European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

COMMENTS ON

"CESR'S ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE DIRECTIVE 2004/39/EC ON MARKETS IN FINANCIAL INSTRUMENTS" OF JUNE 2004

- PART 2 (Best Execution and Post-Trade-Transparency-Requirements)

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I. Introduction

The European Association of Cooperative Banks (EACB) responded to the CESR consultation paper (CESR/04-261b) on September 17. EACB welcomes the opportunity to comment on the remaining subjects and is thankful to CESR for having extended the deadline for comments, given the complexity of those issues.

In line with our first response, we are still under the impression that CESR's implementation measures present an excessive degree of details. It should be noticed, however that this approach would be particularly detrimental for smaller investment firms who due to the high fixed costs associated with implementing detailed provisions, might no longer be able to maintain their services on competitive terms.

In the light of the above we strongly call upon CESR to take into account the provisions under MiFID and the Commission's mandate in its proposed recommendation.

The sections below contain our specific comments on best execution and post trade requirements and our answers to CESR's questions. In particular, section II provides our comments on Best Execution while Section III responds to the related CESR's questions. Section IV addresses post trade transparency, Section V answers the related CESR's questionnaire.

II. Best Execution (Art. 21) : General Remarks

This Association appreciates CESR's general approach which is based on posing questions to the industry, because the field "Best Execution" is very complex. Nonetheless we fear that a large number of issues is still unresolved . Therefore we would welcome the fact that those issues would be subject to a further, more in-depth review.

The proposed degree of detail appears excessive, as it would lead to unrealistic requirements of difficult and expensive applicability. In particular we would like to draw your attention on the specific issues outlined below:

- According to MiFID, client's instruction is the defining criterion for choosing the execution venue. This means that the requirements of best execution only apply on an auxiliary basis. Therefore excessive requirements of best execution policy and arrangements would be inappropriate.
- If the requirements of best execution are inappropriate, this would lead to a situation where certain transactions can no longer be offered to retail clients, because the costs will highly increase and the retail clients will not be willing to pay the much higher costs.
- There should not be a regulatory need to define a fixed number of venues. This should be a market requirement rather than a regulatory one.

In conclusion we believe that best execution provisions should leave sufficient flexibility in choosing the venues and should not result in stringent and expensive regulatory straightjacket that would prevent rather than enhance competition.

III. Best Execution (Article 21) : Answers to Individual Questions

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Q1: *Are the criteria described above relevant in determining the relative importance of the factors in Article 21(1)? How do you think the advice should determine the relative importance of the factors included under Article 21(1)?*

Answer: Yes, the criteria described are generally relevant in this context. In practice, however, it will be virtually impossible to translate them into an abstract decision making matrix applicable to most cases. We believe that a high degree of flexibility needs to be maintained in order to take account of different client segments, transaction specificity and other. The principles might be used as a guideline which shall generally inform the clients about the investment firm's policy. The possibility to deviate from the principles in particular cases should remain.

Q2: *Are there other criteria that firms might wish to consider in determining the relative importance of the factors? Do you think that the explanatory text clearly explains the meaning of all the different factors in respect of the different financial instruments?*

Answer: An extension of the list to include further factors is not necessary since all material aspects have been covered. The explanatory text provides a sufficiently clear explanation of the meaning of all different factors.

Q3: *How might appropriate criteria for determining the relative importance of the factors in Article 21(1) differ depending on the services, clients, instruments and markets in question? Please provide specific examples.*
Q4: *Please provide specific examples of how firms apply the factors in Article 21(1) to determine the best possible result for their clients.*

Answer: A regime for determining the relative importance of the factors seems unrealistic since it wouldn't allow firms to meet the different client requirements. The number of differentiation criteria is so large (liquidity, client segment, transaction type and so on) that any attempt of drawing up an exhaustive list would result impossible. Particularities have to be taken into account in individual cases. Hence, based on the interests of their clients, firms need to be allowed to pursue a differentiated order placement policy.

Page 75 questions

Q.1: *What investment services does your firm provide?*

Answer: As European Association we are not in the position to answer the question directly given the variety of business models our members pursue. However generally speaking, the cooperative banks represented by us provide the entire range of investment services.

Q 2: *How many venues does your firm access now? Does your firm expect to access more venues after the Directive becomes effective?*

Answer: As European Association we are not in the position to answer the question directly given the variety of business models that our members pursue. Broadly speaking, in particular smaller and medium-sized cooperative banks have no direct access to trading venues, but through their cooperative central bank (specific financial network structure). Abroad, foreign brokers are often involved.

We would like to highlight one aspect in the context of the trading venues. Even though on the grounds of competition, investment firms must secure that they have access to all venues which allow best execution on a continuous basis, this does not mean that they must have access to <u>all</u> trading venues worldwide. For an investment firm and its clients, the integration of each and any exotic trading venue would not be a financially sound solution. Furthermore investment firms should be able to draw upon the expertise of foreign brokers.

