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BBA RESPONSE TO CESR ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS

Second Consultation Paper (due 4 April 2005) on

- **Aspects of the definition of Investment Advice and of the General Obligation to Act Fairly, Honestly and Professionally in the Best interests of Clients**
- **Best execution**
- **Market Transparency**

The British Bankers' Association represents more than 250 banks carrying on business in the United Kingdom. The majority of these banks come from outside the United Kingdom and our members cover the whole range of investment services covered by the Directive.

We would like to draw CESR's attention to the following key issues in our response:

Investment Advice

- We welcome CESR's statement that the suitability obligation will not apply to professional clients as they are deemed to have sufficient knowledge and experience to exercise their own judgement
- Our members do not believe that there should be any obligation to assess suitability for retail lending and we would urge CESR to issue no advice relating to lending to retail customers. Furthermore CESR should not introduce an additional requirement to obtain information about a retail client's investment objectives.
- Our members consider that for investor protection considerations it is reasonable to restrict "investment advice" to recommendations of specific financial instruments.

Including generic discussions under the scope of the advice would have the negative effect of discouraging firms from entering into useful discussion with their clients thus limiting the level of customer service provided.

Best Execution

- As we have stated in previous consultation responses we believe that the Level 1 text already provides sufficient detail and that CESR's technical advice should be very light touch.
- We welcome the fact that CESR has acknowledged the differences between different markets and asset classes. In particular we believe that the application of best execution requirements to non-equity markets requires specific attention and should avoid onerous and inappropriate requirements. Applying a retail agency equities model to other markets would be hugely damaging for Europe. However, we believe that this issue should be addressed at Level 3 rather than Level 2 and would be very happy to engage in discussions on the most appropriate way forward.
- We welcome the fact that CESR has recognised that a prescriptive approach to the application of the factors in Article 21 (1) is not feasible and has focused on high-level principles and factors whilst leaving the assessment of the relative importance of these factors to investment firms.
- Our members consider venue selection an important commercial aspect of business operations based on a sophisticated set of regulatory, tax, political and venue-specific criteria. This tends to be a commercially driven review based on good business practice and we believe that there should be NO annual regulatory requirement. Venue review and selection should be addressed in a firm's best execution policy but a specific annual review requirement would add no value but increase costs which will ultimately be passed on the client.
- We believe that CESR's proposals regarding the information on order execution policy to be provided to clients is impracticable and excessive whilst providing few tangible benefits to clients. Firms should be merely required to provide general information appropriate to the nature of its business, type of clients etc but CESR should refrain from outlining a specific approach or setting out very detailed disclosure requirements.

Definition of Systematic Internaliser

- CESR's revision of the criteria for systematic internalisers has been significantly enhanced. We welcome CESR's rewording of the definition in order to take account of Recital 53 (the exclusion of OTC transactions). The following criteria should also be included to exclude firms from being an SI:
 - Ad-hoc and irregular transactions. Transactions only carried out with professional customers and eligible counterparties.
 - Orders that are not client orders, e.g. orders from other group entities, orders from eligible counterparties.
 - Orders that are part of a business relationship which is itself characterised by dealings above standard market size.

Our members are generally not in favour of additional quantitative criteria. In particular 12b is problematic as it corresponds to factors outside of the control of the firm and the threshold appears very low overall thus essentially discriminating against large firms.

Definition of Liquid Shares (Article 27)

- There are a number of revisions we would suggest to CESR's draft proposals. In Box 2, the two criteria c) and d) should be used cumulatively. Selecting an average of 500 trades a day as single criterion for liquid shares would bring some fundamentally illiquid shares into the definition of 'liquid'. Therefore a combination of both average number of trades and average daily turnover (we suggest €5 million) should be applied rather than a "pick and mix" approach. Using both criteria would help to create a more consistent approach on an EU wide basis, with the resulting increase in transparency and reduction in costs. We continue to support an EU wide test rather than a country by country approach.

Number of Classes of Liquid Shares

- Under the current proposals there would be 10 classes under €100,000 alone and it is likely to be cumbersome to deal with such a large number of classes. A number of BBA members would support CESR's suggestion of using a logarithmic scale rather than a linear one and we strongly recommend having a smaller number of classes (around 5 or 6). Whilst this would seem a more complex methodology it would produce a simpler and clearer outcome. Given that firms will need to build new systems technology to implement these requirements, using a log scale would not represent a significant extra cost.

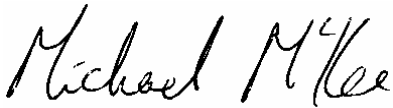
Our members welcome CESR's consultation on MFID and we recognise the time constraints imposed on CESR by the Commission end of April deadline. However, we are extremely concerned over the 1-month deadline which includes the Easter holidays.

