Enclosure to Letter N°0656

Fédération Bancaire Européenne

European Banking Federation

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ADDITIONAL RESPONSE TO

CONSULTATION PAPER ON CESR'S ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE DIRECTIVE 2004/39/EC ON MARKETS IN FINANCIAL INSTRUMENTS - Ref.: CESR/04-261b

June 2004

I. INTRODUCTION

1. The European Banking Federation (FBE) responded to the CESR Consultation Paper CESR/04-261b) on September 17, 2004. The FBE welcomes the opportunity to comment on the remaining subjects within the Consultation Paper (CP) and is grateful to CESR for the additional time to do so, given the complexity of these issues and their relationship with the issues covered in the 2nd mandate.

2. Below we provide an Executive Summary (II.), followed by a more detailed section (III.) which will respond to CESR's questions. Section IV. will address a few issues that were part of the first part of the CP to which we would like to come back in order to provide further thoughts. Section V. will conclude.

II. EXECUTIVE SUMMARY

3. First of all, as stated in our response to the CP submitted on September 17, we believe that it will be necessary to consider grandfathering arrangements and transitional measures for some of the Level 2 requirements of the Directive. This will ensure that the introduction of the Directive has an optimal impact on all clients and the market. For example, grandfathering arrangements for client agreements and transitional provisions for the best execution obligation should be considered.

Best execution

4. We appreciate the fact that the section on best execution takes the approach of posing questions rather than proposing solutions. Given that Article 21 was concluded at a very late stage in the co-decision process and given the range of issues that are inter-linked with other parts of the Directive that are part of the 2nd mandate, we find this cautious approach laudable. At the same time, we find the degree of detail contained in the questions often excessive and in contradiction with the objectives of the Directive. As we indicated in our earlier responses to CESR, Article 21 of the Directive is rather detailed, leaving no great need for a further set of detailed rules at Level 2.

5. The overarching principle guiding CESR's approach to this section should be one of evidence-based regulation, as called for by the Post-FSAP Securities Expert Group. A prerequisite for evidence-based regulation is, however, a demonstration that the proposed policies will result in net benefits and will achieve the outlined

regulatory objectives. In this sense, we see the questions posed by CESR related to certain actions (e.g. page 75) as useful, but far too narrowly defined to answer the question as to whether the (suggested) requirements would really deliver net benefits to the market as a whole. Furthermore, much of the information requested by CESR is not possible to collate on an industry-wide basis. As a trade association, we have made our best to at least indicate what kind of costs might be involved and should be taken into account. We would like to point out that in some cases, we have responded to questions that go into the kind of detail we do not believe is appropriate for the Level 2 measures. Therefore, the fact that we have answered these questions should not be presumed to support the view that such requirements should be included in the draft advice.

6. We believe that best execution should be guided by the following principles:

   - Best execution should be understood as a process, rather than an absolute result;

   - The framework should leave sufficient flexibility for choosing venues, and not become a straitjacket; the choice must be commercial, and allow room for differentiation by product, client, service, market, etc;

   - The true test as to whether the firm is achieving best execution or not – as well as the most effective pressure to ensure this - is the satisfaction of the client. It should be possible for the firm to satisfy the customer needs, while still respecting the spirit of the MiFID, without being restricted in its choices by an overly prescriptive regulatory requirement.

7. In this sense, we fully support the statement on page 5 that:

   > "It is the responsibility of the Commission to draft a proposal for implementing measures taking into account the technical advice provided by CESR. CESR, having to address appropriate differentiation between classes of financial instruments (equities/non equities) and sizes of investment firms, makes use at this stage of flexible wording encompassing all situations, such as "where appropriate", "where relevant" and other similar. CESR aims at elaborating further more precise proposals before final adoption of its technical advice; therefore CESR invites comments on the appropriate calibration to be given to different circumstances."

8. Accordingly, there must not be a regulatory need to look at any fixed number of venues. While the impact of such a requirement would be particularly disastrous for smaller institutions, we believe that no intermediary should be forced to establish direct or indirect access to venues by regulation.

9. No 'weighting' can be done on an *a priori* basis for the relative importance of the factors which the firm needs to take into account. Neither would such an approach be in line with Level 1. Furthermore, the principle of allowing market flexibility to determine the relative importance of these factors is necessary to ensure a competitive environment in Europe.

10. Hence we welcome CESR's statement on page 5 that:

> "Mandate 3.4.1 does not invite CESR to determine the relative importance of the factors. That job is left to investment firms. Rather, CESR is asked to provide criteria that firms may use to assess the relative importance of the factors."

11. However, we find some of the questions that follow in that section contradictory to this approach, in so far as they suggest that CESR might be considering an *a priori* matrix for each of these factors. Furthermore, we would caution against the formulation of some of these factors (e.g. "price", which states that this is the first factor to consider) and the fact that there seems to be an intended hierarchy among them (we believe there should be none, as the relative importance will depend on individual cases).

12. The review of venues should not be dictated and not get in the way of the firm carrying out its natural internal review; perhaps even an annual review might be cumbersome if applied in a rigid way.

13. The Level 2 provisions must not confuse the internal execution policy of a firm with what the firm needs to disclose to the client. There are good reasons why the full internal execution policy would not be useful to the client if disclosed.[1]

14. Finally, it is not clear to us how the best execution policy is to apply when there is a chain of intermediaries involved in different capacities (e.g. portfolio manager versus executing broker or receiver and transmitter of orders versus executing broker).

<u>Post-trade transparency</u>

15. In principle, we fully support the objectives of the post-trade transparency requirement imposed on intermediaries. However, it should be recognized that such a requirement does not exist at all in several jurisdictions in Europe today (e.g. Austria, Belgium, Germany, Luxembourg) where other types of transaction reporting have been used instead. It is therefore important to devise interim solutions that facilitate a smooth transition for those countries where the new rules will require radical changes.

16. For the reasons we highlight in the next section, we believe that the one-minute suggestion is not appropriate; CESR should consider the needs of different asset classes and markets in its further deliberation on this subject.

17. As for the distribution of the information, we would like to remind CESR that the Level 1 text expressly allows proprietary arrangements for post-trade transparency. CESR's approach is therefore contradictory to the Directive.

18. CESR should not equate "easily accessible" with "easy to consolidate". Especially when one takes into account the fact that information can be disseminated through a multitude of channels, it becomes obvious that the standard of "easy to

[1] Please note that the views regarding disclosure of execution policy to clients in this position paper are not supported by the Italian member of the FBE (ABI).

consolidate" would be impossible to reach in the absence of a major technological revolution in the market. Such a change overnight would be too disruptive and is furthermore fully unjustified in our opinion. This change should be left to market forces, which will find a solution if there is demand for it.

Post-trade transparency for RMs and MTFs

19. As in the case of Post-trade transparency for intermediaries*,* the Level 1 text expressly allows proprietary arrangements for post-trade transparency for RMs and MTFs. CESR's approach is therefore contradictory to the Directive.

Pre-trade transparency for RMs and MTFs

20. The full debate on the pre-trade transparency to be provided by RMs and MTFs should be coupled with the Level 2 mandate on pre-trade transparency for intermediaries. Nonetheless, we would like to point out here a couple of high-level principles which should guide the work of CESR on this subject:

    - Level 2 should establish general principles that allow for future market development and innovation;

    - Level 2 advice should take into account the diversity of markets in Europe today and be justified on the basis of net benefits to the market as a whole;

    - Impact of pre-trade transparency on illiquid shares and illiquid markets must be carefully considered;

    - The fact that the Level 2 advice will only apply to shares must be made clear. Given the differences between equity and non-equity markets, applying pre-trade transparency rules designed for shares to non-shares would be inappropriate. In this sense, it would be useful for CESR to limit the upcoming advice to shares only.

Information to clients[2]

21. CESR's current proposals on Article 19 seem to go against the Directive, which is indeed very clear in stating that Article 19.3 will depend on the nature of the service(s) offered or provided to the client or potential client, the nature of the financial instruments being offered or considered, and the retail or professional nature of the client or potential clients. The current proposal of Box 8 would make it impossible to differentiate between the three types of services as explained above. Some of the items required in Box 8 (e.g. Paragraph 7) would be impossible to deliver in a written format even in the context of investment advice, and would be inappropriate for the services under Article 19.5 and 19.6.

22. In addition, this Box would contradict another clear statement in the Directive, i.e. that it should be possible to provide information in a standardized format (as stated in the last indent of Article 19.3). This provision, however, is of utmost importance to be able to deliver the necessary information to the clients on a reasonable cost

[2] Please note that the views regarding information to clients in the context of Article 19.3 in this position paper are not supported by the Italian member of the FBE (ABI).

basis. Otherwise some services might not be offered any more which would clearly be to the detriment of the clients.

23. We believe that this section should be fundamentally revised. Furthermore, it would seem to make sense to re-visit this section in the context of the 2nd mandate CP (which deals with Paragraphs 4, 5 and 6 of the same Article), so that one has the opportunity to see if the whole framework functions well.

24. We also believe that changes need to be made to the sections on outsourcing, safeguarding of assets, and voice recording of telephone orders, and provide additional comments below.

