German Banking Industry Committee

Die Deutsche Kreditwirtschaft

Comments

on the European Commission's legislative proposals

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on markets in financial instruments repealing Directive 2002004/39/EC of the European Parliament and of the Council (Recast)
(COM(2011) 656 final – 2011/0298 (COD)

Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories
(COM(2011) 652 final – 2011/0296 (COD))

Register of Interest Representatives
Identification number in the register: 52646912360-95

Contact:
Georg Baur
Director
Telephone: +49 30 1663-3310
E-Mail: georg.baur@bdb.de

Berlin, 30. November 2011

The **German Banking Industry Committee** 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 2,200 banks.

Coordinator:
Association of German Banks
Burgstraße 28 | 10178 Berlin | Germany
Telephone: +49 30 1663-1204
Telefax: +49 30 1663-1298
www.die-deutsche-kreditwirtschaft.de

Comments on MIFID review

On 20 October 2011, the European Commission presented its proposals for a review of the Markets in Financial Instruments Directives (MiFID). The new European legal framework is designed to reorganise the European securities, derivatives and commodities markets and, not least, to further enhance investor protection. The German Banking Industry Committee (GBIC) is grateful for the opportunity to comment on the Commission's legislative proposals.

The approach adopted by the Commission of using a Regulation in addition to a Directive (MiFID) in future is in principle understandable, and the proposed allocation of issues to both by the Commission is appropriate in our view. At the same time, we call for consistent implementation of the proportionality principle and further specification of the bases for empowerment at Level 2, some of which are too broadly worded. At present, it is in many cases not clear enough to addressees what the exact content or purpose of the rules to be drafted at Level 2 are to be.

The political debate currently focuses strongly on a small number of issues. These include rules on achieving the best possible market transparency and regulation of high-frequency trading. Yet it would be fatal for the German financial marketplace, with its different business models and sizes, and ultimately also for investors if equally important but less discussed aspects of the new rules were to be ignored when evaluating the proposals. Such aspects will therefore also be dealt with in the following comments.

These comments are divided into two sections: in section A, we broadly outline the positions we take on a number of key issues, while in section B we deal with these issues in more detail, adding further points to our general remarks.

A. General remarks

I. Investor protection

Germany has a strong retail market. This is why new rules in the field of investor protection are of more importance to banks in Germany than in many other EU countries. In Article 24(3) of the MiFID II draft, the European Commission intends to promote **independent (i.e. fee-based) investment advice**. In future, clients are to be made aware, through appropriate information, of whether advice is provided to them for a fee or whether it is free of charge for them but the adviser may receive payments from a third party if a transaction is subsequently concluded. If sales remuneration were no longer to be paid in future, the compensation for the various services, i.e. not only for independent advice, would have to be raised to maintain the same quality standards. In the end, large numbers of citizens will then no longer, or no longer be able to, make use of investment advice.

The GBIC takes the view that fee-based advice may be an option for some clients, particularly wealthy ones. The "order-related advice" model, whereby monetary benefits paid by third parties (inducements) are allowed for example if these are explained properly to clients, must be retained, however. It would therefore be counter-productive in our view to label fee-based advice "independent" and thus other types of advice "non-independent". The label used must not be allowed to create any incorrect impression among clients about the quality of advice. The type of "remuneration" (either direct remuneration on a fee basis or indirect remuneration via commission) is no criterion for the quality of advice. An independent adviser, too, may generate more in the way remuneration through the type of fees he charges and the number of times he advises clients, and he, too, is allowed to recommend products of his own or products of third parties with close links. For example, even advisers who in future sell closed-end funds for a fee and are not subject to the more stringent provisions of the German Securities Trading Act,

would be allowed to call themselves “independent advisers”, whilst the provision of advice by banks, which indicate the percentage rate of commission to clients before completing this service, would be stigmatised.

The advisory services labelled “non-independent” would also be so devalued that we expect clients to shy away from them. For many clients, particularly those most in need of protection, fee-based advice will not be an acceptable alternative, however, since it will be too expensive. The experience made with independent advice in Germany already shows that particularly retail clients who have only a small investment portfolio and only conduct a small number of transactions per year are reluctant to pay high fees for advice. A recent representative survey of 2,000 consumers also makes clear that clients are sceptical about independent advice: 82% of all consumers say that fees for investment advice are neither sensible nor socially fair[1]. In the end, large numbers of citizens will no longer, or no longer be able to, obtain advice.

