

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 GIROVERBANDE E. V. BERLIN-BONN • VERBAND DEUTSCHER HYPOTHEKENBANKEN E. V. BERLIN

Comments
of the Zentraler Kreditausschuss¹
on Working Document ESC/20/2005-rev 1
on implementing measures for articles 22(2), 27 to 30, 40 and 44 to 45
of Directive 2004/39/EC of the European Parliament and of the Council

16 August 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 Pfandbriefbanken (vdp), for the Pfandbrief banks. Collectively, they represent more than 2,300 banks.

I. Introduction

We thank the European Commission for the opportunity to comment on its working document on implementing measures for the articles concerning market transparency and admission to trading in the Directive on Markets in Financial Instruments (MiFID). Our comments refer to version ESC/20/2005-rev 1 of the working document, which was published on 29 July 2005.

II. Executive summary

1. Criteria for a systematic internaliser

The criteria in Article 6(1) for determining when an investment firm is to be classed as a systematic internaliser are much too broad. The envisaged distinguishing criteria in subparagraphs (a) to (c) would probably be satisfied by almost any financial institution offering investment services. This is not a suitable basis for identifying systematic internalisers; the criteria need to be more targeted.

Another important factor is for Recital 53 of the MiFID to be adequately reflected at Level 2. Recital 53 clearly states that the pre-trade transparency rules for systematic internalisers are not intended for application to the usually high-volume transactions between investment firms and wholesale counterparties. In light of the nature of these transactions and with the principle of proportionality in mind, it would be excessive to require investment firms to have reporting systems in place for the rare cases where transactions of below standard market size were concluded.

2. Transactions covered / loans of shares

We firmly reject the envisaged requirement in Article 12(1) for loans of shares also to be made public under post-trade transparency obligations. In particular, this would do nothing to achieve the desired objective of obtaining information about short sales.

3. Deferred post-trade transparency / thresholds

The rules determining when the post-trade publication of transactions may be deferred do not reflect 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, this approach fails to take account of the fact that liquidity fluctuates significantly over the course of a day. It is therefore inappropriate for post-trade transparency requirements to be triggered solely by exceeding certain thresholds.

A more practical approach would be 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 will 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.

The thresholds should, in any event, be based on the number, not the total value, of shares involved in a trade. It would be much easier to implement such thresholds in practice. Shares are, after all, traded in units, not values. This approach would also have the advantage of avoiding distortions arising from price volatility in a class of shares.

III. Specific comments

1. Article 6(1) (criteria for a systemic internaliser)

The criteria in Article 6(1) for determining when an investment firm is to be classed as a systematic internaliser are much too broad. The envisaged distinguishing criteria in subparagraphs (a) to (c) would probably be satisfied by almost any financial institution offering investment services. This is not a suitable basis for identifying systematic internalisers; the criteria need to be more targeted. It goes without saying, for example, that the investment firm's activity plays a "commercial role" in its business model. The qualifying "material", especially in conjunction with the recital proposed in footnote 12, does not improve matters: with a very few exceptions, the services offered by all investment firms can be deemed to play a "material commercial role". Also to be rejected are the criteria in subparagraph (b), which define systematic internalisation as an activity requiring specifically assigned personnel or technical equipment. These criteria are too global to allow the necessary distinction to be made.

It is also important for Recital 53 of the MiFID to be adequately reflected at Level 2. Recital 53 clearly states that the pre-trade transparency rules for systematic internalisers are not intended for application to the usually high-volume transactions between investment firms and wholesale counterparties. In light of the nature of these transactions and with the principle of proportionality in mind, it would be excessive to require investment firms to have reporting systems in place for the rare cases where transactions of below standard market size were concluded. We therefore suggest amending subparagraph (c) of Article 1(1) as follows in line with CESR's consultation document 05/164:

“(c) The activity is marketed and is available to clients on a regular and continuous basis.”

