ZENTRALER KREDITAUSSCHUSS

MITGLIEDER: BUNDESVERBAND DER DEUTSCHEN VOLKSBANKEN UND RAIFFEISENBANKEN E.V. BERLIN · BUNDESVERBAND DEUTSCHER BANKEN E.V. BERLIN
BUNDESVERBAND ÖFFENTLICHER BANKEN DEUTSCHLANDS E.V. BERLIN · DEUTSCHER SPARKASSEN- UND GIROVERBAND E.V. BERLIN-BONN
VERBAND DEUTSCHER PFANDBRIEFBANKEN E.V. BERLIN

16 March 2007

Charlottenstraße 47
10117 Berlin
Tel.: +49-3020225-5352
Fax.: +49-3020225-5345
Az: 4515

Committee of European Securities Regulators
11-13 avenue de Friedland
75008 Paris
France

CESR Consultation Paper "Best execution under MiFID"
ZKA: 413-CESR-MiFID

Dear Sirs,

the ZENTRALER KREDITAUSSCHUSS welcomes the opportunity to comment on the CESR consultation paper "Best execution under MiFID" (CESR Ref.: 07-050b) and it is our pleasure to enclose a document outlining our joint position to this effect. Should you have any queries regarding our comments, please do not hesitate to contact us.

Yours sincerely
on behalf of
the ZENTRALER KREDITAUSSCHUSS
Deutscher Sparkassen- und Giroverband

Dr. Thomas Schürmann

Dr. Carsten Nickel

Enclosure

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Comments of the Zentraler Kreditausschuss (ZKA) on CESR's Consultation Paper „Best execution under MiFID"

Ref: CESR/07-050b

16 March 2007

The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), for the cooperative banks, the Bundesverband deutscher Banken (BdB), for the private commercial banks, the Bundesverband Öffentlicher Banken Deutschlands (VÖB), for the public-sector banks, the Deutscher Sparkassen- und Giroverband (DSGV), for the savings banks financial group, and the Verband deutscher Pfandbriefbanken (VdP), for the mortgage banks. Collectively, they represent more than 2300 banks.

I. General

We are obliged to CESR for this opportunity to comment on the consultation document „Best Execution under MiFID," published in February 2007. The paper relates to a particular regulatory field of the MiFID, which in the opinion of the German banking industry is amongst the most important of the new regulations.

In Germany there is already a civil and supervisory legal framework in force which ensures that orders are executed in the best possible interests of the client. The detailed requirements, intended to provide a system of measures based on a comparison between the execution venues available and ensuring the best possible execution of client orders - requirements newly-introduced by the MiFID - will constitute a special challenge to participants in the market. Even if they do not foreseeably give rise to any fundamental differences in the results flowing from executing client orders, the new requirements will bring with them considerable administrative expense which will lead to increases in the cost of processing orders.

It remains to be seen whether this increase in expense is in fact more than sufficiently compensated for by the increase in competition between the market places intended by the new requirements leading to falls in prices and increases in quality in relation to the execution of orders. It is in any case in the interest both of the industry affected and of the consumer to try to keep administrative costs down in order to achieve a positive cost-benefit ratio.

Thus any interpretation of the new regulations at level 3 which hinders the flexible treatment of the Directive's requirements or which would in the end lead to an extension of their scope is to be avoided. The consultation paper for the most part has regard to this concern and large parts of it constitute a useful aid to implementation for participants in the market. So far as what in our view are needful outstanding improvements are concerned, we refer to the individual observations below.

We await with interest the statement of the Commission as to which transactions shall be exempt from the MiFID Best Execution Rules. We assume that in particular contracts concluded bilaterally with the client, such as security lending agreements, repurchase agreements or other Master Agreements for Derivative Transactions are not subject to the Rules. The client shows by his choice of business partner that he desires to conclude this bilateral contract with him. There is no room here for an examination of alternative methods or venues of execution. Alternatively one can arrive at the same result by the supervisory body recognising that the client has, by selecting his business partner, at the same time expressed his will, that is he has issued instructions that he wishes to conclude a contract with this institute.

We are of the opinion that this reasoning should also be applied to all purchase and sale transactions between bank and client, as here too the client expresses his will by having already decided on the venue of execution.

The explanations on portfolio managers and RTOs that do not execute client orders themselves but uses an intermediary have to be revised fundamentally. On the on hand this concerns the possibility to take into account the service level agreed upon with the intermediary (cf. our comments on para. 27) and on the other hand the duty to monitor and review the quality of execution (cf. our comments on para. 40, 68 and 87).

