



DANISH BANKERS ASSOCIATION

CESR

DBA response to CESR's Consultation Paper – MiFID 2nd Set of Mandates

Introduction

The Danish Bankers Association appreciates this opportunity to provide comments on CESR's Consultation Paper regarding advice for level 2-regulation on MiFID – 2nd Set of Mandates (CP). We have previously responded to the two consultations regarding the 1st set of mandates.

The Danish Bankers Association - Finansrådet - is the trade organisation for Danish banks, covering the entire banking sector. Members include banks, savings banks and Danish branches of foreign banks. We would like to express the following general and specific remarks to the consultation paper.

General Remarks

We welcome this opportunity to respond to CESR's CP on the 2nd Set of Mandates. We appreciate the fact that CESR has taken a more general approach in this CP. The CP is in general less prescriptive and CESR shows an effort to avoid excessive regulation. As requested by several respondents CESR is more pragmatic towards the use of previous CESR standards instead of an almost word-for-word application of standards.

We expressly welcome the refrain from excessive detail on various points. We find that when regulating focus should be on the result and less on the means to reach that result. An end result for regulating could for instance be avoiding problems due to conflict of interest. Hence, the means the individual firm chooses to use in order to avoid or handle such conflict of interest are of less importance compared to the result; that the conflict of interest is in fact handled without harming the interest of clients.

We would like to make the following specific remarks to the CP:

Specific remarks

Investment advice

Question 1.1. – Do you agree that advice on services, such as recommendations to use a particular broker, fund manager or custodian, should not be used?

Question 1.1: We agree that investment advice should not be defined to include advice on services.

21. januar 2005

Finansrådets Hus
Amaliegade 7
DK-1256 Copenhagen K

Phone +45 3370 1000
Fax +45 3393 0260

mail@finansraadet.dk
www.finansraadet.dk

File no. 514/11
Doc. no. 117591-v1

Question 1.2. – Do you agree with the approach that a personal recommendation has to be held out as being suited to, or based on a consideration of, the client's personal situation or do you consider this criterion to be unnecessary or ambiguous and would like to refer to the bilateral nature of the relationships and bilateral contacts between the firm and its clients? In the latter case which criteria would you use to differentiate between a "personal recommendation" and a "general recommendation" or a "marketing communication"?

File no. 514/11
Doc. no. 117591-v1

Question 1.2: We do not consider that it is helpful to refer to the bilateral nature of the relationship. Such an expression suggests a very broad application indeed. Investment advice should be limited to where a personal recommendation is held out as suited to, or based on a consideration of, the client's personal situation.

Question 1.3: Do you think it is reasonable to restrict "investment advice" to recommendations of specific financial instruments or is it necessary to cover generic information including financial planning and asset allocation services for financial instruments?

Question 1.3: We support that the definition should cover specific advice only.

List of Financial Instruments

No comments.

General Obligation to act fairly, honestly and professionally and in accordance with the best interest of the client

We find that the level 1 text is sufficient. Hence, we do not see a need for level 2 regulation regarding article 19(1).

Suitability test

In general it is important that CESR acknowledges that by the end of the day the decision and choice to trade lies with the client. If the client wishes to trade an instrument, which the investment firm does not find suitable for the client and the firm has warned the client thereof, the investment firm is not obliged to refuse to enter into such a transaction with the client, if the client wish to continue with the transaction.

Question 4.1: Do market participants think that adequate investment advice or portfolio management service is still possible on the basis of the assumption that the client has no knowledge and experience, the assets provided by the client are his only liquid assets and/or the financial instruments envisaged have the lowest level of risk if the client is not able to or refuses to provide any information either on his knowledge and experience, his financial situation or its investment objectives? Or would this assumption give a reasonable observer of the type of the client or potential client the impression that the recommendation is not suited to, or based on a consideration of his personal circumstances?