The CP addresses some of the most complex and controversial aspects of the Directive and it is unrealistic to expect the industry to evaluate them fully in less than a month, especially as many of the proposals are entirely new yet potentially far reaching. Given the length and complexity of CESR CP's it is difficult for the industry to address every single proposal in detail, especially where CESR has not raised a specific question addressing it. We would therefore urge CESR not to automatically assume that the industry endorses proposals if no specific objections have been raised, especially in the absence of draft text. (See Paragraph 122 on obtaining client consent). If CESR requires any further specific input we would be very happy to provide further information where possible.

We would urge both CESR and the Commission be flexible in their approach to the next steps required, given that the industry has had to bear the brunt of a series of delays at level 2.

We would be happy to discuss with CESR any questions arising from our response.

Yours faithfully,



Executive Director
British Bankers' Association



Director
British Bankers' Association

**GENERAL OBLIGATION TO ACT FAIRLY, HONESTLY AND PROFESSIONALLY
AND IN ACCORDANCE WITH THE BEST INTERESTS OF THE CLIENT**

Q.1: *Do you agree with the proposed advice in this area, including the proposed limitations on the scope of the obligation?*

We welcome CESR's statement that the suitability obligation will not apply to professional clients as they are deemed to have sufficient knowledge and experience to exercise their own judgement. However, we do not believe that there should be an obligation separately to assess the suitability of lending/extending credit to retail customers in connection with the provision of investment advice. We would prefer the second option on page 6 of CESR's advice i.e. no advice relating to lending to retail customers. Provided the firm has conducted a suitability assessment (19 (5)) or an appropriateness assessment (19 (6)) in relation to a transaction, then there is no need to conduct a separate assessment with regard to related credit which will usually be an element of the transaction proposition. The granting of credit should be based on commercial credit criteria (including any credit limits agreed for individual customers) and the information given to the investment firm by the client.

Q.2: *Do market participants consider that investment firms have to obtain the necessary information about the retail client's investment objectives in addition to his financial situation?*

Our members do not believe that the requirement to obtain information about the retail client's investment objectives should be introduced at level 2 beyond the existing customer assessment already required under Article 19.

THE DEFINITION OF INVESTMENT ADVICE – GENERIC AND SPECIFIC ADVICE

Q.1: *Do you believe that investor protection considerations require the application of the above conduct of business requirements from the point at which generic advice is provided or do you believe that sufficient protection is provided in any event to allow the definition of investment advice to be limited to specific recommendations?*

Our members consider that for investor protection considerations it is reasonable to restrict "investment advice" to recommendations of specific financial instruments. We agree with CESR's concerns that including generic discussions under the scope of the advice would have the negative effect of discouraging firms from entering into certain types of discussion that many customers find currently useful and discouraging firms from publishing or disseminating certain generic information; thus limiting the level of customer service provided.

In fact we do not believe that the most appropriate interpretation of the Level 1 advice permits extension to generic information.

As a practical matter CESR has acknowledged in previous consultations that it is very difficult to separate marketing communications, generic recommendations and investment advice from one another, unless one is making a distinction on the basis of whether a specific instrument was involved and a specific transaction was entered into as result of the advice. From an investor protection point of view if the generic discussion is followed by specific advice on specific instruments, then the investor is protected under other provisions for investment advice. If no specific product is recommended and no transaction results then we do not believe that investor protection considerations are raised.

Q.2: *Do you believe that considerations relating to the scope of the passport and the scope of the authorisation requirements point towards the inclusion or exclusion of generic advice from the definition of investment advice.*

We believe that considerations relating to the scope of the passport and the scope of the authorisation requirements point towards the exclusion of generic advice from the definition of investment advice. The regulatory effort should be focused on specific advice that is readily identifiable leading a client to take a specific investment action. If generic advice was included this would be likely to result in a substantial increase in the attendant regulatory requirements. We do not believe that this is justified as the principal risks to consider are all focused on advice about specific instruments.

General remarks:

We continue to have serious concerns over CESR's suggestion that advice or specific recommendations could be *implicit* – in our view advice always has to be explicit, otherwise there is a real danger that a huge range of communications from a promotional poster on a wall to an investment advisors general remarks could fall under the scope of “implicit advice”. We do not believe that CESR intended this. We do not see how the concept of an “implicit” recommendation can operate in practice. Prima facie, if an investment firm wishes to make a recommendation it will do so explicitly – it will not seek to rely on implicit signals. The notion of “implicit” recommendations also further increases litigation risks.