In addition, a third paragraph should be added to Article 1 with the following wording:

“3. Article 27 will not apply to transactions carried out on an OTC basis, the characteristics of which include that they are ad-hoc and irregular and are carried out with wholesale counterparties and are part of a business relationship which is itself characterised by dealings of above standard market size, and where the deals are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser.”

We welcome the fact that the Commission has not adopted the quantitative second criterion proposed by CESR in subparagraph (b) of its recommendation in Box 20 (page 59 of CESR’s Technical Advice 05/290b). Any kind of quantitative criteria would be extremely difficult to apply in practice. But this goes particularly for the condition mentioned in subparagraph (b), which is based on external values. It would not be possible for investment firms to organise their business models in such a way as to integrate reliably all the external values which had to be taken into account.

2. Article 12(1) (transactions covered / loans of shares)

We firmly reject the envisaged requirement in Article 12(1) for loans of shares also to be made public under post-trade transparency obligations. This would do nothing to achieve the desired objective of obtaining information about short sales. Instead, misleading signals would be sent to the market since lending transactions are concluded at prices which differ from the market price. They do not, in consequence, reflect current market conditions. We therefore advocate excluding loans of shares from the scope of this requirement.

3. Article 12(2) a) (items to be disclosed)

According to our understanding of this paragraph, the execution venue would always have to be made public in the event that post-trade transparency obligations had to be fulfilled. This would go beyond CESR’s recommendation, which limited the requirement to systematic internalisers.

If our interpretation of the Commission’s intention is correct, investment firms would no longer be able to issue anonymous post-trade transparency reports. This would place investment firms at a disadvantage compared to regulated markets. While investment firms enter into risk positions, exchanges merely make a trading platform available to third parties; identifying the regulated market therefore entails no risk whatsoever for the parties involved. If the investment firm had to identify itself, on the other hand, there would be a risk of the market turning against it if the acquired position could not immediately be unwound.

It should therefore be clarified that item a) does not apply to investment firms that are not systematic internalisers. We suggest amending the item as follows:

“a) execution venue identification/OTC;”.

4. Article 13(1) (deferred post-trade transparency)

Article 13(1) allows regulated markets and operators of MTFs to defer post-trade transparency under certain circumstances. Probably due to an editing error, there is no mention of investment firms that are subject to post-trade transparency obligations. Article 28(2) MiFID explicitly states that post-trade disclosure requirements for investment firms should mirror the requirements set out in Article 45 MiFID. The wording of Article 13(1) should therefore be modified accordingly.

5. Article 13(1) in conjunction with Table 4 of the Annex (deferred post-trade transparency)

The Commission's proposal envisages a highly schematic division of shares into three liquidity categories with certain specified periods for deferred post-trade transparency depending on certain volumes of trades (Table 4 of the Annex).

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. The chosen approach also disregards the fact that liquidity fluctuates significantly over the course of a day. When the NYSE opens in the afternoon, trade 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 ADT alone. To enable a position to be unwound, it is essential to consider the risk which the investment firm has entered into.

The impression arises that the Commission 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 length 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.

It would therefore be more practical 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 did not distort price

² Enclosure 1 contains 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.

formation and, at the same time, would take adequate account of the market participant's risk. There should also be maximum permitted delays, i.e. deadlines by which transactions must in any event be disclosed.

Furthermore, the thresholds should be based on the number, not the total value, of shares in a trade. Thresholds based on numbers of shares would be much easier to apply in practice. Shares are, after all, traded in units, not values. If the Commission's proposal were implemented in its present form, the euro threshold would have to be converted at the current share price into numbers of shares before concluding every single trade. Only then would the trader know whether the threshold had been exceeded. There would be no need for this calculation if the thresholds were set in numbers of shares anyway.

