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CESR's Consultation Paper „CESR Technical Advice to the European Commission in the Context of the MiFID Review –Investor Protection and Intermediaries” (Ref.: CESR/10/417)

Dear Sirs,

Enclosed please find our response to the Consultation Paper „CESR Technical Advice to the European Commission in the Context of the MiFID Review –Investor Protection and Intermediaries” (Ref.: CESR/10/417). We are grateful for the opportunity to comment on this important issue.

Yours sincerely,

Dirk Elberskirch

Thomas Dierkes

Enclosure

Response of the

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to the Consultation Paper

„CESR Technical Advice to the European Commission in the
Context of the MiFID Review –Investor Protection and
Intermediaries”

Ref.: CESR/10/417

31 May 2010

The comments of the Düsseldorf Stock Exchange focus on answering questions regarding Part 2: Execution quality data (Art 44(5) of the MiFID Level 2 Directive) see page 26 of Consultation Paper. Before moving to the questions in detail we would like to make some preliminary comments on data in the context of Best Execution according to MiFID.

Part Two of the consultation paper deals with many aspects in relation to the data which are necessary for the assessment of MiFID criteria. These data, for example, the information of pre-trade transparency, the corresponding volume, or the information about the speed of execution is usually published by the venues themselves. As far as under paragraph 88 of the consultation paper data vendors are listed as another source of possibly processed or aggregated data, it has to be kept in mind, that they receive most part of their data directly from the venues and thus the validity of the offered data and results depends directly on the quality of the basic data.

Basically it is about the quality of delivered or published data by the venues themselves. Usually, this aspect is given much too little or no attention during the practical implementation of Best Execution by the banks in Germany. Also in the consultation paper, this is not sufficiently expressed. Moreover, the true appreciation and evaluation of different data quality is absolutely crucial to the content and accuracy of the Best Execution Policies. In particular, the MiFID criteria price and likelihood of execution are affected by this.

Liability of pricing information

With regard to the factor “price” it should be noted that - in addition to the increasing needs of algo-traders` oriented Xetra trading system - in Germany the price building for the German retail business is done by specialists ("specialist market models" in accordance

with Art. 17 (5) Commission Regulation (EC) No 1287/2006). Within this specialist market model used by almost all German stock exchanges, the venues use different ways of creating pre-trade transparency: on the one hand by publishing in its rules and regulations stipulated binding quotes or on the other hand by non-binding quotes, which are only an indication. Only binding quotes, consisting of bid and ask and the accompanying guaranteed volumes, ensure an execution at that price. Consequently, without additional testing the basis of Best Execution Policies may only be binding quotes and not indications.

However, if a venue publishes only non-binding quotes, it is necessary to compare the actual order execution with the non-binding quotes at regular intervals with sufficiently extensive sampling. It must be checked whether the non-binding quotes, which are the basis for orders without instructions to a special execution venue, will be changed again or if they will be executed by the conditions published on arrival of the orders. Only in this way it can be determined whether the respective venue executes orders similar to the non-binding quotes.

Liability of execution volumes

Also concerning the likelihood of execution, the liability of the shown volume is essential. If a venue publishes binding quotes with volumes, which are guaranteed and stipulated in its rules and regulations, every order which fits the quotes will be executed.

In Germany, the Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin) recognized the importance of the quality of the delivered price data by the venues and accordingly commented on the Best Execution of client orders in the draft of "Mindestanforderungen an Compliance und die weiteren Verhaltens-, Organisations- und Transparenzpflichten nach §§ 31 ff. WpHG

[Wertpapierhandelsgesetz, Securities Trading Act] (MaComp)". In accordance with the text of BT 4.1.2., the liability of quotes and other price information as well as other qualitative differences between the venues should be taken into consideration for the establishment of the Best Execution Policy.

We take the following position to the issues:

13. Do you agree that to enable firms to make effective decisions about venue selection it is necessary, as a minimum, to have available data about prices, costs, volumes, likelihood of execution and speed across all trading venues?

