

ZENTRALER KREDITAUSSCHUSS

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Comments

of the Zentraler Kreditausschuss¹ on the Consultation Paper of the Committee of European Securities Regulators (CESR)

Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

- **Market Transparency**

Ref.: CESR/05-164

6 April 2005

¹ 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 Hypothekendarlehenbanken (VdH), for the mortgage banks. Collectively, they represent more than 2,300 banks.

I. Introductory remarks

The consultation paper published by CESR on 3 March 2005 contains proposals on key issues of the MiFID. Substantial changes and additions were made compared to the first consultation paper, and these had to be evaluated within four weeks. Although this procedure complies with the letter of the consultation process, and we welcome the fact that CESR has postponed the deadline for submitting comments by two days, we would point out that some of the proposals are new to the consultations. It would thus have been helpful if CESR had sought greater input from market participants during the over five-month drafting phase. This would have made the process easier for all concerned and reduced the time pressure. Moreover, it would also have been useful for the purposes of evaluating the proposed thresholds for transparency requirements if relevant statistics had been published together with the consultation paper.

II. Executive summary

Deferred publication of post-trade information (Box 5 in conjunction with Table 2)

The proposals on when the publication of post-trade information may be deferred take insufficient account of market realities. The combination of very high thresholds and short time limits without any link to the unwinding of a position will have an adverse effect on price formation. Furthermore, CESR has failed to consider the fact that liquidity fluctuates significantly over the course of a day. It is therefore inappropriate to base post-trade transparency requirements on ADV alone. To enable a position to be unwound, it is essential to consider the risk which the investment firm has entered into and allow more time to comply with transparency obligations.

It would, in any event, be advisable to establish a link with the unwinding of a position. Publication should become mandatory when the investment firm has unwound at least 80% of the total volume. This threshold would enable trades to be executed in a manner which does not disrupt the market or distort price formation while at the same time taking adequate account of the investment firm's risk. A detailed statistical analysis needs to be undertaken of market activities. We assume the findings of such an analysis will show that the thresholds need be significantly lowered and the time limits extended.

Identifying the name of the investment firm (Box 5, paragraph 139)

We strongly reject the requirement to make the name of the investment firm public. This would put investment firms at a competitive disadvantage compared to exchanges. While investment firms take risk positions, exchanges merely make a trading platform available to third parties; identifying the exchange therefore presents no risk whatsoever. Identifying the investment firm, on the other hand, would place it at a clear competitive disadvantage since

every investment firm would run the risk of the market turning against it if the acquired position could not be immediately unwound.

Three-minute time limit (Box 7, paragraph 195)

CESR's proposed three-minute time limit cannot be considered in isolation. In the interests of the reliability of the data, there is a need to pinpoint more specifically when a transaction may be deemed to have been completed. It would make good sense to stipulate that, after confirmation of the transaction has been dispatched without delay by the seller or buyer, a period of one hour will be allowed for the other party to raise an objection. If no objection is raised, the information should then be made public within three minutes. This arrangement would ensure that the published information was reliable.

III. Specific comments on the advice in Chapter 4

1. Definition of systematic internaliser

Paragraph 8 in conjunction with Box 1

The clearly expressed intention in paragraph 8 to exclude from the definition of systematic internaliser transactions covered by Recital 53 of the MiFID reflects market realities and is to be welcomed. We believe the proposed definition in Box 1 satisfies this objective. It is imperative, however, that the well-balanced wording is not changed in any way, since this would upset the interrelationship between the factors mentioned.

2. Pre-trade transparency requirements for RMs, MTFs and for investment firms

Box 3, paragraph 81 (exemptions for certain types of orders)

We support the approach of exempting detailed information about certain types of orders from pre-trade transparency.