This approach would also have the advantage of avoiding distortions arising from price volatility in a class of shares. Such distortions would arise if, for example, deferred publication of a transaction were possible at time t but not at time t + 5 minutes because a dip in the price meant that the value of the second transaction was slightly below the threshold although the same number of shares was involved in both cases.³

We therefore suggest modifying Table 4 as follows:

Maximum permitted delay for trade publication	Minimum qualifying size of trade (and cash ceilings)		
	Average Daily Turnover (ADT) > number of shares representing €50m at the [date of latest ADT-calculation]	Average Daily Turnover number of shares representing €1-50m at the [date of latest ADT-calculation]	Average Daily Turnover < number of shares representing €1m at the [date of latest ADT-calculation]
3 minutes after unwinding of 80% of the risk position	The lowest of 10% of ADT or number of shares representing €7.5m at the [date of latest ADT-calculation]	The lowest of 10% of ADT or number of shares representing €3.5m at the [date of latest ADT-calculation]	More than 5% of ADT but at least number of shares representing €25,000 at the [date of latest ADT-calculation]
At the latest end of next trading day	x	x	
At the latest end of second trading day following trade			x ⁴

³ See enclosure 2 for an illustration.

⁴ The competent authority can authorise an extension to the deadline in exceptional circumstances.

The deferred publication rules do not yet cover cases where the three-minute deadline cannot be complied with because of events on the market or technical problems. This would include, above all, the exceptional circumstances in a fast market (e.g. 11 September 2001). A further paragraph should be added to Article 13 to take account of situations of this kind.

6. Article 14(2), sentence 2 (three-minute deadline)

The envisaged additional rule making the timing of publication dependent on “the characteristics of the trading venue where the transaction was executed and the complexity of the trade” serves no useful purpose whatsoever in conjunction with the unchanged three-minute maximum deadline. This deadline is, in any event, too short. But the supplementary rule would result in “non-complex” trades (meaning what exactly?) possibly having to be published even before the three-minute deadline. We firmly reject any such requirement. The additional phrase “the characteristics of the trading venue where the transaction was executed and the complexity of the trade” should therefore be deleted.

7. Article 14(5) (client limit order display)

To fulfil the obligations of Article 22(2) MiFID an investment firm may transmit client limit orders which are not immediately executable to a regulated market or MTF. The requirement to transmit the order to a regulated market or MTF “that operates a continuous auction order book trading system” exceeds the wording of Article 22(2) MiFID. In any case, a clarification would be useful, to the effect that the price determination process that has been used at most German stock exchanges for decades now qualifies for the disclosure of client limit orders. At German stock exchanges price determination is conducted by market members acting as market personnel (“Skontroführer”). All buy and sell orders in a particular security are collected in the electronic order book, to which only the assigned market personnel has access. The latter discloses an indicative price range (“Taxe”) based on the current order book status. With the entry of the indicative price range into the exchange’s computer system, the information is immediately displayed and accessible to all investors, regardless of whether or not they are admitted to trading at the exchange. Investors can readjust their orders or give new orders. For price determination the order book is “locked”. The price then to be determined is the one which will allow the greatest turnover of securities with the least carryover of unexecuted trades.

8. Article 14(6)(b) (consolidation of the data)

The MiFID does not explicitly require arrangements to be in place to make it easy to consolidate the post-trade information published by investment firms. Instead, Recital 34 leaves it up to

Member States to take steps to facilitate consolidation. This would be better reflected by the following wording:

„ (b) not ~~prevent or~~ impede Member States' ability to remove obstacles to the consolidation of the data with ~~similar~~ data from other sources as provided for in Recital 34 of the Directive;”.

9. Article 20(1), sentence 1 (monitoring)

The proposed rule requiring regulated markets to monitor issuers' compliance with disclosure obligations would give the exchanges a monitoring role parallel to that of the competent authorities. Such a role for the exchanges in the area of “initial ... disclosure obligations”, for example, was abolished only recently by the Prospectus Directive (2003/71/EC). The proposal should be deleted.

10. Article 20(2) and (3) (publication of prospectuses)

The matters covered by paragraphs (2) and (3) are already adequately regulated by the Prospectus Directive (2003/71/EC). Paragraphs (2) and (3) should therefore be deleted.

