

**BME SPANISH EXCHANGES COMMENTS ON THE SECOND
CONSULTATION PAPER CESR/05-164 REGARDING CESR'S DRAFT
TECHNICAL ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE
DIRECTIVE 2004/39/EC ON MARKETS IN FINANCIAL INSTRUMENTS**

Bolsas y Mercados Españoles (BME) integrates the companies that direct and manage the securities markets and financial systems in Spain. It brings together, under a single activity, decision-making and coordination unit, the Spanish equity, fixed-income and derivatives markets and their clearing and settlement systems.

With respect to the CESR Consultation Paper CESR/05-164 "CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments", we would like to put forward the following comments:

CHAPTER 3- BEST EXECUTION (Articles 19 (1) and 21)

1) Criteria for determining the relative importance of the different factors to be taken into account for best execution

CESR draft advice considers that the characteristics of the execution venues, may be used as a criteria to be taken into account in determining the relative importance of the factors listed in Article 21 (points 1 d) of Box 2).

It seems that factors and their importance could depend on the characteristics of the venues and, afterwards, venues shall be selected using the new order of importance of factors.

As the factors will be used to choose among the execution venues (art. 2.13 of the Directive), we find that the characteristics of the execution venues should not then be used as a key for selecting the factors.

Then, we suggest to leave only the other criteria for determining the importance of the factors.

We will further comment on this issue when dealing with the relative importance of factors for retail clients.

2) Requirements for selecting and reviewing execution venues

a) Use of only one execution venue

In answer to the question on par. 56, about situations in which a firm might satisfy the requirements of Article 21 while using only one execution venue, we

find that such situation could arise if the venue is an order driven regulated market, as it internally provides with the best execution of the orders carried out within the system.

b) Cost analysis

We welcome CESR approach on the relevance of the costs for investment firms under article 21 and for trading venues assessment.

Nevertheless, Box 3, b), points out that an investment firm must review the ability of each relevant venue to offer the best possible result for the execution of its clients orders. This leaves out the fact that the best result may depend not only on the venue ability but on the firms ability or even on its cost structure.

The fact that a trading venue provides the best result in a consistent basis, does not necessarily imply that the firm gets the best execution nor the firm's clients.

3) Information on the execution policy of the firm

a) Direct or indirect access to a trading venue

CESR proposes within the execution policy the disclosure of the direct access to a trading venue but does not include of the indirect access.

We wonder if the fact that the trading venues with indirect access are not included in the execution policy could affect to the monitoring and review of venues as well as to the eventual acceptance by the client. In the case that a firm uses only indirect accesses it would be completely out of monitoring.

In any case, if information of selection of execution venues is not given to clients, the information about its revision will not be given either. Therefore, we support the inclusion of indirect access information within the execution policy.

b) Information of different arrangements for different clients

Par. 104 of the draft advice indicates that an investment firm may have a different execution policy and arrangements for its retail clients and for institutional ones. If the investment firm accesses different venues for its institutional clients this need not to be disclosed to its retail clients. Retail clients would only receive information about the execution policy and arrangements used for them.

We feel that the execution policy should be public for all the eventual clients of the investment firm and retail clients should be given the chance to know whether institutional clients access to the same venues as them or not.

c) Relative important of factors for retail clients

There is a new proposal, in section 128 and in Box 4 of the advice, point 1 a) ii), suggesting that if the investment firm gives or might give a factor other than the price or cost more importance than any price or cost for the purposes of article 21 (1) of the Directive, in the case of a service provided to a retail client, an explanation of why this is in the best interest of its retail clients must be given.

As in other matters related to best execution and execution policy, we believe that this should apply not only to retail clients but also to institutional ones.

Moreover, from our point of view, such explanation should be included within the execution policy and be accessible to every client of the investment firm, according to article 21.3 of the Directive.

d) Acceptance of specific instructions

Box 4 of the draft advice, point 1 a) iii) indicates that "if the investment firm accepts specific instructions from its clients...". We believe that this wording can be confusing, as it could be understood that investment firms can deny specific instructions from clients. It would be more clear to write "if there is an specific instruction from a client,...".

e) Execution venues not included in the execution policy

Box 4, point 1 a), iv) includes within the information provided to clients regarding their execution policy, "whether the investment firm may use execution venues not included in its execution policy and, if so, how the investment firm makes the determination of such venues".

We understand that it refers to those execution venues that the firm accesses indirectly as it was already mentioned above and therefore, we refer to our previous comments on that issue. In the event that the reference is kept within the advice, it should be expressly limited to those venues with indirect access because the current wording is too wide.

CHAPTER 4- MARKET TRANSPARENCY

1. Definition of Systematic Internaliser (Article 4)

We welcome CESR's approach to the criteria for delineating the activity of systematic internalisation.

However, in order to avoid misunderstandings when defining systematic internalisers, we believe that the criteria should, in any case, be non-cumulative, i.e., that if the investment firm meets any of the criteria mentioned, it should be considered as systematic internaliser.

Regarding the proposed use of a quantitative measure as an additional indicator, a quantitative approach can play a very useful role in the definition of systematic internalisers only if qualitative and quantitative criteria are considered non-cumulative requirements. Under such conditions, we find that quantitative criteria can make up a constructive complementary indicator.