BEST EXECUTION

General Remarks:

As we have stated in previous consultation responses we believe that the Level 1 text already provides sufficient detail and that CESR's technical advice should be very light touch.

We welcome the fact that CESR has acknowledged the differences between different markets and asset classes. In particular we believe that the application of best execution requirements to non-equity markets requires specific attention and should avoid onerous and inappropriate requirements. Applying a retail agency equities model to other markets would be hugely damaging for Europe. However, we believe that this issue should be addressed at Level 3 rather than Level 2 and we would be happy to discuss the appropriate way forward.

We welcome the fact that CESR has recognised that a prescriptive approach to the application of the factors in Article (21) 1 is not feasible and drafted Box 2 based on high-level principles. We also welcome that CESR acknowledges that the relative importance assigned to the relevant factors is the responsibility of the firm and we believe this approach is sufficiently flexible and in line with Level 1. However, we have some concerns that CESR has not fully implemented this approach in its advice as evidenced by its prioritisation of the specific information requirement regarding price and cost for retail clients (Box 4(1)(a)(ii). (See also our answer to the question in para 129)

With regards to Box 3 we welcome in principle the high level approach taken to the review requirement of best execution arrangements. However we do not believe that there should be an annual review requirement (See our answer to the question in para 82). We suggest to redraft the review requirement in Box 3 (a)(iii) from "whenever a material change occurs" to "*whenever an investment firm becomes aware that a material change has occurred or is about to occur*" as this is more realistic in that firms cannot act on information that is not yet available to them.

Our members are very concerned over CESR's proposals in Box 4, 1(a)(iii) which requires a prominent risk warning that client instructions may affect a firm's ability to achieve best execution. We have no objections to a firm being required to include general wording to that effect in its best execution policy but would be extremely concerned if such a warning was required on a case-by-case basis. Our members do not share CESR's concerns that including such warnings in general terms of business or otherwise would lead to firms "evading their obligations under Article 21".

- 30 a:** *How do firms compare venues (for intermediaries) that offer inducements with those that do not?*

Such considerations will form part of a firm's overall strategy in ensuring best customer service and best execution. Inducements are not a major element of such evaluation and only become relevant when other things are equal once all other factors influencing best execution have been evaluated. It is therefore very rare that inducements play any part in a firm's decision. We also believe that the issue of inducements has already been covered in CESR's advice on Article 19 and this is acknowledged by CESR in para 120. We do not therefore believe that CESR should provide any further specific wording on this topic in its final advice.

- 30 b:** *Where the fees and commissions that firms pay to execution venues or intermediaries include payment for goods or services other than execution, please indicate the circumstances in which firms might determine how much of these commissions represents payment for goods or services other than execution? Under what circumstances do firms consider the entire commission as payment for execution?*

This question has to be considered in the wider debate on issues such as unbundling. The issue is too complex to be addressed in a simplistic question like this and we do not believe that CESR will be able to give it appropriate attention in the very short time remaining. We therefore believe it should not be included in CESR's advice.

- 56:** *Please suggest situations and circumstances in which a firm might satisfy the requirements of Article 21 while using only one execution venue.*

There are a number of examples where this requirement could be met. For example a customer may have specifically requested execution on a specific venue and the firm would wish to fulfil client instructions. Other examples would be where the products desired by the customer are only offered on a single venue which could be the case for e.g. OTC derivatives or for contracts written on specific exchanges, e.g. a contract written on a future traded only on Euronext-LIFFE. However, even though client instructions would indicate that Article 21 requirements could be satisfied on a single execution venue, investment firms would need to consider whether similar contracts exist on other execution venues that may better meet the client's needs.

Whilst we welcome MFID's objective of enhancing competition between execution venues, CESR has recognised in its advice on the definition of liquid markets that "in 95% of all the cases, [by volume] the most liquid market had at least five times the size of the second biggest market". This may mean that in many instances the second or third largest markets are unlikely to meet the best execution requirement on a regular and consistent basis. If a firm habitually uses only one execution venue this should be explained in its general execution policy.

65: *Do market participants consider that the distinction between internal and external costs is relevant? Does the investment firm have to take into account also internal costs? If so, which ones?*

Our members are not entirely clear about the terminology used by CESR e.g. the distinction between internal and implicit costs and the purpose for asking this question. We would agree with CESR if the purpose of the question was to establish that in selecting an execution venue, firms should be allowed to choose a venue that is quoting a lower price as long as transaction costs are lower and therefore the firm can generate a better net result for the client.

We also believe there should be a distinction between costs such as market impact and commission. For example some costs such as market impact are difficult to quantify upfront and should therefore be treated differently from costs which are more easily quantifiable e.g. commission. We believe that CESR should focus on quantifiable costs only. We agree with CESR that firms should be allowed to make reasonable judgements about the relative importance of implicit costs for its trading costs and how to address them.

