



Milan, 4th April 2005
Prot. n. 44/05/MCO/nms

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

RE: CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/CE on Markets in Financial Instruments".

- **Aspects of the definition of Investment Advice and of the General Obligation to Act Fairly, Honestly and Professionally in the Best Interests of Clients**
- **Best execution**
- **Market Transparency**

Introduction

ASSOSIM is the Italian Association of Financial Intermediaries, which represents the majority of Italian financial intermediaries, banks and branches of foreign institutions, active in the Investment Services Industry.

Before addressing the matters at hand, we would like to thank CESR for arranging a second consultation on such important issues.

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

In this consultation CESR puts forward a new proposal which, while relating to the obligation provided for by Article 19(1), serves to restrict the scope of applicability of the concept of execution only.

CESR maintains that whenever a retail client (the obligation does not apply in the case of professional clients) requests a loan or a monetary credit in the course of or in connection with the provision of an investment service, the intermediary may not avoid performing an assessment of suitability. The intermediary should at least enquire into the client's financial situation.

While agreeing with the reasons behind this assertion, as it is clearly advisable to be aware of the client's financial situation before granting a loan or opening a credit line, we do not agree with the terms and the context in which this provision has been inserted. An assessment of this kind is important irrespective of the final purpose of the service. If this regulation were to be introduced, the rules governing suitability would become extremely confused and the provisions of paragraph 6 of the same Article 19 (execution only) would be devoid of applicability. Furthermore, two operational situations featuring the same degree of risk would be treated differently in that a client borrowing funds from a subject other than the intermediary acting as broker or collector (without any intervention on the part of the latter) would be

treated differently from the same type of client who, on the other hand, chose to apply to the intermediary providing the investment service. In one case, the client would be obliged to disclose his financial situation, in the other he would not. Furthermore, it is worth remembering that, according to the directive, the client's financial situation must be taken into account in assessing suitability only where investment advice and portfolio management services are to be provided. In this context the request is pertinent to the investment service being provided, in the other cases it is not. Hence we hope that a provision to this effect is not included in the second level regulation. The same consideration applies, to an even greater degree, to the enquiry into investment objectives.

Best execution (Article 19 (1) and 21)

Best execution obligation in case of both direct and indirect execution of orders on behalf of clients (i.e. portfolio manager or intermediary in charge of reception and transmission of orders).

CESR notes a substantial difference in terms of discretion of the intermediary who has direct relations with the client in the two circumstances set forth below:

- 1) in the first case (fig. 3) the intermediary applies to a broker only in so far as he accesses a specific venue, having made the decision to execute the order on that venue.
- 2) in the second case (fig. 4) the intermediary's choice falls on a broker who accesses several venues and has sole control over the final part of the execution process, without the first intermediary being able to influence the final choice.

In the second case CESR draws attention to the way in which the intermediary delegates control over the order execution process to the broker and refers to the exercise of discretion in the execution process or at least in the choice of the broker.

Firstly we agree that responsibility for execution of the order must remain with the intermediary who has direct relations with the investor and this must be so for the entire process of order execution. Furthermore, said intermediary, precisely on account of the execution policy instrument, referred to in Article 21, par. 2, of the MiFID, may arrange with the broker every aspect of the service to be rendered by the latter, establishing the details of execution, including those relating to the final part of the process.

Nevertheless account must be taken of the fact that the broker's choice of final venue at which to execute the order may not be completely controlled by the intermediary and might also be influenced by elements which the latter is not entitled to question, such as the commercial choices and policies favoured by the broker.

In light of these considerations, we are of the opinion that, in determining the best execution obligations to be observed by this category of intermediaries, CESR should take into account the existence of a *margin that is not completely controllable in the execution process*, which is quite a different matter from the discretion or willingness to delegate, mentioned by CESR in the consultation document.

The first consultation document on the issue of best execution raised the question of the particular nature of the best execution obligations in respect of the intermediaries providing reception and transmission and portfolio management investment services, thus bringing up a specific aspect of the argument that has just been put forward. In the order execution process, the intermediary who is responsible for receiving and transmitting orders and the portfolio

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manager must guarantee their retail customers best execution in accordance with a different order of priority compared to that which the broker may guarantee them, in so far as they are professional clients. Furthermore, if they were not to request treatment as clients they would, pursuant to Article 24, be considered eligible counterparties, towards which the obligations arising from respect of the rules of conduct would not need to be observed at all.