Furthermore, “independent” advisers will also face quite considerable legal risks if the label creates unrealistically high expectations about their service, e.g. also about the range of suitable products. It would therefore be better to adopt a descriptive and competitively-neutral term (“advice provided with/without third-party inducements”) and to also increase transparency requirements at European level by requiring investment advice to indicate the amount of third-party inducements in each case (in line with the provisions already applying in Germany as a result of rulings issued by the highest civil courts). For further details, see section B of these comments.

We also wish to draw attention to the establishment in Articles 31 and 32 of the MiFID II draft of highly problematic empowerment bases for the issue of **product bans** at supervisory level. The focus of our criticism is not on possible product bans themselves, but mainly on the endless scope of the potential consumer policy measures based on these. Large sections of the banking industry are in favour of putting authority to issue product bans in the hands of national supervisors. Otherwise direct supervision of banks by ESMA would be established in a particular area. This would be at odds with the present system. National supervisors also have the required knowledge of markets. It is important that ESMA is given a coordinating role, as already envisaged in Article 9 of the ESMA Regulation, so as to – if necessary – ensure a uniform European approach. A European patchwork of different product bans should be avoided.

Endless scope is something we also criticise in connection with the power given to ESMA in Article 35(1)(a) and (b) of the MiFIR draft to intervene in the management of positions or exposures. Whilst such drastic intervention is generally only possible and thus appropriate to maintain the orderly functioning, integrity and stability of markets, the threshold for intervention in the field of investor protection is set significantly lower. A European product ban by ESMA merely requires evidence of a “threat to investor protection”. In Article 32, “significant concerns” are actually enough to trigger intervention by national supervisors. Given the consequences of a product ban for issuers, advisers and clients, this is unacceptable. Every financial instrument harbours risks for investors, and only an investor’s individual risk-bearing capacity may be an issue. There can therefore be no blanket protection.

According to the wording of the provision, a product ban is subject to some additional requirements, although these conditions are unlikely to have any restrictive effect either in practice. If the competent supervisor intends to deal with a case on the basis of this new legal framework, “existing regulatory requirements” or “actions that have been taken” previously by a supervisor have evidently failed to work.

---

[1] See enclosure

Comments on MIFID review

These restrictively meant conditions are merely a given. Only the additional requirement to comply with the principle of proportionality would basically be effective, although it is not made clear whether it includes consideration of whether other supervisory action would be just as effective but less drastic. This idea of a last resort approach, i.e. a requirement to examine alternative action, must be adopted. In order to exclude individual cases that can be dealt with in the established manner by the courts in particular, intervention should, moreover, only be triggered if a serious and sustained disruption of the retail market as a whole has become evident.

We take an extremely critical view of the **requirement to record securities orders placed by telephone** in Article 16(7) of the MiFID II draft. The arguments put forward at European level to justify such a requirement fail to convince in our opinion. This view is shared by BaFin, the German financial regulator (see dissenting opinion by BaFin in the CESR recommendations to the Commission). There are no plausible reasons why existing national discretion and, consequently, national powers should be further curtailed.

A look in this connection at the implications of such a requirement for the German banking industry makes the proposed provision all the more difficult to understand. Attention should be drawn firstly to the enormous costs associated with such a requirement. Besides costs of at least EUR 632 million for acquiring the necessary recording equipment, the German banking industry would face further operating costs of at least EUR 332 million annually. As a result, it is to be feared that many banks would no longer be able to broadly provide investment advice or non-advised services by telephone. These costs would be incurred despite the fact that there would be no real added value either for clients or for supervisors. It is therefore no surprise that German lawmakers refrained from introducing a voice recording requirement for investment advice in 2009. In our view, the written record of investment advice provided to clients in Germany is an at least equally suitable and, in addition, much less drastic approach.

A clear-cut separation between receipt of an order/investment advice on the one hand and private contents of a conversation on the other hand is ultimately likely to be unfeasible in practice or impossible to communicate to clients. It goes without saying that clients are highly sceptical of mandatory voice recording, including a requirement to keep records for a period of three years, in such sensitive areas.

Finally, because of existing or planned other European rules, a voice recording requirement would lead to multiple regulation for one and the same area.

The introduction of a voice recording requirement is therefore neither necessary nor advisable, let alone reasonable. We thus urge you to support retention of national discretion in this respect. As an alternative to mandatory voice recording, we suggest that the rudimentary requirements for explaining in writing the reasons for a personal recommendation could be expanded along the lines of the written record of investment advice provided to clients in Germany.