No, we disagree. The question wrongly assumes that with this interpretation the investment firms have to consider all existing execution venues. Such a commitment is neither created in MiFID nor in section 33 a WpHG.

Therefore, it is vital to make clear that in the context of the establishment of the Best Execution Policies only such venues must be considered, to which the investment firms are connected. It is essential to avoid the impression that the investment firms must connect to all available execution venues. The question of which venue a bank/ an investment firm is connected to and is offering its customers for order completion, is a business policy decision and a matter for each individual bank/investment firm. This has no impact on the duties of Best Execution. For the establishment of the execution policies the bank/investment firm must therefore only take into consideration those venues to which it is connected. Of course, the investment firm has to make sufficiently clear to customers which venues have been involved in the process of identifying the customers` best execution.

Regarding these venues, where a connection exists, the investment firm needs of course data to assess the venues on the basis of MiFID-criteria. In this context, the already described differences in the liability of pre-trade data have to be regarded and appreciated. The need for information is low for such venues, where binding rules and regulations guaranty the MiFID criteria. A main reason for this is the fact that the observance of the exchange regulations in Germany is monitored by the market surveillances (public-legal authorities, determined in section 7 BörsG, (Börsengesetz, Exchange Act)) of the stock exchange.

14. How frequently do investment firms need data on execution quality: monthly, quarterly, annually?

In our view a half year cycle keeps a proper balance between costs and benefits of data collection and analysis. Data processing and possible changes in the execution policies with respect to the necessary customer information causes considerable work in the investment firms. This effort has ultimately to be paid for by the private clients. Considering the marginal differences in quality between the venues in Germany, the resulting benefit for the customers are very limited.

15. Do you believe that investment firms have adequate information on the basis of which to make decisions about venue selection for shares?

Investment firms usually have a data access to the venues, which they offer to their customers for order completion. With this access any investment firm has the possibility, to note and to use all pre-trade-information and execution data, which are necessary for the establishment of the Best Execution Policy. Moreover, important data of the venues

such as pricing and information on binding rules and regulations (if they exist) are available and can be downloaded on the web sites of the stock exchanges.

Investment firms, which do not want to generate such information themselves, have the possibility to obtain the necessary data from the venues directly. In Germany, this approach is already used by several major transaction banks, gaining data from the venues in a six-month rotation. Such a practice constitutes a reasonable balance between costs and benefits of data collection and processing.

16. Do you believe investment firms have adequate information on the basis of which to make decisions about venue selection for classes of financial instruments other than shares?

At German exchanges the trading of non-shares works just like trading of shares. Therefore, the answer to this question follows the remarks on question 15.

But, great differences exist in the number of venues, which is significantly lower for non-shares than those for liquid shares. The more specific the securities, the fewer venues are there. In the market it can be observed that there are increasingly more venues, which are specialized in highly liquid shares and which limit their offer to such securities. Based on this Cherry-Picking, these venues have the opportunity to offer their services for much lower fees than it is possible for the traditional stock exchanges as a venue with an "All-in-one-Solution". However, these traditional exchanges with their complete range of services represent a fundamental and important contribution to the functioning of the financial markets. In the whole discussion, this fact gets far too little attention with regard to Best Execution.

17. Do you agree with CESR’s proposal that execution venues should produce regular information on their performance against definitions of various aspects of execution quality in relation to shares? If not, then why not?

The Duesseldorf Stock Exchange would of course provide all the data defined by CESR and would make it available for investment firms. However, we are critical about the central guidance on the content and organization.

If guidelines are implemented, it is important to make the measuring and evaluating of the quality of data to a compulsory part of the CESR-definitions. Already at the beginning of our comments we have extensively shown the importance of different qualities of the data (esp. price) of the execution venues. If CESR limits the delivered information without defining any quality certification by the venues or without validation by the investment firms, this would discriminate against the venues acting in the market with binding rules and regulations on e.g. price, spread and volume.

Even though the qualitative differences will be taken sufficiently into account, central guidance on the content and organization show even then the danger of leading to uniform policies, although the banks should create Best Execution of the individual retail order-flow according to MiFID.

