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**Response to CESR/ 05-164;
Second consultation paper on possible implementing measures of
the Directive 2004/ 39/ EC (MiFID)**

Dear Fabrice,

Thank you for the opportunity to comment on CESR's second consultation paper on possible implementing measures of MiFID.

This document and its attachment constitutes the Deutsche Börse's response, first summarizing the most important points from our perspective and second providing specific comments on consultation questions as appendix.

We explicitly recognize the considerable efforts CESR has spend on discussing and providing its current draft advice. Overall, we welcome CESR's current draft advice and regard its results, in most aspects, as valuable contribution to the overall MiFID process. Our three most important points in discussing the second consultation paper are:

■ **Best Execution**

Best Execution is both a core aspect of investor protection and provides an important linkage between the different aspects of MiFID to ensure current and improve future service quality in the provision of investment services. We support CESR in its basic approach towards Best Execution. CESR's current draft advice will serve as a valuable basis to implement Best Execution as a guiding principle in investment services quality. CESR's advice has the potential to support investor education and to provide an effective framework to further develop Best Execution practices by market forces over time.

■ **Systematic Internalisation**

With respect to the definition of systematic internalisers, we oppose the inclusion of quantitative criteria in CESR's draft advice as unnecessary. We regard the so far qualitative definition as a sufficient approach and workable alternative on the principle "same business, same rules".

With respect to the definition of a liquid market in an individual share, we suggest to implement the criteria turnover velocity instead of free float. CESR's draft advice focuses on large cap instruments only, missing the relevant instrument universe in the context of Article 27, and provides a "one-size-fits-all" approach which is not suitable on a pan-European basis.

■ **Pre trade transparency requirements for regulated markets and MTFs**

We generally welcome and support CESR's advice on pre-trade transparency requirements for regulated markets and MTFs. We explicitly recognize the significant improvements CESR has achieved in respect to Article 44 advice.

Nevertheless, the current CESR advice introduces a new paradigm of "pre-negotiated trades" into the discussion of pre-trade transparency waivers. We regard this paradigm as incomprehensible and unjustified both with respect to level one text as well as with respect to level two mandate. CESR's draft advice includes potential regulatory loopholes between regulated markets, MTFs and systematic internalisation and appears counter-productive in its results. Therefore, we ask CESR to either delete the respective advice or clearly justify its relation to level one text and level two mandate, provide the motivation for additional waiver necessity and precisely define the scope of the respective advice.

We hope that you find the attached comments useful in your further considerations and look forward to continue the successful work with CESR on these issues.

Yours sincerely

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Appendix - Specific questions raised in consultation and comments

Best Execution

Best Execution and Article 21 are key elements of MiFID. The principle of Best Execution is a core aspect of investor protection and provides for the necessary linkage between the different aspects of MiFID. We support CESR in its basic approach towards Best Execution. CESR's current draft advice will serve as a valuable basis to implement Best Execution as a guiding principle in investment services quality. CESR's advice has two important potentials. First the potential to support investor education which is the most effective way to promote investor protection. Second the potential to provide for an effective framework to further develop future Best Execution practices by market forces over time.

The potential for further development is especially important as one should not expect an already concluding Best Execution setup at this stage. Best Execution is no static, ex-ante defined methodology across market structures, investors, financial instruments and business models. Instead, Best Execution focuses on the results of order execution processes and develops its proper best practices dynamically with changing market structure, trading strategies and patterns, technology and investor needs with respect to different financial instruments. Therefore, it is most important today to guide the right direction towards developing future Best Execution practices in European capital markets.

CESR has taken up that difficult task and managed it successfully. The current draft advice is an important and big step ahead down the road, it is sufficiently definite to guide the right direction but yet flexible enough to allow for Best Execution to develop its best potentials for the benefit of investors and market efficiency at first glance.

However, one key question remains still open: If one expects Best Execution to develop recognized best practices and work effectively in the future, how can this happen without the ability to compare between individual Best Execution practices resulting in different investment services quality?

