BORSA ITALIANA

Response to

CESR'S CONSULTATION PAPER

Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

Ref: (CESR / 04 – 261b)

Following the Lamfalussy process, the Committee of European Securities Regulators (CESR) published, for a round of consultation, a Paper (Ref: CESR/04-261b) containing the first set of implementing measures for the Directive on Markets in Financial Instruments (MiFiD). After the consultation process, CESR advice will be submitted to the European Commission by the first months of 2005 (some advice by January and others, mainly related to transparency issues, by April).

This Consultation Paper covers different areas: Definitions, Intermediaries (section II), Markets (section III) and Cooperation and Enforcement (section IV); it mainly deals with organisational requirements for intermediaries, conflicts of interest, conduct of business obligations and order handling rules, pre- and post- trade transparency obligations by Regulated Markets and MTFs, post-trade transparency for investment firms, admission of financial instruments to trading, transaction reporting and cooperation between competent authorities.

Responses to the questions and comments to the issues that can have a major impact on the framework of the Regulated Markets and on their competitive environment are reported below.

Section II: Intermediaries

Organisational requirements [Art.13]

As regards this matter in general, we basically refer to the concepts stated and the issues raised by FESE Response (Ref. P700A), and we underline here again the need of creating a level playing field between Regulated Markets and MTFs, while avoiding at the same time any overregulation of competitive structures, especially by finding a balanced approach. We argue that explicit mention should be made at several places in the level II instrument of examples where particularities of investment firms warrant specific treatment, thinking here mainly of investment firms with a restricted license whose only investment service is the operation of an MTF ("MTF-only firms").

Referring to the issue of conflicts of interest [Art. 13(3) and art.18], we generally agree with the principles and the provisions stated in the Consultation Paper and in the Draft Advice, and specially with the principle for which "the investment firm's policy must be appropriate to the nature, scale and complexity of its business". Referring specifically to the single questions, our comments follow hereby.

Q6.1 - Q6.2: We think that the arrangements disclosed in paragraph 8, letters a) to f) should always be considered and provided by the conflicts policy of any investment firm.

Q6.3: Referring to the issue of the information barriers between analysts and the other investment firm's divisions, we firmly agree with such principle and we think that such barriers should be established in particular between analysts and the investment banking division and analysts and trading units. Likewise, we agree with the principles stated up to date in the works done by IOSCO and the Forum Group, which are also reflected in this Consultation Paper.

Q6.4: We share the view expressed by the first option which basically states the principle "comply or disclose".

Best execution [Art.21]

Level I provisions regarding the obligation to execute orders on terms most favourable to the client introduce some main principles:

- a "result" obligation;
- the search for the best possible conditions within an execution policy;
- the consideration of different factors, some of which are subjective, qualitative and linked to execution.

This approach does not provide for a "common" definition of best execution and makes it difficult the comparison and the pre- and post- verification of the compliance with the obligation itself. It also opens to potential disputes the person who has to apply the rule and be compliant with it.

An effective improvement could be made by the introduction of the so called *default rule*, a principle for which the execution of an order on the "relevant" market assures in itself the best execution.
Such principle is already partially introduced by Level I, when stating that "the order execution policy (…) shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders".
The proposed rule takes into account the intrinsic benefits for the client and for the financial system assured by the execution of orders within a Regulated Market. The existence of specific market surveillance, the presence of strict rules, the attention

and monitoring of potential conflicts of interest, the reliability of the price formation and post-trade processes put Regulated Markets in a position to better meet investors' needs.

With reference to the specific issue regarding the factors that are to be considered, we hope that CESR could in particular specify which factors (among price, costs, size, speed, likelihood of execution and settlement, nature of order) are to be taken into consideration for determining the best possible result, and determine them for both retail and professional clients.
We think that even if the Commission mandate does not explicitly invite CESR to determine the relative importance of the factors, it should be useful for all market participants that CESR could give an indication about which factors are to be taken into account for "measuring" best execution and not only establish the criteria for determining their relative importance. Moreover, the criteria mentioned in the Consultation Paper almost replicate concepts already stated al Level I.
We also underline in this context the importance of fixing the net price as the indicator to be considered for determining the best possible result referring to retail clients.

