



FEDERATION OF EUROPEAN SECURITIES EXCHANGES (FESE)

Rue du Lombard, 41
B-1000 Bruxelles
P646/1(final)

T (0032 2) 551.01.80

F 512.49.05

www.fese.org

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**Response by the Federation of European Securities Exchanges (FESE) to
CESR's Call for Evidence on the
First Provisional Mandate on implementing measures for the FIMD (ISD2)
(CESR 04-421)**

The Federation and its Members welcome the opportunity to provide CESR with a number of initial thoughts on level 2 work on implementation measures for the new Financial Instruments Markets Directive (FIMD/ISD2). We also refer to any comments and suggestions that individual FESE Members have already submitted. Such additional comments should in many cases be seen as a reflection of the need for flexible arrangements.

We would like to underline that we see the comments in this document as our contribution at the start of a fruitful discussion and we will in any case follow up with additional comments during the further course of the consultation on implementing measures for the new ISD.

Ad ch. 3.1. Organisational requirements

It is currently not yet decided in the legislative process whether and in which form the provisions of Art. 13 of the Directive will become applicable to Regulated Markets when operating an MTF. When devising on how to apply the requirements of Art. 13 to market operators that run an MTF, CESR should take good account of all parallel requirements for the operation of a Regulated Market. Duplication of requirements should be avoided as well as any unnecessary divergence of requirements for the operation, by the same operator, of an MTF on one side and of a RM on the other.

As CESR regulators are aware, they are requested by the mandate to look (under Art. 13(1)) at "concrete organisational requirements to be imposed on investment firms performing different investment services". This invites developing a distinct approach to those investment firms that operate an MTF as their sole investment service. It would, on the other hand, leave room for reference to and reliance on the regulatory framework for market operators.

Ad 3.2. Conflicts of interest

In the Annex to the provisional mandate, the Commission requests CESR to pay special attention to four practices that carry a particular potential for conflicts of interest (payment for order flow; routing of orders to other investment firms; distribution of UCITS; soft commissions). In addition, our Federation urges CESR to explicitly analyse and address potential conflicts of interest also in a fifth important area, namely internalisation.

Ad 3.3. Conduct of business rules

We would like to comment only briefly on the text of the provisional mandate. We do not regard it feasible that CESR should define the exact content of each of the obligations laid down in Art. 19 of the Draft FIMD. Likewise, we would at a later stage advise the Commission against any effort to enshrine such "exact" content in any level 2 instrument.

With regard to the instruction to consider establishing a "typology of investment services and financial instruments", we suggest that CESR focus mainly on further work on a typology of clients.

Ad 3.4. Best Execution

Given the removal of concentration rules from some markets, we fully appreciate the importance of introducing a robust and practical best execution regime if CESR is to meet the twin objectives of protecting investors and promoting fair, competitive, transparent, efficient, and integrated financial markets.

A proper evaluation by the investment firm of a client's (probable) preferences for order execution is of crucial importance. We support the clear wording in the body text of the mandate (p. 12) and see no reason why this mandate should be weakened in the corresponding passage of the Annex.

We underline that, according to observations of several of our Members, speed and likelihood of execution are commonly of only very subordinate importance for retail investors – for professional investors, these criteria may of course be of high importance. These FESE Members would therefore see a value in a "default assumption" that for retail clients a minimisation of net price + costs should be achieved.

We do not expect CESR to come up with a decision on any minimum number of execution venues that an investment firm shall establish access to. It is conceivable that the deliberate decision by a firm to link up to only one execution venue will save that firm search, participation and/or IT costs and will – if savings are properly passed on – benefit the end customer. Such claimed advantages should, however, be demonstrable and quantifiable.

The explanation of the firm's execution policy will in our view have to include, among other information, a certain rationale in what circumstances and for what types of business the firm screens and uses what venues.

Ad 3.6. – Reporting of transactions

We would like to emphasise on behalf of those of our Members that operate commodity derivatives markets, that transaction reporting will be a completely new obligation for their participants. Due to this, to the specific nature of their markets, and to the wholesale character of the business, we urge CESR to subject reporting requirements in this area to a particular and separate cost-benefit analysis.