82: *How do you assure that your execution arrangements reflect current market developments? For example, if you do not use a particular execution intermediary or venue, how would you know whether they have started to offer “better execution” than the venues and intermediaries that you do use?*

Our members consider venue selection a very important commercial aspect of business operations. Most of our members review execution venues or arrangements periodically and based on a sophisticated set of regulatory, tax, political and venue-specific criteria. This tends to be a commercially driven review based on good business practice and we believe that there should be NO annual regulatory requirement. Venue review and selection should be addressed in a firm’s best execution policy. If regulators believe that there is evidence that a firm is not delivering best execution as a result of insufficient venue review, regulators have the powers to request this firm to demonstrate how it meets its obligations. A specific annual review requirement would add no value but increase costs which will ultimately be passed on the client. We also believe that smaller firms with limited resources may be particularly disadvantaged by an annual review requirement.

87: *Are intermediaries likely to inform investment firms that manage portfolios or receive and transmit orders about material changes to their business?*

Having discussed this question with both banking members and investment firms that manage portfolios, we have received confirmation that they are fully satisfied with the level of information and advice received. We also believe that the CESR's wording of "material changes to their business" is potentially misleading and should be restricted to information regarding material changes to a firm's execution policy.

110a: *Please identify and estimate the specific costs that investment firms will incur to identify the execution venues and intermediaries that have executed or received and transmitted their client orders and to collect historical information about what portion of their client orders they directed to each such venue or intermediary. For example, what costs would be associated with determining what percentage of client orders an investment firm directed to each venue or intermediary it used in the last 12 months, based on both the number of trades and the value of trades?*

110b: *Please explain what competitive disadvantage or other damage to their commercial interests firms would experience if they were to publish the percentage of their business that they direct to different execution venues and intermediaries.*

110c: *If firms are required only to make this information available upon request, would that address respondents' concerns about overwhelming clients with too much information?*

110d: *Please suggest approaches to focus this information. For example, should this information be disclosed for each execution venue, for different types of instrument, country-by-country, etc? Should firms break out this disclosure for different business lines (e.g. retail versus institutional). How?*

This answer refers to Questions 110a-d:

We do not believe that CESR should provide specific level 2 advice regarding the type of information to be provided. We object to CESR's approach of ignoring the majority of feedback responses to a previous consultation which clearly identified the information suggested as unnecessary and excessive.

The level of detail suggested by CESR is excessive and disclosure of historic information is unlikely to provide useful information to retail clients regarding a firm's future performance and strategy. In addition, disclosure of volumes of business conducted with particular counterparties who would now be regarded as 'venues' raises serious commercial issues.

Firms should be merely required to provide general information in its execution policy appropriate to the nature of its business, type of clients etc but CESR should refrain from outlining a specific approach.

Whilst we have no specific information regarding the costs that would arise from detailed information requirements we believe that they would be excessive in relation to the investor protection rationale and would ultimately have to be borne by retail clients without giving them tangible benefits. Cost would not only arise from the maintenance of information systems and distribution of information to clients, but the initial set up costs of systems are likely to be particularly high especially for small firms.

We believe that enough relevant information is already in the public domain and even if the information would only have to be made available on request it would still necessitate firms keeping detailed and costly information systems with the costs borne by all clients although the information is likely to be requested by only a very small sub-set of the total client base.

110e: *Should there be information for execution venues that investment firms access indirectly? And, if so, should it be on the main intermediaries to whom the firms usually entrust the execution of their orders?*

We do not believe that such a requirement should be introduced.

110f: *Please provide specific information about why, in less liquid markets, this sort of disclosure actually might be misleading. Is such disclosure about equity transactions more meaningful or useful than disclosure about transactions in other types of instruments?*

In a number of illiquid markets e.g. OTC bond markets brokers may only deal in a very limited number of venues and disclosure requirements may be potentially misleading especially as there seems to be little intrinsic value to such disclosures in the first place (see above).

115: *With respect to the fourth disclosure suggested by respondents, CESR requests further comment on whether investment firms that execute client orders directly or indirectly should be required to disclose information about their error correction and order handling procedures.*

We do not believe that firms should be required to disclose this information specifically as this would be very complex and costly and merely add to clients' information overload. However, we agree that companies should be required to employ and monitor appropriate error correction methods under their general business obligations.

