



DANISH BANKERS ASSOCIATION

CESR

DBA's response to CESR's CP on draft advice regarding MiFID – best execution, market transparency, investment advice and lending (CESR/05-164)

Introduction

The Danish Bankers Association (DBA)¹ responded on the 1st Consultation Paper by CESR on the 2nd set of mandates of the implementing measures on the Markets in Financial Instruments Directive (MiFID) (best execution and transparency). We welcome the opportunity to comment on the 2nd Consultation Paper (CP) issued by CESR on these important issues.

We acknowledge the time pressure that CESR is subject to, nevertheless it is regretful that we have not received the relevant data regarding article 27 in sufficient time to enable us to give more than general points of view. Furthermore, many figures, which are part of completely new proposals, are introduced without any explanation on why CESR has chosen these figures (e.g. customer retail size is 7.500 euros – we have suggested 5000 euro and we know other respondents have suggested lower or equal figures as ours).

Due to the time pressure we have chosen to focus on some key messages as regards CESR's draft advice and thereby not answer all of CESR's questions. This should not lead to the conclusion that we necessarily endorse CESR's proposals on issues we have not addressed.

Specific comments

Issues linked to article 19

Box 1 – proposal concerning lending for financial transactions to be subject to suitability assessment

We disagree with CESR that there should be a rationale for the proposal in box 1 on page 7. We do not see a need for such a proposal since lending activity for financial transactions is a traditional banking activity and it should be left to the commercial criteria to be used by banks. Furthermore, we believe that CESR should not use a general clause as article 19.1 to regulate such a matter.

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Definition of investment advice – generic and specific advice

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As stated previously, we do not believe that there is justification for including generic information provided to clients in the definition of investment advice.

Best execution

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We appreciate the high-level approach taken by CESR, which has the purpose of taking into account the differences between markets. We see best execution as having two layers. One layer is the best execution obligation towards the client in respect of the individual trade. The other layer is the overall obligation of the firm to ensure – by reviewing and monitoring its execution arrangement - that clients in general receives the best possible result when executing the clients' orders. These two layers envisage different challenges for an investment firm.

Furthermore, we agree that the application of the best execution requirement as regards non-equity markets will need to be examined carefully. We support the idea of working on this question at level 3 since the complexity of these products in relation to best execution needs further work. Such products are often characterized by being individualized to the client's special need or by containing one or more elements of options. This makes it difficult to collect relevant data and to compare different transactions and the price of these transactions.

Box 1

CESR suggest extending the best execution obligation to portfolio managers and firms that are transmitting the client's order to another investment firm. Such an extension would need to be tailored to the circumstances of these institutions, which often have very limited control over the execution. As an example the retail flow from Danish banks as regard "non-Danish" shares will mainly be in the form of a delegation of the control over the trading process to a foreign investment firm. Smaller Danish investment firms will also often use larger Danish investment firms to execute client's orders and may delegate the control over the trading process.

Therefore, we believe that CESR's advice should reflect more clearly these different trading models. CESR seems to acknowledge this in the text (paragraph 23) but box 1 on page 19 does not allow for such tailoring. In cases of delegation the intermediary's (order receiver/transmitter and portfolio manager) best execution obligation should not be focused on the day-to-day evaluation of the trades which it has delegated control over. The best execution obligation in these cases should be narrowed to the duty to choose the right intermediaries and on a general basis (as compared to daily basis) evaluate the performance of the chosen intermediaries.

This evaluation or monitoring obligation should be proportionate in the sense that if an investment firm only routes occasionally a small number of orders to a given intermediary (e.g. because the executing intermediary is situated in a member state where it is specialized and has access to trading

in shares, which are only traded on a regulated market in that country), it should not be deemed to have the same monitoring arrangements towards this intermediary as towards an intermediary where it routes a large number of trades.