III. DETAILED RESPONSES TO THE CP QUESTIONS

BEST EXECUTION

Best execution - Factors

Q1: Are the criteria described above relevant in determining the relative importance of the factors in Article 21(1)? How do you think the advice should determine the relative importance of the factors included under Article 21(1)?

Answer: Broadly speaking, they are the relevant criteria, although we have some comments on the way the individual factors are formulated on page 72. For example, the statement that “Price is the first consideration in executing client orders” is in contradiction with the multi-factor definition of best execution since it makes a definitive *a priori* judgement about one of the factors. While it is true that price is an important factor, this sentence as it stands contradicts the CP’s own approach itself as well as the Directive and should be deleted, or amended to reflect the multi-factor nature of the best execution obligation.

Separately, the statement at the end of page 72 that instructions are to be taken into account “besides the factors defined in Article 21.1. and any other consideration” is incorrect and contradicts Article 21.1, which clearly states that the firm “shall execute following the specific instruction”.

Most importantly, one cannot determine the relative importance of these factors. In fact, Q1 contradicts the statement in the CP, which we support: “It is important to emphasise that Mandate 3.4.1 does not invite CESR to determine the relative importance of the factors. That job is left to investment firms. Rather, CESR is asked to provide criteria that firms may use to assess the relative importance of the factors.” (page 73 of the CP). We support this approach, and believe that it would be impossible to pre-determine the relative importance of these factors as there would be an endless number of different situations to take into account. The relative importance will not only vary among different client segments but also within a given client segment, depending on the specifics of a transaction.

Q2: Are there other criteria that firms might wish to consider in determining the relative importance of the factors? Do you think that the explanatory text clearly explains the meaning of all the different factors in respect of the different financial instruments?

Answer: In the bullet point "likelihood of settlement" on page 72, we believe that three factors need to be considered, i.e. ***clearing, settlement, and location of assets".***

> Q3: How might appropriate criteria for determining the relative importance of the factors in Article 21(1) differ depending on the services, clients, instruments and markets in question? Please provide specific examples.

Answer: One must keep in mind that best execution is not an exact science. As noted above, the relative importance of these factors will vary not only among different client segments but also within a given client segment, depending on the specifics of a transaction. The relative importance might also vary over time. CESR must specifically address execution in a professional context, where market forces play a particularly big role and where a lighter touch would be appropriate.

> Q.4: Please provide specific examples of how firms apply the factors in Article 21(1) to determine the best possible result for their clients. –

Answer: We are not able to provide examples, since it is not possible to provide a list of possible scenarios that could affect the decision on best execution within different segments of the market. We refer to our remarks above which indicate the kind of factors that would play a role.

<u>Review of Venues</u>

> Q.1: What investment services does your firm provide?
>
> Q.2: How many venues does your firm access now? Does your firm expect to access more venues after the Directive becomes effective?
>
> Q.3: What factors does your firm consider in selecting and reviewing venues?
>
> Q.4: Please provide specific examples of costs you consider in evaluating venues.
>
> Q.5: How do costs affect your decisions about venue selection?
>
> Q.6: Do you take account of implicit costs such as market impact? Is the question of implicit costs only relevant to firms that act as portfolio managers?
>
> Q.7: What specific events have led your firm to re-evaluate venues in the past? Please provide examples of how your firm has changed the venues that it accesses as the firm, its clients, or markets have changed. In addition, we invite comments on the following issues:

Answer to Questions 1-7: As a trade association, we are not in a position to answer the above questions directly. As a general remark, we believe that the scope of costs foreseen here is too narrow. The cost of establishing direct or indirect access to a venue would include not only the cost of the access but also the fees paid to data vendors and external and internal IT costs.

When our members determine the venues they will have direct or indirect access to, they take into account above all the needs of their customers. This is in their own interest to do so, since their commercial viability depends on ensuring best execution to clients in ever changing market conditions. It is important for the regulatory framework to leave sufficient space for the commercial review to be done. An imposed review of the venues would not benefit the clients.

Q.8: Have we identified the key criteria?

Q.9: What data is available to carry out these reviews? If no data is available, are market solutions likely to provide it?

Answer to Questions 8-9: Broadly speaking**,** and subject to the comments made above, you have identified the correct criteria. Our members' experience shows that a good review takes a considerable amount of time, irrespective of the difficulties with respect to data. Data availability is still not perfect but improving. In principle, any kind of information that might be needed in such reviews will be available in the market at a commercial price. One must accept that reviews will inevitably involve a value judgment on the part of the investment firm based on the data available to it. The firm may have to make a decision without access to information about new MTFs, for example. Considering all these factors, the firm must have the necessary flexibility to make these commercial decisions in the interest of its clients. We do not believe that any regulatory action is necessary at this point to require a mandatory disclosure of data.

Monitoring execution quality

Q.1: What kinds of monitoring arrangements do firms use now?

Answer: The kind of monitoring that is being done today in the EU varies, reflecting above all the different regulatory regimes with regard to execution of client orders off-exchange, market traditions and structures. There is no country in which the kind of detailed monitoring requirements that are suggested in the CP are in place. While complying with such requirements would take more time in some countries than in others, new arrangements would be necessary for all. This suggests that it would be useful to allow, as much as possible, for existing systems to be used.

In those countries in the EU where arrangements have been in place for a while, a variety of mechanisms is used to monitor the quality of execution attained: brokers monitor their own execution; fund managers monitor the execution they receive; compliance review carries out monitoring on a basis of sampling.

If CESR wants to introduce any rules regarding this process, the rules should be flexible enough to allow a range of different techniques.

Q.2: How frequently do firms monitor execution quality?

Answer: The reviews mentioned above are usually driven by market changes and not driven by regulations. The frequency varies by firm, as it should, since the frequency of a review reflects the needs of the business of the given firm.

Q.3: What data is available to aid firms in their monitoring obligations? What does the data cost?
Q.4: In what respects does the frequency with which firms monitor execution quality depend on the types of instruments, clients, markets and investment services in question? Please provide specific examples.

Q.5: What, if any, market data do firms consult in order to monitor execution quality?

Q.6: What additional data do firms expect to use after the Directive's transparency requirements become effective?

Answer: The amount of information, both external and internal to the firm, necessary to carry out a review is immense. There is sufficient information for the firms to carry out an adequate review of venues.

Evaluation of venues

Q.1: How frequently do firms review the venues to which they direct orders on behalf of clients?
Q.2: Do firms re-evaluate their trading venues:
- whenever there is a material change at any of the trading venues ?
- whenever there is a material change at the firm that affects its execution arrangements?

whenever the firm's monitoring indicates that it is not obtaining the best possible result for clients on a consistent basis?
Q.3: What difficulties would firms face in reviewing their execution arrangements in response to each of the foregoing events?
Q.4: Do venues make firms aware of material changes in their business?
Q.5: Please provide examples of instances in which firms have changed the venues that they use.

Answer to Questions 1-5: Review of venues, like review of execution quality, occurs on a consistent basis and fully driven by the need to ensure customer satisfaction; broadly speaking, changes in the policy of the firm or the venue, or significant market changes could trigger such a review. These could be inter-linked. It is not necessary to establish a mechanistic list of incidents to induce a review.

Q.1: At present, how many venues do firms access directly? Indirectly?

Answer: Not applicable to the FBE.

Q.2: Should an investment firm be required to provide clients and potential clients with information on the percentage of a firm's orders that have been directed to each venue?
Q.3: For example, should an investment firm be required to disclose to clients and potential clients what percentage of its client orders were executed in the trading venues to which the firm directed most of its client orders (to cover, at least 75% of the transactions executed)?
Q.4: How frequently should investment firms make this information available to clients? On a quarterly basis, for example?
Q.5: Should firms be required to update the information to reflect recent usage? How frequently?
Q.6: Are there any other categories of information that a client or potential client needs to be adequately informed about the execution services provided by firms?

Answer: We believe that one needs to be careful with the scope of information that will be mandated to be given to clients. The Level 2 provisions must not confuse the internal execution policy of a firm with the information which would be useful for the client. There are good reasons why the full internal execution policy would not be useful to the client if disclosed. First of all, the execution policy would be updated each time a new venue is added; it would be unreasonable to require the firm to inform all clients each time such a change occurs. Secondly, the client has all the information about his/her own orders, as well as general information that will be available about the firm on the firm's web-site. For the majority of investors, the proposed information will not be helpful in assessing the quality of the execution they are receiving from their bank. All customers would have to indirectly pay for the costs of such disclosure. Finally, the disclosure of the usage by the firm of the venues to which it has access would surely constitute proprietary information about its business decisions, and its disclosure might well put it at a competitive disadvantage.

We therefore believe that disclosure must be done in a general way and on the basis that the client will have access to this information rather than it being sent to all clients. This is the approach developed in the Market Abuse Directive with respect to policies to manage conflicts of interest, for example. This can be supplemented, for example, with a broader regulatory policy of encouraging investor education, through information made available by the regulators on a market-wide basis.