II. Individual observations

Execution policies and arrangements

Question 1:

Do respondents agree with CESR's views on:

- *the main issues to be addressed in an (execution) policy? Are there any other major aspects or issues that should ordinarily be included in an (execution) policy?*
- *the execution policy being a distinct part of a firm's execution arrangements for firms covered by Article 21?*
- *the execution policy under Article 21 being a statement of the most important and / or relevant aspects of a firm's detailed execution arrangements?*

Yes, we share the CESR's view on the points listed. However we would ask for a clearer explanation of the relationship between „execution arrangements", the internal „execution policy" and the information to be provided to clients. In our view, these requirements are contained within each other, like "Russian dolls". The core elements of the „execution arrangements" are summarised in the „execution policy" whereas the information to be provided to clients contains only those parts of the „execution policy" which are of significance to the client.

Question 2:

For routine orders from retail clients, Article 44(3) requires that the best possible result be determined in terms of the "total consideration" and Recital 67 reduces the importance of the Level 1 Article 21(1) factors accordingly. In what specific circumstances do respondents consider that implicit costs are likely to be relevant for retail clients and how should those implicit costs be measured?

One factor, which is neither part of the costs nor of the ancillary expenses, but which is nevertheless implicitly costly, is the risk of partial executions. Venues of execution where this risk is minor and / or where costs accruing from such partial executions do not or only seldom arise might therefore in the case of retail orders be preferable to other execution venues.

All in all, the statement in para. 27 that for retail orders essentially only the net cost / price is to be considered as a factor would appear to be too sweeping. We would point out that in highly volatile or falling markets such as those influenced from Asia at the end of February

2007, the reliability of a trading system and thus the probability of execution of a commission may play a greater role, even for retail clients, than merely the net cost /price. We would thus ask the CESR to adopt this in practice very important instance as an exception to the rule.

A further example is in the case of orders which a portfolio manager or RTO gives or passes on for private clients to an intermediary for execution; the service level agreed with the intermediary (invoicing, processing, deposit holding and other services such as for example supportive consultant services, as well as executing the order) is a decisive criterion. Solely to take the costs of execution into account would not be in the interests of the client in these cases. It may be precisely cooperation with a particular intermediary over many areas on the basis of a conscious commercial policy decision that leads to a reduction in costs when services in relation to securities are provided and thus makes it possible to provide the client with better value service. We would urge the adoption of these examples in order to clarify the problems discussed in para. 27.

It is also true that even in the case of professional clients, implicit costs are difficult to calculate. We do not recognise any duty on the part of the banks to have regard to implicit costs in the case of professional clients.

Question 3:
Do respondents agree with CESR's views on the use of a single execution venue?

Yes, we share this view.

We would however point out the following for the sake of completeness:

The explanations in para. 30 could lead to the misunderstanding that investment firms are under a duty to have different execution policies on offer even within the categories of client (e. g. for clients for which speedy execution is paramount). We would strictly oppose any such interpretation; the duty to provide the best possible execution of clients' commissions does not call for any individualisation of the policy. On the contrary, it allows one to proceed on the basis of the average client when drawing it up and applying it. The peculiarities of particular types of client (such as e.g. hedge funds) may of course be the subject of a special, "made-to-measure" policy, but they do not have to be. It is to be assumed that in so far as there is a demand for them, such models would develop amongst investment firms with an appropriate client base anyway, for reasons of competitiveness. To anticipate practice in this area would not be part of the intention and purpose of the MiFID Best Execution Rules and would be inappropriate.

For the reasons given above we also strictly reject any differentiation in the case of retail clients between typical and atypical retail clients as implied in para. 50, last sentence, with a view to the duty to provide information.

Further, the statements in para. 38 second sentence could lead to the misunderstanding that securities firms are under a duty to take into consideration all trading venues throughout the world. Such a construction would be contrary to consideration 66 of level 2. This makes it quite clear that the requirement of Directive 2004/39/EC to take all appropriate steps to achieve the best possible result for the client should not be so interpreted as to mean that a securities firm has to have regard to all possible trading venues in its policies for the execution of orders.

In connection with para. 40 we consider it to be absolutely essential that it be made clear that the necessary monitoring and reviewing of the quality of execution provided does not have to be carried out by the portfolio managers or RTOs themselves. At least in those cases where the intermediary himself is under a duty to supervise it should be sufficient that the results of the review by the intermediary be notified to the portfolio managers or RTOs and the portfolio managers or RTOs review on this basis whether the intermediary is still continuing to guarantee the best possible performance of the commissions passed on to him. Any other interpretation would be impractical, especially in the case of intermediaries who carry out commissions for several portfolio managers and / or RTOs simultaneously, and would also be disproportionately burdensome for the portfolio managers and RTOs who have engaged the intermediaries especially because of their expertise in the matter of executing orders. Finally, the CESR rightly refers in para. 72 to the fact that portfolio managers or RTOs are permitted largely to rely on the decisions of the intermediary, provided that the latter fulfils the requirements of art. 21.