Question 4.1: We understand the question as whether an investment firm can provide adequate investment advice or portfolio management services even though the client does not provide the necessary information. We find that it is possible to provide adequate advice/services in such a situation. As stated by CESR the investment firm will provide the advice on the assumption that the client has no knowledge and experience, the assets provided by the client is his only liquid assets/or the financial instruments envisaged have the lowest level of risk. Therefore, the investment firm will provide the client with the maximum level of investor protection when providing advice to the client.

File no. 514/11

Doc. no. 117591-v1

Appropriateness test (Article 19(5))

No comments.

Execution only (Article 19(6))

Question 5.1: In determining criteria, should CESR pay more attention to the legal categorisation or the economic effect of the financial instrument?

Question 5.1: In determining criteria CESR should pay predominantly attention to the economic effect of the financial instrument.

Question 5.2: Do you think that it is reasonable to assume that a service is not provided "at the initiative of the client" if undue influence by or on behalf of the investment firm impairs the client's or the potential client's freedom of choice or is likely to significantly limit the client's or potential client's ability to make an informed decision?

Alternatively, do you think that the consideration of this overarching principle is not necessary because the use of undue influence could be subject to the general regulation under the UCPD and that CESR should base its advice more strictly on Recital 30 or refer entirely to this Recital advising the Commission that it is not necessary to adopt Level 2 measures in this area?

Question 5.2: We believe that Recital 30 is sufficiently clear and does not need any further clarification at level 2.

Transactions executed with eligible counterparties

Question 6.1: Do Market Participants agree that the quantitative thresholds for undertakings to request treatment as eligible counterparties should be the same as the thresholds for professional clients? Please provide the reasons for your position.

Question 6.1: Yes we agree that the thresholds should be the same as the thresholds for professional clients. It is simpler and more practical to use the same thresholds.

We find the "opt-out Regime" proposed in Box 11 too restrictive. It is difficult to work with a regime where the investment firm must obtain in writing and in a separate document that the client is aware of the consequences of

losing protection. Experience tells us that procedures based upon a reply from the client are difficult to manage due to the fact that clients often do not reply! The problem is that the client expects that he is treated as an eligible counterparty even though he has not replied. The non-reaction from the client is often based on indifference. Therefore, a notification of the client should be sufficient.

Page 4

File no. 514/11

Doc. no. 117591-v1

We disagree with CESR's proposal to require the investment firm to inform the eligible counterparties which are in the "per se" category, that they are being classified as such before providing any services. We think it is unreasonable to require the firm to assume the cost and responsibility to inform about the law. Neither is it the role of the firm to inform these eligible counterparties that they can opt out of the regime. Eligible counterparties are experienced market participants and do not need the advice and warnings that a customer of a firm needs. Hence, the first three paragraphs of box 11 should be deleted.

Display of Client Limit Orders

Question 7.1: In your view, what types of arrangements other than RMs and MTFs could be considered as complying with Article 22.2?

Question 7.1: Firms should be able to comply with Article 22.2 through publication at firm's own website or through a 3rd party system. This would be in line with the objective of enhancing competition among venues.

We do *not* think CESR should rule out any publication arrangement. CESR could consider requiring that standard data formats must be used when publication is outside a RM or MTF, to permit easy consolidation of that data.

CESR's proposal at Box 13, paragraph 5 to require disclosure of the firm's arrangements for limit order display in the order execution policy seems to go beyond the level 1 text.

Definition of Systematic Internaliser

Question 8.1: Do consultees agree with criteria for determining systematic internaliser? Should additional /other criteria be used and if so, what should these be?

Question 8.1: CESR's definition is too wide and ambiguous which would result in capturing activities that should not qualify as systematic internalisation. A better balance must be struck. Hence, the criteria proposed in Box 14 state facts that would be fulfilled as a matter of course by any properly managed firm. However, the Level 1 text of Article 4.1.7 and the Recitals, clearly intend that the definition should only apply to a smaller group of firms that conduct a particular type of activity. As a result, the criteria set out in Box 14 would not define criteria for determining which firms 'deals on own account on an organised, frequent and systematic basis by executing client orders' in the context of the Level 1 definition as a whole.