Q.7: Should the information provided by portfolio managers and firms that receive and transmit orders be different from that provided by brokers? What are the key differences?

Answer: We believe that the kind of information suggested in the previous section would be excessive for portfolio managers, firms that receive and transmit orders, and brokers alike.

Q.8: Have all of the key conflicts of interest been identified?

Answer: This topic should be dealt with in connection with Articles 13.3 and 18 of the Directive.

Q.9: When should firms be required to provide required disclosure to clients and potential clients?
Q.10: Is there any reason to impose different timing requirements for disclosure under Article 21 than are required in the Level 2 measures under Article 19(3)?

Answer to Questions 9-10: Clients should receive the appropriate information before they start receiving the service and whenever there is a material change (as in Article 21(4).

POST-TRADE TRANSPARENCY FOR INTERMEDIARIES (PAGE 91 OF THE CP)

In principle, we fully support the objectives of the post-trade transparency requirement imposed on intermediaries. However, it should be recognized that such a requirement does not exist at all in several jurisdictions in Europe today (e.g. Austria, Belgium, Germany, Luxembourg) where other types of transaction reporting have been used instead. It is therefore important to devise interim solutions that facilitate a smooth transition for those countries where the new rules will require radical changes.

Q13.1: Do consultees support the method of post trade transparency (trade by trade information), should some other method be chosen (which)?

Answer: Yes, we generally support it.

Q13.2: Do consultees support the inclusion of "aggregated information" in paragraph 22 or should it be left for market forces to provide on the basis of the information disclosed under paragraph 21. If it is included what should the content be?

Answer: We believe that this should be left to market forces.

Q13.3: Do consultees support the two week period for which the post trade information should be available?

Answer: We do not believe there is any justification for requiring any mandatory data storage. If it proves to be useful, there will be market-based supply for such storage offered at commercial prices. This is also in line with the fact that stock exchanges are able to charge for information they make available to the market; there is no reason why intermediaries should be obliged to keep such information stored.

Q13.4: Should some minor trades be excluded from publication (and if so, what should be the determining factor)?

Answer: Yes. However, we believe that this is not up to Level 2 to determine, but rather to be defined at Level 3.

Q13.5: Do consultees agree on the method of defining the time limit in paragraph 24 and is the one minute limit capable of meeting the needs of occasional off-market trades?

Answer: We find the one-minute suggestion unrealistic for the majority of trades in most of the markets. Off-exchange trades are typically completed without the use of a computer, as a result of a discussion between two professional dealers. Furthermore, the point at which the period starts (the time of conclusion of trade) is not practical, since the post-trade transparency obligation on an off-exchange trade can be fulfilled only after the intermediaries have reliable information at hand on the details of the trade.

We therefore believe that it would be necessary to allow the transparency requirements to be fulfilled within a reasonable period after the trade confirmation has come, taking into account the different asset types and the nature of the markets and transactions involved. This timeframe should allow the firm to verify the data, finish all the back-office work, and ensure generally that the data to be reported is reliable, as is required by the Directive.

Q13.6: Do consultees support the view that only intermediaries who have created a risk position to facilitate the trade of a third party should benefit from deferred publication or should all trades which are above the block size be eligible for deferred publication?

Answer: We fully support the principle of a deferral for all cases where there is a risk created; since this applies by definition to all block size trades, we believe that all block size transactions should benefit from it.

The right of deferral should also apply to all transactions that are part of a block size; hence, the deferral should run until the whole position is unwound.

Q13.7: Should the identifier of a security be harmonised and if so to what extent? What should be the applicable standard (ISIN code, other)?

Answer: We do see benefit in a common standard, subject to the following conditions: The standard should be not a completely new one, but one that is already commonly used today. Additionally, it should not only be a standard in common use in Europe but one that is valid globally.

Q13.8: Should more information be available on stock lending? If so, which should be the content? Are there other similar types of activities which should be covered?

Answer: We do not believe that CESR should be carrying out work on this issue at Level 2. We do support the concept of such an exemption, and believe it should apply to all types of transactions that have the same characteristics as stock lending, e.g. repo and exercising an option, which are irrelevant for price formation and therefore do not contain any information that is useful for the market. Furthermore, in all of these cases, disclosure of this transaction would give the market unfair information about the firm and would put it on a competitive disadvantage.

Q13.9: Should CESR initiate work, in collaboration with the industry and data publishers, to determine how best to ensure that post trade transparency data be disseminated on a pan-European basis?

Answer: No, we believe this should be left to market forces. Harmonisation of the data will be possible over time, but there is no justification for initiating it right now.

PRE-TRADE TRANSPARENCY FOR RMS AND MTFS (PAGE 86)

The full debate on the pre-trade transparency to be provided by RMs and MTFs should be coupled with the Level 2 mandate on pre-trade transparency for intermediaries. Nonetheless, we would like to point out here a couple of high-level principles which should guide the work of CESR on this subject:

- Level 2 should establish general principles that allow for future market development and innovation.
- Level 2 advice should take into account the diversity of markets in Europe today and be justified on the basis of net benefits to the market as a whole.
- Impact of pre-trade transparency on illiquid shares and illiquid markets must be carefully considered.
- The fact that the Level 2 advice will only apply to shares must be made clear. Given the differences between equity and non-equity markets, applying pre-trade transparency rules designed for shares to non-shares would be inappropriate. In this sense, it would be useful for CESR to limit the upcoming advice to shares only.

POST-TRADE FOR RMS AND MTFS (PAGE 91)

As in the case of Post-trade transparency for intermediaries, the Level 1 text expressly allows proprietary arrangements for post-trade transparency for RMs and MTFs. CESR's approach is therefore contradictory to the Directive.

IV. OTHER POINTS FROM THE 1ST PART OF THE CP

Last but not least, we would like to come back to a number of issues from the first part of the CP. We would like to take this opportunity to elaborate on our views on these subjects in light of recent discussions:

Outsourcing

We believe that there should be no prior notification, irrespective of whether there is a materiality test. We believe that requiring a notification of outsourcing arrangements, even if very narrowly defined, would lead to confusion about the respective roles of the regulator and the intermediary. Although it is now clear to us that CESR did not intend this requirement to involve approval by the regulator, the process would inevitably create the impression of tacit approval, which would lead to difficulties for the regulator in case of any adverse turn of events.

Regarding the definition of outsourcing, we would like to state again that Article 13.5 of the Directive speaks about outsourcing of important operational functions; therefore it is not clear to us why (as listed in paragraph 3 of Box 3) outsourcing arrangements for the human resources department and marketing, for example, should fall within the scope. In our opinion, these activities are not operational functions.

Thirdly, we would like to point out that the scope of the outsourcing section should not include intra-group operations, as these clearly have a different nature.

<u>Client agreements</u>

Overall, the client agreements should contain only the vital information which will be of direct use to the client. In this regard, we welcome the provision in Paragraph 3 of Box 9 stating that the retail client agreement must be clear and easily understandable. However, we doubt the value of the enormous amount of information for the client written down in the following paragraph 4. Over-charging the basic retail client agreement with information that is not vital would simply lead to the client not reading the document and therefore not being informed of the vital characteristics of the service offered.

As promised, we would like to provide some further examples of items from the client agreement which are not justifiable from the perspective of usefulness to the investor and should be deleted or amended:

Paragraph 4 (b) - We reject the proposal that the phone number of the investment firm has to be indicated in the basic retail client agreement. In those cases where the investment firm refuses to conclude contracts via telephone because of liability reasons, the indication of a telephone number makes no sense at all. In addition, it is almost impossible to indicate all the telephone numbers of the contact persons in charge, and the client would be rather confused to find out who is the right contact person for his/her problem or question. If the telephone numbers have to be changed (which may not necessarily be initiated by the investment firm), the expense for information of the clients would be disproportionate to the expected benefit for the client.

Paragraph 4 (c) – The version from the Distance Selling Directive is more appropriate; therefore we propose that the proposed paragraph here be deleted completely. It is absolutely unclear who the "relevant representative of the firm" should be (presumably a representative of the investment firm). The fact that the client enters into an agreement with the firm does not mean that the various representative offices will be contacted by the client. The services asked for by the clients and all possible sanctions will be subject to civil law, administrative penal law and regulatory provisions.

Paragraph 4 (e) is not necessary and would cause additional operating expenditures (resulting from updates) as this information is subject to very frequent change.

Paragraph 4 (f) would make the contract excessively long as the full list of withdrawal rights is very long. Therefore 4 (f) has to specify that only those rights of withdrawal which are directly linked to the basic client agreement are to be included. A listing of all possible rights of withdrawal or cooling-off periods would not be appropriate. This is also in the interest of the client, who would not be able to judge which rights of withdrawal would be relevant. Many such rights (e.g. in case of default of a door-to-door sale) would not be applicable and their inclusion would be misleading.

Paragraph 4 (h) corresponds to information that is available to the client in general terms but would be too cumbersome to include in the client agreement, especially as it would require constant updating. Furthermore, it raises the question as to what use there would be in informing the client of all the services and products that may not be accessible to the client. Compliance with Paragraph 4 (h) as drafted would be impossible for banks because of the extent of the services they provide. Moreover, this provision would lead to a clash with contract law, because each alteration would necessarily result in an amendment of the contract, whether or not the respective client has already called for the services by that point. To provide this information in the client agreement would be very costly and counterproductive.

