Febelfin comments on the CESR's draft technical advice - second mandate -on possible implementing measures of the Directive 2004/39/EC on Market in Financial Instruments –

Introduction

Febelfin is the Federation of six trade associations from the Belgian financial industry: the Belgian Bankers' and Stockbroking Firms' Association (BBA), the Professional Union of Credit Providers (PUCP), the Belgian Asset Management Association (BEAMA, which regroups as of 25/03/2004 the former Belgian Association of Investment Funds and Companies and the former Belgian Association of Asset Managers and Investment Advisers), the Belgian Leasing Association (BLA).

Febelfin welcomes again the opportunity to provide the views of its members on the consultation papers issued by CESR. Nevertheless, Febelfin also deeply regret the very limited timeframe that is offered to market participants to formulate remarks on such important topics like best execution, internalisation and pre- and post trade transparency, which will, in its view, substantially overhaul the current financial regulatory framework and determine the outlook of the financial system for the coming decade. Febelfin understand that it is desirable to stay as much as possible within a set time-frame. However in its view timing should yield to organising the possibility to get a profound feed-back from the different market participants, especially on new items (e.g. suitability assessment for lending transactions, new details on best execution). Given the very tight time frame and the fact that the deadline lapsed again in the middle of a holiday period, it has been impossible for the Belgian sector to debate sufficiently, within each Belgian financial institutions and within Febelfin. Therefore CESR's advice, although being of a very important nature, could not be given the necessary attention.

Hereafter you will find, as a consequence, some limited comments on the aspects we considered at first glance to be crucial. This does however not imply that – given more time – we would have further comments to issues treated in CESR's advice and we want to make it clear that any matter not treated in this letter does not mean that we support CESR's point of view in any way (as suggested in nr. 122 of its advice) but that such absence of comments is solely due to the lack of response time. Consequently, we also reserve the right to supplement and modify this position later on, if necessary.

Furthermore the lack of time forced us sometimes to limit ourselves to state the preliminary perception of the sector without extensive detail or further elaboration.

Chapter 1: lending to retail clients (article 19 (1))

Question 1 : Do you agree with the proposed advice in this area, including the proposed limitations on the scope of the obligation ?

Taking into account the fact that the directive itself does not give any legal basis to further develop this item (since it is not a transaction in financial instruments), we find it inappropriate to regulate this specific kind of lending activity (we don't see any reason why this kind of lending should be otherwise regulated than a loan with any other purpose).

If CESR however is resolute to regulate this activity, we are of the opinion that :

(i) The inclusion of lending as an ancillary service under article 19.1 would contradict the objectives of the articles 19.5 and 19.6 and simply make impossible the services provided in accordance with these articles;

(ii) The comparison between lending for a financial transaction and a derivative product is not appropriate since (i) the discussion on derivatives as complex products remains unsettled; (ii) lending would require a full suitability assessment where the options for the client are not limited to art. 19.4; (iii) lending is an ancillary service under MiFID whereas derivatives are financial instruments under MiFID;

(iii) Exception 2 (a) is not clear. We wonder if this exception applies to the entire settlement business, or is it limited to settlement where the investment firm is ensured that payment will arrive within a short time : e.g. we think of a delivery versus payment (DVP) transaction. If the settlement is successful, the investment firm knows that cash or financial instruments will arrive. This is a "riskless" service for the customer. However, it is possible that this exception applies to the whole settlement circle (also settlement where there is no absolute certainty that payment will arrive) : e.g. a client executes a transaction with investment firm X. Since investment firm Y acts as its custodian, the client will give settlement instructions to investment firm Y. The investment firm Y only executes the settlement instructions and is not engaged in the trading process. If investment firm Y does not control whether the customer has sufficient assets in order to execute the settlement instruction, investment firm Y takes a credit risk (grants a loan) to the customer. If the investment firm does not apply a margining system, the investment firm is not sure that the customer is able to pay back this loan. If however a margining system is applied, the investment firm will apply a buy-in if the customer has not paid back the loan within the prescribed period of time and will use the margin if there is difference in market value. Is the exception applicable to both examples?

(v) If CESR is of the opinion to regulate this business, it is not logical to set the rules solely for funds lending. It would be logical to also apply the same rules to securities lending for retail customers ;

(vi) A waiver should be granted for lending transactions of a marginal nature.

Question 2 : Do market participants consider that investment firms have to obtain the necessary information about the retail client's investment objectives in addition to his financial situation ?