CESR's current draft advice misses that open key question so far. What is obviously missing to enable investors to decide whether they obtained best quality or not by their needs is the ability to compare between Best Execution practices and results. But who will decide on what is Best Execution and how best practices should be further developed if not investors? Consequently, Best Execution results should be published to give investors the possibility to compare for different market practices in Best Execution. Without any transparency on Best Execution results, it remains open how Best Execution should

develop its future potentials and best practices effectively in operational business.

On that background, CESR's current draft advice provides a truly valuable basis for the implementation of Best Execution as guiding principle - CESR puts up Best Execution on sound standing feet but it remains questionable how Best Execution should walk on them in the future.

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 and support the rephrasing of the qualitative criteria defining systematic internalisation in paragraph 11 as they reflect the past discussions accurately. We regard the drafted qualitative criteria as a workable and sufficient approach on the basis "same business, same rules".

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

We regard the inclusion of quantitative criteria as unnecessary, especially on an indicative basis. The drafted quantitative criteria rely on a speculative basis without funded derivation or impact assessment but departing from the principle of equal treatment "same business, same rules". The question how these quantitative criteria should be verified remains all open. We suggest deleting paragraph 12.

Pre-trade transparency requirements

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.

CESR's proposed approach to identify liquid shares in the context of Article 27 on the basis of free float is focused on large cap instruments only and provides a "one-size-fits-all" approach which is not suitable on a pan-European basis.

The free float requirement of 1 billion Euro includes already large cap instruments only and by that misses to assess the relevant instrument universe in the context of Article 27 and its objective of investor protection. The free float

approach does not reflect market reality of systematic internalisation where often technology shares or mid caps are in focus as “hot shares” in retail business although these instruments do not provide for any comparable market cap or free float in contrast to established blue chip equities. But especially the high retail investor interest and the high trading frequency defines these shares as attractive for systematic internalisation and consequently liquid in the context of Article 27. E.g. in the German market, the current advice defines as liquid all 30 DAX equities but only 1 TecDAX equity.

As an alternative approach to the proposed absolute criteria, we suggest the relative criteria turnover velocity, defined as the ratio of turnover and market cap or free float. This criteria has the potential to identify the necessary and required trading activity more objectively and refers to the individual instrument characteristics for the purposes of Article 27. The criteria unites the proposed CESR measures and therefore imposes no additional computation efforts in comparison to CESR's current draft advice. As a reasonable threshold to consider a share as liquid for the purpose of Article 27, we suggest referring to the lower bound of 100% on an annual basis, i.e. the total free float or market cap is traded at least once in a year.

Ultimately, the criteria turnover velocity resolves the problems associated with CESR's current draft advice. Turnover velocity provides for a meaningful distribution of liquid shares across branches that adequately reflects the business approach of systematic internalisation and does not impose a restrictive definition in a pan-European context.

CESR may wish to evaluate this alternative approach on the basis of the market data at hand as published (Annex to the consultation document CESR/ 04-562) and we will be happy to further discuss the advantages of it.

Alternatively, we argue to rely on current market definition and data for the free float criteria instead of creating a new definition and suggest lowering the restrictive criteria of 1 billion Euro to not more than 500 million Euro.

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

We agree with the specific proposals in Box 3, numbers 73-80.

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

We welcome CESR's more flexible approach to different market models as well as the decision to limit the required market depth display up to the five best bid/ offer levels.

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?

To our understanding, level one text allows for no exceptions by certain order management facilities but only by order type or market model. We would like to ask CESR to clarify number 81 of the advice.

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 capacity (systematic internalisation, crossing client orders etc.)? Are there alternative ways to address the potential loophole between Article 27 and Article 44?

We strongly disagree on the proposal. Box 3/ 84 in combination with numbers 41/ 42 in CESR's explanatory text appears incomprehensible in the context of regulated markets and unjustified both against level one text and level two mandate.