Paragraph 4 (l) – We are not sure as to what is meant by "full details" in this paragraph. Generally speaking, information on a firm's fees and prices charged for the provision of services is available to the client. In many cases, they may be displayed by banks in the cashier's hall. But the basis of calculation for the charges/fees can by no means be indicated. This is because it would be rather difficult to calculate this in detail in most cases; moreover, such disclosure would violate the right of banks to maintain the privacy of proprietary, internal information.

Paragraph 4 (m) - It should be sufficient that the client has easy access to the information as per Paragraph 4 (m), e.g. via the internet on the homepage of the investment firm. Therefore such information should not be required to be included in the contract itself.

Paragraph 4 (o) – Concerning the procedure mentioned in this paragraph, i.e. out-of-court complaint mechanisms and redress procedures, information to the client on demand should be sufficient.

Paragraph 5 - It should additionally be stated that this provision can also be applied for the other two agreements mentioned (portfolio management and trading in derivatives).

Finally, we object to the use of the terms "as a minimum" before the list of items. It is obvious that the firm would be free to include additional items if necessary. The use of such a term preceding a mandatory list, especially one that is already so detailed, is unfortunate because it would lead to overlapping requirements imposed by competent authorities. Hence the phrase should be deleted.

Information to clients

We understand from the CP that CESR is interpreting the Directive in such a way that Article 19.3 requires providing the same level of information to all clients, irrespective of the type of service they are receiving. Furthermore, there seems to be a presumption that customers receiving services other than investment advice need to be 'compensated' for the lack of advice with tailored information about the products to allow them to make 'better decisions'.

We read the Directive in a different way. The total information to be received by the client is a direct function of the type of service received by the client, i.e. whether it is 19.4 (advice), 19.5 ('light suitability'), or 19.6 (execution-only). These three services are very distinct from each other and are the result of a long political discussion. CESR should not attempt to deviate from this compromise. Furthermore, it should be borne in mind that clients pay different prices for different service levels. By definition the highest level of service – i.e. advice – has a corresponding price level. Maintaining the current level of choice offered to clients would require continuing to allow the firms to offer to their clients a variety of services that are truly distinguished form each other. Clients who choose an execution-only service, for example, do so because they feel that they do not need advice. Accordingly they would expect lower fees than the fees for investment advice.

It should also be noted that Article 19.3 is the only part of this Article where the requirements for information for these three types of services can be differentiated from each other. Articles 19.4, 19.5 and 19.6 will deal with the arrangements related to the services, such as the information to be requested from the client (in the case of the paragraphs 4 and 5) and the scope of instruments that are eligible for the service (for paragraph 6). However, the information to be provided to clients is at the very heart of the difference between these three services; if the information to be provided were to be the same, there would be no difference between the services. Hence we strongly take issue with CESR's current suggestion, as we understand, that the information to be provided to clients under Article 19.3 will only differ by type of client.

The Directive is indeed very clear in stating that Article 19.3 will depend on the nature of the service(s) offered or provided to the client or potential client, the nature of the financial instruments being offered or considered, and the retail or professional nature of the client or potential clients. This point is made very clear in the comitology paragraph (19.10), which states the following:

> "In order to ensure the necessary protection of investors and the uniform application of paragraphs 1 to 8, the Commission shall adopt, in accordance with the procedure referred to in Article 64(2), implementing measures to ensure that investment firms comply with the principles set out therein when providing investment or ancillary services to their clients.
>
> "Those implementing measures shall take into account:
>
> > (a) the nature of the service(s) offered or provided to the client or potential client, taking into account the type, object, size and frequency of the transactions;
> >
> > (b) the nature of the financial instruments being offered or considered;
> >
> > (c) the retail or professional nature of the client or potential clients."

In addition, Article 19.3 itself states:

> "Appropriate information shall be provided in a comprehensible form to clients or potential clients about:
>
> > — the investment firm and its services,
> >
> > — financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies,
> >
> > — execution venues, and
> >
> > — costs and associated charges
>
> so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format."

The fact that "appropriate" information is required makes it clear that the legislators wanted to differentiate this information based on the factors listed in the Paragraph 10.

Hence we would have to disagree with any interpretation of the Directive that fails to take into account the type of service (subparagraph (a) of Article 19.10) as a basis of differentiation for Article 19.3. It is self-evident that clients receiving investment advice will receive more information than clients who are receiving the service under Article 19.5 or 19.6. This is accordingly reflected in the fees attached to these services.

It should not be forgotten that it was precisely because of the total absence of any advice from the intermediary that the provision of the service under Article 19.6 was made subject to series of safeguards, most importantly: the limited scope of instruments, the requirement that it be made at the initiative of the client; and the requirement that the client or potential client be clearly informed that "in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules". Similarly, Article 19.5 was defined as a service clearly distinct from investment advice.

The current proposal of Box 8 would make it impossible to differentiate between the three types of services as explained above. Some of the items required in Box 8 (e.g. Paragraph 7) would be impossible to deliver in a written format even in the context of investment advice, and would be inappropriate for the services under Article 19.5 and 19.6.

In addition, this Box would contradict another clear statement in the Directive, i.e. that it should be possible to provide information in a standardized format (as stated in the last indent of Article 19.3) This provision, however, is of utmost importance to be able to deliver the necessary information to the clients on a reasonable cost basis. Otherwise some services might not be offered any more which would clearly be to the detriment of the clients.

For all the reasons given above, we believe that this section should be fundamentally revised. Furthermore, it would seem to make sense to re-visit this section in the context of the 2nd mandate CP (which deals with Paragraphs 4, 5 and 6 of the same Article), so that one has the opportunity to see if the whole framework functions well.

Safeguarding of assets

Going back to our answer to Question 5.2 (page 33 of the CP), we would like to underline that the real difficulty with CESR's requirement comes from having to record where assets are on a client-by-client basis. This is why we do not support CESR's proposal to require banks' records to indicate the depository for each client.

Voice recording of telephone orders

We strictly oppose the obligation to keep voice records of telephone orders envisaged under item 2 (b). Such a practice may be standard market practice with regard to dealings with institutional investors. Yet, in the field of retail clients, we feel it would be utterly inappropriate. The effective potential value-added for the client which may result from such a measure is that it may allow for an easier investigation in those very rare exceptions where there has not been correct recording, and/or where the forwarding of a client order. This potential benefit is not comparable with the financial and organizational logistics which would be triggered through a technical change to the infrastructure of thousands of bank branches. Furthermore, such an obligation lacks a legal basis under Article 13.6 of the Directive, which does not differentiate between the various forms of communication. Hence, subjecting any individual form of communication to a specific regime is not warranted by the MiFID.

Even where there are recording systems in use, a practical concern here would be storage capacity, triggering an immense cost to comply with CESR's proposal. At a more conceptual level, the proposal would not lead to any commensurate benefit, because in most cases, clients' complaints would be settled in a short period of time and keeping such records would not have any added value.

One way of solving this problem might be to allow the firm to make a record of the order (a note) instead of a voice recording, as is the way some jurisdictions implement the CESR Standards for Investor Protection.

V. CONCLUSION

25. The 1st mandate CP is a very useful basis of discussion on issues that are of critical importance to the integration of secondary markets in Europe. We would like to thank the CESR Expert Groups for their work on this document. As our response indicates, there are several elements of the current CP which we believe would have to be revised in order to better align the resulting technical advice with the objectives of the Directive. We have particularly strong concerns related to the proposed advice in Information to Clients, Client Agreements, and Best Execution. On this latter subject, while it is to be welcomed that the CP does not yet make any proposals, we would like to caution against following the degree of detail contained in the questions posed.

26. We believe that a 2nd round of consultation on all of these subjects would be greatly useful for all parties involved, and would like to express our commitment to assisting in the continuation of the process in any way required.

Fédération Bancaire Européenne
European Banking Federation
Le Secrétaire Général

BI/AB
N° 0656

Wednesday, October 6, 2004

Mr Fabrice DEMARIGNY
Secretary General of CESR
CESR, 11-13 avenue de Friedland
F- 75008 PARIS

Subject: Additional Response to the Consultation Paper on CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments - Ref.: Cesr/04-261b (extended deadline of October 4)

Dear Mr Demarigny,

On behalf of the European Banking Federation[1] (FBE), I am happy to submit to you the FBE's additional response to the Consultation Paper on CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments.

This response addresses best execution, post-trade transparency for intermediaries, and pre-and post-trade transparency for RMs and MTFs. In addition, we wanted to come back to a few subjects of particular importance which were included in the first part of the CP and discussed in our recent bilateral meeting: information to clients, client agreements, outsourcing, safeguarding of assets, and voice recording of telephone orders.

We would also like to take this opportunity to present our apologies for missing the deadline of Monday 4th October and would hope that the small delay will not prevent the FBE comments being taken into account. We would be happy, naturally, to see the enclosure to this letter listed on your website along with the other responses.