- 126 a)** *How might an investment firm gain the necessary consents required under Art 21 (3) of the Directive as part of a voice telephone communication?*
- 126 b)** *What impact would there be on cross-border business and distance marketing if investment firms are not permitted to obtain the client consents required by Art. 21 using voice telephone?*
- 126 c)** *Can respondents suggest a different approach than the one used in paragraph 5 of the advice under Art 19(3) that would permit investment firms operating via voice telephone to satisfy the objectives of Article 21's consent requirements?*
- 126 d)** *How might firms evidence that they had obtained client consent if they obtained that consent via voice telephone?*

This answer refers to Question 126 a-d.

Overall we believe that CESR's proposals are too complicated and impractical. For example one investment firm timed how long it took to read out current UK Pension Fund Level One Disclosure guidelines (endorsed by the National Association of Pension funds). Reading out aloud these guidelines which are quite limited in that they only cover disclosure of house policies, processes and procedures in relation to the management of costs incurred on behalf of clients took over 12 minutes (not leaving any time for questions). Given CESR's far wider reaching disclosure proposals we believe reading out the suggested disclosures to clients and obtaining consent could easily take some 30 or 40 minutes with the cost of the long phone call borne by the client, if he or she has to had the patience to persist that long.

CESR should encourage the Commission to focus on a flexible and principle-based interpretation of the Directive. In general this approach would be mostly relevant when a firm is establishing a new client relationship over the phone and is taking a new order at the same time. In practice this is unlikely to happen (especially for professional clients) and firms would normally first open the account including all formalities and communication of terms of business and then trade only later.

- 129:** *Should investment firms that do not consider speed to be an important factor in the execution of retail client orders be required to highlight this judgement.*

No, we do not believe that there should be a specific disclosure. Instead firms' should have a clear general best execution policy which is disclosed to clients in an appropriate manner.

MARKET TRANSPARENCY

DEFINITION OF SYSTEMATIC INTERNALISER

Q.1.1: *Do the revised criteria for assessing 'organised, systematic and frequent' better delineate the activity of systematic internalisation? If not, what further modifications would they propose?*

We welcome CESR's revision of the criteria for systematic internalisers which represents an improvement over earlier proposals. For example we welcome CESR's rewording of the definition in order to take account of Recital 53 (the exclusion of OTC transactions).

We believe the following additional criteria should be considered in determining that a firm is not a SI:

- **Ad-hoc and irregular transactions. Transactions only carried out with professional customers and eligible counterparties.**
- **Orders that are not client orders, e.g. orders from other group entities, orders from eligible counterparties.**
- **Orders that are part of a business relationship which is itself characterised by dealings above standard market size**

Q.1.2: *Is the proposed use of a quantitative measure as an additional indicator useful?*

Our members do not believe these are useful additional criteria. The requirement to monitor exactly which trades are being systematically internalised would create significant additional cost. In particular 12b is problematic as it corresponds to factors outside of the control of the firm and the threshold appears very low overall. This criterion would therefore be only useful for very small firms. By essentially discriminating against large firms CESR's goes against MFID's objective of creating a level playing field for financial services in Europe. Introducing such a criterion would also not significantly alter the number of firms that are within the SI definition and therefore we would query the necessity for regulatory intervention.

Q.1.3 *Has the quantitative test been appropriately structured? If not, how should it be improved?*

See our response to Q1.2. Our members are against an introduction of additional quantitative measures. However, if CESR's intends to include such advice, at the very least it needs to clarify the interaction between Box 1 paragraph 11 and paragraph 12.

We believe both paragraphs should be read cumulatively and this should be made clear in the text. We welcome CESR's agreement in the Open Hearing to review the paragraph with a view to making the cumulative interpretation clearer.

PRE-TRADE TRANSPARENCY REQUIREMENTS FOR REGULATED MARKETS, MTFS AND SYSTEMATIC INTERNALISERS

Overall we have found it difficult to analyse CESR proposals in this area as underlying quantitative data have either been unavailable or where available difficult to interpret or inconsistent. Whilst we agree with Mr Kaspari's comments at the Open Hearing that even imperfect data holds the potential of being useful, and appreciate the fact that CESR has made data available as early as possible under the difficult circumstances it faced, we still regret that the data needed to understand, test and comment on the proposals has not been available to us from the start of the consultation period. This has made it difficult for us to evaluate the proposals fully.

2.1 Defining the scope of the quoting obligation for systematic internalisers

Q.2.1: Does the proposed approach to identifying liquid shares establish a sound methodological approach in the context of Article 27? If not, please specify (in sufficient detail) a modified or alternative approach and explain why it would be superior.

We agree with many aspects of CESR's methodology in approaching the question of liquid shares. In particular we strongly agree with CESR that liquid shares should be defined on a pan-European basis rather than market by market.

