



International and European Affairs

**BANCA INTESA'S RESPONSE TO
CESR'S SECOND CONSULTATION
ON ITS DRAFT ADVICE TO THE EUROPEAN COMMISSION
FOR IMPLEMENTING LEGISLATION UNDER DIRECTIVE 39/2004**

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A. INTRODUCTION

Banca Intesa is the holding company of the Intesa Group, the largest Italian banking group and one of the main players at European level. The Intesa Group is also active in new Member States like Hungary, where Central-European International Bank-CIB is the fourth largest bank, and Slovakia, where Všeobecná úverová Banka-VUB is the second largest bank.

Banca Intesa appreciates this new CESR's consultation on the revised version of its draft advice concerning possible technical implementing measures (hereinafter the "Level 2 Measures") of the Directive on Markets in Financial Instruments (2004/39/EC, hereinafter the "MIFID"), which it is rendering to the European Commission in accordance with the mandate granted to it on 25 June 2004.

This response addresses the questions already raised in the concept paper on best execution of June 2004 and in the second part of the October 2004 first consultation. Banca Intesa's position on these issues is set forth respectively in the 4 October 2004 and the 21 January 2005 responses to CESR. Our comments below are based on our previous position, which is here fully confirmed and further detailed.

B. LENDING TO RETAIL CLIENTS – ART. 19 (1) MIFID

Banca Intesa is convinced that, in order to avoid overlapping legislation, an *ad hoc* protection, such as the one provided by Level 2 Measures with respect to the lending of money or granting of monetary credit to retail clients for the purpose of allowing them to carry out a transaction in a financial instrument, is justified when the general rules do not suffice.

In any other case, we consider the application of general rules preferable, in that it ensures the aimed result in an effective and simple way, thus avoiding overlapping, interpretation and coordination problems.

QUESTIONS N. 1 AND 2

Question N.1 page 7

The granting of credit to a retail client in connection with the provision of an investment service is already regulated by EU Directives other than the MIFID, such as:

- a) the Directive on Consumer Credit (1987/102/EC), providing for direct investors' protection, which will be further enhanced by the proposed Directive on the Credit to Consumers repealing the existing Consumer Credit Directive; and
- b) the Consolidated Banking Directive (2000/12/EC), where the requirement on banks to execute the creditworthiness test before granting any loan or credit

facility is to the benefit not only of the credit institution but also of retail investors, in that it fosters the principle of responsible lending.

Therefore, we are convinced that retail investors are already protected as far as loan granting is concerned, and hence also in relation to loans ancillary to investment services. Thus any duplication of protection in the context of MIFID Level 2 Measures would create more coordination problems than real benefits.

Question N.2 page 7

We believe that financial intermediaries should ask their clients proportionate questions, which are not uselessly intrusive, taking into account the type of financial services or instruments to be provided.

Accordingly we are convinced that, in order to grant credit to a client, a bank should obtain only the information necessary for the execution of the creditworthiness test.

On the other hand an investment firm should obtain the information concerning the client's investment objectives if a suitability test is required pursuant to Article 19, paragraph 4, MIFID (i.e. in the case of the provision of investment advice or portfolio management). Level 2 Measures should take into account and merely implement the balance between the client's privacy and the investor's protection stricken by the MIFID.

C. DEFINITION OF INVESTMENT ADVICE – ART. 4 (1) (4) MIFID

The rationale of Article 19, paragraph 4, MIFID is to specifically protect investors in connection with investment advice, one of the most sensitive financial activities he/she can engage in. Therefore the definition of investment advice should be necessarily broad, so that all cases requiring protection are covered.

In our view, the criterion to determine when the regime of Article 19(4) should apply lies in the degree of personalisation of the communication. As soon as some financial advice tailored to the personal situation of an investor (i.e. it qualifies as advice and not as information, recommendation or marketing communication) is given, the latter is entitled to fully rely on it. Therefore the advice has to be provided by a regulated and supervised financial institution and it has to meet a certain quality standard. It follows that the provision of investment advice can give rise to liability of the investment firm in case of mistake or carelessness.