We hope that you will find the FBE paper a valuable contribution to the ongoing work of CESR on the draft technical advice for implementing measures on these subjects.

Should you have any queries regarding the Draft Response please do not hesitate to contact me, or Ms Burçak Inel, Financial Markets Adviser, (b.inel@fbe.be).

Yours sincerely,

Tanguy van de WERVE
Secretary General *ad interim*

cc.: Mr Caspari; Mr Comporti; Mr McCarthy; Mr Prada

Encl.: 1

[1] Set up in 1960, the European Banking Federation (FBE) is the voice of the European banking sector. It represents the interests of over 4,500 European banks, large and small, with total assets of more than EUR 20,000 billion and over 2.3 million employees.

Rue Montoyer 10 • B-1000 Brussels • Tel: +32 (0)2 508 37 11 • Fax: +32 (0)2 511 23 28
www.fbe.be • info@fbe.be
http://ebf.irisb2b.com (Extranet – members only)

Enclosure to Letter N°0656

FBE

Fédération Bancaire Européenne

European Banking Federation

BI
05/10/04

ADDITIONAL RESPONSE TO

CONSULTATION PAPER ON CESR'S ADVICE ON POSSIBLE IMPLEMENTING MEASURES OF THE DIRECTIVE 2004/39/EC ON MARKETS IN FINANCIAL INSTRUMENTS - Ref.: CESR/04-261b

June 2004

I. INTRODUCTION

1. The European Banking Federation (FBE) responded to the CESR Consultation Paper CESR/04-261b) on September 17, 2004. The FBE welcomes the opportunity to comment on the remaining subjects within the Consultation Paper (CP) and is grateful to CESR for the additional time to do so, given the complexity of these issues and their relationship with the issues covered in the 2nd mandate.

2. Below we provide an Executive Summary (II.), followed by a more detailed section (III.) which will respond to CESR's questions. Section IV. will address a few issues that were part of the first part of the CP to which we would like to come back in order to provide further thoughts. Section V. will conclude.

II. EXECUTIVE SUMMARY

3. First of all, as stated in our response to the CP submitted on September 17, we believe that it will be necessary to consider grandfathering arrangements and transitional measures for some of the Level 2 requirements of the Directive. This will ensure that the introduction of the Directive has an optimal impact on all clients and the market. For example, grandfathering arrangements for client agreements and transitional provisions for the best execution obligation should be considered.

Best execution

4. We appreciate the fact that the section on best execution takes the approach of posing questions rather than proposing solutions. Given that Article 21 was concluded at a very late stage in the co-decision process and given the range of issues that are inter-linked with other parts of the Directive that are part of the 2nd mandate, we find this cautious approach laudable. At the same time, we find the degree of detail contained in the questions often excessive and in contradiction with the objectives of the Directive. As we indicated in our earlier responses to CESR, Article 21 of the Directive is rather detailed, leaving no great need for a further set of detailed rules at Level 2.

5. The overarching principle guiding CESR's approach to this section should be one of evidence-based regulation, as called for by the Post-FSAP Securities Expert Group. A prerequisite for evidence-based regulation is, however, a demonstration that the proposed policies will result in net benefits and will achieve the outlined

regulatory objectives. In this sense, we see the questions posed by CESR related to certain actions (e.g. page 75) as useful, but far too narrowly defined to answer the question as to whether the (suggested) requirements would really deliver net benefits to the market as a whole. Furthermore, much of the information requested by CESR is not possible to collate on an industry-wide basis. As a trade association, we have made our best to at least indicate what kind of costs might be involved and should be taken into account. We would like to point out that in some cases, we have responded to questions that go into the kind of detail we do not believe is appropriate for the Level 2 measures. Therefore, the fact that we have answered these questions should not be presumed to support the view that such requirements should be included in the draft advice.

6. We believe that best execution should be guided by the following principles:

   - Best execution should be understood as a process, rather than an absolute result;

   - The framework should leave sufficient flexibility for choosing venues, and not become a straitjacket; the choice must be commercial, and allow room for differentiation by product, client, service, market, etc;

   - The true test as to whether the firm is achieving best execution or not – as well as the most effective pressure to ensure this - is the satisfaction of the client. It should be possible for the firm to satisfy the customer needs, while still respecting the spirit of the MiFID, without being restricted in its choices by an overly prescriptive regulatory requirement.

7. In this sense, we fully support the statement on page 5 that:

   > "It is the responsibility of the Commission to draft a proposal for implementing measures taking into account the technical advice provided by CESR. CESR, having to address appropriate differentiation between classes of financial instruments (equities/non equities) and sizes of investment firms, makes use at this stage of flexible wording encompassing all situations, such as "where appropriate", "where relevant" and other similar. CESR aims at elaborating further more precise proposals before final adoption of its technical advice; therefore CESR invites comments on the appropriate calibration to be given to different circumstances."

8. Accordingly, there must not be a regulatory need to look at any fixed number of venues. While the impact of such a requirement would be particularly disastrous for smaller institutions, we believe that no intermediary should be forced to establish direct or indirect access to venues by regulation.

9. No 'weighting' can be done on an *a priori* basis for the relative importance of the factors which the firm needs to take into account. Neither would such an approach be in line with Level 1. Furthermore, the principle of allowing market flexibility to determine the relative importance of these factors is necessary to ensure a competitive environment in Europe.

10. Hence we welcome CESR's statement on page 5 that:

> "Mandate 3.4.1 does not invite CESR to determine the relative importance of the factors. That job is left to investment firms. Rather, CESR is asked to provide criteria that firms may use to assess the relative importance of the factors."

11. However, we find some of the questions that follow in that section contradictory to this approach, in so far as they suggest that CESR might be considering an *a priori* matrix for each of these factors. Furthermore, we would caution against the formulation of some of these factors (e.g. "price", which states that this is the first factor to consider) and the fact that there seems to be an intended hierarchy among them (we believe there should be none, as the relative importance will depend on individual cases).

12. The review of venues should not be dictated and not get in the way of the firm carrying out its natural internal review; perhaps even an annual review might be cumbersome if applied in a rigid way.

13. The Level 2 provisions must not confuse the internal execution policy of a firm with what the firm needs to disclose to the client. There are good reasons why the full internal execution policy would not be useful to the client if disclosed.[1]

14. Finally, it is not clear to us how the best execution policy is to apply when there is a chain of intermediaries involved in different capacities (e.g. portfolio manager versus executing broker or receiver and transmitter of orders versus executing broker).

<u>Post-trade transparency</u>

15. In principle, we fully support the objectives of the post-trade transparency requirement imposed on intermediaries. However, it should be recognized that such a requirement does not exist at all in several jurisdictions in Europe today (e.g. Austria, Belgium, Germany, Luxembourg) where other types of transaction reporting have been used instead. It is therefore important to devise interim solutions that facilitate a smooth transition for those countries where the new rules will require radical changes.

16. For the reasons we highlight in the next section, we believe that the one-minute suggestion is not appropriate; CESR should consider the needs of different asset classes and markets in its further deliberation on this subject.

17. As for the distribution of the information, we would like to remind CESR that the Level 1 text expressly allows proprietary arrangements for post-trade transparency. CESR's approach is therefore contradictory to the Directive.

18. CESR should not equate "easily accessible" with "easy to consolidate". Especially when one takes into account the fact that information can be disseminated through a multitude of channels, it becomes obvious that the standard of "easy to

[1] Please note that the views regarding disclosure of execution policy to clients in this position paper are not supported by the Italian member of the FBE (ABI).

consolidate" would be impossible to reach in the absence of a major technological revolution in the market. Such a change overnight would be too disruptive and is furthermore fully unjustified in our opinion. This change should be left to market forces, which will find a solution if there is demand for it.

Post-trade transparency for RMs and MTFs

19. As in the case of Post-trade transparency for intermediaries*,* the Level 1 text expressly allows proprietary arrangements for post-trade transparency for RMs and MTFs. CESR's approach is therefore contradictory to the Directive.

Pre-trade transparency for RMs and MTFs

20. The full debate on the pre-trade transparency to be provided by RMs and MTFs should be coupled with the Level 2 mandate on pre-trade transparency for intermediaries. Nonetheless, we would like to point out here a couple of high-level principles which should guide the work of CESR on this subject:

    - Level 2 should establish general principles that allow for future market development and innovation;

    - Level 2 advice should take into account the diversity of markets in Europe today and be justified on the basis of net benefits to the market as a whole;

    - Impact of pre-trade transparency on illiquid shares and illiquid markets must be carefully considered;

    - The fact that the Level 2 advice will only apply to shares must be made clear. Given the differences between equity and non-equity markets, applying pre-trade transparency rules designed for shares to non-shares would be inappropriate. In this sense, it would be useful for CESR to limit the upcoming advice to shares only.