3. Post-trade transparency requirements for RMs, MTFs and for investment firms

Box 5, paragraph 139 (identifying the name of the investment firm)

We strongly reject the requirement to make the name of the investment firm public. This proposal clearly exceeds the basic principles set out at Level 1 as well as CESR's mandate from the Commission. The result would be to put investment firms at a competitive disadvantage compared to exchanges. Reports there have to be published anonymously. Although it becomes apparent on publication on which exchange the trade was executed, the exchange has merely made available a trading platform on which the parties meet. An

investment firm, on the other hand, enters into a risk position; the two situations cannot, therefore, be compared. Identifying the investment firm would put it at a clear competitive disadvantage, despite the fact that a major objective of the MiFID is to promote competition. Every investment firm would run the risk of the market turning against it if the acquired position could not immediately be unwound. The requirement to publish the investment firm's name must therefore be deleted.

Box 5, paragraph 139 f, g and h (negotiated trades etc.)

Subdividing the reasons for deviation from normal market conditions as suggested would merely make the information more complex without providing other market participants with useful data. Subparagraphs f to h should therefore be consolidated so that these types of trades are flagged as exceptions, but without the need to state an explicit reason. Subparagraph 2 of paragraph 141 should consequently also be deleted.

Box 5, paragraph 141 (transactions not at market prices)

The first subparagraph of paragraph 141 is to be welcomed, in principle, since it will help to achieve better price formation. Nevertheless, the exemption should also explicitly cover the situations mentioned in Article 28(3)(b) of the MiFID (collateral, lending). The same applies to exercising options and to large trades on which a premium is paid on the market price of the shares.

5. Publication of transparency information and consolidation

Paragraph 179 (availability of data)

We warmly welcome the deletion of the original requirement to make data available for 14 days after publication.

Paragraphs 183-185 (publication on websites)

We welcome the clarification that websites in principle meet the criteria of proprietary arrangements.

Box 7, paragraph 195 (three-minute time limit)

CESR's proposed three-minute time limit offers no significant benefit over the original one-minute deadline. More important will be to identify more specifically when a transaction may be deemed to have been completed. It would make good sense to stipulate that, after confirmation of the transaction has been dispatched without delay by the seller or buyer, a period of one hour will be allowed for the other party to raise an objection. If no objection is raised, the information should then be made public within three minutes. This arrangement would ensure that the published information was reliable. Otherwise, the possibility of the

market receiving incorrect price signals cannot be excluded and, given the pace at which the market operates, the damage could not be undone by issuing a correction.

Box 7, paragraph 196 (period for publication)

We reject the proposal that post-trade transparency requirements should apply throughout the period outside market opening hours. This would impose an unacceptably high risk on market participants. Instead, the opening hours of the lead market should apply. Transactions executed after trading hours should be made public no later than 15 minutes after trading begins on the following exchange business day. This arrangement would take account of the fact that liquidity is considerably lower during evening hours. An investment firm must, however, be able to lay off positions without unnecessary risk. CESR expressly acknowledges this in paragraph 154, but it must also be taken into account for periods during which no trading on the exchange is possible.

IV. Replies to the questions in the consultation paper

Q 5.1:

Do consultees support the method of publishing post-trade information (either trade by trade information or on the basis of one price determination)?

We agree that it makes good sense to publish information trade by trade or, provided that the transactions have been executed at the same time and at the same price, on a consolidated basis.

Q 5.2:

Do consultees agree that the responsibility for publishing the post-trade information lies on the seller in case of trades made outside RMs and MTFs?

It is ultimately of little consequence which party is responsible for publishing the information. In the interests of practicality, however, the matter needs to be decided one way or the other. CESR's proposal to make the seller responsible is therefore acceptable. The most important point, however, is to allow firms which have entered into a risk position to lay off the risk in an undamaging manner. Appropriate deferred post-trade transparency arrangements must thus be put in place. For details, please see the following reply to question 6.3.

Q 6.3:

Do consultees agree with the proposals for determining thresholds for deferred publication arrangements? Is the balance of proposed threshold sizes and time delays appropriate? If you consider that they should be modified, please suggest how and why.

CESR has made a highly schematic division into three liquidity categories and then specified periods for permitted delays depending on certain volumes of trades. It is not made sufficiently clear on what considerations this division is based. There is no explanation of how the size categories have been arrived at, nor is there any indication of why periods of one or two hours should apply. What is more, the statistics needed for a proper evaluation of the proposals were made available only at a very late stage.