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O#MUVGn.DE * MUEENCH. 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			EuropeanPrice	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	280CT03			
surVol Bid					Chain	.GDAXHI				
surVol Ask					Backgr.	MUVGn.DEB2				
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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			EuropeanPrice	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	280CT03			
surVol Bid					Chain	.GDAXHI				
surVol Ask					Backgr.	MUVGn.DEB2				
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OTC Post-Trade Transparency - Deferred Publication -

Example:

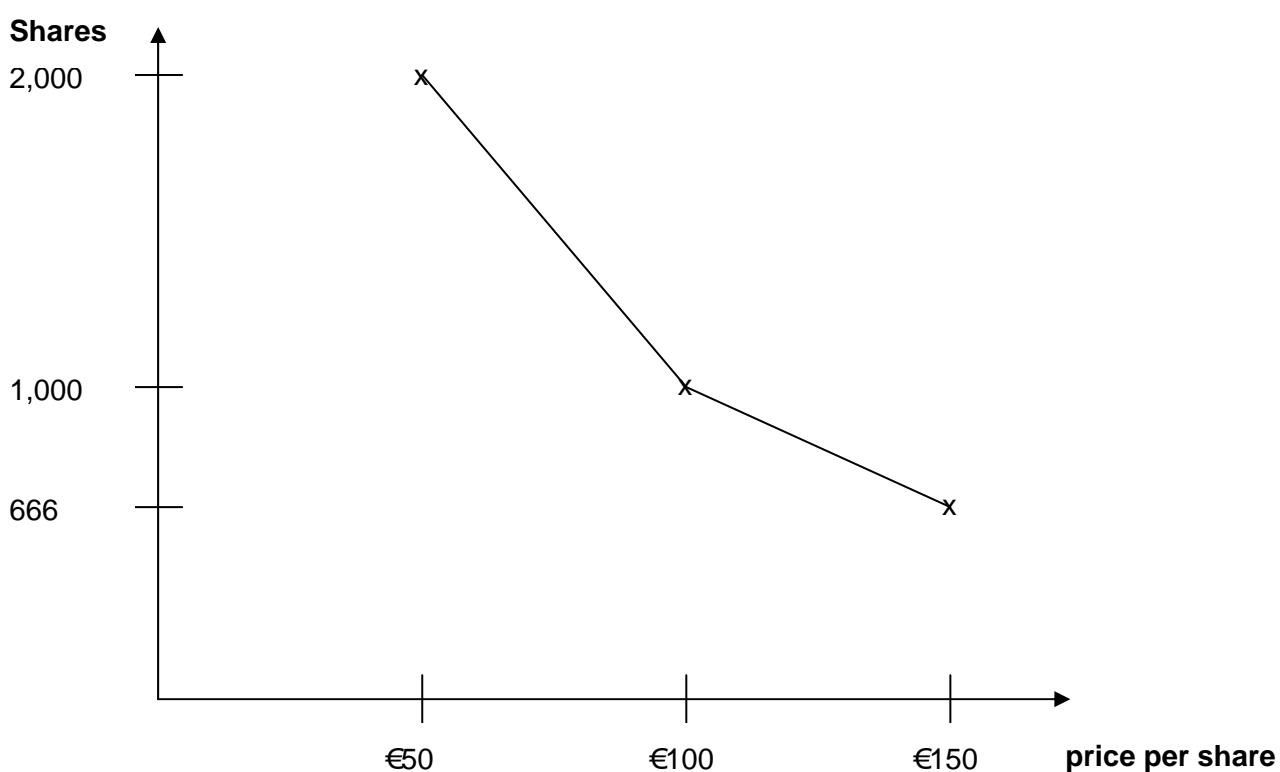
Share issuer: N.N.