The consequence of this reasoning is that in most cases, investment advice – either generic or specific – will be given in the context of a contractual relationship between the client and the investment firm. Investment firms are likely not to provide generic investment advice to potential clients because of the liability–profit unbalance. This expected behaviour will reduce the flexibility of the market in respect to the provision of generic investment advice but will at

the same time introduce a high quality standard and a significant investor protection in connection with one of the most significant financial services.

QUESTIONS N. 1 AND 2

Question N.1 page 11

There are several reasons, both practical and theoretical, which suggest that the conduct of business rules under Article 19 MIFID should apply also to generic advice:

1. Given the practical difficulty to draw the distinction between information, marketing communication, general recommendation and investment advice, we would refrain from introducing a further distinction between generic and specific investment advice. A major advantage of regulation is simplicity and clarity, which should always be taken into account;
2. Since the provision of investment advice is by definition based on the personal condition of a client, it is generally aimed at ending with a specific advice and the consequent sale of the financial instrument, which has been chosen by the client on the basis of the investment advice. This implies that any generic advice naturally and organically should lead to a specific one. It is often difficult to draw the line between the two situations and we do not believe that neither a general rule, nor a list of possible cases, nor a case by case assessment are effective workable solutions. The best solution to eliminate the loopholes deriving from the introduction of a sub-category is not to introduce it;
3. A broad definition of investment advice would reserve this activity to authorised financial intermediaries, which hence would be supervised and regulated. In other terms, it would reserve all and every personalised financial relationship with investors to the same category of subjects (save the exceptions provided for by the MIFID): this would eliminate most possibilities of circumvention of the law; and
4. Since the financial planning determines the actual investment, it can potentially harm investors materially: therefore, the same protective regime of specific advice should apply to generic advice, in order to provide clients with a consistent protection at any stage of the investment process.

Question N.2 page 12

Banca Intesa is convinced that, given the scope of the passport and the scope of the authorisation requirements, the definition of investment advice should include generic advice. From an investor's perspective, it really makes sense that every advisory activity tailored to his/her situation is provided by supervised and regulated entities, such as investment firms. From the perspective of investment firms, as investment advice will become a main financial service and

will then develop and grow to be strategic, the possibility to offer this service in the whole market of the European Union under the same regulatory regime constitutes a major advantage and a stimulus to further develop, refine and innovate this service.

D. BEST EXECUTION – ARTT. 19(1) AND 21 MIFID

Box 1

Best execution, as defined by MIFID, is a new concept for investment firms established in Member States where the concentration rule has been existing so far, like in Italy. This lack of experience is the reason why our remarks cannot be based on factual analysis. The novelty of the matter is a further reason why we expect CESR to provide clear and precise guidelines, by way of Level 2 Measures, on the concrete application of Article 21 MIFID.

QUESTION § 30

Question § 30 page 19

- A)** According to Italian law, all transactions in shares have to be executed on regulated markets. Therefore Banca Intesa does not have a specific experience in comparing venues (or intermediaries) that offer inducements with those that do not.
- B)** When a transaction is executed, fees and commissions are often split between execution costs and clearing and settlement costs.

Box 2

Banca Intesa appreciates that in Box 2 CESR provides for the investment firm's task to determine the relative importance of the factors listed in Article 21(1) MIFID, taking into account the characteristics of the clients, of the orders, of the financial instrument and of the execution venues. In our perception this implies that each investment firm can stress one, rather than another factor, in accordance with its execution policy. On the other hand, this also implies that execution policies will become a significant battlefield of the competition among investment firms.

Therefore best execution can be considered as a process, which an investment firms is committed to comply with towards its clients. Best execution should not resolve into "a best possible outcome": if there were a single "best possible outcome", there would be a single possible "best execution" and it would not make sense to grant investment firms flexibility in the weighting of the factors comprising best execution.

We would ask CESR to further clarify this central issue, especially explaining the coordination between the Level 2 Measures in Box 2 and the explanatory text under §39 and §40 where, for instance, it is written that “...there is a best possible outcome and investment firms must be held accountable for taking all reasonable steps to achieve it”.

Box 3

On the same line as the comment on Box 2, we would invite CESR to clarify that there does not exist “the best possible result for the execution of [...] clients orders” mentioned in Box 2, letter (a). Consistently with the Level 2 Measures under letter (b), we would suggest CESR to consider the concept of “best result” throughout all Level 2 Measures with a sense of proportion to the execution policy and arrangements and never to treat it as an absolute notion.