However, there are a number of revisions we would suggest. In Box 2, the two criteria c) and d) should be used cumulatively. Selecting an average of 500 trades a day as single criterion for liquid shares could potentially bring some fundamentally illiquid shares into the definition of 'liquid'. Therefore a combination of both average number of trades and average daily turnover should be applied rather than a "pick and mix" approach. Using both criteria would also help to create a more consistent approach on an EU wide basis, with the resulting increase in transparency and reduction in costs. We continue to support an EU wide test rather than a country by country approach.

Our members' would regard the €2 million as on the lowest edge of what they might consider to be an appropriate threshold for liquidity for a "pan-European" share. As we have previously proposed, a higher threshold of at least €5 million turnover (and 500 trades, defined as orders executed) may be more reasonable.

We would suggest that the daily turnover criteria should be raised especially as in CESR's proposed thresholds for pre-trade waivers, lower-mid-liquidity shares are those defined as between €1-25 million.

We also suggest that CESR should initially limit the number of shares in the definition of liquid in order to iron out any potential issues that are not obvious until the scheme is implemented. This would allow problems to be addressed on a rolling basis and the number of shares could be widened over time.

With regards to 22b) the free float requirement of €1 billion is dependent on share price and it is not exactly clear how it would be calculated.

2.2 Content of Pre-trade Transparency

Q. 3.1 Do consultees agree with the specific proposals as presented or would they prefer to see more general proposals?

Whilst we welcome CESR's decision to revise some of the most comprehensive publication requirements detailed in earlier consultations, we still consider the proposals to be overly detailed for Level 2 and would prefer to see more general and flexible proposals to take account of the differing needs of different market users. For example we object to CESR's proposals in paragraph 24 to extend the pre-trade transparency requirements for RM/s and MTFs.

Q. 3.2: Is the content for pre-trade transparency information appropriate?

We support CESR's decision to reduce the requirements for pre-trade transparency and welcome in particular CESR's acknowledgement that "MFID accepts different market models with varying degrees of pre-trade transparency as being sufficiently pre-trade transparent". We would encourage CESR to emphasise the text in paragraph 78 allowing flexibility for hybrid trading systems or those that do not rigidly fit the basic definitions. A flexible, principle based approach of seeking pre trade transparency that "...shall be in the interest of fair and orderly trading" is one we would support but we are not sure that for example 78 is appropriate to meet this objective.

Q.3.3: Do consultees agree on the proposed exemptions to pre-trade transparency? Are there other types of order/transaction or market models which should be exempted?

CESR has not outlined its methodology in reaching the pre-trade transparency waiver thresholds. Given the impact of these proposals, it is vital to ensure that these numbers are set at appropriate levels.

The pre-trade transparency waivers and definitions of liquidity do not seem to mesh very well with the definition of liquid shares given for Article 27 purposes. Our members have reflected that the waiver thresholds do not accurately represent current market practice and should therefore be lowered.

In line with our response to Q.6.1 we would support the calculation of thresholds based on the Annex I, option 2, second method approach, that is, 95% of number of trades, although we feel that CESR should consider lowering the threshold proposed.

Q.3.4: *Do consultees agree on the proposal in the second subparagraph of paragraph 84? Would it cause difficulties for firms trading in several capacities (systematic internalisation, crossing client orders etc)? Are there alternative ways to address the potential loophole between Article 27 and Article 44?*

We do not agree with this proposal which could have potentially unintended anti-competitive ramifications. The waiver should apply equally to all firms. Inserting such a provision equates effectively to introducing a concentration rule.

We do not share CESR's concerns over a potential loophole from transparency obligations as long as the systematic internaliser definition is correctly interpreted as applying to a particular activity in a firm.

We would urge CESR to delete the following section in paragraph 84:

"The Waiver is not available where the transaction is made by a member / participant in a share in which it is a systematic internaliser in a size equal to or smaller than the SMS for that share, except where the transaction involves the crossing of two client orders".

Secondly the terminology in paragraphs 83 and 84 should be made consistent; "members / participants of the RM or MTF" in 83 and "member / participant in a share" should both be replaced by "market participant".

Q.3.5: *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 MFID on the one hand and Art. 29, 44 MFID on the other hand would be advisable.*

Yes. We would support the proposal for a unified block regime provided that appropriate methodology is applied. The provision of worked examples with sufficient consultation time by CESR would have been useful and very desirable in aiding our assessment but this was not available at the time of writing our response.

Q.3.6: *Would you consider a large number of SMS in order to reflect a large number of classes each comprising a relatively small bandwidth of arithmetic average value of orders executed as problematic for systematic internalisers?*

As outlined in our previous response, CESR should be looking to achieve somewhere in the region of 5 to 6 classes as it is likely to be cumbersome to deal with a much larger number of classes. Under the current proposals there would be 10 classes under €100,000 alone. A number of BBA members have expressed support for CESR's suggestion of using a logarithmic scale rather than a linear one. Whilst this would seem a more complex methodology it would produce a simpler and clearer outcome. Given that firms will need to build new systems technology to implement these requirements, using a log scale would not represent a significant extra cost.