It does not appear unlikely that in Germany the planned CESR guidelines will further strengthen the already discernible tendency for the outsourcing of Execution Policies by the investment firms. This mainly because of the particularly at large settlement and transaction banks practiced purely digital-mathematical implementation of the best execution rules. This mathematical implementation of best execution rules leads in the end to an absolute priority of eligible execution venues, technically implemented in the

order routing systems.

Determining the priority of execution venues at the first level, when criterion is price, virtual sales and purchases are calculated. This is done randomly for certain order sizes in various types of securities on the basis of non-binding quotes or binding quotes. As a result the transaction bank gets the implicit costs of those transactions as the difference between bid and ask. These virtual costs and the individual transaction costs of every stock exchange are added. The sum represents the total costs per stock exchange.

In this mathematical logic the total costs are crucial for the hierarchy of execution venues for each type of security. That means, that already a positive difference of Euro 0,01 leads to rank no.1 and thus this stock exchange receives all orders in the relevant type of security. In this case the other stock exchanges will not get any orders without instructions concerning the execution venue. The mathematical approach leads to a digital solution: One execution venue is the winner and receives all orders while already rank 2 is last and receives no single order.

The digital interpretation of the Best Execution requirements is not the intention of MiFID and the German implementation act. According to § 33 a WpHG (Securities Trading Act) the choice of the execution venue for orders without instructions must be affected by relevant differences, not relevant differences on the other hand can be taken into account. If the differences between execution venues are small, for example in total costs only a few cents meaning tenth of a percent of the value of an order, then it must be possible to choose between venues without getting into trouble with Financial Supervisory Authorities. The legal requirements approve such a spread.

A “spread solution” does not only comply with the wording of MiFID but also with its objectives. By MiFID competition for the benefit of customers between the execution

venues should be promoted and not be finished. However, the objective cannot be achieved if the application of the Best Execution requirements targets only one proper solution. With digital, mathematical models the objectives of MiFID will ultimately be thwarted.

Thinking the mathematical model to its end, it would lead not only in Germany, but in an ultimate consequence in all EU member states in the various types of security to only one remaining execution venue. Competition would be finished.

This risk must be respected in the central guidelines on the content and organization of data for Best Execution. So, in the definition of the guidelines it should be considered, also to define a permissible range for each of the criteria.

18. Do you have any comments on the following specifics of CESR’s proposal: imposing the obligation to produce reports on regulated markets, MTFs and systematic internalisers; restricting the coverage of the obligation to liquid shares; the execution quality metrics; the requirement to produce the reports on a quarterly basis?

imposing the obligation to produce reports on regulated markets, MTFs and systematic internalisers

As already stated in question 17, the Duesseldorf Stock Exchange will provide all data defined by CESR and will make it available for investment firms. We have already expressed our doubts concerning the danger of providing uniform policies and the impact on competition.

restricting the coverage of the obligation to liquid shares

The commitment should be limited to the area of liquid shares.

the execution quality metrics

We see some of those in paragraph 120 according to US-Rule 605 reports listed points critical. In detail, we have the following comments.

- **the types of orders relevant to include in key metrics of execution quality**

At first glance, we do not recognize at least for the area of retail customers, the effects of order types on best execution in the sense of MiFID. However, if the project of defining guidelines is kept, in the definition of the order types it is important to ensure that the fixing of them does not act in a discriminating way against venues, which do not offer this special order type due to their market model.

- **a market share statistic for trading in individual shares**

For several reasons we think it is unfavourable to use statistics on market shares for the decision on the customers best execution. Yesterdays water does not power the mill today.

There are - at least in Germany - no constraints on what data must be incorporate in the different order and sales statistics. At present, for the various venues there are some very different practices accounting sales, they needed to be harmonized at first.

In addition, it is difficult to say what kind of impact historical based transactions statistics have on Best Execution. We admit, that for a long time, the question of the execution venue with the best execution was answered looking at the trading volume in

the past. Orders without execution venue assignment were routed to the exchange where in the relevant securities at that day or, more generally, overall the highest trading volume was recorded. With a view to mandatory price and volume guarantees at different venues, the concept of liquidity has now to be redefined. If the execution is guaranteed (by rules and regulations) to a defined price and a certain size by the venue, it must be assured according to MiFID that the criterion of historical turnover will not be of further interest. It is crucial to look ahead, in other words: the question of how the order will be executed is interesting.