The Commission's intention to extend securities legislation to cover so-called **structured deposits** also meets with reservations. This type of deposits is to be subject in future to the stringent provisions of securities law although the deposits themselves are fully secure. The broad definition of the scope in Article 1(3) sentence 1 of the MiFID II draft leads to a disproportionate expansion of the requirements relating to financial instruments under the German Securities Trading Act to deposits since, according to the wording, only deposits with a "rate of return which is determined in relation to an interest rate" are to be exempted. Strictly speaking, this exemption covers only deposits whose rate of return is linked to a benchmark such as Euribor, Eonia or the like. This is only the case with a minority of deposit products;

the great majority are fixed-rate or variable-rate products that are not referenced to a benchmark. These simple products (e.g. savings book, fixed-term deposits) are not structured and should therefore also be excluded from the scope of the MiFID rules. The definition thus needs to be amended accordingly. Otherwise such an extension would lead to drastic changes in the organisation of banks, as these have strictly separated investment business and deposit business so far. The upshot would be high costs and a disproportionate bureaucratic burden that are in no way justified for these simple deposit products (savings book, fixed-term deposits).

We welcome it that the full **exemption of certain activities of intermediaries** is limited under Article 3(1) of the MiFID II draft, since – irrespective of the type of distribution – a comparable level of investor protection must be ensured. This means that the MiFID rules should be applied in full in this respect, however.

Moreover, given numerous initiatives on financial consumer protection in different countries, particularly also in Germany, it should be clearly stipulated that the **MiFID rules are final** and not amenable to extension at national level. Otherwise competition would be impeded by unequal market conditions; precisely this is to be avoided under MiFID.

II. Market structures

The **market transparency requirements** for bond trading by way of systematic internalisation proposed in MiFIR are new. As we understand the Commission's proposal, the broad scope of the provision means that all transactions in bonds and derivatives, including fixed-price transactions, could be affected in Germany. Existing pre-and post-trade transparency requirements in respect to other market participants for transactions in shares are now to apply in comparable form to many other financial instruments as well. We are, in particular, concerned that the establishment of disproportionate transparency requirements will seriously disrupt the bond markets.

Unlike in equity trading, the purchase and sale of bonds usually takes place in the form of bilateral transactions. Pre-trade transparency requirements would mean that investors' buying and selling intentions would be made evident to the entire market. No investor wants such an effect. Transparency requirements in bond trading would also have serious implications for banks and, ultimately, for issuers. Banks make liquidity available to the market by buying and selling bonds; when doing so, they take the risks on to their own books. If they were to be required to disclose their transactions to other market participants too early, the risk of the market moving against them and of their only being able to unwind their positions at unreasonable prices would be too high. As a consequence, banks would avoid exposing themselves to such risks, so that liquidity would dry up. This would, however, seriously affect bond issuers, be they companies, the public sector or banks. The same goes for block trading in shares. Full and immediate transparency would thus have adverse effects. The aim must therefore be to achieve the best possible transparency. The scope and form of pre-trade transparency envisaged for so-called systematic internalisers in bonds already appear unsuitable. A detailed description of practical pre-trade transparency problems and their implications for bond trading is enclosed with these comments.

With regard to post-trade transparency for bond and equity trading, appropriate scope for deferring post-trade transparency and suitable publications thresholds are the tools of choice. The delays applying in equity trading today show that differentiated transparency solutions which must take due account of the market and the respective type of product. The established differentiated system of post-trade transparency thus provides good guidance. The wording of MiFIR in this respect should be drafted so concretely that appropriate Level 2 arrangements are ensured.

Comments on MIFID review

We take a similarly critical view of the transparency requirements for derivatives. If banks are to be subject in their activity as systematic internalisers to a requirement to offer the prices published for pre-trade transparency purposes to other market participants, this ignores the fact that the price also reflects the counterparty risk. Counterparties of different credit standing must be priced identically according to the proposals; this cannot be in the interest of either competition or risk management. Like with bonds, post-trade transparency for derivatives involves the risk that no hedging in line with the market can be conducted as it is often possible to identify the counterparty to the contract. As a result, only derivatives that are cleared centrally and traded on organised markets should be subjected to the transparency requirements in order to avoid adverse effects on necessary hedging transactions with individually designed hedging instruments.

As regards the new category "organised trading facility", part of the banking industry sees the need to allow operators of OTFs to also trade **against their own books**, particularly when it is a question of helping arrange execution of client orders. Otherwise there is the danger that banks would be prevented from conducting transactions at the venues offered by them and thus from helping clients to conclude trades. Concerns about a possible conflict of interests can be allayed by adopting appropriate rules.

