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CESR Final Consultation (Ref. CESR/05-164) on Best Execution and Transparency Requirement under the MiFID, Directive 2004/39/EC

Comments from the Swedish Shareholders' Association, SARF, to CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments 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, on Best Execution and on Market Transparency. Ref.: CESR/05-164.

The Swedish Shareholders' Association (Sveriges Aktiesparares Riksförbund - Aktiespararna) is an independent organisation working in the interests of private individuals who invest in stocks, mutual funds and other stocks related securities.

CESR has released a last consultation paper (Ref. CESR/05-164) on possible implementing measures needed of the Directive 2004/39/EC on Markets in Financial Instruments (MiFID). MiFID forms one of the cornerstones of the EU's securities regulatory regime, and is intended to deliver an effective 'single passport' allowing investment firms and regulated markets to operate across Europe, under a common set of rules which enhance the protection of European investors.

These measures are being developed on the basis of mandates given to CESR by the European Commission. Under these mandates, CESR has been asked to widely consult on many substantive areas set out in the MiFID and to provide its advice to the Commission on the possible implementing measures. The consultation paper addresses the technical advice and covers the following areas:

- General obligation to act fairly, honestly and professionally and in accordance with the best interests of the client - lending to retail clients (Article 19(1))
- The definition of investment advice - generic and specific advice (Article 4(1))
- Best executions (Article 19 (1) and 21))
- Transparency requirements (Article 4, 22(2), 27 to 30, 44 and 45)

Chapter 1: General Obligation to act fairly, honestly and professionally and in accordance with the best interests of the clients – lending to retail clients, Article 19(1)

Question 1 and 2 are answered as one.

Article 19(1) of the Directive states a general principle of fair treatment of clients. The important point is to protect the interests of the client. Consumer has a weaker position on the financial market compared with the investment firms dominate position and for that reason the consumer's protection must be protected by legislation. Therefore SARF believes that before an investment firm accept a loan or credit of money for investment in the financial market they should be obliged to evaluate the suitability of that loan or credit, especially taken in mind the financial as well as complexity of investing in the stock market. The investment firm should also evaluate the client's ability to pay off the loan if the transaction in a financial instrument turns out to be unsuccessful. It is also important that the investment firm obtains the necessary information about the retail client's investment objectives in addition to his financial situation. Especially since clients tend to believe that the investment firm has approved his total strategy because the investment firm knows everything about his economic situation.

Chapter 2 The definition of investment advice – generic and specific advice, Article 4(1)

Question 1 and 2 are answered as one.

In its draft advice published on 21 October 2004, CESR proposed implementing measures under Article 4(1), (4) of the MiFID on the definition of "investment advice". CESR believes that the advice should conform to the following principles:

- the approach should strike an appropriate balance between the need to protect clients and potential clients and the desirability of providing firms with commercial freedom in the way they structure their services; and
- the approach should also ensure an appropriate perimeter for the regulatory regime (both in terms of the scope of the authorisation requirement and the scope of the passport), bearing in mind the other applicable provisions in the Directive.

Advice provided by an investment firm should always be considered an investment advice. Clients and investment firms will never have a clear common understanding of which information is an information advice, and which is not. Private clients cannot understand the difference between generic and specific advice. They misinterpret general information as investment advice. The investment firm's people on the other hand are obliged to sell more and since there are economic advantage when the client buys and sells, as well as the firm provide the client with loans or a credit. Consequently, there can easily become conflicts of interest.

SARF would like to emphasize the importance of investment firms obtaining information about the clients and his financial situation before recommending any financial instrument or transaction. This would enable the financial firm to determine the suitability of the investment service and instrument for the client. The consumer always has a weaker position on the financial market, particularly when it comes to knowledge. Therefore the directive should try to protect the financial investor in the best way, which might include both generic and specific advice. Furthermore, we would like to make the point that information about forthcoming decisions on listings, corporate actions, inclusion in a specific market segment or index, or on the creation of a derivative could, among many others, also easily obtain the character of a recommendation.

Chapter 3 Best execution, Articles 19 (1) and 21

The questions are to a large extent directed to investment firms and intermediaries. So our comments are of a general character.

The paper addresses mandates regarding investment firms' duty of best executing an order. The articles 19(1) and 21 are intending to guarantee the customer the best execution of an order no matter if the order is carried out by the investment firm itself or by an execution venues. The fact that Article 21 is not limited to shares but applies to all financial instruments gives a wider extent of the legislation which will benefit the investors especially since the increase along with the development of complex investment instruments. SARF consequently believes that both Articles will enhance the consumers' situation on the financial market.