The proposals do not take account of market realities. The combination of very high thresholds and short time limits without any link to the unwinding of a position will have an adverse effect on price formation. Unwinding a position of ten million euros within one hour, for example, will almost always impact negatively on prices and the pressure on the market will increase volatility². Furthermore, CESR has failed to consider the fact that liquidity fluctuates significantly over the course of a day. When the NYSE opens in the afternoon, trade also picks up significantly in the European markets. In the morning, on the other hand, trading volumes are generally below average. It is therefore inappropriate to base transparency requirements on ADV alone. To enable a position to be unwound, it is essential to consider the risk which the investment firm has entered into and allow more time to comply with publication requirements.

The impression arises that CESR is wrongly assuming that OTC trading is totally divorced from exchange trading. In reality, however, most of the positions bought or sold by an investment firm OTC are previously or subsequently covered or unwound on the stock exchange. There is therefore a clear link between on and off-market trading. Investment firms are providing a service for their clients by ensuring that large positions can be unwound in a way that does not disrupt the market. Only seldom do they intend to keep the shares on their own books for any period of time. A transparency requirement that ignores these circumstances would be counterproductive. Transparency cannot be regarded as an end in itself; its purpose must be to promote efficient price formation on the market. Where this is not the case, transparency requirements should be dispensed with.

² We enclose two screenshots from the Xetra order book for *Münchener Rückversicherung* shares. These show that more time is needed to unwind a position without an adverse effect on prices.

As a rule of thumb: volume X, traded on the stock exchange during period Y, will require at least twice period Y to be unwound by a single market player. In the case of highly liquid shares, amounts of three to four million euros can possibly be laid off within one hour.

A more practical solution, in any event, would be to base deadlines for deferred publication on the concrete unwinding of a position rather than on schematic time parameters. We suggest that publication should become mandatory when the investment firm has unwound at least 80% of the total volume. This threshold would enable trades to be executed in a manner which does not disrupt the market or distort price formation and, at the same time, takes adequate account of the market participant's risk.

In our view, the thresholds and time limits in Table 2 have not yet been adequately backed up by a statistical analysis of market activity. CESR should therefore undertake such an analysis – possibly in collaboration with market participants – and revise Table 2 accordingly before drafting its advice on this issue and submitting it to the Commission. We assume the findings will show that the thresholds need to be significantly lowered and the time limits extended.

Finally, CESR should also consider introducing a fast market rule. This could ensure that special rules would apply in the event of exceptional trading situations such as those in the aftermath of September 11, 2001. Appropriate criteria for the rule would need to be defined.

Q 6.4:

Do consultees consider that intermediaries should benefit from the maximum delay proposed, regardless of whether they have unwound their position? If not, on what basis should CESR recommend a rule aimed at requiring immediate disclosure once all, or the major part, of the position have been unwound?

In practical terms, instances of an intermediary unwinding its position ahead of the deadline are likely to arise rarely, if at all (see our reply to question 6.3). From a technical point of view, it would make sense to leave it to the investment firm to decide whether to disclose the information ahead of, or at, the deadline. An obligation to publish before the end of the permitted period would make it more difficult to automate reporting systems.

Q 6.5:

Do consultees agree with the proposal that competent authorities should be able to grant pretrade waivers and/or approve deferred publication arrangements that comply with the minimum thresholds regardless of whether or not the competent authority of the lead market adopts higher standards? Would it be better to require all member states to follow the transparency arrangements adopted by the competent authority of the lead market, whether

by the competent authority or the lead market operator? CESR would like to receive comments that throw more light on the pros and cons of each option?

The same thresholds should apply throughout the EU. Regulatory arbitrage will otherwise occur, which cannot be CESR's intention. The thresholds should be set by the competent authority of the lead market.

Q 6.6:

Do consultees have any comments on the proposed short-term arrangements?

CESR's proposed short-term arrangements should also apply in the long term. If calculations were based not only on the order book but on the total volume, this would often result in an artificial inflation of liquidity figures.