We share the Commission's view that **algorithmic trading** needs to be regulated but regard the proposed definition as too unspecific and past the intended legal consequences as inappropriate. The Commission's aim in this connection is particularly to strengthen supervision of high-frequency trading. With this in mind, we regard the required registration and supervision of all traders as appropriate, along with the establishment of certain organisational requirements in respect to risk management, resilience of trading systems, compliance with trading limits, prevention of generation of erroneous orders and prohibition of market manipulation. At the same time, we welcome the envisaged stronger harmonisation of the use and design of **circuit breakers** to temporarily halt trading in financial instruments. Together, they can prevent any uncontrolled market disruption. This aim is right and deserves support. The Commission's proposal that algorithmic trading strategies should continuously post firm quotes during trading hours and provide liquidity to the market goes too far, however. It not only ignores the fact that algorithmic trading reacts to certain market situations but would also effectively establish an unlimited market making requirement without any compensation. This would also go well beyond the obligations of real market makers. The consequences would be less liquidity and bigger spreads between bid and offer prices. Moreover, the arbitrage that takes place today to overcome fragmented markets would no longer be possible. Ultimately, poorer prices for all market participants, be they private investors or institutional investors such as insurance firms or pension funds, would be likely. This approach should therefore not be pursued any further.

Transparency for supervisors plays a key role for functioning financial markets. It is essential that supervisors have full details of transactions concluded. In Germany, BaFin received around 5.15 million transaction reports from market participants every trading day in 2010. These reports, which are analysed by BaFin, enable it to perform market supervision in respect to insider trading and market abuse. All transactions in securities and derivatives admitted to trading on a German stock exchange and all transactions in 'pure' open market securities are reported to BaFin. BaFin also receives information of how these transactions were concluded. It can thus, for example, see whether intermediate commission agents or brokers were involved. Article 23 of the MiFIR draft says that the data set required for reports will be harmonised at European level in future. We recommend bearing in mind in connection with the envisaged stronger harmonisation that high-quality supervision can only be achieved in all EU Member States if reporting institutions can submit high-quality reports. To enable them to do so, key terms such

as "transaction" must firstly be defined clearly at Level 1 and, secondly, it must be ensured that the format and content of the reports are geared to the type of transaction, and not vice-versa, in future as well. Harmonised reporting requirements must therefore also make allowance for nationally designed types of transaction. Otherwise it is to be feared that use of established transaction types such as intermediate commission-based transactions will no longer be possible due to their "unreportability". It should therefore be ensured at Level 1 that the reporting record to be developed at Level 2 satisfies such requirements. This is the only way to make sure that, firstly, clients have continued access to established transaction types and, secondly, that BaFin can continue to perform high-quality supervision in future as well.

III. Other

We believe it is important that management is suitably qualified to ensure the fair and orderly provision of investment services. However, we take a critical view of the new requirements proposed in the MiFID II draft, which are, moreover, to be fleshed out further by ESMA. In particular, the number of executive directorships or diversity in the composition of management bodies are in no way specifically related to investment services. They should instead be dealt with within the scope of general corporate governance, i.e. under company law. Corresponding proposals have already been made by the Commission in the draft CRD IV, which builds on the Commission's Green Paper of 2 June 2010 (COM 2010) (286 final). Under the definition in Article 1(a) of the draft CRD IV, they are to cover both banks and investment firms alike. Parallel regulation of the same issues in MiFID is therefore unnecessary. There is instead the danger that the different sets of rules may have contradictory regulatory thrusts. As regards the regulatory proposals in CRD IV, we should also like to point out that the requirements set under these fail to take sufficient account of the different management models (including the German two-tier board system) and legal forms of companies.

B. Specific remarks

1. Investment advice

a) Article 24(3) of the MiFID II draft: For the aforementioned reasons, we believe that the "independent advice" label is flawed and not in clients' interests. The distinction would put commission-based advice in a bad light. It would suggest to clients that they are getting inferior advice although the requirements that have to be complied with when providing such advice are no different from those applying to the provision of so-called "independent" advice. The GBIC is instead in favour of making clear to clients whether advice is provided with or without any inducements from third parties and therefore suggests adopting the following wording:

Article 24(3): Clients and potential clients [...]