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Furthermore consideration should be taken to the fact that the delegation will most likely be to another authorised investment firm. It is important that the overall requirement to ensure best execution by review and monitoring of the execution arrangement does not lead to such cost that it will hamper cross border investment service. The obligation should take into consideration the size and the complexity of the business of a firm. A small firm who only uses one or a few execution venues should not be expected to set up expensive monitoring arrangements in order to monitor execution venues which it has no access to or having significant cost by collecting data regarding many other venues.

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Furthermore, CESR should take into account that the relationship between the transmitting firm/portfolio manager and the firm executing the client orders is itself governed by a clear contractual relationship. This contractual relationship will allow the transmitting firm/portfolio manager to impose its requirements on the executing intermediary so that the client's best execution needs are in fact addressed and taken care of. Any regulatory requirement introduced in this area has to take into account this contractual relationship.

Box 2

We appreciate the principle-based approach, which is reflected in the draft advice in Box 2. As CESR acknowledge it should be up to the investment firms to determine the relative importance of these criteria.

Box 3

We welcome the high-level approach taken in box 3 to the monitoring obligation. We appreciate CESR's statement in paragraph 71 that the firms should be allowed the necessary freedom to monitor in a manner that is appropriate to the markets and financial instruments they operate in, instead of specifying the particular methods that must be used to discharge that obligation.

We question that the annual review as envisaged in box 3, paragraph a, item iv) would add any benefit in those cases where no review was triggered by the requirement outlined in sub-paragraphs i) through iii). CESR should consider the benefit of an annual review in cases where none of the elements in sub-paragraph i) to iii) has been activated compared to the cost of such an annually review obligation. Firms will often have to hire additional staff to carry out this exercise, which would lead to additional cost without any significant benefit.

Box 4

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Disclosure of an investment firm's order execution policy can be relevant for clients. It is important that the client receive the information that is necessary to enable him to understand the kind of execution he can expect from the investment firm. However, we urge CESR to find the right balance between necessary information and information overload. We believe that this balance has not been struck.

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We find that the proposal in box 4, paragraph 1, item a ii) to require disclosure to the client, if another factor than price, cost (and speed) has been a key factor, has the downside that it undermines the principle of not prejudging the relative importance of the factors for best execution. Hence, we think this proposal should be deleted.

Furthermore, we are deeply concerned by the warning obligation proposed in box 4, paragraph 1, item a iii) whereby firms should warn clients that chooses to instruct an order. We believe that this proposal contradicts level 1. Article 21 makes it clear that the obligations imposed in this article do not apply to the case of a specific client instruction. However, CESR's wording in box 4 and the explanatory text implies that best execution is owed to all clients, even when they are giving instructions.

CESR must recognize that there are many business models, with significant market shares, where instructions from clients are a prerequisite. Execution only and trading via the Internet in general is based on client's instructions. The obligation in these cases lies in providing the client with information, which enables the client to make an informed decision as foreseen in article 19.3. CESR should not - by extending the best execution obligation to trades which are based on a client instruction – limit legitimate business model, which are based on article 19.5 and 19.6. CESR would severely damage the increasing use of the Internet as a mean of trading if this proposal and the rationale of it are not deleted from the advice.

Yours sincerely

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DANISH BANKERS ASSOCIATION

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DBA response to CESR's draft technical advice on possible implementing measures of MiFID - Market Transparency (CESR/05-164)

Introduction

The Danish Bankers Association (DBA)¹ welcomes the opportunity to comment on the Consultations Paper (CP) issued by CESR for the 2nd set of mandates of the implementing measures on MiFID. In January 2005 and September 2004 we responded to the first Consultation Paper issued by CESR on these important issues.

We responded 4th April to the parts of CESR's Consultation Paper (CP) that regards the definition of investment advice, the general obligation to act fairly, honestly and professionally and best execution. As mentioned in that response, the delay of the relevant data and the shortness of time to be able to assess these difficult questions have resulted in a more general response from our part. Hence, we will focus on key messages and not be able to answer all the questions that CESR is asking.