As for the number of venues, it is unlikely that MiFID will lead to an increase. On the contrary a decrease is likely to take place if excessive logistical demands were placed upon the firms, thus limiting the choices available.

Q 3: *What factors does your firm consider in selecting and reviewing venues?*

Answer: As European Association we are not in the position to answer the question directly anyhow broadly speaking a difference needs to be made between direct access to the execution venue or selecting a broker.

In the event of direct access, the following criteria will generally play a role: product type, liquidity/order penetration, order volume, price and service at the execution venue.

When selecting the broker, this decision will be based on e.g. the following criteria: reputation, presence, care and due diligence, punctuality/swiftness, technical infrastructure/integration possibilities, service quality, reporting, contractual terms (e.g. costs, provision of collateral), and structure of the client orders.

Q 4: *Please provide specific examples of costs you consider in evaluating venues.*
Q.5: *How do costs affect your decisions about venue selection?*

Answer: For instance broker fees and currency expenses could be mentioned here.

Q.8: *Have we identified the key criteria?*

Answer: Subject to the comments made above, the key criteria have been identified. Nonetheless we still believe that covering this topic exhaustively down to the last detail would not be a realistic undertaking.

Q.9: *What data is available to carry out these reviews? If no data is available, are market solutions likely to provide it?*

Answer: Today, data availability is fairly good (e.g. rates or sales figures). Yet, this data is not always accessible in a detailed or consolidated format since there has never been a need for this. Should the requirements change in this respect, the market will find an appropriate solution in order to provide the necessary data.

<u>Page 76 questions</u>

Q.1: *What kinds of monitoring arrangements do firms use now?*
Q.2: *How frequently do firms monitor execution quality?*
Q.3: *What data is available to aid firms in their monitoring obligations? What does the data cost?*
Q.4: *In what respects does the frequency with which firms monitor execution quality depend on the types of instruments, clients, markets and investment services in question? Please provide specific examples.*
Q.5: *What, if any, market data do firms consult in order to monitor execution quality?*
Q.6: *What additional data do firms expect to use after the Directive's transparency requirements become effective?*

Answer: Already today investment firms in their search to provide the client with the best possible solutions are forced to monitor the market on an ongoing basis. Furthermore, it should be highlighted that the monitoring scope shall be restricted to those venues to which investment firms have a direct access. Related reviews of the execution policy of a broker would not be possible. The only obligation that can be made incumbent upon investment firms in this case is the duty of information through the usual sources of information in compliance with the duty of care and due diligence. Any proactive enquiry obligation beyond this would clearly be too far-reaching in scope.

<u>Page 77 questions</u>

Q.1: *How frequently do firms review the venues to which they direct orders on behalf of clients?*
Q.2: *Do firms re-evaluate their trading venues:*
- *whenever there is a material change at any of the trading venues ?*
- *whenever there is a material change at the firm that affects its execution arrangements?*

whenever the firm's monitoring indicates that it is not obtaining the best possible result for clients on a consistent basis?
Q.3: *What difficulties would firms face in reviewing their execution arrangements in response to each of the foregoing events?*
Q.4: *Do venues make firms aware of material changes in their business?*
Q.5: *Please provide examples of instances in which firms have changed the venues that they use.*

Answer: Broadly speaking, reviews of venues take place on an ongoing basis and are driven by the need to satisfy the client. For example following significant changes in the policy of the organisation or in the business policy of the execution venue, an investment firm will invariably carry out a review of its execution policy and will adjust the latter if necessary. Therefore no exact information on the frequency of reviews is available.

Page 78/79 questions:

Q.2: *Should an investment firm be required to provide clients and potential clients with information on the percentage of a firm's orders that have been directed to each venue?*
Q.3: *For example, should an investment firm be required to disclose to clients and potential clients what percentage of its client orders were executed in the trading venues to which the firm directed most of its client- orders (to cover, at least 75% of the transactions executed)?*
Q.4: *How frequently should investment firms make this information available to clients? On a quarterly basis, for example?*
Q.5: *Should firms be required to update the information to reflect recent usage? How frequently?*
Q.6: *Are there any other categories of information that a client or potential client needs to be adequately informed about the execution services provided by firms?*

Answer: Investment firms should not be obliged to provide clients with information on order routing. This information is irrelevant for the client and would not be helpful in assessing the quality of execution, on the other hand it would significantly increase the administrative effort and the related costs. As far as his order is concerned, the client shall receive each and any necessary information immediately after order execution (cf. also recommendations on Art. 19 (8) MiFID, Box 10). The decision as to whether a firm wishes to additionally disclose general information – e.g. for customer retention purposes or in order to achieve a USP over its competitors - should, however, be left to the investment firm's own discretion, since from the prudential supervision point of view, there appears to be no need for this. Additionally the further information requirements seem to lack a legal mandate since under MiFID (Art. 21 (3) and (4)), the investment firms are merely obliged to provide the client with information concerning their execution policy or notify any material changes to their order execution arrangements and their execution policy.