QUESTION § 56

Question § 56 page 23

It is foreseeable that for financial instruments traded so far on a regulated market only, this regulated market will continue to be - at least for some years - the trading venue with the greatest liquidity, the best price discovery and the lowest execution costs. In this case, for the relevant financial instrument, an investment firm can use only one trading venue. This is the case of Italian shares, which so far could be only traded on “Borsa Italiana”.

Another example would be the case of an investment firm of small dimensions, which would simply go to the most liquid trading venue, since otherwise the access to a second trading venue would not be justified from an economic perspective.

A further example is the case of exchange traded derivatives, which are mostly traded in a single trading venue. In this case the investment firm has a strong incentive to go to the most liquid trading venue for that specific exchange traded derivative.

QUESTION § 65

Question § 65 page 25

Banca Intesa is convinced that all costs to be borne in connection with the trading in a given trading venue should be taken into account, be they internal or external. In fact the price of the execution of a transaction has to be calculated by summing up all the costs. This is pivotal for the choice of a trading venue, since it is expected that the competition among investment firms will be fierce as far as costs, and therefore commissions, are concerned.

Consequently we believe that also internal costs should be considered in the selection of the trading venues for the reason that – like external costs – they determine the commission due by the client.

This being said, Banca Intesa strongly opposes any requirement of disclosure concerning the quality, description, nature or splitting of costs.

QUESTION § 82

Question § 82 page 27

We agree that each investment firm has to monitor, assess and compare the various trading venues on an on-going basis, in order to offer to its clients an execution policy, which fits to their needs and requirements. We believe that the simplest and most effective way to ensure that the market developments are reflected in the execution arrangements is to compare periodically the historical results of the concurrent trading venues.

The information to carry on this analysis is normally available to the public (e.g. public statistics, press, newsletter) - even though often not formatted - or can be bought from info providers and agencies. It is in fact in the interest of trading venues and intermediaries to make public detailed information on their services for marketing purposes.

QUESTION § 87

Question § 87 page 28

We believe that intermediaries should be required to inform in due course investment firms that manage portfolios or receive and transmit orders about material changes in their business. Such timely communication would put investment firms in a position to update or amend their execution policy.

Box 4

Since the execution policy is likely to become one of the clients' core elements of choice of their investment firm, there follows that it has to be clear, comparable and comprehensive. For instance, a merely descriptive execution policy would not put investors in a position to compare the various offers, as it is difficult to benchmark descriptions.

On the other side of the spectrum, we reiterate the concept that only significant information should be conveyed to investors and that regulations should not lead to overwhelm clients with information they cannot assess or even understand.

Therefore, we would suggest CESR to provide for the introduction not only of qualitative information but also of quantitative data and percentages in the execution policies, provided that they are significant and not misleading.

QUESTION § 110

Question § 110 page 31

A) Since in Italy there is the obligation to execute all transactions on regulated markets, we do not have any quantitative analysis on the costs to identify the execution venues that have executed the transactions or to collect historical information on this matter.

B) We believe that the majority of our retail clients could be in a position not to fully understand and exploit the technical information on the percentage of business directed to different execution venues and intermediaries. Furthermore, this information can both be misleading for investors and cause misunderstandings between investment firms and clients. Also considering that this information normally is confidential (as it pertains to the strategy of an investment firm) and is also difficult and costly to provide, we would suggest it be not disclosed to the clients in the execution policy.

C) Making information available only upon request is for sure one of the most effective strategies to combine transparency and effectiveness of communication, thus not overwhelming clients with undesired and potentially confusing information. It is to notice, however, that the costs to make available any information are justified if there is an interest on such information from a significant number of clients.

D) We believe that the most effective way to convey this information is to refer it to each execution venue and to each type of financial instrument (e.g. shares, bonds, derivatives). This information should be tailored to the profile of the addressee, i.e. of the client, taking into account his/her level of financial sophistication.

E) We believe that the clients should be provided with information on all the execution venues directly accessed by the investment firm. The disclosure of indirectly accessed trading venues should be left to the discretion of each investment firm.