The Article 4(1)(7) wording should be considered both in its entirety and with reference to the recitals relevant to systematic internalisers, in particular Recital 53. The criteria proposed by CESR should not extend the definition of "systematic internalisation" to cover any dealing on own account by execution of customer orders outside a regulated market. CESR should instead develop criteria that would tend to indicate when a firm was dealing on own account on an organised, frequent and systematic basis by executing client orders, and when it was not.

Page 5

File no. 514/11

Doc. no. 117591-v1

Question 8.2: Should the criteria be fulfilled collectively or used separately?

Question 8.2: Criteria should be fulfilled collectively.

Question 8.3: Should CESR set criteria for the term 'frequent'? If so, do consultees support the setting of numeric criteria or do they believe that a more flexible approach would be useful? What should these criteria be?

Question 8.3: We think that the term "frequent" is included in the definition in order to exclude firms that internalise only on an occasional basis. We think that CESR should make reference to this in its advice, as it is not otherwise dealt with. We agree with CESR that numeric criteria would not deliver the right result. The aim should be to exclude firms whose use of internalisation is incidental to their main business, or to the overall market, and this should be done in a descriptive way.

Question 8.4: Do you agree with the proposed obligation to disclose the intention to cease systematic internalisation? Should CESR propose more detailed proposals on this and if so, what should be the appropriate notice period?

Question 8.4: The level 1 text does not refer to such a disclosure and CESR should not propose such disclosure obligation.

Scope of the Rule

Initially, we would like to support the "two-stage approach" suggested by a number of joint association among others ISDA, LIBA and Nordic securities dealers associations. Article 27 represents a major change to market structures. This approach would enable the Commission, CESR, and "systematic internalisers" to make sure that the necessary new arrangements worked before rolling the requirements out to a broader range of liquid shares.

CESR should keep in mind that if the obligations are too onerous and apply to too many shares there is a possibility that firms will withdraw from acting as systematic internalisers all together or from acting as systematic internalisers in relation to some shares which will be damaging to the overall liquidity.

Question 8.5: Should liquidity be measured on an EU-wide or national basis?

Question 8.5: We believe that the pre-trade quoting obligation should apply to shares in which there are a suitable level of liquidity on a pan-European basis. The pre-trade quoting obligation should apply in relation to those shares that are most frequently traded and which represent the major part of the volume of shares trade across Europe as a whole.

Page 6

Question 8.6: Do consultees have a preference in favour of setting pre-determined criteria or using a proxy approach?

File no. 514/11

Doc. no. 117591-v1

Question 8.6: The fact that the whole regime being introduced by Article 27 is in any event going to be very complex to manage suggests that starting with the simplest possible method would be optimal. Hence, at the outset there is a lot to be said in favour of the use of a Europe-wide index and the proxy method. When more consistent and comprehensive data become available pre-determined criteria should be considered.

If pre-determined criteria are used the most simple method should be applied which in our view is (1) average number of daily trades in a share and (2) average total daily turnover in a share. Later on, more complex methods could be chosen to calculate the most liquid shares, if experience and sufficient data deemed it necessary.

Question 8.7: Regarding the different criteria described above, do consultees agree with the analysis of each of them, and are there other methods that should be evaluated?

Question 8.7: Generally, we agree with the analysis.

Question 8.8: Is it possible and/or appropriate to use for the purposes of Article 27 a combination of absolute and relative criteria to define shares as liquid?

Question 8.8: No comments

Question 8.9: Do consultees consider the proposed figures (ie 480 trades per day and 95% of total trading) as appropriate? If not, and where no figures are suggested what are the appropriate figures in your opinion?

Question 8.9: See our answer to question 8.6.

Question 8.10: Do consultees agree with the analysis of the relative merits and drawbacks of using proxies such as indices?