We are aware that the market forces involved shall find a practical solution in the course of the negotiation phase preceding the provision of services. However at this stage the critical aspects and the inconsistencies that clearly emerge from the analysis of the proposed regulation cannot be overlooked.

Some specific considerations on the issue of best execution guaranteed by the portfolio manager.

CESR specifically deals with the issue of the choice of venue on the part of the portfolio manager, within the scope of the (indirect) best execution obligation. CESR is of the opinion that, in order to guarantee best execution, the portfolio manager must not allow his choice to be influenced by inducements on the part of the chosen venues. Only where best execution is guaranteed to the same extent may the portfolio manager consider the inducement as a further element for preferring one venue to another.

In our opinion, particularly with regard to the portfolio manager, there is a danger that this interpretation may shift attention from the actual content of the service provided to the execution of the order.

Without prejudice to the obligation to disclose inducements received, we believe that the portfolio manager, in providing the portfolio management service, must consider the execution as only one component, albeit an important one, of said service.

Research, on the other hand, is a fundamental aspect of portfolio management. Hence, if this is one of the services offered by the broker, by way of inducement, the order of priority is incorrectly inverted, with the erroneous result that research comes to be considered an “extra” where execution terms are equal. In the provision of such a service, it is precisely the research and the quality of the same that are of greater consequence than the execution in the portfolio manager’s assessment.

Criteria for determining the relative importance of the different factors to be taken into account for best execution (21.1)

As far as the definition of the execution policy is concerned, we approve of CESR’s general approach.

However some reservation must be voiced with regard to the considerations expressed in paragraphs 45 and 46, even though these conclude sound arguments in relation to the peculiarity of the execution policy for financial instruments other than shares.

CESR recognises the need to assess differing factors for the purposes of determining the concept of best execution and the procedure by which to ensure that this is achieved.

It is clear that in writing Article 21 the first level legislator was referring only to shares. A policy for the execution of financial instruments other than shares, which should explain, as provided by Article 21 sub-section 3, the choices relating to the priority of the factors referred to in Article 21 sub-section 1, should be entirely formulated as an explanation of the complete lack of provision for the factors listed therein. In the case of unlisted bonds, for example (but the

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same could be said of all the OTC products, especially derivatives), there is no reference price, which for CESR constitutes a principal element, together with costs, in the execution policy that is defined and conveyed to the retail clients. In the case of bonds, the rating, the residual life of the bond and the rate shall be the elements of greater importance to the execution policy representing the execution process of this type of financial instrument.

While recognising these problematic aspects CESR defers their assessment and solution to level 3 legislation, where member states are known to be granted a certain margin of discretion. From a harmonisation standpoint this is unacceptable. Diversity in national regulations on such a delicate and essential issue could give rise to adverse repercussions on the competition between different subjects, who would not be operating on the level playing field the community legislator had hoped to establish.

A detailed second level legislation to replace what CESR refers to in point 45 as the “reasonable steps approach” is absolutely necessary.

Trading venues to be included in the order execution policy (21.2)

Obligation to monitor and update the order execution policy (21.3)

Execution policy with single venue (question 56)

We reaffirm the opinion expressed in the reply to the first consultation according to which an intermediary considering a single venue in his execution policy may be deemed to be in compliance with the obligations provided for by Article 21.

If we look at the case of a small intermediary whose policy features the venue considered as “relevant market” for that security, accessing another venue could prove extremely costly for him and in this case also not particularly useful to the investor. In fact, accessing another venue would actually be detrimental to the investor in terms of cost.

Implicit costs (par. 42) and internal costs (question 65) must not be identified and distinguished from all the other costs, but considered in the general category.

Monitoring of arrangements.

On the subject of monitoring the execution process we again agree with the approach proposed by CESR, by which it is recommended that investments firms be granted a certain degree of freedom to establish the procedures by which to ensure compliance with this obligation. It is superfluous to regulate monitoring methods or frequency of procedure revision. The important fact is that these procedures allow clients to be constantly guaranteed best execution.

CESR raises the question (no. 82) as to how to assure clients that the execution organisation reflects market trends and that the venues chosen by the intermediary guarantee compliance with best execution.