Information to clients[2]

21. CESR's current proposals on Article 19 seem to go against the Directive, which is indeed very clear in stating that Article 19.3 will depend on the nature of the service(s) offered or provided to the client or potential client, the nature of the financial instruments being offered or considered, and the retail or professional nature of the client or potential clients. The current proposal of Box 8 would make it impossible to differentiate between the three types of services as explained above. Some of the items required in Box 8 (e.g. Paragraph 7) would be impossible to deliver in a written format even in the context of investment advice, and would be inappropriate for the services under Article 19.5 and 19.6.

22. In addition, this Box would contradict another clear statement in the Directive, i.e. that it should be possible to provide information in a standardized format (as stated in the last indent of Article 19.3). This provision, however, is of utmost importance to be able to deliver the necessary information to the clients on a reasonable cost

[2] Please note that the views regarding information to clients in the context of Article 19.3 in this position paper are not supported by the Italian member of the FBE (ABI).

basis. Otherwise some services might not be offered any more which would clearly be to the detriment of the clients.

23. We believe that this section should be fundamentally revised. Furthermore, it would seem to make sense to re-visit this section in the context of the 2nd mandate CP (which deals with Paragraphs 4, 5 and 6 of the same Article), so that one has the opportunity to see if the whole framework functions well.

24. We also believe that changes need to be made to the sections on outsourcing, safeguarding of assets, and voice recording of telephone orders, and provide additional comments below.

III. DETAILED RESPONSES TO THE CP QUESTIONS

BEST EXECUTION

Best execution - Factors

Q1: Are the criteria described above relevant in determining the relative importance of the factors in Article 21(1)? How do you think the advice should determine the relative importance of the factors included under Article 21(1)?

Answer: Broadly speaking, they are the relevant criteria, although we have some comments on the way the individual factors are formulated on page 72. For example, the statement that "Price is the first consideration in executing client orders" is in contradiction with the multi-factor definition of best execution since it makes a definitive *a priori* judgement about one of the factors. While it is true that price is an important factor, this sentence as it stands contradicts the CP's own approach itself as well as the Directive and should be deleted, or amended to reflect the multi-factor nature of the best execution obligation.

Separately, the statement at the end of page 72 that instructions are to be taken into account "besides the factors defined in Article 21.1. and any other consideration" is incorrect and contradicts Article 21.1, which clearly states that the firm "shall execute following the specific instruction".

Most importantly, one cannot determine the relative importance of these factors. In fact, Q1 contradicts the statement in the CP, which we support: "It is important to emphasise that Mandate 3.4.1 does not invite CESR to determine the relative importance of the factors. That job is left to investment firms. Rather, CESR is asked to provide criteria that firms may use to assess the relative importance of the factors." (page 73 of the CP). We support this approach, and believe that it would be impossible to pre-determine the relative importance of these factors as there would be an endless number of different situations to take into account. The relative importance will not only vary among different client segments but also within a given client segment, depending on the specifics of a transaction.

Q2: Are there other criteria that firms might wish to consider in determining the relative importance of the factors? Do you think that the explanatory text clearly explains the meaning of all the different factors in respect of the different financial instruments?

Answer: In the bullet point "likelihood of settlement" on page 72, we believe that three factors need to be considered, i.e. ***clearing, settlement, and location of assets".***

Q3: How might appropriate criteria for determining the relative importance of the factors in Article 21(1) differ depending on the services, clients, instruments and markets in question? Please provide specific examples.

Answer: One must keep in mind that best execution is not an exact science. As noted above, the relative importance of these factors will vary not only among different client segments but also within a given client segment, depending on the specifics of a transaction. The relative importance might also vary over time. CESR must specifically address execution in a professional context, where market forces play a particularly big role and where a lighter touch would be appropriate.

Q.4: Please provide specific examples of how firms apply the factors in Article 21(1) to determine the best possible result for their clients. –

Answer: We are not able to provide examples, since it is not possible to provide a list of possible scenarios that could affect the decision on best execution within different segments of the market. We refer to our remarks above which indicate the kind of factors that would play a role.

Review of Venues

Q.1: What investment services does your firm provide?

Q.2: How many venues does your firm access now? Does your firm expect to access more venues after the Directive becomes effective?

Q.3: What factors does your firm consider in selecting and reviewing venues?

Q.4: Please provide specific examples of costs you consider in evaluating venues.

Q.5: How do costs affect your decisions about venue selection?

Q.6: Do you take account of implicit costs such as market impact? Is the question of implicit costs only relevant to firms that act as portfolio managers?

Q.7: What specific events have led your firm to re-evaluate venues in the past? Please provide examples of how your firm has changed the venues that it accesses as the firm, its clients, or markets have changed. In addition, we invite comments on the following issues:

Answer to Questions 1-7: As a trade association, we are not in a position to answer the above questions directly. As a general remark, we believe that the scope of costs foreseen here is too narrow. The cost of establishing direct or indirect access to a venue would include not only the cost of the access but also the fees paid to data vendors and external and internal IT costs.

When our members determine the venues they will have direct or indirect access to, they take into account above all the needs of their customers. This is in their own interest to do so, since their commercial viability depends on ensuring best execution to clients in ever changing market conditions. It is important for the regulatory framework to leave sufficient space for the commercial review to be done. An imposed review of the venues would not benefit the clients.

Q.8: Have we identified the key criteria? Q.9: What data is available to carry out these reviews? If no data is available, are market solutions likely to provide it?

Answer to Questions 8-9: Broadly speaking**,** and subject to the comments made above, you have identified the correct criteria. Our members' experience shows that a good review takes a considerable amount of time, irrespective of the difficulties with respect to data. Data availability is still not perfect but improving. In principle, any kind of information that might be needed in such reviews will be available in the market at a commercial price. One must accept that reviews will inevitably involve a value judgment on the part of the investment firm based on the data available to it. The firm may have to make a decision without access to information about new MTFs, for example. Considering all these factors, the firm must have the necessary flexibility to make these commercial decisions in the interest of its clients. We do not believe that any regulatory action is necessary at this point to require a mandatory disclosure of data.

Monitoring execution quality

Q.1: What kinds of monitoring arrangements do firms use now?

Answer: The kind of monitoring that is being done today in the EU varies, reflecting above all the different regulatory regimes with regard to execution of client orders off-exchange, market traditions and structures. There is no country in which the kind of detailed monitoring requirements that are suggested in the CP are in place. While complying with such requirements would take more time in some countries than in others, new arrangements would be necessary for all. This suggests that it would be useful to allow, as much as possible, for existing systems to be used.

In those countries in the EU where arrangements have been in place for a while, a variety of mechanisms is used to monitor the quality of execution attained: brokers monitor their own execution; fund managers monitor the execution they receive; compliance review carries out monitoring on a basis of sampling.

If CESR wants to introduce any rules regarding this process, the rules should be flexible enough to allow a range of different techniques.

Q.2: How frequently do firms monitor execution quality?

Answer: The reviews mentioned above are usually driven by market changes and not driven by regulations. The frequency varies by firm, as it should, since the frequency of a review reflects the needs of the business of the given firm.

Q.3: What data is available to aid firms in their monitoring obligations? What does the data cost?
Q.4: In what respects does the frequency with which firms monitor execution quality depend on the types of instruments, clients, markets and investment services in question? Please provide specific examples.

Q.5: What, if any, market data do firms consult in order to monitor execution quality?

Q.6: What additional data do firms expect to use after the Directive's transparency requirements become effective?

Answer: The amount of information, both external and internal to the firm, necessary to carry out a review is immense. There is sufficient information for the firms to carry out an adequate review of venues.

Evaluation of venues

Q.1: How frequently do firms review the venues to which they direct orders on behalf of clients?
Q.2: Do firms re-evaluate their trading venues:
- whenever there is a material change at any of the trading venues ?
- whenever there is a material change at the firm that affects its execution arrangements?

whenever the firm's monitoring indicates that it is not obtaining the best possible result for clients on a consistent basis?
Q.3: What difficulties would firms face in reviewing their execution arrangements in response to each of the foregoing events?
Q.4: Do venues make firms aware of material changes in their business?
Q.5: Please provide examples of instances in which firms have changed the venues that they use.

Answer to Questions 1-5: Review of venues, like review of execution quality, occurs on a consistent basis and fully driven by the need to ensure customer satisfaction; broadly speaking, changes in the policy of the firm or the venue, or significant market changes could trigger such a review. These could be inter-linked. It is not necessary to establish a mechanistic list of incidents to induce a review.

Q.1: At present, how many venues do firms access directly? Indirectly?

Answer: Not applicable to the FBE.

Q.2: Should an investment firm be required to provide clients and potential clients with information on the percentage of a firm's orders that have been directed to each venue?
Q.3: For example, should an investment firm be required to disclose to clients and potential clients what percentage of its client orders were executed in the trading venues to which the firm directed most of its client orders (to cover, at least 75% of the transactions executed)?
Q.4: How frequently should investment firms make this information available to clients? On a quarterly basis, for example?
Q.5: Should firms be required to update the information to reflect recent usage? How frequently?
Q.6: Are there any other categories of information that a client or potential client needs to be adequately informed about the execution services provided by firms?