Market transparency

Definition of systematic internaliser - box 1

We believe that the definition of systematic internaliser (SI) has improved since the first CP. However, the definition still needs to be worked at in order for it to catch the essential elements of "organised, systematic and frequent". First of all we believe that paragraph 11 and 12 should be cumulative and the two elements of 11 a should also be regarded as cumulative. Secondly, 11 a should reflect more clearly that the criteria "organised, systematic and frequent" relates to a separately identifiable activity within a firm to which article 27 would apply.

CESR has chosen to introduce quantitative criteria in paragraph 12 in order to define more clearly the term "frequent". We acknowledge the difficulties of establishing quantitative criteria, which are objective and non-discriminatory. However we do not believe that CESR has been able to find such objective and non-discriminatory criteria and we question whether there should be quantitative criteria at all. If CESR wishes to include quantitative

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criteria in its advice to the Commission such criteria should be calculated taking into account the relevant exemptions to article 27 - such as trading above standard market size.

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Furthermore, we find that CESR should not only define systematic internaliser by the use of positive indicators, negative indicators should also be part of the definition. The following examples of negative indicators should be part of the definition:

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- Client orders, where the price is a cross reference price generated from an external source, such as the most liquid market for the relevant share. In these cases the systematic internalisation does not represent an alternative, price information since the price discovery of the systematic internalisation will be the same as on the regulated market.
- Trading, where the client by his/hers instructions chooses how the trade should be executed (on or off exchange). In such cases it is not up to the investment firm whether or not to deal on own account on a systematic basis it is the client that decides whether to route the order "on or off exchange."

Definition of liquid shares - box 2

We would like to repeat the view, we previously have expressed in our former response to CESR. The definition of liquid shares in the sense of article 27 should be based on a pan-European perspective. The investment firm which have a risk position in relation to article 27 should only be subject to this risk as regards the most liquid shares in the EU.

RM and MTF + obligations of SI- box 3

We welcome the more principle-based approach in relation to pre-trade information provided by RM and MTF's. As mentioned in paragraph 26 CESR recognises the need both to leave different markets sufficient flexibility for their particular market models and to provide for future evolution in trading methods and trading practices. However, we disagree that publication of an indicative auction volume should be made public in a periodic auction trading system as proposed in paragraph 75. If an investment firm has a large order in an illiquid share the firm would be reluctant to place such an order on a RM or MTF operating a periodic auction trading system if the volume is to be made public. Furthermore the proposed construction would have a potential of leading to manipulative behaviour.

We strongly believe that there is a need for exemption from pre-trade transparency as regards "negotiated trades". As CESR argues in paragraph 42 negotiated trades are commonly used in cases where it would not be in the interest of the client to enter the order into the order book because a better quality of execution might sometimes be achieved outside the order book. Negotiated trades can for instance provide best execution to clients in the case of small retail orders that would be too costly to place on a RM or MTF's order book. By stating this CESR acknowledge the fact that transparency in some situations has to give way to best execution.

Therefore, we urge CESR to delete the last sentence of paragraph 84, which in fact neutralises the effect of the rest of paragraph 84 as regards SIs when executing orders smaller than Standard Market Size (SMS). It is precisely to transactions below SMS that paragraph 83-85 are most relevant. We fail to see the rationale of this discrimination against the clients of SIs. The rationale for a need for pre-trade transparency does not exist in the case of a SI that executes a client's order within or at the current spread on a RM/MTF and fulfils the other obligations stated in paragraph 84. This is due to the fact that there is not a new/alternative price discovery since the price of the transaction is the same as on the RM/MTF whereby there is not a need for transparency. The effect of the last sentence in paragraph 84 would be that client's of SIs would be disadvantaged compared to clients of non-SIs.

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Furthermore, we believe that from a competition point of view the waiver should also apply to SIs that are not member or participant of the RM or MTF but still fulfil the criteria in paragraph 84.