General remarks regarding SMS:

- We believe that Standard Market Size groups and Standard Market Sizes should be reviewed and amended by the Commission more frequently than every 3 years (Box 3, paragraph 91). Whilst the regime is bedding down we would suggest at least annual revision.

Q.3.7: *In your opinion, would it be more appropriate to fix the SMS as monetary value or convert it into number of shares?*

While Art. 27 requires the calculation to be based upon an “arithmetic average value of transactions executed”, the majority of our members believe that it would be more practical for firms to quote in terms of a number of shares than by value. This is because most quote systems are automated and the number of shares can be set for the whole of the quotation period whereas if the system is set by a fixed value this needs to be reset every day as the value of the shares go up and down.

Q.3.8: *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, especially, should the time of revision be fixed at level 2?*

Standard market size should be calculated on a clearly defined periodic basis which should not be too frequent. It will be important that this is done in a co-ordinated fashion on the same date and at the same time across all member states. We would suggest that SMS groupings are reviewed after the first year of operation as this is a new, untested, financial structure.

We welcome the text in paragraph 19, for SMS sizes to be adjusted as a result of exceptional market circumstances.

Our members believe that it is important for SMS classes to be reviewed when there is a fundamental material change to the share. This concept should take priority over a simple annual review.

While the Directive seems to envisage that national competent authorities will do this from state to state it would seem to make sense for CESR to create a co-ordinating policy for this so that there is consistency across European markets.

Q.3.9: 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 stocks to determine which class the share should belong to?

It would be reasonable to fix an initial SMS from the first day of trading by reference to its peer stocks. This initial SMS could be reviewed after a base period e.g. 1 month/ 3 months etc. This would be more efficient for the market and a similar process already takes place on regulated exchanges.

Q.3.10: Do you consider a two week period from publication as sufficient for systematic internalisers to adapt to new SMSs?

As outlined in our response to the previous CP, CESR should not set a fixed two-week period from publication at Level 2 as sufficient for systematic internalisers to adapt to new SMS. The time period should be appropriate to the share and the market respectively.

Given the technical implementation problems of changing the SMS in bank's systems, our members have suggested a period of 2 months to adapt to new SMS sizes.

Q.3.11: Do you agree on the proposal on publication of the classification of shares, would you prefer establishing a single contact point (at level 2)?

It would be helpful to consolidate the information about classification of shares at a single point of access, such as the CESR website. However national regulators should also be encouraged to at least repeat the information relevant to the local market on their website and link to CESR's website.

Q.3.12: *Do you have further comments on the proposals for the obligations of systematic internalisers?*

It is vital that firms which are acting as systematic internalisers be able to restrict their continuous quoting to European core trading hours. Firms should not be required to continue quoting because they have subsidiary branches in other global locations where markets are open. This would represent a significant and onerous requirement.

Post-Trade Transparency requirements for Regulated Markets, MTFs and for Investment Firms

Q.5.1: *Do consultees support the method of publishing post-trade information (either trade by trade information or on the basis of one price determination)?*

In paragraph 141 of the consultation paper, CESR outlines a requirement that an explanation is required to be published when a trade is executed at a deviation from the current market price. This seems an overly burdensome requirement and seems to indicate that CESR would need to prepare a whole list of “reason or explanation codes”. There may be myriad legitimate reasons for the divergence. This new indicator may also not be compatible with current trading platforms. Our members therefore do not support this requirement.

Q.5.2: *Do consultees agree that the responsibility for publishing the post-trade information lies on the seller in case of trades outside RM's and MTFs.*

Our members support this proposition in principle.

Transactions large in scale compared to normal market size

Q. 6.1: *Do consultees agree with the approach to establishing a threshold for a waiver from pre-trade transparency? Would the categoric approach cause difficulties or market distortion for shares with different trading patterns? Would the alternative proposal described in annex I option 2 (footnote 19) as more stock sensitive provide better outcome? If that approach would be taken, would the proposed threshold (95%) be appropriate and should it be calculated on the basis of trading volume of number of trades? Are there other alternative proposals that you would put forward, bearing in mind the objective of finding an easily understood and easily implemented solution?*

Overall with agree with CESR's suggestion that pre-trade thresholds should be smaller than post-trade thresholds for the reasons explained by CESR but mathematical analysis of the figures proposed does not always support this with CESR's proposals being occasionally inconsistent. For example ADV €2 million would yield pre-trade thresholds of €250 000 but post-trade thresholds of €200 000.