Question 4:
Do respondents agree with CESR's views on the degree of differentiation of the (execution) policy?

Yes, we agree with the CESR's approach. In particular the statement in para. 44 reflects the needs of practice.

Disclosure

In para. 52 the duty to draw up a list of execution venues is mentioned. The industry would be grateful if this statement were more nuanced. We understand the requirement of naming those execution venues „on which the firm places significant reliance" to mean that here too a differentiation may be made reflecting the volume of orders generated by retail clients. This would mean that for example such execution venues which are only rarely used by the generality of retail clients (such as Asia, South America) need not be listed by name, but just generically described.

In para. 55 the question is addressed as to whether there is an obligation to provide professional clients with more information than retail clients. As we read the MiFID this is clearly

not the case. Thus the pronouncement in para. 58 that this is a question for the organisation of the individual banks is entirely correct.

Ouestion 5:

Do respondents agree that the 'appropriate' level of information disclosure for professional clients is at the discretion of investment firms, subject to the duty on firms to respond to reasonable and proportionate requests? On the basis of this duty, should firms be required to provide more information to clients, in particular professional clients, than is required to be provided under Article 46(2) of Level 2?

We agree with the view of the CESR that according to the Implementing Directive the nature and extent of the information which is to be made available to professional clients in view of the execution policies is left to the properly exercised discretion of the securities firms. Against this background we recognise neither a binding duty on the part of securities firms to give professional clients the information under Art. 46 (2) of the Implementing Directive, nor to give any other information. Such requirements would conflict with the consideration contained in Recital 44, which assumes a less stringent duty to provide information in relation to professional clients.

Consent

Ouestion 6:

Do respondents agree with CESR on how "prior express consent" should be expressed? If not, how should this consent be manifested? How do firms plan to evidence such consent?

The definition of what constitutes client's "prior express consent" or "prior consent" should be based on existing national law.

We essentially agree with the CESR interpretation of the question of "express consent" to the execution of commissions other than on a regulated market or MTF. We would however urge that „actual expression" of consent by the client should be further interpreted as follows: For reasons of practicality it should be considered sufficient, in those cases where under domestic civil law silence until the expiry of particular period after notice is deemed to mean consent, if in the course thereof the client has had his attention expressly drawn – e.g. by a clearly indicated notice – to the possibility of the commission being executed other than on a regulated market or MTF, and on the basis of this information he places orders in relation to financial instruments which according to the policy may be executed on such other markets.

With regard to "prior consent", in those cases where this correspondents to domestic civil law silence until the expiry of particular period after notice should be deemed to mean "prior consent".

Chain of execution

Question 7:
Do respondents agree with CESR's analysis of the responsibilities of investment firms involved in a chain of execution?

Para. 68 deals with the duty of the portfolio managers and RTOs to examine and monitor the „execution approaches of the entities." This concept introduces a new wording which is not used in Art. 45 of Level 2. It remains therefore unclear what is meant by this formulation. With regard to the aforementioned duty of the portfolio managers and RTOs we refer to our comments on para. 40 (cf. answer to Question 3).

Review and monitoring

Para. 85 discusses how the institutions can monitor the quality of execution of orders. We would like to emphasise that various approaches are possible. In particular in our opinion it may also be sufficient that the trading venue trades on the basis of a regulatory system licensed by the regulator that guarantees execution at a recognised regular price.

We reject the requirement set forth in para. 87 according to which portfolio managers and RTOs have to take into account the results produced by other intermediaries in order to monitor the suitability of a contracted intermediary. It remains unclear how this is to work in practice. Moreover, a thus far reaching duty is disproportionate and should at the most be taken into account as "ultima ratio", i. e. if the intermediary does not any more ensure a constant best execution of the orders forwarded to it and it has failed to produced relief despite having been called to do so. Finally, the meaning of the last sentence of para. 87 is unclear.

Execution policy data

Question 8:
What core information and/or other variables do respondents consider would be relevant to evaluating execution quality for the purposes of best execution?

At present it cannot be said what information can be prayed in aid other than one's own experience. The information market is still developing and is also dependent upon the product. It is of decisive importance that the investment firm decides on the selection of execution venues on a comprehensible basis. A binding rule as to which basis of information is to be used is not necessary here.

Other

In para. 95 it is stated that some institutions have expressed the fear that they may have to have data available on the market situation at the point in time of the execution of individual orders. We are strongly opposed to this view. The correct view is that the MiFID merely obliges them to show that their own execution policy has been followed.