F) In the case of transactions which are executed in a given trading venue because of technical reasons and not because of better price, or liquidity, or price discovery, this sort of disclosure would be misleading.

We believe that this disclosure for equity is as meaningful as for other types of financial instruments. The recent financial scandals call for an increased transparency also with respect to bonds, as invoked by Consob and IOSCO. This is especially true for the Italian market, where the gross total financial exposure of Italian families equals 2.2 times the GDP, being well above the

European average.

QUESTION § 115

Question § 115 page 32

It is the opinion of Banca Intesa that error correction and handling policies are core elements of the execution of transactions and therefore should be disclosed to the clients.

Furthermore, these issues should also be an integral part of the contractual relationship between the client and the investment firm. In this respect it is to notice that in the Italian practice, error correction is governed by the general terms and conditions, while binding rules are applied to the handling of orders. In view of the prospected competition among investment firms, we suggest that both the handling policies and the error correction become part of the execution policy of investment firms.

QUESTION § 126

Question § 126 page 34

We believe that the consents under Article 21(3) MIFID can be given also by telephone, provided that they are duly recorded and stored. This is already the rule applying to a number of other cases, such as the authorisation for transactions with a conflict of interests or for transactions not fitting the investor profile.

We would like to suggest CESR to clarify the nature and the quality of information that investment firms will be required to supply to investors when executing orders by telephone.

QUESTION § 129

Question § 129 page 35

According to the experience of Banca Intesa speed and price are very important factors in the execution of an order. If no priority is given to the price, an explanation is due (see Level 2 Measures at page 35, 21 (3) (a) (ii)). In a symmetrical way, investment firm should highlight a low consideration of speed. Such remark would attract the attention of investors on a crucial factor of execution, hence improving the level of clients' protection.

E. DEFINITION OF SYSTEMATIC INTERNALISER – ART. 4 MIFID

Banca Intesa is convinced that the Level 2 Measures on the definition of systematic internaliser should be as comprehensive and precise as possible, so that they can be directly applicable throughout the whole European Union. A maximum harmonisation regime is crucial in this respect, as the definition of systematic internaliser directly affects the quality and the quantity of trading venues, with material effects not only on the trading venues and the investment firms but also on the financial market in general.

We would suggest the introduction of further qualitative criteria to identify an internaliser which carries out this activity on an “organised” and “systematic” basis. These further criteria should refer to the IT and technological resources employed for this activity by the alleged systematic internaliser.

QUESTIONS N. 1.1 – 1.3

Question N. 1.1 page 40

Banca Intesa appreciates that CESR has further refined its criteria and has also introduced – although in a dubitative form – two alternative quantitative criteria to assess frequency. We believe that this will help to identify the entities which carry on systematic internalisation.

Question N. 1.2 page 40

We deem advisable coupling qualitative and quantitative criteria for the purpose of determining when an investment firm internalises “frequently”. This would offer a more objective and stringent basis for the definition of systematic internaliser, hence leaving little room to dodgy interpretations.

Question N. 1.3 page 40

We appreciate the first criterion (i.e. the ratio of the value of client orders executed on own account outside the RM or MTF to the total value of executed orders for each share on an yearly basis), which according to our tests works with respect to small and medium sized systematic internalisers.

We appreciate also the second criterion (i.e. the ratio of the value of client orders executed on own account outside the RM or MTF to the total value of trading in a share on the most liquid market on an yearly basis) as it captures big systematic internalisers in the definition in question.

F. PRE TRADE TRANSPARENCY – ARTT. 44, 29 AND 27 MIFID

Without entering into the technical and complex details of pre-trade transparency, it is immediate that the existence of different regimes of pre-trade transparency depending either on the Member State of incorporation of a given trading venue or on the nature of trading venue would put in a significant

competitive disadvantage the trading venues subject to more stringent rules. This leads us to emphasise the need that fair competition is ensured (i) among trading venues of different nature and (ii) among trading venues of different Member States.

In Banca Intesa's opinion the most effective legal device to obtain the result of fair competition among trading venues is to fully harmonise the rules governing this matter. In this respect Level 2 Measures implemented by way of regulations would work very well, because of their direct applicability and contemporary entering into force in all Member States.