Answer: We believe that one needs to be careful with the scope of information that will be mandated to be given to clients. The Level 2 provisions must not confuse the internal execution policy of a firm with the information which would be useful for the client. There are good reasons why the full internal execution policy would not be useful to the client if disclosed. First of all, the execution policy would be updated each time a new venue is added; it would be unreasonable to require the firm to inform all clients each time such a change occurs. Secondly, the client has all the information about his/her own orders, as well as general information that will be available about the firm on the firm's web-site. For the majority of investors, the proposed information will not be helpful in assessing the quality of the execution they are receiving from their bank. All customers would have to indirectly pay for the costs of such disclosure. Finally, the disclosure of the usage by the firm of the venues to which it has access would surely constitute proprietary information about its business decisions, and its disclosure might well put it at a competitive disadvantage.

We therefore believe that disclosure must be done in a general way and on the basis that the client will have access to this information rather than it being sent to all clients. This is the approach developed in the Market Abuse Directive with respect to policies to manage conflicts of interest, for example. This can be supplemented, for example, with a broader regulatory policy of encouraging investor education, through information made available by the regulators on a market-wide basis.

Q.7: Should the information provided by portfolio managers and firms that receive and transmit orders be different from that provided by brokers? What are the key differences?

Answer: We believe that the kind of information suggested in the previous section would be excessive for portfolio managers, firms that receive and transmit orders, and brokers alike.

Q.8: Have all of the key conflicts of interest been identified?

Answer: This topic should be dealt with in connection with Articles 13.3 and 18 of the Directive.

Q.9: When should firms be required to provide required disclosure to clients and potential clients?
Q.10: Is there any reason to impose different timing requirements for disclosure under Article 21 than are required in the Level 2 measures under Article 19(3)?

Answer to Questions 9-10: Clients should receive the appropriate information before they start receiving the service and whenever there is a material change (as in Article 21(4).

POST-TRADE TRANSPARENCY FOR INTERMEDIARIES (PAGE 91 OF THE CP)

In principle, we fully support the objectives of the post-trade transparency requirement imposed on intermediaries. However, it should be recognized that such a requirement does not exist at all in several jurisdictions in Europe today (e.g. Austria, Belgium, Germany, Luxembourg) where other types of transaction reporting have been used instead. It is therefore important to devise interim solutions that facilitate a smooth transition for those countries where the new rules will require radical changes.

Q13.1: Do consultees support the method of post trade transparency (trade by trade information), should some other method be chosen (which)?

Answer: Yes, we generally support it.

Q13.2: Do consultees support the inclusion of "aggregated information" in paragraph 22 or should it be left for market forces to provide on the basis of the information disclosed under paragraph 21. If it is included what should the content be?

Answer: We believe that this should be left to market forces.

Q13.3: Do consultees support the two week period for which the post trade information should be available?

Answer: We do not believe there is any justification for requiring any mandatory data storage. If it proves to be useful, there will be market-based supply for such storage offered at commercial prices. This is also in line with the fact that stock exchanges are able to charge for information they make available to the market; there is no reason why intermediaries should be obliged to keep such information stored.

Q13.4: Should some minor trades be excluded from publication (and if so, what should be the determining factor)?

Answer: Yes. However, we believe that this is not up to Level 2 to determine, but rather to be defined at Level 3.

Q13.5: Do consultees agree on the method of defining the time limit in paragraph 24 and is the one minute limit capable of meeting the needs of occasional off-market trades?

Answer: We find the one-minute suggestion unrealistic for the majority of trades in most of the markets. Off-exchange trades are typically completed without the use of a computer, as a result of a discussion between two professional dealers. Furthermore, the point at which the period starts (the time of conclusion of trade) is not practical, since the post-trade transparency obligation on an off-exchange trade can be fulfilled only after the intermediaries have reliable information at hand on the details of the trade.

We therefore believe that it would be necessary to allow the transparency requirements to be fulfilled within a reasonable period after the trade confirmation has come, taking into account the different asset types and the nature of the markets and transactions involved. This timeframe should allow the firm to verify the data, finish all the back-office work, and ensure generally that the data to be reported is reliable, as is required by the Directive.

Q13.6: Do consultees support the view that only intermediaries who have created a risk position to facilitate the trade of a third party should benefit from deferred publication or should all trades which are above the block size be eligible for deferred publication?

Answer: We fully support the principle of a deferral for all cases where there is a risk created; since this applies by definition to all block size trades, we believe that all block size transactions should benefit from it.

The right of deferral should also apply to all transactions that are part of a block size; hence, the deferral should run until the whole position is unwound.

Q13.7: Should the identifier of a security be harmonised and if so to what extent? What should be the applicable standard (ISIN code, other)?

Answer: We do see benefit in a common standard, subject to the following conditions: The standard should be not a completely new one, but one that is already commonly used today. Additionally, it should not only be a standard in common use in Europe but one that is valid globally.

Q13.8: Should more information be available on stock lending? If so, which should be the content? Are there other similar types of activities which should be covered?

Answer: We do not believe that CESR should be carrying out work on this issue at Level 2. We do support the concept of such an exemption, and believe it should apply to all types of transactions that have the same characteristics as stock lending, e.g. repo and exercising an option, which are irrelevant for price formation and therefore do not contain any information that is useful for the market. Furthermore, in all of these cases, disclosure of this transaction would give the market unfair information about the firm and would put it on a competitive disadvantage.

Q13.9: Should CESR initiate work, in collaboration with the industry and data publishers, to determine how best to ensure that post trade transparency data be disseminated on a pan-European basis?

Answer: No, we believe this should be left to market forces. Harmonisation of the data will be possible over time, but there is no justification for initiating it right now.

PRE-TRADE TRANSPARENCY FOR RMS AND MTFS (PAGE 86)

The full debate on the pre-trade transparency to be provided by RMs and MTFs should be coupled with the Level 2 mandate on pre-trade transparency for intermediaries. Nonetheless, we would like to point out here a couple of high-level principles which should guide the work of CESR on this subject:

- Level 2 should establish general principles that allow for future market development and innovation.
- Level 2 advice should take into account the diversity of markets in Europe today and be justified on the basis of net benefits to the market as a whole.
- Impact of pre-trade transparency on illiquid shares and illiquid markets must be carefully considered.
- The fact that the Level 2 advice will only apply to shares must be made clear. Given the differences between equity and non-equity markets, applying pre-trade transparency rules designed for shares to non-shares would be inappropriate. In this sense, it would be useful for CESR to limit the upcoming advice to shares only.

POST-TRADE FOR RMS AND MTFS (PAGE 91)

As in the case of Post-trade transparency for intermediaries, the Level 1 text expressly allows proprietary arrangements for post-trade transparency for RMs and MTFs. CESR's approach is therefore contradictory to the Directive.

IV. OTHER POINTS FROM THE 1ST PART OF THE CP

Last but not least, we would like to come back to a number of issues from the first part of the CP. We would like to take this opportunity to elaborate on our views on these subjects in light of recent discussions:

Outsourcing

We believe that there should be no prior notification, irrespective of whether there is a materiality test. We believe that requiring a notification of outsourcing arrangements, even if very narrowly defined, would lead to confusion about the respective roles of the regulator and the intermediary. Although it is now clear to us that CESR did not intend this requirement to involve approval by the regulator, the process would inevitably create the impression of tacit approval, which would lead to difficulties for the regulator in case of any adverse turn of events.

Regarding the definition of outsourcing, we would like to state again that Article 13.5 of the Directive speaks about outsourcing of important operational functions; therefore it is not clear to us why (as listed in paragraph 3 of Box 3) outsourcing arrangements for the human resources department and marketing, for example, should fall within the scope. In our opinion, these activities are not operational functions.

Thirdly, we would like to point out that the scope of the outsourcing section should not include intra-group operations, as these clearly have a different nature.

Client agreements

Overall, the client agreements should contain only the vital information which will be of direct use to the client. In this regard, we welcome the provision in Paragraph 3 of Box 9 stating that the retail client agreement must be clear and easily understandable. However, we doubt the value of the enormous amount of information for the client written down in the following paragraph 4. Over-charging the basic retail client agreement with information that is not vital would simply lead to the client not reading the document and therefore not being informed of the vital characteristics of the service offered.

As promised, we would like to provide some further examples of items from the client agreement which are not justifiable from the perspective of usefulness to the investor and should be deleted or amended:

Paragraph 4 (b) - We reject the proposal that the phone number of the investment firm has to be indicated in the basic retail client agreement. In those cases where the investment firm refuses to conclude contracts via telephone because of liability reasons, the indication of a telephone number makes no sense at all. In addition, it is almost impossible to indicate all the telephone numbers of the contact persons in charge, and the client would be rather confused to find out who is the right contact person for his/her problem or question. If the telephone numbers have to be changed (which may not necessarily be initiated by the investment firm), the expense for information of the clients would be disproportionate to the expected benefit for the client.

Paragraph 4 (c) – The version from the Distance Selling Directive is more appropriate; therefore we propose that the proposed paragraph here be deleted completely. It is absolutely unclear who the "relevant representative of the firm" should be (presumably a representative of the investment firm). The fact that the client enters into an agreement with the firm does not mean that the various representative offices will be contacted by the client. The services asked for by the clients and all possible sanctions will be subject to civil law, administrative penal law and regulatory provisions.