In connection with any lending aspect, we consider it appropriate to limit the assessment requirement by the investment firm to the financial situation of the customer. See however our remarks above on articles 19.5 and 19.6.

CHAPTER 2: The definition of investment advice

"Implicit" advice

This is in our view a contradiction. Advice by its nature is and should be explicit. Any other view would (a) be unmanageable within any institution, and (b) increase enormously the potential claims for liability towards investment firms by clients on the basis that they felt they got 'implicit' advice.

Moreover the example given by CESR (on p. 10) is not nuanced at all. Only deliberate, repeated behaviour which is intended to circumvent the requirements on investment advice through the provision of advice which "on its surface" would not qualify as investment advice but within the specific context does not raise any discussion regarding its specific nature should be caught. However, this is an issue of control and supervision which should be left with the competent authorities.

What CESR is describing in our view may also lead to fraudulous pressure to do something (which is another item and the control and sanctioning thereof should be left to the appropriate authorities)."

Question 1 : Investment advice should not cover any kind of *generic advice* (see also our advice on financial planning in response to the CP of October 21, 2004). In our view investment advice should always relate to (a) one or more orders in financial instruments and (b) take into account the specific situation of the client.

General discussions with the client or general papers concerning financial instruments or issuers without taking into account any specific clients' situation (such as broker notes or other equity research) should not enter into this definition (moreover research is already covered by the Market Abuse Directive).

Finally, we believe that the interests of the investor are well protected without a proposal to cover generic advice : (i) if generic advice is followed by specific (i.e. investment advice in the meaning of art. 4, para1, subpara4), the investor is fully protected; (ii) if the generic advice is not followed by a specific advice, the client's interests are covered by other provisions of the Directive (art; 19.1 to 19.3) and MAD.

Question 2 : We do not think that the scope of the passport implies the coverage of generic advice under the directive.

CHAPTER 3: BEST EXECUTION (articles 19 (1) and 21)

We are of the opinion that the redefined obligations with regard to best execution remain complex and ambiguous as they are generated from a "cherry-picking" of different elements from different national legal and business systems. As a consequence it becomes very difficult, if not impossible, to formulate a best execution policy and to manage it in practice.

We agree with the general approach to extend best execution to portfolio managers and order transmitters. However, the best execution obligation would need to be tailored to the circumstances of these institutions. The full application of best execution should be limited to those cases where the firm fully controls the trading process.

Paragraph 1 d and 2 c : it is not clear to us what is meant by (i) "except when they execute client orders by dealing on own account or by crossing one client order with another client order"?

Requirements for Selecting and Reviewing Execution Venues (p. 23)

Each investment firm needs to offer the best possible result for the execution of its client orders, based on its execution policy.

The best possible result is however the best result that a particular investment firm can offer taking into account the particular position of that investment firm. Since the situation of every investment firm is different, the execution policy will also differ. The best execution policy will inform the customer of the best possible result that the investment firm can offer, taking into account the specific business model of that investment firm. It is up to the regulator of that investment firm to check that the best possible result (taking into account the investment firms' specific business model) is in reality ensured.

We have the impression that the best possible result is still considered as an objective element, which does not at all take into account the specific situation of the investment firm. This can not be the intention of the regulator.

Let's consider the following example : taking into account the relative small volume of a specific investment firm, the best possible result for that investment firm will be achieved by selecting another broker for the execution of the order on a specific exchange. The investment firm therefore will not choose for a direct access to a specific exchange. The second broker however can obtain better prices from the exchange since its volume becomes bigger. There is a chance that the "direct" customers of that second broker will also obtain improved commissions and fees. The "indirect" customers of the first investment firm will benefit from improved commissions and fees as well (this in comparison with what that they would have paid

as additional fees, should their direct broker have chosen for a direct membership to the exchange), but there is a high probability that they would obtain still better fees and commissions (and as a result net price) if they would directly select the second broker. It would be difficult to understand that the "first" investment firm should be obliged to explain to its customer that they would obtain better fees and commissions if they would directly select the second broker (as (a) this would be contrary to European competition philosophy and (b) should oblige investment firms to monitor constantly the fee- and cost structure of other investment firms on a real time basis). The obligation of the investment firm should be therefore to formulate a best execution policy, taking into account its business model.

Taking into account the foregoing, we think that the answer to the question formulated under paragraph 56 (p. 23) is logical: if the selection of one execution venue gives the best possible result taking into account the specific business model of the investment firm, this possibility should not be excluded.