Pre-negotiated trades as referred to in number 41 are closely related to pre-arranged trades which are generally interdicted on regulated markets not only in Germany. It remains questionable why general market practices, interdicted for good reasons today, need to be legalized by future European regulation? This question remains especially evident as level one text defines the core of a regulated market on a multilateral and not a bilateral trading basis (Article 4(14)) with the clearly defined exceptions in recitals 49 and 53 MiFID.

With its current draft advice, CESR gives the impression that bilateral trading would be at the core of regulated markets and enlarges by level two advice the clear scope and definition of MiFID recitals 49 and 53. On this background, we regard CESR's advice to be in opposition to level one text.

Level two mandate includes the request for advice on pre-trade transparency waivers with respect to order size, type and market model. In number 84, CESR advises on a selected type of trades, namely negotiated trades. The mandate on Article 44 does not include trade types.

CESR current draft advice opens up potential for regulatory arbitrage on European level and bears the potential to cancel level one intention on pre-trade transparency for selected business models on level two.

Number 42 explains CESR's motivation by reference to large orders or non-standard market conditions in order book trading. With regard to large orders, Box 3, number 82 already provides for the proper waiver in pre-trade transparency making number 84 redundant, especially as number 84 speaks of "regardless of the size of orders ...". With regard to non-standard market con-

ditions in order book trading, CESR should include this explicit reference in its draft advice for number 84 if the waiver is meant for that exceptional, limited scope of trades only.

In any case, we ask CESR to clarify the justification of Box 3/ 84 on the basis of level one text and level two mandate. We ask CESR to clearly define the market model to which number 84 refers to as motivation to grant a waiver from pre-trade transparency, to clearly define the intention of number 84 advice and to avoid any loopholes between Articles 27 and 44 by mixing up regulation on systematic internalisation as bilateral trading model and regulated markets as multilateral trading models.

Unwanted loopholes can be avoided either by deleting number 84 or at least by deleting Box 1/ 12 and making the level one text justification and intention of Box 3/ 84 unambiguously clear and comprehensible.

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 MiFID on the one hand and Art.29, 44 MiFID on the other hand would be advisable?

We agree with CESR's draft advice for a unified block regime.

Q 3.6: Would you consider a large number of SMSs 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?

We generally agree with CESR's current draft advice.

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?

The SMS should be fixed as monetary value to avoid any confusion within one class of shares but also between classes of shares.

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?

We agree with the CESR draft advice on annual revision cycles, the time of revision should be fixed at level 2.

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 peer stocks to determine which class the share should belong to?

We regard it as reasonable to fix an initial SMS from the first day of trading of a new issue and support CESR in its draft advice Box 3/ 95.

Display of client limit orders

We support CESR's draft advice with respect to the display of client limit orders in Box 4. Except, we regret that CESR has deleted in its current draft advice the Best Execution reference as an important aspect in order execution. We suggest to keep the Best Execution reference in Box 4 advice as has been suggested by CESR in its first consultation.

Post-trade transparency requirements

We welcome and support CESR's draft advice that the publishing of trades done on a regulated market or MTF should happen according to their rules. Regulated markets have proven track records organizing market transparency in a very efficient, reliable and upright manner accessible to every interested party.

Q5.1: Do consultees support the method of publishing post-trade information (either trade by trade information or on the basis of one price determination)?

We support CESR's current draft advice to allow for publishing of post-trade information on the basis of one price determination at one point in time.

However, in case an execution venue and/ or market segment operates a block delay function, and/ or the trade data will be reported via a reporting channel using a block-delay mechanism, trades should be reported "trade by trade" to avoid unwanted triggering of delays for which every single trades itself would not have qualified for.

Q5.2: Do consultees agree that the responsibility for publishing the post-trade information lies on the seller in case of trades made outside RMs and MTFs?

We see no alternative but that a clear decision will be made as to whether the sell side or the buy side of the transaction is responsible for post-trade reporting outside a regulated market or MTF. A lack of decision will likely lead to uncontrollable and random reporting and may increase the risk of inferior market transparency in general. We have no preferences as to which side of the transaction should assume responsibility for reporting but it should be consistent.