Making optimal use of transaction reporting is foremost the duty of competent authorities. This implies in principle their obligation to arrange for efficient and effective reception, forwarding, concentration, and screening of data. FESE and its Members are alerted by the ambiguity of the respective passages on level 1. It is in our view not clear to which competent authority a Regulated Market should report transactions done by its international participants.

In any case where more than one competent authority is or could be involved, we see difficulties and inefficiencies if more than one report should have to be created. We expect from CESR clear advice for a solution that provides a one-stop-shop solution, in particular when the reporting is done by a RM/MTF operator. Subsequent forwarding/distributing/sharing of data falls, in our view, clearly in the responsibility of CESR Members.

Furthermore, we would like to reiterate our opinion expressed on many earlier occasions that pursuing the notion of a "most liquid market" for any instrument threatens to ossify current market structures, is intrinsically anti-competitive and promises to create confusion and problems. We understand that CESR Members themselves share many of our concerns in this respect.

Ad 3.7.1. Pre-trade transparency for Regulated Markets and MTFs

As a first remark, we would like to emphasise that the mandate to CESR calls for opinions on the extent of the obligation placed on RMs and MTFs and on possibilities for waivers for certain types and size of orders and for certain market models. The mandate, however, does not ask CESR to consider the requirements that RMs or MTFs place on their participants with respect to the information that they must submit to the markets.

Secondly, FESE Members note with concern that the Call for Evidence as well as the Technical Annex calls for advice about potentially rather detailed regulations with regard to order book information. We consider it important for CESR to adopt a light approach, as there should be sufficient room for flexibility with regard to the various market models designed in Europe. In addition, our Members want to emphasise that there is a firm connection between the scope and quantity of information to be provided and IT capacity. Having to drastically upgrade and expand systems in order to comply with transparency requirements could indeed entail sizeable cost

FESE Response to FIMD Call for Evidence I

consequences; we therefore urge CESR to weigh carefully the potential costs and benefits of different levels of transparency requirements. We submit this concern not exclusively, but with a certain emphasis, on behalf of our smaller Members, both in current and in future Member States.

With regard to the forthcoming discussions about a definition of block size, we would like to emphasise at this stage that much speaks for a uniform definition of any block size threshold for the same instrument across all markets. This would provide the level playing field between all EU venues with a similar market model and would help to avoid damaging regulatory arbitrage. This does not mean, however, that the block size threshold should be identical for all equities, regardless of their liquidity, their market capitalisation, and of other decisive factors.

As a further matter of course we take it that CESR will limit its guidance to issues of pre-trade transparency for “shares admitted to trading” which limited mandate is expressed clearly on level 1 as well as in the provisional mandate by the Commission. Notwithstanding the FESE Members’ commitment to promote transparent markets in all instruments and in view of the respective draft review clause, we expect a broad and structured discussion on this issue in due course with the aim of tailoring such requirements, if any, to the respective markets for each individual class of instruments. This comment applies equally to the area of post-trade transparency; see below.

Ad 3.7.2. Post-trade transparency for Regulated Markets and MTFs

Some FESE Members find it confusing that the mandate includes under this heading a possible application of post-trade transparency requirement for RMs and MTFs to off-exchange trading.

Moreover, we are concerned that the Annex to the mandate requests CESR to advise on “the exact content of the information that has to be made public as well as the different forms in which it can be presented.” This we would regard as overly prescriptive and potentially inflexible. We argue particularly in favour of a minimum definition approach that would leave it to Regulated Markets to fine-tune their requirements.

Lastly, we are alerted by the fact that in the Annex text refers again to a definition of the “reasonable commercial terms” for the publication of trading data. At the current stage of the legislative discussions, neither the Council text nor the proposals by the EP rapporteur contain any mandate for level 2 implementation measures in this regard. We can therefore only take the inclusion of these words in the mandate text as an editorial error on the side of the Commission.

Ad 3.7.3 Post-trade transparency for investment firms

In this context, we would like to quote directly from a text that was made available to us by one of our Members and which we regard as very much to the point of what we see as a major problem:

FESE Response to FIMD Call for Evidence I

“The revised ISD introduces choice of reporting venue for investment firms allowing publication through RMs or MTFs, through the offices of a third party or by proprietary means. However, this choice introduces a number of significant regulatory risks the CESR must address.