QUESTIONS N. 2 AND 3
Question N. 2.1 page 44 We agree with CESR's proposed approach to identify a liquid share.
Questions N. 3.1 and 3.2 page 57 We agree with the level of specificity of CESR's proposals and deem the content of pre-trade transparency appropriate.
Question N. 3.3 page 57 In our view the proposed exemptions to pre-trade transparency can be shared and it is not necessary to provide for any other case.
Question N. 3.4 page 57 We agree with the waiver under §84, second subparagraph, because it is consistent with the introduction of a standard market size.
Question N. 3.5 page 57 We agree with the proposed unified block regime.
Question N. 3.6 page 57 Generally speaking we think that the proposed system strikes a satisfactory balance between the relevance of SMS and the practical issues arising from the number of SMSs introduced. However we would suggest that the SMS for the first band should be fixed at Eur 7,500 (instead of Eur 5,000). This would also be consistent with the customer retail size provided for under § 105 of Level 2 Measures.
Question N. 3.8 page 57 In our view a subsequent annual revision of the grouping of shares is sufficient: actually it is a good compromise between the stability of the grouping and its capacity to reflect current market conditions.

Since the grouping of shares and the SMS determine the pre-trade transparency regime, their revision regime should be fixed at Level 2, in a binding way and uniformly for all Member States.

Question N. 3.9 page 57

Since it should be possible to internalise the orders from the very moment when a share is traded, the SMS should be fixed for each share on the first day of trading. Such initial SMS could be determined by way of a proxy method based on peer stocks.

Question N. 3.10 page 58

We agree with the proposed 2 week period for the adaptation of SMS by systematic internalisers.

Question N. 3.11 page 58

For the sake of simplicity we would prefer a single contact point (i.e. the website of CESR), provided for by a Level 2 Measure.

Question N. 3.12 page 58

Banca Intesa is convinced that systematic internalisers should be allowed to update their quote whenever there is a market variation or new information on a financial instrument are available. Since the whole rationale of the introduction of systematic internalisers as third trading venue by the MIFID lies in the opportunity to improve the price discovery mechanism, internalisers have to be free to update quotes actively and not to simply react to a change of market conditions. In other words, systematic internalisers should be treated in the same way as market makers, and therefore should be left free to update their quotes.

G. POST TRADE TRANSPARENCY – ARTT. 45, 30 AND 28 MIFID

QUESTIONS N. 5

Questions N. 5.1 and 5.2 page 64-65

Banca Intesa agrees on the proposed method of publishing post-trade information and on the fact that the seller is the responsible subject for publishing the post-trading information. We would like to suggest CESR to clarify the scope of the publishing requirements for non EU-intermediaries.

Banca Intesa suggests that the thresholds for the deferral of the publication of important information, such as post trade data and reports, should be fixed at European level and should be the same in the whole European Union. A clear, certain and uniform regime in the field of post-trade transparency, by eliminating

opaque information and comparing obstacles, would definitively be of help in the creation of an integrated European financial market and in the fostering of competition among European intermediaries.

QUESTIONS N. 6

Question N. 6.1 page 74

In the absence of practical experience on this point, we agree with CESR's approach. At any rate we underline that it should be for the Competent Authority to quantify the size of the blocks and to communicate them to the market.

Questions N. 6.3 and N. 6.7 page 74

We would suggest to modify the CESR's proposal for determining the thresholds for deferred publication arrangements by providing the same regime in the cases of "more than 100% of ADV" and "more than 100% ADV but at least € 1m". In both this cases the maximum permitted delay for trade publication should be the end of the next trading day.

Question N. 6.4 page 74

We would suggest that CESR introduces an obligation to disclose information only once that intermediaries have unwound their position, for instance disclosure within 60 minutes after the position is unwound.

Question N. 6.6 page 74

We understand that the proposed short-term arrangements are merely aimed at allowing a quick and smooth implementation of MIFID. Our only remark is that these arrangements have to take into account all daily volumes traded throughout the European Union.

Question N. 6.8 page 74

We have some difficulty to understand how the proposed Level 2 Measures can apply to portfolio trades. We would highly appreciate a more detailed explanation on this point from CESR.

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