- "[...] when investment advice is provided, information shall specify whether or not the advice **is provided in conjunction with the acceptance or receipt of third-party inducements** ~~on an independent basis, whether it is based on a broad or a more restricted analysis of the market~~ and shall indicate whether the investment firm will provide the client with the on-going assessment of the suitability of the financial instruments recommended to clients."
- ...

b) Article 24(5): Because of its vagueness, the requirement for firms providing investment advice on an independent basis to assess a sufficiently large number of financial instruments available on the market

will result in serious legal risks making the provision of such a service unattractive. It makes sense to offer a selected number of recommended products. Investment advice, after all, presupposes in-depth knowledge of the recommended financial instruments. It is also advisable from an economic standpoint for firms to gear the choice of financial instruments to the demand from their own clients. A limited choice of products tailored to clients' needs is therefore more likely to enhance the quality of investment advice. It would ultimately be incompatible with market principles if banks were to be effectively forced to offer their competitors' products as well so as to avoid the incorrect "non-independent adviser" label.

c) Article 25(5) sentence 2:
It should be regulated clearly at Level 1 in which cases the investment firm is required to send periodic reports to clients on the service provided to them. Article 25(5) sentence 2 of the MiFID II draft leaves this completely open so far. In our view, such a requirement can only be set for portfolio management or – where offered by the investment firm to its clients and expressly agreed with them – also for investment advice (for the relevant information requirement, see Article 24(3) of the MiFID II draft). Only then is it actually possible for banks to offer this service without facing enormous liability risks. For banks with a broad client base, monitoring in the case of investment advice is only possible with the help of completely new IT systems and special agreements on the content of the service, as in investment advice – unlike in portfolio management – the client himself decides on the composition of his portfolio and his decisions may differ from the personal recommendations made by the adviser. In addition, the client may buy and sell financial instruments at any time without using the adviser's services. If a requirement to notify the client periodically without any contractual agreement to this effect with him were to be introduced, it would not be possible in Germany, because of court rulings in connection with banks' standard terms and conditions of business, to make any charge for the additional information service, which would impose a considerable extra cost burden. A distortion of competition to the detriment of German banks could then not be ruled out.

d) Article 25(5), sentence 3
Sentence 3 fails to make clear whether the requirement to explain the appropriateness of the personal recommendation made by the adviser is to apply once only when investment advice is provided or whether information provided at regular intervals is envisaged. Only the former can be meant. Clarification to this effect is required.

2. Portfolio management; Article 24(6)

The Commission proposes a ban on third-party inducements in connection with portfolio management (Article 24(6)). Such a ban deprives the client of the chance to decide freely between – higher-priced – portfolio management without any fees, commissions or monetary benefits paid by third parties and portfolio management where part of the management fees paid stem from these third parties. In the latter case, full details of these third-party inducements would of course have to be provided to enable the client to make such a decision on a transparent basis.

3. Bundling, cross-selling requirements; Article 24(7)

Due to its broad scope, we believe that this provision would be problematic in practice. This is because a requirement to provide information on the different price components of a service and also of any product offered together with this service may lead to information overflow for clients and detract from other aspects that are of more importance for the investment decision. The proposed provision is therefore somewhat surprising at a time when thought is rightly being given to how the flood of information for

investors can be reduced to what is absolutely necessary. Moreover, it would constitute serious interference with providers' pricing mechanisms. In addition, the example given in recital 54 (tying the provision of an investment service to the opening of a current account) is problematic. Opening a(n) (current) account is mandatory when investment services are provided by banks, since an account for debiting or crediting items is required. We are therefore in favour of deleting Article 24(7).

4. Execution-only business

In connection with execution-only business, a distinction is to be made in future between complex and non-complex products. The wording of the MiFID II draft could be interpreted to mean that execution-only services would not allowed to be offered if a loan is provided at the same time (Article 25(3), sentence 1 ("with the exclusion")). The provision urgently needs to be confined to a loan specifically provided for investment purposes (Lombard loan). Otherwise the standard practice in Germany of granting an overdraft on a current account would have the unintended consequence of making execution-only business inadmissible.

Still an unsatisfactory point is, moreover, the fact that the complexity of an individual product is made the basis for the decision on whether execution-only services are offered. However, it is not the complexity inherent in the structure of a product but the risk that arises for the client concerned that should be the basis for this decision.

5. Best execution

The requirement set in Article 27(5) of the MiFID II draft for investment firms to summarise and make public the top five execution venues for each class of financial instruments, misses its target of enhancing investor protection. In the area of best execution, practical experience shows that two groups of investors can be distinguished: professional investors and semi-professional retail clients who usually make decisions on their own and therefore tell the bank exactly where they want their orders to be executed. These clients do not need the information that is called for, nor do retail clients, who do not give any such execution instructions and are thus not interested in the customary information on best execution policy. It is therefore highly likely that any further information geared to individual classes of financial instruments will meet with very little interest. At the same time, this provision is a good example of how well-meant information leads to the information overkill, criticised particularly by investor protection organisations, that "buries" actually important information. The provision should therefore be deleted.