We welcome CESR's proposal in paragraph 85 since it ensures a better quality of the pre-trade information.

We find the proposed 3 year review in paragraph 91 too long a period. Since the article 27 provisions are new to the markets we find the review should be more frequent.

As stated in our previous response to CESR, we believe new issues should be assessed once they have been trading for a minimum period of 3 months. Paragraph 95 should be changed accordingly.

Given the differences between the business of RMs and investment firms, the situations that force a RM to close down as mentioned in Paragraph 99 would be too restrictive for the investment firms if these were the only situations in which they were allowed to withdraw quotes. CESR's advice should provide for further options to withdraw quotes.

We oppose the new 3 million euro threshold for portfolio transactions as proposed in paragraph 103 since we find this figure too high. It is our opinion that the figure should be deleted.

Furthermore, we find CESR's proposal in paragraph 105 regarding size customarily undertaken by a retail investor to high. We suggested 5.000 euro and many other respondents suggested a figure of similarly size.

Post-trade requirements for RMs, MTFs and IF – box 5

We welcome CESR's proposal in paragraph 141 not to require trade reporting in case of transactions made outside the RM or MTF where the price is based on factors other than current market price of the share unless the transaction entails information that is significant for the efficient price for-

mation of the share. However, we disagree with the obligation that any information published should include an indicator explaining the reason for the deviation from the current market price.

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We support CESR's proposal in paragraph 142 that deferred trade reporting should be available for block size trades whenever a firm acts as a principal to facilitate third party business.

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However, we have a minor change regarding table 2 "Deferred publication arrangements": We do not support a possibility to defer publication until end of second trading day following trade. A maximum deferral should be end of next trading day. Furthermore we suggest a change in minimum qualifying size of trade regarding "End of next trading day" "mid-liquidity" and "less liquid shares" (to 50% of ADV).

Maximum permitted delay for trade publication	Minimum qualifying size of trade (and cash ceilings)		
	High liquidity shares e.g. Eur 50 m+	Mid-liquidity shares e.g. Eur 1-50m	Less liquid shares e.g. less than Eur 1m
60 minutes	More than 10% of ADV or more than Eur 10m	More than 10% of ADV or more than Eur 3.5m	More than 5% of ADV or more than Eur 10.000
120 minutes	More than 20% of ADV or more than Eur 20m	More than 15% of ADV or more than Eur 5m	More than 15% of ADV or more than Eur 30.000
End of day (+roll-over to close of next trading day if undertaken in final 2 hours of trading)	More than 30% of ADV or more than Eur 50m	More than 25% of ADV or more than Eur 10m	More than 25% of ADV but at least Eur 50.000
End of next trading day	More than 100% of ADV	More than 50% of ADV	More than 50% of ADV

Transactions large in scale compared to normal market size – box 6

As regards the pre-trade waiver thresholds proposed in table 1 CESR proposes an alternative way to define the threshold in annex 1. We prefer option 2, 2nd method where "large in scale" is determined by reference to a percentage of the number of trades. However, we believe the percentage should be lower than 95% and we would prefer a 90% threshold.

Timeliness, availability and disclosure of pre- and post- trade information

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CESR has extended its previous 1-minute deadline for post-trade information to 3 minutes. We agree with CESR that reporting should be as fast as possible. However, we still prefer a deadline of 5 minutes since this would be the most workable solution for the market. Our experience with the 5-minute deadline tells us that even this deadline is sometimes difficult to manage; hence 5-minute deadline is as fast as it is possible.

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The wording used on Para 196 would lead to a situation whereby, due to a global firm's trading hours, the firm would be under a 24-hour obligation to publish pre-trade information even after the opening hour of the relevant RM/MTF. The wording needs to be changed so investment firms only are obliged to publish pre-trade information during "the opening hours of the main market."

Yours sincerely

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