In fact, taking into account intragroup relations, it can be very logical that within a group, one company is specialised in executing orders and therefore has more experience and possibilities in the formulation of the best execution policy. If every group entity confers the execution to that specialist, the group volume is concentrated with that "specialist", which enables the specialist (and therefore each individual group company) to obtain better fee and commission schedules from exchanges and other brokers. The other group companies select only one "venue", but they evaluate the best execution policy of the "specialist" group entity and ask corrections if necessary.

That specialist will in his turn select other execution venues. The question under nr 56 is however not entirely clear. What is meant by the reference to execution venue? The venue to which the investment firm has a direct access as described in 1 (a) (v) under Box 4 or does it refer also to indirect access facilities as described under 1b) of Box 1 ? If the reference is to direct venues only, the chosen venue should prove to offer best execution on a consistent basis.

Regarding paragraph 62 we would appreciate further clarification. We understand that own commissions/fees should not be (mis)used to "deviate" the order execution to a particular venue. Different commissions may however be related to different cost structures.

Question p. 25

When selecting new execution venues to include in its execution policy, an investment firm must be able to take into account internal costs as well (e.g. development of new IT infrastructure, individual access costs and fee structure related to each individual venue) in order to decide on the most appropriate venue in terms of best execution for different type of orders.

Question p. 27

Data of this kind are not always automatically distributed. One tries of course to monitor the market and its evolution (data analysis : spreads, market depth of the

order books, turnover). However, the available data are not always of a comparable nature and in relation to private systems (such as executing brokers) is sometimes of a general nature and as such does not reflect actual criteria, which may be the outcome of negotiations.

Question p. 28

If those portfolio managers or order transmitters are intermediary's clients or potential clients target group, we suppose they would do so ; also, these professional clients are supposed to do their quality review and request such information. The information may however not always be all-encompassing (moreover one could discuss the scope of the concept 'material').

BOX 3

(a) (iv): we do not see the added value of an annual review, given the extensive scope of the other criteria (esp. (a) (i)). This seems a too formal criteria which would lead to additional costs and energy while there are no external factors justifying such review. (Criteria (i) should already cover/prevent a too long period without any review).

(b) In the last sentence about costs, internal costs and fees should also be included.

Mandate 3.4.3. Information to the clients on the execution policy of the firm.

Questions formulated in paragraph 110, p. 31.

We do not see why, when most respondents objected to the idea and without giving any reasons why the reasons as stated under nr 107 are not convincing, CESR still supports such kind of disclosures. Unless there are good and valid reasons for such disclosure which in our view does not bring added value to retail customers but concern high commercially sensitive information with respect to competitive professional clients who should be able to make their own home-work.

b) and e) We appreciate the CESR statement under nr 103 that no information need to be provided to customers with regard to indirect accesses (names of trading venues etc). It is sufficient to inform customers of the direct accesses of the investment firm (see paragraph 103).

However, the question formulated in par. 110 b) causes, without any further explanation, some doubts. If an investment firm is obliged to inform the customer of the identity of the indirect trading venues, this would place the investment firm in an impossible position, since it would be obliged in some cases to publish the name of its main competitor (it has chosen as executing intermediary) on a local market (leaving internalisation out of the discussion because in that case the main competitor would be the "execution venue"). This could even have a negative effect, since no investment firm would select a home market competitor as its executing broker

(which may not have a positive effect on the best execution policy of the investment firm).

It is not a question of publishing the percentage of its business which is executed indirectly, it is a question of giving information with regard to the identity of the indirect executor.

We also think that the obligation to communicate the name of the indirect venue may have an adverse affect on customers, since (at least under Belgian law) the fact that the identity of the subcontractor is communicated to a customer, releases the liability of the investment firm for negligence and mistakes of that subcontractor (since the customer are then able to evaluate directly the subcontractor). Again this could not be the intention of the regulator.

d) We don't think that this information is useful for the (retail) customer and so do not see why it should be provided on request (extra burden for investment firms, which makes the business more expensive for any customer also those which do not request such information, as the set-up of the monitoring systems and databases has to be done anyway in order to anticipate any such requests)

e) We refer to the response under (b) above.

Questions formulated in paragraph 115, p. 32.

We do not find appropriate to disclose information about the error correction and order handling policies. The fact that a selected execution venue makes mistakes should be an element for the investment firm to reconsider this execution venue and as the case may be to re-evaluate its entire execution policy. Disclosures regarding error correction policy, error rates and client order handling policy are relevant for supervisory purposes. They should exclusively be made to the competent authority that is in charge of the overall evaluation of a firm's performance with respect to best execution.

Proposal 5 : timing.