6. Product bans

Large sections of the banking industry are in favour of putting power to issue product bans in the hands of national supervisors. Irrespective of the question of power, the banking industry as a whole regards the provisions – particularly in investor protection terms – as neither necessary nor appropriate.
The GBIC therefore proposes that, should the envisaged power to issue product bans be retained, the relevant empowerment bases should be worded as follows:

Article 31 of the MiFIR draft
"2. [...]
a) the proposed action ~~addresses a threat to investor protection~~ **is essential to avert serious threats to retail investor protection and cannot be achieved by other proportionate means** or addresses a threat...

Article 32 of draft MiFIR
2 [...]
a) [...] a financial instrument, activity or practice ~~gives rise to significant investor protection concerns~~ **gives rise to shortcomings in retail investor protection and such shortcomings can only be remedied by a prohibition or restriction** or
[...]"

7. Recording of telephone conversations or electronic communications

The GBIC takes an extremely critical view of the proposal in Article 16(7) of the MiFID II draft for EU-wide mandatory recording of telephone conversations or electronic communications – with the exception of such conversations or communications between traders – where these involve transactions concluded when dealing on own account and client orders.

Member States should remain free to decide whether or not they wish to introduce such a recording requirement. A "one size fits all" approach in this area is not helpful. We see no reason to introduce such a requirement in the entire EEA if in a member state such as Germany national lawmakers[2] and national supervisors[3] see no need for one, either to sort out extremely rare misunderstandings relating to orders or to enable supervisors to verify whether an investment firm has complied with best practice rules or to combat market abuse. CESR cited/the European Commission cites these three reasons – along with the establishment of uniform rules – as the motive for introducing the aforementioned recording requirement in the entire EEA, without explaining, let alone presenting proof of, its actual benefits. There are no plausible reasons why existing national discretion and national powers should be curtailed further.

A requirement to record telephone conversations and electronic communications would entail significant costs for the German banking industry. According to an impact assessment carried out by the Association of German Banks (BdB) in November 2008, **the German banking industry as a whole would face acquisition costs of at least EUR 632 million, plus additional annual operating costs of at least EUR 332 million** (Enclosure). In its current impact assessment on MiFID II and MiFIR, the Commission puts the expected acquisition costs at only EUR 41.7 to 99.2 million and operating costs at EUR 45.2 to 101.2 million for the entire EU (cf. p. 196 ff). However, this is due particularly to the at least partly incorrect assumption that only 4.6 – 5.8% of investment firm staff would be affected by voice recording. This assumption, which was based on the situation in the UK, is much too low in Germany's case at any rate.[4]

---

[2] See in connection with the introduction of the written record of investment advice provided to clients the recommended decision and report of the parliamentary Legal Committee, BT-Drucksache 16/13672, p.33: "...With regard to the new provision in sentence 3, the Committee takes the view that the purpose of protecting investors can also be achieved without any technical recording of the conversation between client and adviser, which causes not inconsiderable costs and is likely to be objectionable to many clients. It is instead stipulated ..."

[3] For the position of BaFin and the Austrian financial market supervisory authority, see "CESR Technical Advice to the European Commission in the Context of the MiFID Review – Investor Protection and Intermediaries" of 29 July 2010 (CESR/10-859), p.8, para.20.

[4] In the BdB's impact assessment, it was assumed that in Germany an average of 4.5 voice recording machines per bank branch would have to be installed, i.e. for at least 180,000 employees. This is equivalent to 27% of employees on average. The figure can be much higher for decentralised groups of banks, as a current survey conducted by the Association of German Cooperative Banks (BVR) shows. According to this survey, between 44 and 55% of employees at the respondent cooperative banks with a strong investment business are authorised to accept securities orders (as well).

Comments on MIFID review

The Commission's impact assessment shows that smaller firms will be hit much harder by the new requirement than medium-sized and large businesses.[5] This heavy and, what is more, disproportionate cost burden would constitute undue interference in a great many German banks' and savings institutions' business model. It could ultimately mean that particularly small and/or decentralised institutions will no longer be able in future to offer their clients investment advice or non-advised services by telephone. This would not be in their clients' interests.