Q.7: *Should the information provided by portfolio managers and firms that receive and transmit orders be different from that provided by brokers? What are key differences?*

Answer: We believe that in no case there would be a need for providing such information.

Q.8: *Have all of the key conflicts of interest been identified?*

Answer: The issue of conflicts of interests should be dealt with exhaustively under Art. 13 paragraph 3 and 18. In respect of Art. 21 MiFID there is no mandate to provide requirements referring to conflicts of interests.

Q.9: *When should firms be required to provide required disclosure to clients and potential clients?*
Q.10: *Is there any reason to impose different timing requirements for disclosure under Article 21 than are required in the Level 2 measures under Article 19(3)?*

Answer: Both under Art. 21 (6) c) MiFID and under the Commission Mandate, timing requirements as contemplated by explanatory text and by Q. 9, Q. 10, lack any legal mandate and would not be in line with the provisions contained under MiFID and the Commission's Mandate. Nonetheless if CESR would decide to proceed anyhow with its recommendations, we would suggest the following policy for first-time information of existing clients and any further information on material changes. The possibility of sending this information together with the annual statement of clients' asset (cf. item 8 of the recommendations on MiFID, Art. 19 (8), Box 10) should be seriously considered. This would result in considerable cost savings (postage) which otherwise would have to be borne by the client. This is particularly relevant if it is taken into account that execution policy only becomes a relevant issue in the absence of a client instruction. Last but not least, we would like to highlight that Art. 21 (4) MiFID equally refrains from stipulating any timing requirements for such information.

IV. Post-Trade-Transparency-Requirements for Investment Firms (Article 28): General Remarks

We generally support the objective of the post trade transparency requirements, nevertheless already today, it can be perceived that the post-trade-transparency-requirements under the MiFID will lead to a very high, cost intensive technical effort since to date there exist no equivalent provisions in several jurisdiction. At present, a comprehensive assessment of the CESR proposals on post-trade-transparency is not possible. This is due, inter alia, to some unclear point under CESR proposal. In particular the proposals on the consolidability of the data are very vague since CESR merely stipulates that this data must be easily consolidatable (para. 26). Furthermore the negative definition which refers to the data publication on the website of the reporting party as not sufficient (para. 40) and contributes to the vagueness of CESR proposals. If and within which period of time a post-trade disclosure can be presented "on a reasonable commercial basis", can however only be assessed when it is clear which specific requirements are made with regard to the consolidatability of the data. It should be noted that the Level 1 Directive does not entail specific requirements concerning a sufficient degree of consolidatability. On the opposite, the reporting parties are explicitly given the possibility of disclosing the relevant transaction data via "proprietary arrangements". We believe that "proprietary arrangements" include the publication on the website of the reporting party.

To summarise we would like to draw your attention on the following points:

- Paragraph 26: Level 1 explicitly provides that publication may also take place through proprietary arrangements (art. 28 (3) a) iii); a consolidation of the data is neither envisaged at Level 1 nor is it called for by the Commission in its Mandate to CESR. The publication via a corporate website qualifies for proprietary arrangements; an over interpretation of the wording "easily accessible" in the sense of "easily consolidatable" should be avoided as it would rule out this option.

- Paragraph 29: Transactions whose agreed price is decoupled from the current market situation should generally be exempt from the publication obligation. This applies for instance to package deals transactions where prices are being generated independently from the market situation. A publication could influence the market without being influenced by fundamental data. Yet, this is not the rationale behind the post-trade-transparency. For further exceptions cf. also the answer question 8.
- Paragraph 32: We believe that the use of terms and definitions should be carefully considered. In this case, the threshold volume should lie below the block size. Any order which exceeds 10 % of the average daily turnover of a share (calculated on the basis of a certain time period) should qualify for a block trade.
- Paragraph 36: We tend to oppose the requirement of publishing transactions made outside regulated markets irrespectively of the trading hours of the relevant market since the risk of disclosure of positions would be excessive for market participants. We believe that the trading hours of those European markets which are most liquid for the respective share should be the relevant ones. Transactions conducted after market close should therefore be published on the next trading day within 15 minutes after opening of the stock exchange.

V. Post-Trade-Transparency- Answers to Individual Questions

***Q13.1**: Do consultees support the method of post-trade transparency (trade by trade information), should some other method be chosen (which)?*

Answer Yes, if the post-trade-transparency shall enhance market efficiency at all, a trade-by-trade information shall generally be required. Furthermore, a summary of individual trades would unnecessarily reduce the available time period for generating the disclosure.