“Where firms choose to meet their obligation through RMs or MTFs that have admitted the respective shares to trading, those RMs or MTFs must make the details of those transactions public in the same manner as transactions conducted under their own rules and systems. Given the rigorous regulatory standards applied to RMs and MTFs, regulators can have the confidence that the information will be disseminated in a manner that is accessible by market participants and is received in a comprehensible and comparable manner. RMs and MTFs also perform real-time market monitoring, ensuring that the data they receive is “clean” and reliable. Given the significance of trading data for price information it is vital that market participants have confidence that prices they see on the screen are correct.

“The issues of access and data integrity become more important when considering the conditions whereby firms may make details of transactions public by means of the offices of a third party or by proprietary systems. It seems reasonably obvious that where a firm is publishing its own data there ... (can emerge) ... a clear conflict of interest when it comes to making sure that the data is accurate and widely available. Equally, where a firm is publishing through the offices of a third party, there is no clear commercial imperative for it to apply the same exacting standards of monitoring to that data as that performed by RMs and MTFs.

“We believe that if these conflicts are to be addressed and if the market is to have confidence in the accuracy and comparability of the trading data that it receives, then there is a clear need for ... standards that must be met by any organisation that wished to provide transparency to trading information, be they RMs, MTFs, investment firms, or data vendors.

“These standards would determine the means by which these organisations make the information public – clearly, publication of data on investment firms’ ... (own websites alone) ... would be ... (very difficult to accept) ... as this would be difficult and expensive to consolidate. (The standards would) ... require that firms (where market monitoring is not performed by another entity) have that business monitored. This monitoring could be performed by a third party but we do not believe that an investment firm would be able to monitor its own business (effectively), given the potentially huge conflicts of interest. They could, however, outsource the monitoring function to a body that (in turn) meets the standards.”

Ad 3.8. Admission of instruments to Regulated Markets

Regarding the admission of financial instruments to trading, we welcome the intention that implementing measures should concentrate on a minimum content. For Europe’s Regulated Markets, it is crucial that they are given the possibility to adapt their admission rules to the policy they themselves see appropriate for all instruments that they admit.

FESE Response to FIMD Call for Evidence I

In this context, we regard it important not to set any quantitative requirements for certain parameters, e.g. the free float. We believe that CESR should focus on setting/proposing more general requirements, such as “adequate liquidity” with due regard to the characteristics of a particular market, market segment, or instrument. The old Listings Directive of 1979 (now part of Directive 2001/34) provides some flexibility; it should not automatically, however, be used as the benchmark for devising a regime for all EU Regulated Markets. Room should be left in any case for adequate flexibility allowing for innovation and competition.

We reject the idea that CESR should considering whether Regulated Markets should establish formal separations or segments in respect of different characteristics of the same type of instruments and that regulators should define those characteristics. The rules for admission to any segment of every Regulated Market will eventually be subject to some form of approval by the Regulated Market’s competent authority. We see no justification for CESR to include any comments about formal market separations and/or segmentations in their advice for level 2 measures. Respective discussions may be held on level 3 in order to assure harmonised implementation across the EU.

With regard of the Annex text, we are not certain how to interpret the allusion to “parallel trading”, but we are looking forward to CESR’s first draft work on this issue.

Issues not raised in the first provisional mandate

Apart from the contentious issues that were with good justification spared out from the first provisional mandate (internalisation and related topics), we regret that the Commission has not yet picked up the empowerment (“may” clauses) for level 2 measures in the context of Art. 2(1) letters (c), (i), and (k) and Art. 24. Those FESE Members that operate commodity derivatives markets see a necessity for further work on specific issues related to that highly specialised market, both on levels 1 and 2. This relates particularly to the exemptions (c), (i), and (k) in Art. 2(1) of the Draft Directive.

On this latter, highly specialised issue, as indeed on all other issues, the Federation and its Members remain of course available to CESR and its Members for any further information and clarification. We look forward to an intense, meaningful and fruitful discussion on ISD issues over the months to come.

Yours sincerely,

Gregor Pozniak
Deputy Secretary General.