Questions formulated in paragraph 126, p. 34.

a) We don't think it is possible to describe a best execution policy via a telephone communication. For that reason, we think that the customer needs to approve this policy in writing before accepting orders via telephone (and on the condition that no changes occurred to the policy after the customer approval).

(d) Through the tapes of such telephone conversation (if there are) and the fact that orders have been given by the client.

BOX 4

Point (a) (ii) is not understood. On the one hand it is covered already under (a) (i) (the firm must determine the relative importance of the criteria) and on the other hand, considering this as a specific requirement, seems to draw special attention to and

delivers the two stated factors (price and cost) a status “as primus inter pari”, which is incompatible with the basic approach of article 21.1..

Point (a) (iii): we are very much concerned about the warnings included in Box 4 under this item. The wording included in article 21.1 of the Directive makes it very clear that the best execution obligation does not apply to the cases where the firm is following the client’s instruction. CESR’s wording in the box 4 and explanatory text seems to imply that best execution is owed to all clients, including those giving explicit instructions. In our view an investment firm’s execution policy covers exactly those orders for which the client has not provided instructions. A combination of both is not possible. We understand however that intentional behaviour to deprive investors from best execution should be avoided (supervisory task). Furthermore, the statement about soliciting instructions under paragraph 130 is ambiguous. Execution only business models cannot survive without specific instructions. How should we understand CESR’s comment ? In addition, in relation to paragraph 131, the execution venue chosen will largely determine the outcome and there may be no room left for the investment firm to apply other aspects of its execution policy.

Point d) (i) we don’t see any reason why the transmission of an order to an affiliate would oblige the investment firm to give a description of that “practice” to the customer.

The investment firm needs to formulate a best execution policy. The fact that an affiliate, instead of a third party executing broker, is used in this regard is not relevant. Suppose an investment firm has different branches in different countries : in such a case, it would not be necessary to give a description of the order transmission route (transmission and execution via the head quarter or a branch in another country), while in case an affiliate is used, such information would need to be given (the choice of business organisation – either separate legal entities as opposed to branches – should not have an impact here). We don’t see any reason why a customer needs specific information on the intra-group arrangement in such a case. We understand however that the group’s conflict of interest management and inducements policy should be disclosed in general terms and that in case the group affiliate systematically internalises the orders of the other group entities, one should obtain the explicit consent of the ultimate client (our reading of box 1, b).

(ii) What should we understand by “arrange transactions between its clients or between its clients and clients of its affiliates” ? Crossing/compensation of client orders ? We don’t see any reason why a customer needs this kind of information only the way how conflicts are managed are relevant, which may describe the group’s policy without disclosing the specific practices.

Chapter 4 : Market Transparency

Overall there are several references to the “most liquid market” or its competent authority (see fi Box 1 - § 12 (b); § 64, Box 3 - § 97, …);

However in its last advice with respect to article 25, CESR also stated that the competent authority of the most liquid market would no longer be disclosed externally

in order to avoid competition-distortions resulting from such 'status'. It's unclear what kind of reference (without distorting competition) would replace any such concept for the purpose of market transparency.

Additionally, this chapter pre-eminently is based on a lot of mathematical data, which was only disclosed to us recently and is still not complete. Moreover the motives to choose for one or another criteria or formula have not been explained. Therefore the impact could not sufficiently be assessed and it is very difficult to provide sensible further input.

BOX 3

§ 89 (+ § 53) → We would propose a differentiation in band-width that starts at a lower level than 100,000 and is applicable to the "liquid shares" with the lowest liquidity (i.e. less than 30,000) the lowest tiers would then go up with 3,000 and thereafter 5,000. This would result in a somewhat less steep increase in SMS for the less liquid shares. All Belgian (liquid) shares f.i. would be represented in the lowest 3 tiers.

§ 89 (+ § 55) → We strongly advise to compute an SMS in a (rounded) number of shares (to be reviewed regularly, f.i. at each material change in the issuer or its share and otherwise yearly or after a change in the quotation price with 20% intervals). Although it may be a little more complex for CESR, a daily (or more frequent) fluctuating SMS which also results an odd lot number of shares is not manageable at the level of an investment firm (and its dealers).