In paragraph 60 – which, though it focuses on systematic internalisers, could also have relevance to the basis calculations for post-trade transparency in the rest of the market – CESR suggests that new share issues should immediately be subject to transparency requirements. This is acceptable, in principle, though it must be borne in mind that the first few days after admission to trading are not normally typical. In many cases, far more trades are executed initially than in the weeks and months following the issue. It would therefore be appropriate, in our view, to allocate newly issued shares to the illiquid securities. Re-allocation could then take place in the course of a subsequent routine review.

Q 6.8:

Is the suggestion in respect of portfolio trades suitable?

The suggested handling of portfolio trades is not suitable. It is not clear why baskets should be excluded if they do not contain any highly liquid shares. The possibility of deferring publication should cover all portfolio trades.

Enclosure

Quote Browser: Item Address: Q0#MUVGn.DE									
0#MUVGn.DE * MUECH. RUECK N GER/GER EUR 843002 17MAR05									
Last	/	/	TrdVol	Pct.Chng %	Net.Chng	Bid Size	Bid / Ask	Ask Size	
↑ 93.04			1200	-0.02	-0.02	1869	93.04 / 93.05	1113	13:51
93.04	Moves	1428			1st Best	1869	93.040/93.050	1113	13:52
93.00	Open	93.30			2nd Best	200	93.030/93.060	200	
93.04	High	93.65			3rd Best	139	93.000/93.090	400	
93.00	Low	92.80			4th Best	41	92.980/93.100	1003	
					5th Best	200	92.960/93.130	169	
Volume	888483				6th Best	400	92.950/93.140	3118	
Turnover	82687.17	x1000			7th Best	100	92.890/93.200	1998	
VWAP	93.065				8th Best	400	92.870/93.240	2000	
Offcl Cls	93.06	16MAR05			9th Best	2092	92.860/93.290	200	
Offcl Cls		ForToday			10th Best	2171	92.850/93.310	1000	
Clean Lst									
BlkTrade		Blk.Vol							
Auction Data					Background Data				
IndLast	IndVolume	Bid/Ask		PaidDividend			Ex.Date	Yield	
		/		1.25			27MAY04	1.343 %	
OpenAuction	93.30			PropDividend			Date	DivCurrency	
ContAuction	92.98			2				EUR	
Cls.Auction				CapAdj. Fact			0.951	28OCT03	
surVol Bid				Chain			.GDAXHI		
surVol Ask				Backgr.			MUVGn.DEB2		
				Headlines			10:56		
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Quote Browser: Item Address: Q0#MUVGn.DE									
0#MUVGn.DE * MUECH. RUECK N GER/GER EUR 843002 17MAR05									
Last	/	/	TrdVol	Pct.Chng %	Net.Chng	Bid Size	Bid / Ask	Ask Size	
↑ 93.05			13	-0.01	-0.01	1859	93.04 / 93.10	1003	13:53
93.05	Moves	1430			1st Best	1859	93.040/93.100	1003	13:53
93.04	Open	93.30			2nd Best	339	93.000/93.120	400	
93.04	High	93.65			3rd Best	41	92.980/93.130	369	
93.00	Low	92.80			4th Best	400	92.960/93.140	3118	
					5th Best	200	92.950/93.200	2298	
Volume	889596				6th Best	100	92.890/93.290	2200	
Turnover	82790.74	x1000			7th Best	400	92.870/93.310	1000	
VWAP	93.065				8th Best	2092	92.860/93.410	200	
Offcl Cls	93.06	16MAR05			9th Best	2171	92.850/93.420	600	
Offcl Cls		ForToday			10th Best	50	92.840/93.470	241	
Clean Lst									
BlkTrade		Blk.Vol							
Auction Data					Background Data				
IndLast	IndVolume	Bid/Ask		PaidDividend			Ex.Date	Yield	
		/		1.25			27MAY04	1.343 %	
OpenAuction	93.30			PropDividend			Date	DivCurrency	
ContAuction	92.98			2				EUR	
Cls.Auction				CapAdj. Fact			0.951	28OCT03	
surVol Bid				Chain			.GDAXHI		
surVol Ask				Backgr.			MUVGn.DEB2		
				Headlines			10:56		
				ISIN			DE0008430026		