Finally, we would like to underline here again what we already stated in our response to the Call for Evidence on the Commission second mandate (Ref: CESR/04-323) as regards specifically the concepts of pre-trade transparency and best execution, commenting on the concepts explained in the "Transparency" paragraph, where it is stated that "the Directive considers transparency as a fundamental mean to ensure market efficiency and investor protection in a fragmented and competitive marketplace. To this end ISD2 highlights the importance of the disclosure of price information as well as its availability to all market participants in a manner that could allow them to take their investment decisions in an informed manner and to the intermediaries to provide for effective best execution".
As regards pre-trade transparency, we share the principle of the full and consolidated disclosure of price information. We think that a wide disclosure of bid/offer prices for transactions is fundamental in order to assure the most possible complete information and to strengthen the price discovery process, as well as to assure that competition among different trading venues is carried out within rules which are the same for every operator. This means that, if transparency is considered as a mean to reach best execution, bid/offer prices that are shown on every single trading venue are to be comparable.
In particular, we think that the most effective way to assure the comparability among prices is to use net prices, that are prices which do not comprise commissions or any other type of cost and which do not take into consideration trading capacity (own account versus third party account). Once agreed on that and in order to achieve the above mentioned Commission's goal (best execution through transparency), such prices should also be considered as the primary guide and the most important factor for determining best execution, especially when referring to retail clients.

In this context, execution of orders on the most "relevant" market in terms of liquidity should be considered as a proxy for best execution. Liquidity measured by the "price impact" method can assure by itself best execution.

Client order handling [Art.22(1)]

As regards the obligation for investment firms to "implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders (…), and which "shall allow for the execution of otherwise comparable client orders in accordance with the time of their reception (…)", we have comments on the following specific issues of the Draft level II Advice.

Q4: Referring to paragraph 7, which states that " the requirements to carry out orders promptly and sequentially do not apply where the characteristics of the order and/or prevailing market conditions make this impossible or require otherwise in the interest of the client", we think that the principle of carrying out orders promptly and sequentially shall not be complied with only in the case of an explicit request by the client (for example in the case of our "ordini curando")

Q5-7 : Aggregation of client orders and of client and own account orders:
As regards this issue, we basically support our current regulations, which state that "in the case of orders to buy or sell, authorised intermediaries may, when transmitting them to the dealing intermediary, batch individual orders received from investors where that is compatible with the nature of the orders and the operating procedures of the market in which they are to be executed do not involve the formation of prices for individual trades. In no case may orders issued by intermediaries for own account be batched with those issued by investors". That means that up till now aggregated orders can be executed only during auction phases and not during continuous trading. We firmly hope for the maintenance of this principle within the implementing measures of the MiFiD.
Referring now to the possibility of aggregating client and own account orders, we underline that it could weaken the surveillance activity, both by the stock exchange and by the competent authority, on the orderly conduct of trading and particularly on the regular behaviour of intermediaries; the monitoring on the regularity of trading would take place only during inspections on records kept by intermediaries. Moreover, we remind that the current functioning of clearing and settlement systems is based on the separation between own accounts and clients' accounts, which are automatically moved by trades coming from the market. Aggregation of own and client account orders, with the entering in the market of "mixed" orders, would oblige intermediaries to transmit to the above mentioned systems, after contracts are executed, information regarding the type of order (either on own or on client account); by that way the automated link between markets and settlement would disappear, with a consequent increase of operational risks.

Section III: Markets

As regards this section in general, we refer again to the concepts stated and the issues raised by FESE Response (Ref: P700B), and we underline here again the importance of not defining a closed list of market models: maintaining a variety of existing models, but also allowing innovation and diversification is not only of high importance for the individual market operators but also crucial for the european financial market as a whole to be able to maintain the necessary flexibility and innovative power to compete on a global scale.
We also express our full support to CESR in its view that only proper consolidation of pre- and post-trade data adequately serves the needs of investors; trade data coming from market operators, MTFs and investment firms need to fulfill certain criteria with regard to both quality and consolidatability. At the same time, we welcome the assertion by CESR that the ways of consolidating trade information should be left at the discretion of trading venues and market users.

