, anyway.

- *Appropriateness*

From our point of view, there is no obvious need to look into Article 19 (5) of the MiFID. What is more, the stipulation of criteria for an assessment of the appropriateness incurs

the danger of new rules – and the adoption of such rules at Level 3 is not a legitimate option. Since this, too, is an area where the industry has to make extensive investments into its IT infrastructure, the respective Level 3 interpretation would have to be finalised by January 2007, otherwise there will not be any chance to incorporate said provisions in time.

- *Compliance*

We see no need to look into the matter of compliance issues. Besides, the items listed are not covered by MiFID and the Level 2 Implementing Directive. Hence, a review of these matters will have become obsolete by now. At any rate, CESR action scheduled for the second quarter, 2008 would be too late, anyway.

- *Information to clients*

We see no need for a CESR level review of the requirements contained under Articles 27 to 34; after all, these provisions are already highly detailed in their existing form. Furthermore, the rationale behind plans for CESR involvement in this matter remains rather unclear. At any rate, CESR action scheduled for after the second quarter, 2008 would be too late, anyway.

- *Reporting obligations*

This point is unclear. At any rate, CESR action scheduled for after the fourth quarter, 2008 would be too late, anyway.

- *Contingent liability transaction for retail clients*

We are not aware of any need for CESR-level involvement. Here, again, the rationale behind CESR involvement remains completely unclear. At any rate, any CESR treatment of this matter after the fourth quarter, 2008 would be too late, anyway.

- *Conflicts of interest*

Banks have already started drafting a policy for handling potential conflicts of interest. In order to ensure timely information of their clients, this work requires completion by mid-2007. Hence, any further requirements which CESR might prepare as of mid-2008, would be too late. Expecting banks to change their work-flow again after but a few months, would be unacceptable.

- *Investment research*

This point is unclear. At any rate, CESR action scheduled for after the third quarter, 2008 would be too late, anyway.

- *Publication and consolidation of market transparency information*

- *Publication of transparency information (accuracy of the information, avoiding double publication, requirements for proprietary arrangements etc.)*
- *Consolidating the transparency information*

(Articles 27, 28, 29, 30, 44, and 45 of the Level 1 Directive)

We feel that this area has the highest priority. Due to the reasons mentioned above, the final results should be available by January 2007, the latest. A nine month implementation deadline is the absolute minimum needed by banks for an implementation of these entirely new requirements.

- *Common procedures and formats for the calculation and publication of data (liquid shares, block sizes and the list of systematic internalizers) (Articles 27, 28, 30 and 45 of the Level 1 Directive)*

- *Required calculations and estimates concerning liquid shares and delayed publication*

- *Free float: identification of holdings held by a collective investment undertaking or a pension fund and cooperation between competent authorities to share the information;*
- *Average daily turnover*
- *Estimates in relation to “new listings”*
- *Block trade thresholds*

(Articles 27, 28, 30 and 45 of the Level 1 Directive)

These points need to be addressed immediately. Due to the reasons mentioned above, findings should be made available by January 2007. We feel that this is an area which deserves the highest priority. Here, too, a nine month implementation deadline is the absolute minimum needed by banks for an implementation of these entirely new requirements.

- *Clarification of the nature of repo and stock lending*

We cannot detect any need for CESR involvement. Furthermore, the rationale behind a potential CESR involvement remains highly unclear. At any rate, CESR action scheduled only after the third quarter, 2008 would be too late.

- *Transaction reporting*

More likely than not, service level agreements between a bank and the publication channel (cf. sub-item 2) will primarily be of a bilateral nature. We see no need for a standard service level agreement in the form of a supervisory template; what is more, publication of such a template which is scheduled for the fourth quarter 2007 at the earliest would be too late. A general harmonisation of the format (cf. sub-item 4) would be incompatible with the Level 2 Implementing Regulation. Pursuant to Article 12 (1) (e) of the Implementing Regulation, the definition of the format falls under the jurisdiction of the competent authority. What is more, the exchange of information on transactions between competent authorities does not require a harmonised format at the level of the investment firms. All other issues are in need of a final interpretation by January 2007 the latest. This is due to the fact that the industry has to make the necessary investments into its IT infrastructure.

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