There are a number of means by which an intermediary can keep himself up to date with the venues capable of guaranteeing best execution: information (i.e. information providers), marketing activity, research.

However, we would like to stress that the very nature of these means does not allow the automatic replacement of venues, but allows regular indication of those venues which no longer guarantee the best execution on a regular basis, as required by Article 21 sub-section 3, and which must therefore be replaced

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A broker should inform the intermediaries providing portfolio management, order receipt and transmission services of any important changes in his activity (question 87). We deem this type of information to be necessary as said changes may have repercussions on the final execution of the retail investor's order, as discussed above in relation to indirect best execution.

Information to the clients on the execution policy of the firm (21.3)

On a general level, we believe the section of the CESR proposal relating to disclosure to the client to be too detailed. **If this degree of detail were to be upheld, the obligations could prove too burdensome for the intermediaries and at the same time we do not deem the information disclosed to be of any real advantage to the client.**

Furthermore the exhaustive detail contemplated by the CESR proposal appears in some cases to involve repetition of the information to be given to the client pursuant to Article 19.

We believe that only the venues to which the intermediary has direct access should be considered in the policy. The intermediaries are concerned about the difficulty of drawing up and updating the list of venues, which could prove to be very long.

Furthermore the obligation to constantly disclose to the client extremely detailed information (point no. 100) on the names and number of venues could deter the intermediary from updating the list, which could clearly have adverse repercussions on the quality of execution.

ASSOSIM suggests that the updated list be communicated to clients not after every change, but on a periodic basis (not more than once a year).

In points 105 – 110, CESR suggests the possibility of enforcing disclosure to the client on the subject of the percentages of orders which the firm sends to each venue.

Considering that this type of information is recorded and retained by the intermediaries and could therefore be provided to the clients upon request, in our opinion disclosure of this nature is not advisable for the general reasons expressed at the beginning of this paragraph. First of all, the client would receive information that is too detailed and too technical to be understood by the average investor. Just think of the possible misunderstandings and contestations that could arise from disclosure of the order execution percentages. From the intermediary's point of view, on the other hand, the publication of this confidential information could damage the firm's business interests.

In light of the above, the firm would not incur any specific costs in recording this information (question 110 point a)), but the practice would be detrimental to the firm's business interests and would result in the clients receiving over-detailed information (question 110 point b and c)).

The possibility of providing customers with further information on the execution, catalogued by single venue, by type of instrument, by single country or by single line of business, as put forward in question 110 point d) is to be excluded.

The customers should not be provided with information concerning venues to which the intermediary has no indirect access (question 110 point e)).

As far as disclosure on monitoring procedures is concerned (point 111 and thereafter) the intermediaries have stated that they can provide clients with general information about their

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own policies on the matter, without going into detail. Furthermore, this would be consistent with the approach formulated by CESR, which met with our approval, namely that monitoring of the execution policy should not be regulated by specific requirements other than the obligation to guarantee best execution.

The same considerations can be made with regard to order management and error correction (question 115) which among other things would imply the disclosure of highly confidential information to clients (i.e. handling of error account) .

No problems were encountered in relation to the obligation to disclose procedures.

Attention must be drawn to the fact that in the document under review CESR always refers to the “client” or the “potential client”, as the person receiving information on the numerous aspects of the best execution policy that have been highlighted. In substance, Article 21 of the MiFID refers solely to the “client” and does not include the “potential client”, while Article 19 makes a reference to both expressions, showing that for the legislator a difference exists between the two. The breakdown of the execution policy contains information which is highly confidential and its disclosure could prove damaging to the intermediary. We believe that this information should only be submitted to the client when the latter has consented to the execution contract.

In the event of the service being initiated before the client has provided written consent to the execution policy, it is recommended that the execution policy be communicated by way of recorded telephone conversation.

The recording could be used as sole method for obtaining consent to the policy from institutional clients.

Market transparency

Before proceeding to discuss the merits of the individual proposals, we would like to express our concern for what we regard as the extremely piecemeal account of the provisions concerning transparency contained in the CESR proposal.

An adequate regime of transparency is the only means by which to guarantee that only the benefits of internalisation are accomplished on the financial markets, in terms of competition, rather than the adverse effects, in terms of loss of efficiency of the price formation mechanism, mentioned on several occasions.