It is also to be feared that a recording requirement will clash with national law on the **protection of personal privacy,** which enjoys constitutional status in Germany. During both the acceptance/receipt of orders and the provision of investment advice, it will not be possible to make a clear-cut separation between acceptance/receipt or advice on the one hand and private contents of a conversation on the other hand. Recording the private contents of a conversation would at any rate require the client's consent. It is unlikely that clients will give their consent to the recording of private details. Furthermore, it should be noted that in some Member States such as Germany such mandatory recording would be subject to approval by a firm's staff council. Without the staff council's approval, banks would no longer be able to offer clients advice or take their orders by telephone.

A voice recording requirement would also be **disproportionate**. For one thing, no shortcomings in connection with the placement of orders by telephone are known. This is also confirmed by BaFin. For another, investment firms in the EEA are already required to record client orders and their transmission and execution on a durable data carrier (Articles 7 and 8 of the MiFID Implementing Regulation) and to report transactions (Article 25 of MiFID). In order to combat market abuse, they are also required to report suspicious transactions (Article 6(9) of the Market Abuse Directive). In addition, the Commission is planning a requirement to establish systems to identify and report transactions where there is suspicion of market manipulation or attempted market manipulation (cf. Article 11(2) of the draft MAR).

If investment advice is also to be covered (see unclear wording in Article 16(7) of the MiFID II draft and empowerment of the Commission to specify concrete requirements in Article 16(12) of the MiFID II draft)), there are also less burdensome means to achieve the desired objectives[6]: for example, German investment firms have been required since January 2010 to prepare a detailed written record of investment advice provided in each case to retail clients and to make it available to clients. This applies also where investment advice is provided by telephone.

The planned recording of telephone conversations and electronic communications would thus ultimately mean, for dealing on own account and client orders, up to fivefold regulation of one and the same are and double regulation of investment advice, if it is also to be covered.

The GBIC is therefore strongly in favour of retaining Member States' discretion on this issue:

Article 16
"7. Member States have the right to impose obligations on investment firms relating to~~Records shall include~~ the recording of telephone conversations or electronic communications involving~~, at least,~~ transactions concluded when dealing on own account and/or client orders when the services of reception and transmission of orders and execution of orders on behalf of clients are provided.

---

[5] See, e.g. cost of acquiring voice recording equipment, land-line, cf. Impact Assessment, table 38, p. 201: up to EUR 3,080 for small institutions, up to EUR 489 for medium-sized institutions and up to EUR 255 for large institutions.

[6] View also taken by both houses of the German parliament; see footnote 1

~~Records of telephone conversations or electronic communications recorded in accordance with subparagraph 1 shall be provided to the clients involved upon request and shall be kept for a period of three years."~~

As an alternative to a voice recording requirement, we believe that the rudimentary requirements for explaining in writing the reasons for a personal recommendation (Article 25(5), sentence 3 of the MiFID II draft) could be expanded along the lines of the written record of investment advice provided to clients in Germany.

Alternatively, a requirement to record telephone conversations or electronic communications with eligible counterparties (wholesale business) could be considered. No such recording requirement should be envisaged for retail clients and professional clients, however.

8. Structured deposits

The broad definition of the scope of Article 1(3), sentence 1 of the MiFID II draft leads to a disproportionate extension of the requirements with regard to advice on financial instruments to the great majority of bank deposits since, according to the wording, only deposits with a "rate of return which is determined in relation to an interest rate" are to be exempted. We understand this to mean that this exemption covers only deposits whose rate of return is contractually linked to a benchmark such as Euribor, Eonia or the like. In the German marketplace, this is only the case with a minority of deposit products; the great majority are fixed-rate or variable-rate products or are geared to a benchmark like those mentioned by way of example without their rate of return being contractually determined, as provided for in Article 1(3) of the MiFID II draft. These simple products such as savings deposits and fixed-term deposits are not structured, however, and should therefore also be excluded from the scope of MiFID. The definition therefore needs to be amended accordingly. Otherwise such an extension would lead to drastic changes in the organisation of banks, which have strictly separated investment business and deposit business so far. The upshot would be high costs and a disproportionate bureaucratic burden that are by no means justified for these simple deposit products (savings book, fixed-term deposits).

We therefore suggest the following wording:

<u>Article 1 of the MiFID II draft</u>
3. "The following provisions shall also apply to credit institutions authorised under Directive 2006/48/EC, when providing one or more investment services and/or performing investment activities and when selling or advising clients in relation to deposits **other than those with capital risk excluded and an unconditional payment of yield**."