Transactions large in scale

Q6.1: Do consultees agree with the approach to establishing a threshold for a waiver from pre-trade transparency? Would the cathegoric approach cause difficulties or market dstortion 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 or 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?

On the background of past discussions, we regard the approach of CESR's current draft advice as suitable. We oppose the alternative proposal of footnote 19 as unpractical and computing intense without consideration of its suitability. If CESR tends again to introduce more objective methodologies into the discussion, we strictly prefer the Market Impact methodology as best suited to objectify liquidity in an operational sense for the subsequent deduction of waiver thresholds.

Q6.2: For purposes of calculating the average trade size for Article 27 shares, do consultees agree that trades larger than the pre-trade threshold should be those that are 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.

We would like to ask CESR not to rephrase level one text. Share grouping in the context of Article 27 does not refer to average trade size but to the average value of orders executed. In its explanatory text (number 159), CESR mixes up the terms trade, transactions and executed orders. These terms are neither identical nor can they be used substitutional.

If, for matters of practical facts, CESR decides to deviate from level one text, we ask CESR to clearly identify the deviation, provide the motivation for it in its advice or explanatory text and suggest a workable solution to overcome the practical problem.

For the purpose of number 173, we support CESR's draft advice with the addition to include a correcting factor as a workable solution to overcome data problems. To recognize the practical implications of calculating averages on the basis of trades instead of executed orders, this factor should be multiplied with the average trade size for the purposes of Article 27 and be no less than 1.5 as long as practical data problems exist with reference to level one text.

Q6.3: 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.

On the background of past discussions, we basically agree with CESR's draft advice and propose to introduce a fourth class of shares in order to avoid overstretching the mid class from 1-50 million Euro. We suggest to group by 1-25 and 25 to 50 million Euro in order to account better for market needs.

Q6.5: 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?

In general, the argument for a unified transparency regime is to avoid regulatory arbitrage by different transparency requirements across markets. In practice however, we argue that, also in a non-unified transparency regime, market forces will drive towards a harmonized waiver/ deferred publication framework across markets on the basis of minimum thresholds anyway.

For that reason, we propose that competent authorities should be able to grant waivers and 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, if any. This alternative will leave the necessary freedom for market design to fit the needs of individual markets while for the same time enabling market forces to work towards a harmonized environment, developing naturally the most efficient transparency framework.

Q6.8: Is the suggestion in respect of portfolio trades suitable?

We support CESR's draft advice in respect of portfolio trades.

Publication of transparency information

Based on CESR's comments (S.76, no.186) we understand that many open issues regarding transparency and consolidatability of pre- and post-trade data will be postponed until after the finalization of the level two advice.

However, for the avoidance of doubt, we would once more like to put forward

some of the issues which we deem most important to be taken into account in CESR's advice to the European Commission in level two already.

Especially with regard to the pre-trade transparency requirements for systematic internalisers, we clearly would like to point out that the display of pre-trade data on the firms web-sites only will very likely lead to a lack of overall visibility and therefore a lack of accessibility as well and will deprive valuable information for the price formation process from the overall market. We therefore would like to see CESR to propose that systematic internalisers may use proprietary arrangements only in case they can firmly prove that their data is easily consolidatable and is consolidated at least within one global consolidators (usually vendor) and therewith available to a broad public. In any case we embrace market driven solutions.

Besides of this most important issue, CESR did not mention anymore the possible harmonization of a European Securities Identifier in its last advice. We therefore assume that this discussion has been postponed. However, we would like to state once more that in case of a harmonization we do not see any alternative to the ISIN code.

Third, for the avoidance of doubt, it should be noted that Central Counterparties (CCP's) operated by a regulated market do not hold the legal status of an investment firm, and therefore should not be obliged to reporting. This is essential also for the avoidance of duplicate reporting.

Finally, to provide for a level playing field within a competitive Market, CESR should forward within its advice to the European Commission explicitly, that regulated markets may act in the role of a "third party provider" and offer their data dissemination services in more than shares admitted to trading on its systems.

Frankfurt/Main, April 2005