Febelfin comments on the CESR's draft technical advice - second mandate -on possible implementing measures of the Directive 2004/39/EC on Market in Financial Instruments –

Second Part

Chapter 4: Market Transparency

General Remarks

Because of the very short notice at which this 2nd CP has been given and due the fact that this paper has introduced brand new proposals on market transparency based on market data we could not evaluate, as it has been forwarded to us only recently (while still not being complete), we could not manage to make a proper assessment of these new proposals. Moreover, the CP does not explain the reasons for making a choice between one criterion , threshold or formula and another. So, it proved to be impossible to make a thorough assessment of the impact and it was very difficult to provide additional relevant input.

All through the text, there are several references to the "most liquid market" or its competent authority (e.g. Box 1 - paragraph 12 (b); paragraph 64, Box 3 - paragraph 97). In its latest advice with respect to article 25, CESR however also stated that the competent authority of the most liquid market would no longer be disclosed externally (and as a result also not said markets) in order to avoid distortions of competition resulting from this kind of 'status'. It is unclear what kind of reference (without distorting the competition) could replace a concept such as this for the purpose of market transparency.

Definition of systematic internaliser (Box 1, page 40)

In our opinion, the qualitative definition in paragraph 11 of Box 1 is a clear improvement over the previous proposal. More particularly, we are pleased to see that CESR has tried to incorporate Recital 53 into its definition. We also welcome the principle of including additional quantitative elements in order to meet the frequency criterion. We have not been able to assess the potential negative impact of the factor mentioned in paragraph 12 (b), since this factor is beyond the company's control. Furthermore, the text should be more explicit on the cumulative relationship between paragraphs 11 and 12.

As for paragraph 13, we want to repeat our point of view that the intention to start up the systematic internalising activity and the intention to stop it should be made public.

Definition of liquid shares (Box 2, page 43)

We think (see also our response to the 1st CP) that liquidity should be measured on the level of the EU instead of a national level. Although we did not have the opportunity to evaluate the appropriateness of the criteria which have been laid down, in particular as for the Belgian market, we believe that it would be better to err on the side of caution when it comes to defining the number of liquid shares to start with. The definitive criteria should make it possible to start with a relatively low number of shares for the Belgian market (and the European market as a whole). These criteria should also install a level playing field among European market places. In this respect, we doubt whether the possibility of a nationally differentiated approach is the right way forward.

Definition of Standard Market Size (SMS (Box 3, page 55)

As stated in our response to the 1st CP, we agree with a unified block regime for the sole purpose of calculating the average order volume under article 27.1, paragraph 5 on the one hand, and the pre- and post-trade transparency requirements for RMs and MTFs on the other hand.

We would like to point out once again that managing a large number of SMS classes with relatively small bandwidth as proposed for the lower end of liquid shares may prove to be difficult for systematic internalisers. We support the idea introduced by CESR of a logarithmic scale, but nevertheless we think that the bandwidths for the lower end of liquid shares are too large.

Consequently, we would like to propose (referring to pararaph 89 (+ paragraph 53) a differentiation in bandwidth starting at a level below 100,000 and applicable to the “liquid shares” with the lowest liquidity (i.e. less than 30,000). The lowest tiers would go up first by 3,000 and then by 5,000. This would result in a somewhat less steep increase in SMS for the less liquid shares. All Belgian (liquid) shares for example would be represented in the 3 lower tiers.

As for paragraph 89 (and paragraph 55), we strongly advise to compute an SMS in a (rounded up) number of shares (to be reviewed regularly, e.g. whenever there is a material change as for the issuer or his share and otherwise, on an annual basis or after a change in the quotation price with 20% intervals). Although it may be a little more complex for CESR, a daily (or more frequent) fluctuating SMS which also yields an odd number of shares is not manageable at the level of an investment company (and its dealers).

In our opinion, an annual review of shares grouping and of the SMS seems to be preferable. An interim review should be possible if there are material changes as for some particular shares. As for newly issued shares, determining the initial SMS should be done by using a proxy based on peer stocks (see our former remarks on the 1st CP).

Content of post-trade information (Box 5)

We support the method of publishing post-trade information on a trade-by-trade basis instead of a price determination basis. The latter would not be fully reliable in our opinion.

We agree that the person responsible for publishing the post-trade information must be the seller

Waivers for pre-trade transparency and deferrals for post-trade transparency (Box 6)

We could not assess the appropriateness of the pre-trade waiver thresholds nor the alternative calculation method proposed in footnote 19, all the more since there was no rationale for these numbers. The same goes for the post-trade deferred publication arrangements as proposed.

Timeliness and availability of pre- and post-trade info (Box 7)

The obligation for internalisers to provide a disclosure mechanism which must be available during the company's normal trading hours will be a problem for companies acting on a global level (risk-related to the inability to lay-off risk at the relevant market).