***Q13.2**: Do consultees support the inclusion of "aggregated information" in paragraph 22 or should it be left for market forces to provide on the basis of the information disclosed under paragraph 21. If it is included what should the content be?*

Answer The decision on inclusion of the aggregated figures should be left to the market. Level 1 does not give rise to any immediate need.

***Q13.3:**Do consultees support the two week period for which the post-trade information should be available?*

Answer The rationale behind the post-trade-transparency is providing the investor with information in order to facilitate investment decisions. For the investor, disclosure of all information of the past 14 days would lead to information overload whilst for the provider it would turn into a cost-driver. This cost would clearly be disproportionate to the actual benefit of a long-term maintenance of a huge database. If and when the market sees a need for the storage of data over an extended period of time, commercial providers will come up with suitable products.

Q13.4: *Should some minor trades be excluded from publication (and if so, what should be the determining factor)?*

Answer Yes. Minor trades should be exempt from the post-trade-transparency obligation because they are not relevant for market efficiency. As a threshold we thus propose the following: an OTC transaction shall be exempt from the publication obligation pursuant to Article 28 where its volume is less than 10 % of the Standard Market Size (SMS) defined under Article 27 for the respective class of shares.

Alternatively, investment firm may be allowed to publish its reporting under the deadline which is applicable for transaction reporting purposes (Art. 25). This would facilitate the corresponding investment firms, since they would not have to set up their own publication system for the aforementioned de minimis cases.

Q13.5: *Do consultees agree on the method of defining the time limit in paragraph 24 and is the one minute limit capable of meeting the needs of occasional off-market trades?*

Answer No. The proposal submitted by CESR under paragraph 24 features is unrealistic. The point in time as of the 1 minute deadline begins is unpractical as it is defined as the moment when the OTC transaction is finalised. On the contrary a post-trade-publication can only be generated if and when the (reporting) seller is in possession of proof of reliable data on the details of the reported transaction. This is generally that point in time where the order confirmation of the other contractual party has been submitted and when the transaction can be forwarded to the internal transaction clearing. Any CESR deadline should therefore be linked to that moment where a reporting seller receives the order confirmation of the other contractual party. It appears to make sense to grant a 60 minute deadline as of the point where the confirmation has been submitted. Furthermore it needs to be taken into account that block trades frequently will be carried out over a longer period of time, i.e. over several days. The publication should generally take place at the end of completion of the entire trade.

Q13.6: *Do consultees support the view that only intermediaries who have created a risk position to facilitate the trade of a third party should benefit from deferred publication or should all trades which are above the block size be eligible for deferred publication?*

Answer Article 28 nor Article 45 at Level 1 of the Directive give no basis for the limitation of the "deferred reporting" to such block-trade-transactions in which a party enters a risk position. Nor the mandate given to the Commission refers to such limitation at Level 2. The possibility of a "deferred reporting" should therefore generally exist for block trades, i.e. it should also apply to those transactions which e.g. are carried out during (own account) interbank dealings.

Q13.7*:Should the identifier of a security be harmonised and if so to what extent? What should be the applicable standard (ISIN code, other)?*

Answer The ISIN should be used in order to identify the share.

Q13.8: *Should more information be available on stock lending?If so, which should be the content? Are there other similar types of activities which should be covered?*

Answer No; similar to warrants, also lending and repurchase transactions should be exempt from publication (cf. paragraph 41). The rationale behind Art. 28 is the creation of post-trade-transparency. Hence, it makes sense to only publish transactions which are subject to an actual trading process. As far as an option is concerned, the supplier obviously bears the buy-in risk. Potential disclosure of the exercise of his option could lead to a situation where other market players team up against him before he has had an opportunity to finalise the transaction. The same conclusions with regard to the market participants' plans could be drawn in the case of disclosure obligations for lending and Repo-transactions. Yet, disclosure of these positions is not in line with the rationale behind Art. 28.

Furthermore, allotments in share issues and transfers of securities should be exempt from the disclosure obligation since they do not give rise to prices that are relevant for the market.

Q13.9*: Should CESR initiate work, in collaboration with the industry and data publishers, to determine how best to ensure that post-trade transparency date be disseminated on a pan-European basis?*

Answer We would welcome the fact that competent authorities – in competing with commercial vendors – would be entitled to provide post-trade-data for central publication in the light of a pan-European data disclosure; such a solution should however be alternative and should not prejudice the possibility of publication by private vendors or proprietary arrangements of the investment firm. For the time being CESR should refrain from initiating any further work for publication of data at a pan-European level. If and when the market features a need for such a form of publication, the market forces will ensure the emergence of suitable offers.