Question 8.10: We agree with most of CESR's analysis. Where it falls short is in not acknowledging the complexity, for the market, of installing systems to deal with the chosen methodology, which will have to be in place from the implementation date.

Question 8.11: Which criteria would best accommodate the needs of different markets within the EU?

Question 8.11: See our comments on question 8.6.

The determination of Standard Market Size /Classes of shares

Question 9.1: Do you agree with CESR's approach of proposing a unified block regime for the relevant provisions in the Directive or do you see reasons why a differentiation between Art.27 MIFID on the one hand and Art.29, 30, 44, 45 MIFID on the other hand would be advisable?

File no. 514/11
Doc. no. 117591-v1

Question 9.1: It is our opinion that the factors which should give rise to an appropriate post-trade block size are different from the factors which should determine which transactions are excluded from the SMS calculation. There should not be a unified block regime since pre- and post trade information represents two different risk situations. When providing pre-trade information firms have a risk by exposing its quotes where as when providing post-trade information firms have the risk that if they display large trading interests the market will move against them. The "Large in scale compared to normal market size" should be determined on its own merits, determined in order to arrive at the most appropriate size for SMS itself. "Large in scale compared to normal market size" should be determined in such a way that the resulting SMS is one at which systematic internalisers will have a commercial incentive to provide liquidity to the market. This needs to be a size in which Systematic Internalisers are comfortable putting up quotes either on a RM or MTF, or to their clients using a proprietary system.

Question 9.2: Would you consider a large number of SMS classes, each comprising a relatively small bandwidth of arithmetic average value of orders executed, as problematic for systematic internalisers?

Question 9.2: It is difficult to answer this question until CESR has completed its work. However, it is true that a large number of SMS classes will be more difficult to administer.

Question 9.3: In your opinion, would it be more appropriate to fix the SMS as monetary value or convert it into number of shares?

Question 9.3: We prefer a monetary value.

Question 9.4: Do you consider subsequent annual revisions of the grouping of shares as sufficient or would you prefer them to be more frequent? Should CESR make more concrete proposals on revision? In particular, should the time of revisions be fixed at Level 2?

Question 9.4: Annual revisions would seem sufficient

Question 9.5: Do you support the determination of an initial SMS by grouping the share into a class, once a newly issued share is traded for three months, or do you consider it reasonable to fix an initial SMS from the first day of trading of a share by using a proxy based on peer stocks?

Question 9.5: We suggest it is better to fix SMS after six (not three months). This is because a share typically trades more in the initial stabilisation period, during which transaction sizes and volumes are not representative.

Page 8

Question 9.6: Do you consider a two week period from publication as sufficient for systematic internalisers to adapt to new SMS?

File no. 514/11

Doc. no. 117591-v1

Question 9.6: Two weeks seems reasonable. However, there should be flexibility to extend the period if market conditions deem it necessary.

Question 9.7: Do you agree on the proposal on publication of the classification of shares? Would you prefer the establishment of a single contact point (at Level 2)?

Question 9.7: We think it would be suitable to have one single point (e.g. CESR website). Additionally, individual CESR members could set up links to this website, or provide the same information in their own languages.

Obligations of the Systematic Internaliser

Question 10.1: Do consultees consider that there might be specific regulatory issues and specific provisions needed where a systematic internaliser is the trading venue with the largest turnover in a particular share falling within the scope of Article 27?

Question 10.1 No

Question 10.2: Do consultees agree that the availability of quotes during 100% of normal trading hours of the firm is reasonable and workable requirement for 'on a continuous basis'?

Question 10.2: The requirement to publish quotes should relate to the opening hours of the most relevant market in terms of liquidity and not to the normal trading hours of the firm. Requiring firms to make prices around the clock would impose unacceptable and inappropriate risk on firms, since outside market hours they would not be able to hedge the risks incurred through responding to Article 27 orders.