- **a measure of the likelihood of execution based on looking at orders filled relative to orders received (including looking at orders cancelled)**

Here, as well, we do not understand the underlying considerations. The guideline is likely to disadvantage retail-oriented trading venues, because private customers are limiting their orders usually not quite as close to the market price as professional customers and algo-traders do. It is therefore the danger that the quota in retail-oriented venues could get worse.

- **appropriate statistics to measure the speed of execution**

Execution speed is basically quite an important aspect for the client/counterpart. But, in the meantime, there has developed a race to the shortest speed of execution (latency) between individual venues, to be successful in the competition for so-called algo-traders.

Algo-traders are hedge funds and brokers that monitor the markets by computer, feed them with data, generate and send buying and selling orders at the markets in fractions of seconds by self-developed rake and decision-making models. Speed is the duty and, for example for the electronic trading system Xetra of Deutsche Boerse AG, there is already running the technical upgrading in the competition for nanoseconds.

According to the latest figures within the system XETRA algo-traders are already responsible for more than 55 percent of the orders and for more than 45 percent of the executed volume, both with strong rising tendency.

For private investors this competition on speed of execution within milli-, micro- or nanoseconds is simply irrelevant. Especially, because they are not able to see the concerning price changes published on the internet-based information systems. Therefore, the importance of speed in the Best Execution for private clients should not be overstated. This could be wrongly signalled by establishing a sufficient speed of execution for this kind of customer group.

- **a formula for calculating Best Bid and Offer (BBO - which, amongst other things, would need to cover which bids and offers were eligible for inclusion)**

We understand this point in the way that CESR intends to draw up a consolidated BBO-Tape for all venues. Regarding the described different orientations of the execution venues, we are sceptical whether a single BBO-Tape for retail clients and institutionals makes sense.

Moreover, as we already mentioned at the beginning, at the contemplation of the BBO at the various venues, it is crucial to take a look to the differences in the quality of pre-trade prices (bid and ask of the quote). Therefore, we are pleased that this issue correctly recognized that bids and offers differ in their qualities and that these differences will be considered in the CESR-defined guidelines.

- **formulas for effective and realized spread**

In this issue it is indicated that there is a difference between the spreads at the time of the order-arrival and their execution, and that this difference has to be considered within the context of Best Execution. This is our conviction, whereby venues with

binding pre-trade prices should be included differently in the consideration as such, where the pre-trade prices are published as non-binding quotes.

- **indicators of the result of the execution of orders compared to the BBO**

For this mentioned matching with the BBO - and we clearly point out - it is vitally important that the calculation of the BBO only considers binding pre-trade prices.

- **the requirement to produce the reports on a quarterly basis**

As we already stated in our reply to question 14, a half year cycle is sufficient.

19. Do you have any information on the likely costs of an obligation on execution venues to provide regular information on execution quality relating to shares? Where possible please provide quantitative information on one-off and ongoing costs.

Of course, we do not have valid information of costs, resulting from data-delivery-commitments. The amount depends very much on the defined requirements. In our answers to questions 17 and 18 we have already noted that we do not believe in all aspects listed in paragraph 120, leading to a goal.

In this context, also aspects of paragraph 121, such as the frequency with which any reports have to be created, as well as their organization and the way of the publication have to be included. Therefore we would like to estimate that the one-off/non-recurring costs for a venue have to be calculated between Euro 250,000 and 500,000 and the ongoing/ annual costs could be calculated between Euro 100,000 and 150,000.

20. Do you agree with CESR that now is not the time to make a proposal for execution venues to produce data on execution quality for classes of financial instruments other than shares? If not, why not?

We agree with the assessment of CESR. Already for shares the commitment should be restricted to those with high liquidity. It is only logical that the scope of the planned guidelines is not extended on non-shares.