With reference to the ending of the activity of systematic internalisation by an investment firm, we believe that CESR must make clear that a systematic internaliser will stop being considered as such when it doesn't meet any of the criteria above mentioned. It will not be enough just to make an announcement of its intention to cease in the activity: the non fulfilment of the requirements must be effective.

2. Pre-trade Transparency requirements for Regulated Markets (Article 44), MTFs (Article 29) and Systematic Internalisers (Article 27)

2.1 Defining the scope of the quoting obligation for Systematic internalisers

Definition of liquid market (BOX 2):

We welcome the approach taken by CESR on the preferable use of pre-determined criteria to define shares deemed to be liquid for the purposes of Article 27.

We agree with CESR on the choice of criteria as well as on the level defined for each of them. In spite of that, we think that all the criteria should be alternative except Trading activity (a) in order to guarantee more flexibility for the determination of liquid shares and taking into account that none of them are enough by themselves to determine clearly if a share is liquid or not.

For smaller markets, we miss some criteria to avoid excluding them completely from the definition of liquid market.

We agree with CESR on the use of a free float of well recognised and wide EU wide index but we prefer it to be permanent rather than only for the interim period before the entry into force of the Transparency Obligations directive.

We strongly support CESR on its opinion that shares determined to be liquid would be subject to the quote disclosure rule in all Member States even if they are not liquid in the home Member State of a systematic internaliser. This approach should be included in the advice.

2.2. Content of pre-trade transparency

Regulated Markets and MTFs:

We welcome the decisions described in paragraphs 74 and 75 of Box 3 on the publication of five levels of prices for order-matching trading systems providing continuous trading as well as the requirement of an indicative theoretical equilibrium price along with indicative auction volume, for periodic auction trading systems. Both measures will allow a sufficient level of transparency while maintaining the rationality of those systems.

Exemptions from pre-trade transparency

Based on type or size of order/transaction:

We think that negotiated trades can be done within the spread (instead of par. 84.a BOX 3 and Q 3.4) for any volume. In order to trade at the spread or out of the spread, a volume condition should be fulfilled (i.e. volume above the Standard Market Size).

Systematic Internalisation

Regarding question 3.5, we prefer article 27 based on Average order Size (it can not be changed because it is in level one) and Blocks limits related to Average Daily Turnover. It would be better to use a unique parameter but ADT is a more accurate liquidity estimator than Average Order Size.

In answer to question 3.6, in general terms we agree with CESR approach except for the lower band. For the first class (0 to 10.000 €) midpoint is 5.000€, when CESR in par. 72 calculates in 7.500€ the typical retail order size. We think that all the pre-trade transparency limits for internalisers should be above this volume. If the first and the second band are joined mid point can be fixed at 10.000€ or 12.500€.

In reference to question 3.7, we think that SMS must be fixed as a monetary value. The conversion into number of shares could have an impact on the accuracy of the SMS because of possible corporate actions, such as splits, between revision periods.

Concerning question 3.8., we find that a semi-annual revision would be more appropriate and subject to eventual special revisions as indicated for the SMS.

Finally, in response to question 3.9, we believe that an initial SMS from the first day of trading of a share by using a proxy based on peer stocks to determine which class the share should belong to must be fixed.

2.3 Display of client limit orders (Article 22.2)

We support CESR's consideration of a double test (visibility and accessibility) for determining what is "easily accessible".

3. Post-Trade Transparency requirements for Regulated Markets (Article 45) and MTFs (Article 30) and for Investment Firms (Article 28)

We disagree with CESR on the possibility of no post-trade transparency for certain transactions subject to other conditions than the current market price. We believe that those transactions must be published, as they give information about volume traded that is also relevant for price formation. In order to avoid the risk of misleading information about price and as suggested, it is enough to mark (flag) the transaction to indicate that this transaction is not based on the current market price.

In response to question 5.1, we support the method of publishing post-trade information trade by trade as we understand that there is a loss in cumulative information. The addressees of the data have the possibility to receive cumulative information if they want to reduce bandwidth but the information on each trade should be available.

4. Transactions large in scale compared to normal market size (BOX 6)

Waiver from pre-trade transparency obligations for transactions that are large in scale compared with normal market size

As regards question 6.1, we prefer this new approach proposed by CESR in calculating the limits for waiver for large trades based in a fixed threshold. The method of 95% of turnover or trades can be very volatile and not enough representative. The fixed threshold limit is more easy and simple to implement and calculate. It would be better that the limits would be higher to avoid movements from volumes traded in order books with pre and post trade transparency to blocks without pre trade transparency.

In question 6.2 we think that orders large in scale traded without pre-trade transparency should be excluded but if they have been traded with pre-trade transparency it should be included for the calculation of SMS.

With reference to question 6.3, in general we agree with the CESR proposal. In order to make it simple, we recommend standardizing the bands of Average Daily Turnover for pre-trade and deferred post-trade of orders large in scale.

In response to question 6.5, pre trade and deferred post trade transparency volumes are set as minimum and competent authorities will be able to fix them

at that level or above. If the competent authority of the lead market for a share fixes the levels above the minimum, this level should be the same in the EU to avoid regulatory arbitrage.

5. Publication of transparency information (and consolidation)

Three minutes for publication of transaction is still too long to be considered as real time even if we are aware of characteristics of different trading venues. Moreover, we have to take into account that RM and MTF seem to be obliged to publish sooner than three minutes.

Madrid, April 5th 2005