Paragraph 4 (e) is not necessary and would cause additional operating expenditures (resulting from updates) as this information is subject to very frequent change.

Paragraph 4 (f) would make the contract excessively long as the full list of withdrawal rights is very long. Therefore 4 (f) has to specify that only those rights of withdrawal which are directly linked to the basic client agreement are to be included. A listing of all possible rights of withdrawal or cooling-off periods would not be appropriate. This is also in the interest of the client, who would not be able to judge which rights of withdrawal would be relevant. Many such rights (e.g. in case of default of a door-to-door sale) would not be applicable and their inclusion would be misleading.

Paragraph 4 (h) corresponds to information that is available to the client in general terms but would be too cumbersome to include in the client agreement, especially as it would require constant updating. Furthermore, it raises the question as to what use there would be in informing the client of all the services and products that may not be accessible to the client. Compliance with Paragraph 4 (h) as drafted would be impossible for banks because of the extent of the services they provide. Moreover, this provision would lead to a clash with contract law, because each alteration would necessarily result in an amendment of the contract, whether or not the respective client has already called for the services by that point. To provide this information in the client agreement would be very costly and counterproductive.

Paragraph 4 (l) – We are not sure as to what is meant by "full details" in this paragraph. Generally speaking, information on a firm's fees and prices charged for the provision of services is available to the client. In many cases, they may be displayed by banks in the cashier's hall. But the basis of calculation for the charges/fees can by no means be indicated. This is because it would be rather difficult to calculate this in detail in most cases; moreover, such disclosure would violate the right of banks to maintain the privacy of proprietary, internal information.

Paragraph 4 (m) - It should be sufficient that the client has easy access to the information as per Paragraph 4 (m), e.g. via the internet on the homepage of the investment firm. Therefore such information should not be required to be included in the contract itself.

Paragraph 4 (o) – Concerning the procedure mentioned in this paragraph, i.e. out-of-court complaint mechanisms and redress procedures, information to the client on demand should be sufficient.

Paragraph 5 - It should additionally be stated that this provision can also be applied for the other two agreements mentioned (portfolio management and trading in derivatives).

Finally, we object to the use of the terms "as a minimum" before the list of items. It is obvious that the firm would be free to include additional items if necessary. The use of such a term preceding a mandatory list, especially one that is already so detailed, is unfortunate because it would lead to overlapping requirements imposed by competent authorities. Hence the phrase should be deleted.

Information to clients

We understand from the CP that CESR is interpreting the Directive in such a way that Article 19.3 requires providing the same level of information to all clients, irrespective of the type of service they are receiving. Furthermore, there seems to be a presumption that customers receiving services other than investment advice need to be 'compensated' for the lack of advice with tailored information about the products to allow them to make 'better decisions'.

We read the Directive in a different way. The total information to be received by the client is a direct function of the type of service received by the client, i.e. whether it is 19.4 (advice), 19.5 ('light suitability'), or 19.6 (execution-only). These three services are very distinct from each other and are the result of a long political discussion. CESR should not attempt to deviate from this compromise. Furthermore, it should be borne in mind that clients pay different prices for different service levels. By definition the highest level of service – i.e. advice – has a corresponding price level. Maintaining the current level of choice offered to clients would require continuing to allow the firms to offer to their clients a variety of services that are truly distinguished form each other. Clients who choose an execution-only service, for example, do so because they feel that they do not need advice. Accordingly they would expect lower fees than the fees for investment advice.

It should also be noted that Article 19.3 is the only part of this Article where the requirements for information for these three types of services can be differentiated from each other. Articles 19.4, 19.5 and 19.6 will deal with the arrangements related to the services, such as the information to be requested from the client (in the case of the paragraphs 4 and 5) and the scope of instruments that are eligible for the service (for paragraph 6). However, the information to be provided to clients is at the very heart of the difference between these three services; if the information to be provided were to be the same, there would be no difference between the services. Hence we strongly take issue with CESR's current suggestion, as we understand, that the information to be provided to clients under Article 19.3 will only differ by type of client.

The Directive is indeed very clear in stating that Article 19.3 will depend on the nature of the service(s) offered or provided to the client or potential client, the nature of the financial instruments being offered or considered, and the retail or professional nature of the client or potential clients. This point is made very clear in the comitology paragraph (19.10), which states the following:

> "In order to ensure the necessary protection of investors and the uniform application of paragraphs 1 to 8, the Commission shall adopt, in accordance with the procedure referred to in Article 64(2), implementing measures to ensure that investment firms comply with the principles set out therein when providing investment or ancillary services to their clients.
>
> "Those implementing measures shall take into account:
>
>> (a) the nature of the service(s) offered or provided to the client or potential client, taking into account the type, object, size and frequency of the transactions;
>>
>> (b) the nature of the financial instruments being offered or considered;
>>
>> (c) the retail or professional nature of the client or potential clients."

In addition, Article 19.3 itself states:

> "Appropriate information shall be provided in a comprehensible form to clients or potential clients about:
>
>> — the investment firm and its services,
>>
>> — financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies,
>>
>> — execution venues, and
>>
>> — costs and associated charges
>
> so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. This information may be provided in a standardised format."

The fact that “appropriate” information is required makes it clear that the legislators wanted to differentiate this information based on the factors listed in the Paragraph 10.

Hence we would have to disagree with any interpretation of the Directive that fails to take into account the type of service (subparagraph (a) of Article 19.10) as a basis of differentiation for Article 19.3. It is self-evident that clients receiving investment advice will receive more information than clients who are receiving the service under Article 19.5 or 19.6. This is accordingly reflected in the fees attached to these services.

It should not be forgotten that it was precisely because of the total absence of any advice from the intermediary that the provision of the service under Article 19.6 was made subject to series of safeguards, most importantly: the limited scope of instruments, the requirement that it be made at the initiative of the client; and the requirement that the client or potential client be clearly informed that “in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules”. Similarly, Article 19.5 was defined as a service clearly distinct from investment advice.

The current proposal of Box 8 would make it impossible to differentiate between the three types of services as explained above. Some of the items required in Box 8 (e.g. Paragraph 7) would be impossible to deliver in a written format even in the context of investment advice, and would be inappropriate for the services under Article 19.5 and 19.6.

In addition, this Box would contradict another clear statement in the Directive, i.e. that it should be possible to provide information in a standardized format (as stated in the last indent of Article 19.3) This provision, however, is of utmost importance to be able to deliver the necessary information to the clients on a reasonable cost basis. Otherwise some services might not be offered any more which would clearly be to the detriment of the clients.

For all the reasons given above, we believe that this section should be fundamentally revised. Furthermore, it would seem to make sense to re-visit this section in the context of the 2nd mandate CP (which deals with Paragraphs 4, 5 and 6 of the same Article), so that one has the opportunity to see if the whole framework functions well.

Safeguarding of assets

Going back to our answer to Question 5.2 (page 33 of the CP), we would like to underline that the real difficulty with CESR’s requirement comes from having to record where assets are on a client-by-client basis. This is why we do not support CESR’s proposal to require banks’ records to indicate the depository for each client.

Voice recording of telephone orders

We strictly oppose the obligation to keep voice records of telephone orders envisaged under item 2 (b). Such a practice may be standard market practice with regard to dealings with institutional investors. Yet, in the field of retail clients, we feel it would be utterly inappropriate. The effective potential value-added for the client which may result from such a measure is that it may allow for an easier investigation in those very rare exceptions where there has not been correct recording, and/or where the forwarding of a client order. This potential benefit is not comparable with the financial and organizational logistics which would be triggered through a technical change to the infrastructure of thousands of bank branches. Furthermore, such an obligation lacks a legal basis under Article 13.6 of the Directive, which does not differentiate between the various forms of communication. Hence, subjecting any individual form of communication to a specific regime is not warranted by the MiFID.

Even where there are recording systems in use, a practical concern here would be storage capacity, triggering an immense cost to comply with CESR's proposal. At a more conceptual level, the proposal would not lead to any commensurate benefit, because in most cases, clients' complaints would be settled in a short period of time and keeping such records would not have any added value.

One way of solving this problem might be to allow the firm to make a record of the order (a note) instead of a voice recording, as is the way some jurisdictions implement the CESR Standards for Investor Protection.

V. CONCLUSION

25. The 1st mandate CP is a very useful basis of discussion on issues that are of critical importance to the integration of secondary markets in Europe. We would like to thank the CESR Expert Groups for their work on this document. As our response indicates, there are several elements of the current CP which we believe would have to be revised in order to better align the resulting technical advice with the objectives of the Directive. We have particularly strong concerns related to the proposed advice in Information to Clients, Client Agreements, and Best Execution. On this latter subject, while it is to be welcomed that the CP does not yet make any proposals, we would like to caution against following the degree of detail contained in the questions posed.

26. We believe that a 2nd round of consultation on all of these subjects would be greatly useful for all parties involved, and would like to express our commitment to assisting in the continuation of the process in any way required.