ADT at the time of the annual ADT-fixture: €1,000,000

Price per share at the time of the annual ADT-fixture: €100

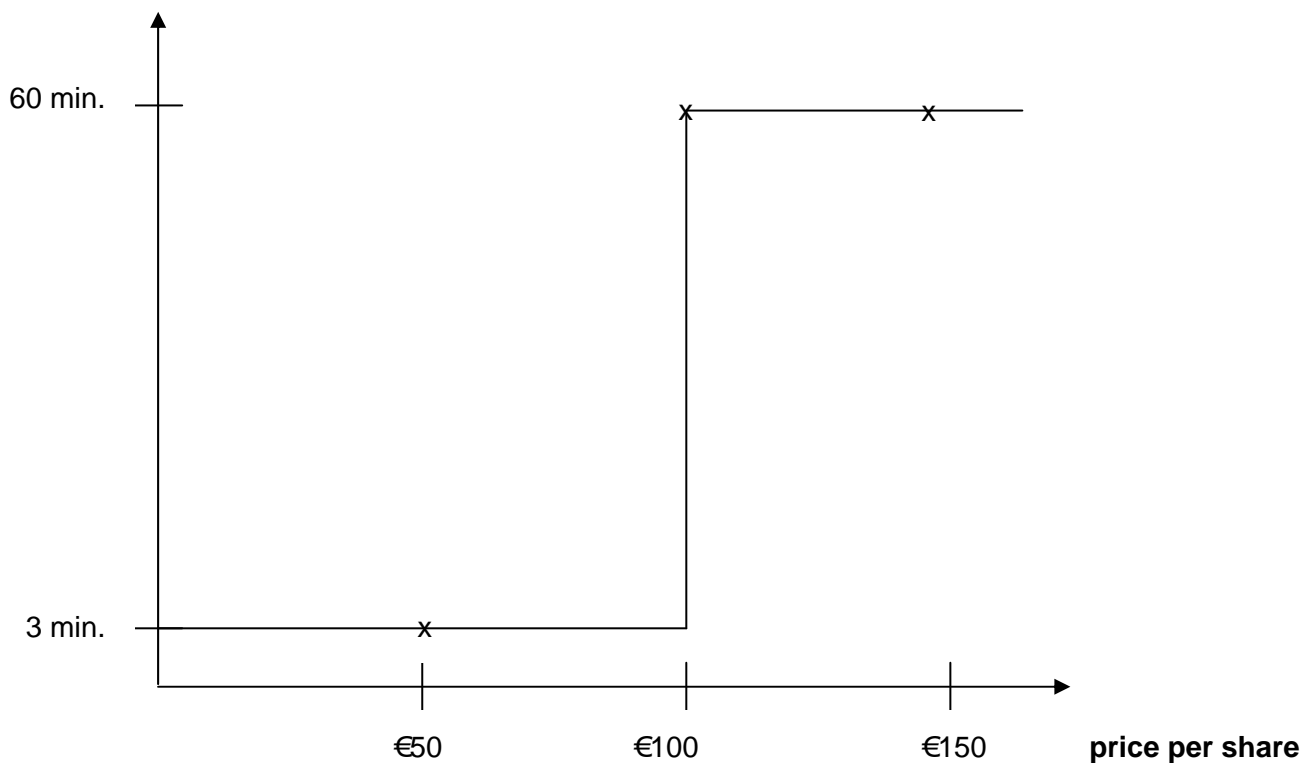
ADT in terms of shares at the time of the annual ADT-fixture: 10,000 units

=> Minimum size to qualify for a 60-minute delay for transaction publication (2nd column of Table 4): €100,000 (= 10% of ADT)



The graph shows that the €100,000 threshold covers different amounts of shares depending on how the share price moves.

In the above example, this means that an investment firm trading 1,000 shares only reaches the €100,000 threshold enabling it to defer publication if the current price per share is at least €100. If the price per share in a second trade is below €100, the firm has to publish the transaction data within three minutes – although 1,000 shares are traded in both cases (see next graph).

Shares: 1,000

The level of the share price alone therefore determines whether the investment firm will be able to defer publication or not. Yet the price of the share at the time of the trade is not really relevant in this context, i.e. to the question of whether deferred publication should be allowed or how much time the firm needs to unwind its position.

Both the ADTs and the thresholds should therefore be based on the number of traded shares, not on their total value.