Of the two options outlined in Annex I, the BBA would support the use of option 2, second method in order to calculate pre-trade transparency waivers. The target percentage should be set on the basis of the number of trades although we believe that 95% may be still too high. As suggested by CESR we consider that this method would more accurately and sensitively track stocks than a simple numeric value threshold. This outcome would lead to a resultant reduction and possible distortions of trading.

(Please also see our response to Q.3.3).

Q.6.2: For purposes of calculating the average trade size for Article 27 shares, do consultees agree that trades larger than pre-trade threshold should be those that should be excluded when calculating the average size? If not, which trades large in scale compared with normal market size should be excluded? It would be helpful if any suggestions could be illustrated with resultant figures.

Yes, we agree with this proposition.

Q.6.3: Do consultees agree with the proposals for determining thresholds for deferred publication arrangements? Is the balance of proposed threshold sizes and time delays appropriate? If you consider that they should be modified, please suggest how and why.

The extension of deferred publication by lowering the average daily value thresholds would help to increase flexibility for firms. The time limits are essentially sufficient but under the current proposals, firms may have to report a number of very large size trades without the ability to have a limited deferred publication timetable.

Q.6.4: Do consultees consider that intermediaries should benefit from the maximum delay proposed, regardless of whether they have unwound their position? If not, on what basis should CESR recommend a rule aimed at requiring immediate disclosure once all, or the major part, of the position have been unwound?

Yes we support the proposition that intermediaries should benefit from the maximum delay proposed regardless of whether they have unwound their position or not.

Q.6.5: *Do consultees agree with the proposal that Competent authorities should be able to grant pre-trade waivers and/or approve deferred publication arrangements that comply with the minimum thresholds regardless of whether or not the competent authority of the lead market adopts higher standards? Would it be better to require all member states to follow the transparency arrangements adopted by the competent authority of the lead market, whether by the competent authority or the lead market operator? CESR would like to receive comments that throw more light on the pros and cons of each option?*

We support the proposal that Competent Authorities should be able to grant pre-trade waivers even if they are not the lead market.

Q.6.6: *Do consultees have any comments on the proposed short-term arrangements?*

We have no specific comments.

Q.6.7: *Do the proposals adequately address issues relating to less liquid shares? If not, what arrangements would be preferable?*

Overall we welcome CESR's recognition that less liquid shares need to be treated differently.

Q.6.8: *Is the suggestion in respect of portfolio trades suitable?*

The €3m market value requirement is unrealistic. Using a fixed value does not help to usefully define a portfolio trade. In the first consultation paper on pre-trade transparency, CESR defined a portfolio transaction as one which involves 10 or more securities grouped together into a basket and traded as a single lot against a specific reference price.

CESR accurately goes on to explain its reason for exempting portfolio trades from pre-trade transparency obligations is because such transactions would be impracticable for systematic internalisers to conduct within the general quote rules of Article 27.

This is for two main reasons. Firstly many investment firms normally tender for such transactions with only generic information about the portfolio, i.e. without knowledge of all the individual securities (or other financial instruments) that comprise the portfolio or even the direction of the trade (i.e. whether it is a buy or a sell). In addition, a portfolio is normally priced as a percentage of the aggregate (and, at the time, unknown) mid-market value of its constituent stocks, not on the basis of the currently quoted best bid or offer prices of individual components.

The application of the dealing rules under Article 27 to such transactions would reduce institutional ability to conduct such trades and in CESR's view this would increase investor dealing costs for no overall market benefit.

The commercial practices and the investor dynamics, which are set out by CESR remain unaffected by the aggregate market value of the portfolio trade. It is the *nature* rather than the value of the transaction that makes it unfeasible to apply pre-trade transparency obligations. The capricious €3m limit for portfolio trades will produce a contradictory result, where there would be additional cost to the client. It would be the investor who bears the cost from the application of the pre-trade transparency obligations to portfolio transactions. CESR should remove the second criterion of a minimum market value from the definition of a portfolio transaction and revert to the original definition proposed by CESR in the first consultation on pre-trade transparency.

Q.6.9: *Do consultees have any other comments on the proposals in this section?*

- We would suggest the following drafting change in paragraph 198: “on a reasonable commercial basis” should be added to the end of the sentence “.....or via proprietary means”.
- We would suggest that CESR should revise its advice in paragraph 187 as a requirement for quote publication during 100% of the normal trading hours of the firm’s internalisation activity is too onerous. Global firms will internalise on an almost 24/7 basis and therefore CESR should make it clear that it is merely referring to a lead market requirement.