Pre-trade transparency requirements for Regulated Markets [Art.44] and MTFs [Art.29]

Referring to the issues raised in Box 12 and the accompanying questions, we basically support what stated by FESE Response.
In particular we would like underline hereby the following concepts:

- on the depth of trading interest and access to pre-trade information: we do not agree with the obligation to display the full depth of the order book at all times, inviting CESR to discuss limitations (such as number of lines, volumes represented or spread), and we strongly argue for market-driven options for Exchanges to differentiate (on a "reasonable commercial basis") the levels of information displayed and available;
- on the exemptions to pre-trade transparency for crossing systems: we believe that any exemption should not be created by narrowly defining market models eligible, but that in this context too, a more abstract and objective-focused approach should be chosen; as regards specifically the waiver for price-taking systems, while agreeing that a purely passive reference price system does not contribute to the price formation process in a narrower sense, we argue that the mere information about a trading opportunity in such a passive system, together with any volume information, is of relevance to the market;
- on the same minimum size of trade for the waiver to transparency pre-trade and delayed publication post-trade: we would be in favour of the same level of thresholds for both cases, basically bringing forward the argument of simplicity;
- on the exemption for particular orders, we would like to raise the question as regards the possible exemption from pre-trade transparency for "cross-orders"; they are represented by a special function, provided by our Rules, for which intermediaries may execute trades by matching two orders of opposite sign for the same quantity, provided that: a) the orders correspond to customer orders, b) the execution price is between the best bid price and the best ask price on the

book at the time of entry, excluding such prices. The condition laid down by letter b) might be the reason for exempting such orders from pre-trade transparency.

Post-trade transparency obligations for Regulated Markets [Art.45] and MTFs [Art.30] and for Investment Firms [Art.28]

Also in the case of the issues raised in Box 13 we refer to what stated by FESE Response.
In particular we would like underline hereby the following concepts:

- on the method of post-trade transparency: we support the approach for trade by trade reporting, and also the minimum contents of "aggregated information" provided by par.22;
- on the availability of post-trade information: we agree on the method of defining the time limit for the reporting of trades and we think that any deviation from the principle of "as close to real time as possible" should be restricted to a minimum; as regards the question of later availability of post-trade data, we have no objection to the two week period for which post-trade information should be available, provided that this availability is subject to commercial terms that may differ from those for real-time and/or short delay data;
- on the exemptions and possibility of delay: we basically see no compelling reason why "some minor trades" should be excluded from the reporting requirement;
- on the dissemination of post-trade data on a pan-European basis: we do not see in this moment a pivotal role for CESR to initiate work to determine the optimal structures for such dissemination, even if we fully support the interest of the regulators for the efficient and reliable dissemination of trade data and the creation of an optimal market overview; we believe that industry, including Europe's Regulated Markets, and data publishers are in the best position to drive structural developments forward this area. All these efforts have of course to be made in a framework of appropriate regulatory quality standards and under the regulatory guidance of CESR Members.

Finally, as a more general issue that refers in particular to Art.28 and the post-trade disclosure by investment firms, we remind hereby what we already underlined in our response to the Call for Evidence on the provisional mandates (ref: CESR/04-021).
The introductory phrase of the comitology clause in Art. 28 calls on the Commission to adopt level II measures with the purpose of ensuring the "orderly functioning of the markets".
We find it difficult to accept that post-trade disclosure by investment firms could also be done "through proprietary arrangements"; we fear that allowing such publication through the investment firm's proprietary arrangements would, even if such arrangements would technically speaking be "easily accessible", fail to achieve the purpose of creating a truly uniform and complete picture of all market activities.

We therefore agree with point 40 of the Draft advice that states that "(…) investment firms shall choose a publication mechanism which publishes the post-trade transparency information in a form which is easily consolidatable".
Moreover, another significant issue raised by "proprietary arrangements" would be how such arrangements are supervised. Regulated Markets currently commit significant resources to ensure that all business transacted on or reported through their systems is monitored in real time. This surveillance is vital, both for the prompt and effective detection of market abuse and to ensure the integrity and accuracy of the data that the market receives. If business is to be reported by other means, arrangements must be made to ensure that the reporting systems are subject to equivalent levels of real-time surveillance.
We argue that post-trade disclosure of executed deals should in any case include a push obligation by the investment firm to a Regulated Market. Only active provision of the data to an environment where quality and reliability standards are applied and supervised can reach the specified purpose.

Admission of financial instruments to trading [art.40]

In order to respond to the issues raised in Box 14, we refer to what stated by FESE Response.
In particular, we appreciate the light-handed approach by CESR towards conditions fostering fair and orderly trading and we concur with CESR on the role of market operators in the process of admission to trading, except for the following two specific objections: a) market operators should not be obliged to assume a quasi-authoritative role in checking that conditions for prospectus exemptions have been met; b) we see no basis for obliging market operators to provide links to issuers' prospectuses on their websites.