Question 10.3: Do consultees think that publication of quotes solely on the firm's own website meets the 'easily accessible' test?

Question 10.3: We think that it would. We believe that it is not appropriate for CESR to seek to prevent firms from using websites to make public Article 27 quotes. The Level 1 text for Article 27 strikes a balance between imposing obligations on a systematic internaliser and the systematic internaliser's right to run its trading book prudently and retain commercial ownership of proprietary data. We do not see this balance reflected in CESR's arguments. If the proprietary route were cut off by preventing the use of internet-based systems, systematic internalisers would be forced to make their quotes public either through a regulated market or a third-party system thus, undermining competition.

Question 10.4: Do you agree with the proposed general criteria for determining when a price or prices reflect market conditions or do you think that more specific criteria should be added? In the latter case, which criteria do you think should be added?

Question 10.4: The proposed general criteria seem reasonable.

File no. 514/11

Doc. no. 117591-v1

Question 10.5: Do you prefer either of the criteria for defining exceptional market conditions, and should those criteria be supplemented by an open list of exceptional market conditions?

Question 10.5: We find both the criteria proposed by CESR too narrow. Suspending shares on a regulated market is a different issue from what may be exceptional market conditions. Making 'exceptional market conditions' dependent on whether an exchange suspends trading would effectively give RMs regulatory powers over the activities of 'systematic internalisers', which is clearly not what the Directive intends.

Question 10.6: Are there exceptional market circumstances where a SI should be able to withdraw its quotes even though a trading suspension has not been called by the RM? In the latter case, which market conditions should be added to an open list?

Question 10.6: We suggest the following further market conditions that should be added to an open list:

- fast markets
- system failure
- force majeure
- a broad consensus in the market not to trade specific securities due to extraordinary circumstances while notifying the customers

Handling of client orders and executing the orders

Question 11.1: Do consultees agree that it is unnecessary for CESR to provide additional advice in respect of the handling of client orders where a systematic internaliser publishes multiple quotes?

Question 11.1: No additional advice is required.

Question 11.2: Would there be any benefit to CESR making more detailed recommendations concerning how a firm should set the number and/or volume of orders that represents the norm? If so, what form should they take?

Question 11.2: We do not see any benefit in more detailed recommendations.

Question 11.3: Do consultees agree with the definition of a transaction where execution in several securities is part of one transaction? In particu-

lar, is there a need to specify a minimum number of securities and if so, what should the number be?

Page 10

Question 11.3: We agree with the definition.

Question 11.4: Do consultees agree with the approach to 'orders subject to conditions other than current market price'?

File no. 514/11

Doc. no. 117591-v1

Question 11.4: No. CESR proposes to exclude from 'orders subject to conditions other than current market price' 'orders [that] contain a simple instruction to buy or sell...at a specified price as soon as the market price permits (i.e. a limit order or equivalent)'. This proposal is inconsistent with the Level 1 text, and risks cutting across the definition of 'limit order' in Article 4.1.16. Any Article 27 obligations or restrictions should not apply to anything other than a client's order for the current market price at any particular moment.

The size customarily undertaken by a retail investor

Question 11.5: Should the size be based on a EU-wide criteria or would national approaches be preferred?

Question 11.5: The size should be based on a EU-wide criteria. In Denmark the size customarily undertaken by a retail investor is approximately € 5.000.

Question 11.6: Do consultees prefer having a fixed threshold for all shares, or should the size be linked to the grouping of shares (and subsequently to the SMS of each class) or to some other factor? If so, which?

Question 11.6: Without a firm proposal from CESR it is difficult to answer this question.

Question 11.7: If a threshold is set, how should it reflect the different sizes around the EU, i.e. should it be the highest retail size, the lowest or something in between?

Question 11.7: Again, it is difficult to answer this question in the absence of a firm proposal.

Kind regards

Berit Dysseholm Fredberg

Direct 3370 1070

bef@finansraadet.dk