As we see it, if the following aspects are taken into consideration: the derogations to the pre-trade transparency obligations for the markets and MTF; the definition of the systematic internaliser and the security's liquidity requirement, as premises to the enforcement of the transparency obligations; the possibility of price improvement above that which shall be defined as customer retail size; not only are we presented with a fragmentary account of the situation, but also with one which is not reliable. The information published shall be of no interest to the market for price determination purposes. These adverse effects shall be amplified by the fact that the market subjects who are supposed to consolidate information shall be disinclined to process partially accurate information and hence this activity, which is deemed by all to be fundamental to a system of internalisation of orders, shall be set aside.

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Another important aspect to consider is the fact that the competent subjects shall have difficulty in implementing efficient supervision with regard to an information framework such as the one described above.

These reflections are not intended as a rhetorical and alarmist statement in favour of transparency, but rather show a desire to influence an area where there is still scope for improving the standards of the regulations concerning disclosure by bringing them back in line with general principles, which may be shared by level 1 legislation.

Definition of Systematic Internaliser (Article 4)

With regard to the definition of systematic internaliser, we reaffirm the position previously expressed by the Association, and namely that said definition must be clear so that its scope of application can be defined without ambiguity and that certainty can be guaranteed in relations with the subjects involved.

We reaffirm the concept that qualitative criteria may be easily evaded where adoption of quantitative thresholds provides greater certainty. Hence ASSOSIM proposes that use of the criteria listed by CESR should be reversed and that the quantitative criteria should come first while the qualitative criteria should be considered as additional indicators.

The first of the two quantitative methods proposed (12. a) considers the ratio between the value of the internalised orders and the total activity on that security, to be higher than 20%, calculated on an annual basis.

It is preferable for said ratio to be calculated by taking into account the counter-value of the orders. A choice of this kind would be consistent with the provision of the regulations contained in other points of the proposal, for example, that of the SMS expressed by a monetary value.

We intend once again to put forward the proposal, submitted during the first consultation on the issue, that the threshold for the quantitative method described above should be 10%.

Pre-trade Transparency requirements for Regulated Markets (Article 44), MTFs (Article 29) and Systematic Internalisers (Article 27).

We suggest that the free float of the share be brought to 500 million euros, as threshold by which a security may be considered liquid, for the purposes of application of Article 27 (22 (b)).

In any case, we ask CESR to determine the figure representing the liquidity threshold only after having performed an in-depth analysis, the results of which we believe should be shared with those participating in the consultation. The analysis should include projections on the percentage of securities currently listed on the regulated European markets that would be covered by the definition of liquid security.

Standard market size:

We agree with the provisions on the different classes and relative SMS.

We suggest that the first two classes (0-10,000 and 10,000 – 20,000) have a single SMS equal to 15,000 euros.

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Should the SMS of the first class be 5,000 it would paradoxically be lower than the customer retail size which has been set at 7,500.

We propose that CESR should raise the customer retail size threshold to 15,000 euros.

The current customer retail size is so low and equal for all classes that as standard market sizes grow such a retail size defeats the value of the guarantee of the significance of the published price.

Deferred publication of transactions of a larger scale than those customarily traded on the market

Firstly, we agree with the end purpose, which is to provide for deferral of publication of the details of large-scale transactions, so as to minimise the detrimental effects on the market. In this regard, we agree with CESR's approach and namely that the deferral should be no longer than is "reasonably" required. **Nonetheless, we believe the calculation method proposed to be too intricate for the final purpose of the regulatory provisions.**

Thus we propose retaining only two phases of temporal deferral, the first of 120 minutes and the second "by the end of the day or by the end of the following trading day if the transaction took place in the last two hours of trading".

Furthermore we deem the method used for determining the different classes of liquidity to be too complex compared to the temporal advantage that ensues. It would be preferable to have easily interpretable classes that help the operator to identify immediately the upper limit within which to effect publication. Thus we propose that for medium-high liquidity securities (> € 25 million) the upper limit should be 120 minutes while for medium-low liquidity securities (< € 25 million) reference should be made to the other band as set forth above.

We remain at your disposal for any other clarifications you should require.

Yours sincerely

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