As regards then the admission of financial instruments to trading on a Regulated Market, we would like also to clarify that a market operator can admit to trading on one of its Regulated Markets also financial instruments that have not been admitted to listing. Only Regulated Markets that are deemed "Official" according to Directive 2001/34 can admit to trading financial instruments that have been at the same time admitted to listing.

Referring finally to the issue of storage and dissemination of regulated information, we would like to underline the following aspects, which also take into consideration the provisions contained on this matter in the Market Abuse and Transparency Directives.
Article 40, paragraphs 3 and 4, of the MiFiD states that Regulated Markets have to establish arrangements to:

- verify that issuers of financial instruments that they have admitted to trading comply with their obligations under Community law in respect of initial, ongoing or ad hoc disclosure obligations;

- facilitate its members or participants in obtaining access to information which has been made public under Community law
- review regularly the compliance with the admission requirements of the financial instruments which they admit to trading.

Such provisions seem to attribute to the Regulated Markets the power of storing and disseminating the regulated information they receive by the issuers and of regulating it on a contractual basis, by establishing the above mentioned arrangements.

On the other hand, Article 2 of the Commission Directive 2003/124/EC implementing the Market Abuse Directive states that Member States shall ensure that the inside information is made public by the issuer in a manner which enables fast access and complete, correct and timely assessment of the information by the public.

No mention on the possible role of Regulated Markets in this context, as it occurs also in the Transparency Directive, where article 17 states that the home Member State shall : a) ensure that the issuer, or the person who has applied for admission to trading on a regulated market without the issuer's consent, discloses regulated information in a manner ensuring fast access to such information on a non discriminatory basis and makes it available to the officially appointed mechanism for the central storage of regulated information and , b) require the issuer to use such media as may reasonably be relied upon for the effective dissemination of information to the public throughout the EU (and where furthermore article 18 states that competent authorities shall draw up appropriate guidelines with a view to further facilitating public access to information to be disclosed under the Market Abuse and the Prospectus Directives).

In this context, we hope for an activity of coordination among the provisions of all the Directives, and in particular for a clarification of the meaning and the functions attributed to the concepts of "storage" and "dissemination" of regulated information, and for a definition of the role of Regulated Markets, which nowadays already often perform such functions.

Section IV: Cooperation and Enforcement

As regards this section in general, we refer again to the concepts stated and the issues raised by FESE Position Paper (Ref: P700C).

In particular, referring to:

- methods and arrangements for reporting financial transactions (Box 15): we underline the need to provide a level playing field for all transaction reporting solutions (by the investment firm itself, through Regulated Markets, MTFs, trade matching systems, reporting systems and others, whether run by a market operator or a third party) and we welcome in general the list of minimum conditions as proposed by CESR; we are also convinced that, over the medium term, considerable advantages in terms of cost savings and information sharing efficiency could be derived from the convergence of national reporting systems.

We see a role for regulators in the search for harmonisation of formats and standards, but not necessarily in the development of any centralised solution for data collection and storage. Particularly at this early stage, CESR should concentrate on harmonising the contents of transaction reporting and on solving the fundamental challenge of exchange of information. Further efforts towards harmonisation or concentration of transaction reporting should be left to market forces, of course under the guidance and eventual oversight of CESR and its members;

- assessing liquidity in order to determine the most relevant market (Box 16): we fully support the wide use of proxies instead of computing liquidity measures for individual financial instruments and we underline the importance of appropriate revision procedures; such procedures seem adequate, but triggering a revision exercise should not be the exclusive right of CESR Members: markets and/or issuers should have the right to propose or even request a revision; revision intervals and modalities can vary and should remain flexible. Finally, we would also suggest CESR to consider the "proxy approach" in the context of best execution, while determining the venue that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders;
- content and standard/format of transaction reports (Box 17 and annexes): we welcome the general commitment by CESR to reduce the possible minimum extent to which existing and functioning reporting mechanisms and arrangements would have to be changed, but we do not follow CESR in its argumentation that a minimum of changes can best be achieved by the setting of minimum information standards to the national level; in the absence of a uniform content standard in the EU, ant reporting mechanism (including Regulated Market and MTFs reporting on behalf of their participants) is exposed to the risk that it would have to report different content to different receiving authorities.

Finally, we wonder whether, in order to adequately implement the Market Abuse Directive and to define the standard market size requested by article 27, the competent authority should periodically receive also information about executed orders.

Milan, September, 21st, 2004