According to Article 21 the investment firm should account the costs when determining what is most favourable to the client. In the paper CESR asks if the market participants consider that the distinction between internal and external costs is relevant? SARF's opinion is that both internal and external costs are relevant for the client and that both costs for that reason must be taken into account when the investment firm executes an order. To only take into account one cost will mislead the customer about the true cost of the transaction. To the private investor the important issue regarding costs is the total costs, which should preferably be expressed in one figure. Additionally SARF would like to point out that firms determine that other factors are more important than price and costs when executing retail orders this should be highlighted. Otherwise the retail client could easily be misled.

CESR suggests in the proposal that most investment firms execute there venues on a continuous basis, but not all. Therefore CESR asks if there is any better way to execute the venues. SARF agrees with CESR that it is necessary to provide a minimum requirement for regular review of an investment firm's execution arrangement, at least annually. Changes in several areas could lead the firm to re-evaluate their execution arrangements; such as changes of commission rates and changes in the trading services. According to the document most executed venues believes that execution venues do make investment firms aware of material changes to their business, but that there were some areas where the information was not

fulfilling. Which leads to the question whether market driven solutions are the best way to guarantee information? Since SARF do not operate in that particular area we can not answer whether an intermediaries are likely to inform an investment firms about material changes to their business or not.

It is difficult for private investors to choose between investment firms based on best execution, because private investors can not test different suppliers the way a professional investor can. So private investors have to make their choice based on the information they can get on the company's policies and the experience they obtain as clients. It is therefore important that private investors learn to ask questions. It is also an essential that investment firms give full information on the risks private clients run. If different execution strategies carry different elements of risks for the clients, this should be stated explicit to the clients up front.

Information regarding the investment firm's policy towards error correction and order handling policies are central to a client's understanding of the firm's execution policy and arrangements. Therefore, SARF is positive to the proposal that investment firms should disclose information about their error correction and order handling policies.

Chapter 4, Transparency requirements (Article 4, 22(2), 27 to 30, 44 and 45)

Pre-trade Transparency for Regulated Markets, MTFs and Systematic Internalisers

According to CESR there are several ways to define those shares which are deemed to be liquid for the purpose of Article 27 and therefore ask whether the proposal approaches to identifying liquid shares establish a sound mythological approach. A share should be deemed to have a liquid market when the shares are traded daily and the free float of the share is at least 1 billion euro. The Member State should also choose one of the following alternative criteria: the daily average number of transaction in a share is more than 500 or the average daily turnover in a share is more than 2 million euro. SARF supports the suggested requirement; however there are some cases when a share is not traded daily even though it is registered for trade.

Pre-trade transparency

CESR propose that regulated markets and multilateral trading facilities should public pre-trade information. SARF agrees with the idea that pre-trade information should be made public, but CESR gives several exemptions to the obligation. For example, RM and MTF should only present the aggregate number of shares and orders represented at each price level up to the five best bid and offer levels. Since the consumer has a weaker position on the financial market SARF are uncertain about the exemption and would like to address CESR to examine their consequences.

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

In the view that Investment Firms should publish the volume and price of transactions made on a regulated market outside a RM or MTF, CESR has specified the scope and content of the information. For example, the security should be identified and the date as well as time of trade, price and volume should be made public. CESR asks if the consultants support the methods of publishing post trade information either by trade by trade information or on the basis of one price determination. Since an effective market requires that all available information is made public SARF supports the idea. The responsibility for publishing the post-trade information should, as CESR suggest be placed on the seller on case of trades made outside RMs and MTFs.

Transactions large in scale compared to normal market size

CESR has been given mandate from the Commission regarding Article 44 and 45 to establish criteria for determining the type and size of orders for which pre-trade transparency obligations may be waived and define orders that are large in scale compared with normal market size. Therefore, CESR suggest that Member State should require the competent authority to calculate the minimum thresholds for a share on the base of the specified percentages for the average daily value of order book trading on the lead market for the share. CESR now asks the consultants whether they agree with the approach to establishing a threshold for a waiver from pre-trade transparency. SARF question the suggestion grant pre-trade waivers. During the past years there have been several scandals on the financial market which have undermined the public belief. The upper point is therefore to re-establish the faith in the market. SARF believes that there is a significant risk that private investors will disadvantage form the system and therefore we would like to see a further investigation before the system is put into legislation.

Furthermore, CESR also asks whether the consultants agree with the suggestion that competent authorities should be able to grant permission and weather the consultants agrees with the suggested methods. SARF consider that if the system of pre-trade transparency obligations may be waived is carried out it is desirable to focus on methodologies that are simple to understand and to calculate.

Yours sincerely,
Swedish Shareholders Association
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