9. Pre-trade transparency for systematic internalisers in the non-equity sector

Whilst MiFID has so far contained legal consequence-related obligations for so-called systematic internalisers (Sis) for equity trading only, the scope is now to be extended considerably. It is also to cover, among other things, bond trading, which in Germany usually takes the form of bilateral transactions. We assume that fixed-price transactions with private investors could also fall under the

definition of systematic internalisation. The pre-trade transparency requirements for SIs in the non-equity sector would, however, be seriously detrimental to functioning markets.

For institutional investors active in the bond markets, Article 17(1) and (2) of the MiFIR draft could, in particular, prove problematic in practice: if an investor asks an SI for a firm quote, the SI shall to make this firm quote available to its other clients, with the size of the quote being of no importance, as we understand it. The "size specific to the instrument" is only introduced in Article 17(3) of the MiFIR draft as a criterion for the firmness of the quote in relation to other clients of the SI.

Investors would accordingly have to assume that their request for a quote will become known to all the SI's other clients even if the size involved is likely to have market impact. The price for the investor requesting the quote could thus deteriorate while he thinks over the quote or obtains a quote from other SIs. Moreover, there would be scope for arbitrage if clients of an SI are informed about quotes of any size but only quotes up to the threshold referred to in paragraph 3 explicitly have to be made public under Article 17(5) of the MiFIR draft. Such far-reaching pre-trade transparency in bond trading is not called for either by investors or by trading banks (and thus potential future SIs), as far as we know. Because of the special characteristics of the non-equity markets, CESR too voiced its opposition to EU-wide pre-trade transparency requirements in its recommendations to the Commission.[7]

Should the idea of pre-trade SI transparency also for these non-equity markets nevertheless be retained, it should be made clear that quotes only have to be made available to the SI's clients if the size involved is below the threshold referred to in Article 17(3) of the MiFIR draft.

The functioning of bond trading in future would then depend to a crucial extent on how the "size specific to the instrument" is defined. At Level 1, it should at least be stipulated what purpose the size specific to the instrument is to serve (e.g. protecting retail clients) and which criteria are to be taken into account when fixing the details at Level 2. The size threshold must be set in such a way that the above-mentioned adverse effects on pricing for investors are avoided and the firmness of quotes up to this threshold does not become an unacceptable business risk for the SI.

In addition, it should be made clear that the rules on access to quotes under Article 16(1) and (2) of the MiFIR draft also apply to SIs in the non-equity sector. Since, it must be ensured that scaled pre-trade quotation is possible so as to take into account the different credit risk of investors. The same goes for trading in derivatives, especially as this involves highly specialised bilateral contracts whose transparency does not deliver any added value to the market.

With regard to fixed-price business with retail clients, it should be noted that retail clients are unlikely to compare prices quoted by several different SIs because for them to actually be able to compare quotes bonds would have to be identical. This will virtually never happen in practice, however. While creating this kind of transparency would be extremely burdensome, it would not deliver any tangible benefits. The burden would be particularly heavy for institutions that are organised in a group and where execution of a securities order very often involves a chain of fixed-price transactions. Such a chain runs, for example, from a central institution to a local institution and from it to the client, which would trigger the SI's obligations at least twice. We therefore believe that, given the disproportionate nature of a provision that also affects retail business, a limitation geared to the group of clients concerned would be advisable.

---

[7] See CESR Technical Advice to the European Commission in the Context of the MiFID Review – Non-Equity Markets Transparency (CESR/10-799) of 29 July 2010, p.6.

As far as the scope of Article 17 of the MiFIR draft is concerned, we wish to point out that to ensure a level playing field it should cover contracts for difference. At least clarification to this effect is required.

Finally, we should like to draw attention in connection with the rules on pre-trade transparency as a whole to an inaccuracy in Article 13(3) of the MiFIR draft regulating pre-trade transparency for SIs. The English version calls for publication of a "firm bid and offer price", whereas the German version refers to a "verbindlichen Geld- und/oder Briefkurs" (firm bid **and/or** offer price). The German version contains the correct wording in our view. We therefore believe that the English version should be amended accordingly.

10. Post-trade transparency

a) Post-trade transparency for transactions in shares

Articles 28, 30 and 45 of the existing MiFID stipulate that transactions in shares – whether they are concluded on a regulated market, an MTF or bilaterally between two contracting parties – must be made known immediately to all interested investors. Under Article 45(2) of MiFID in conjunction with Article 28 of Regulation (EC) no. 1287/2006, Annex II, table 4 of this Regulation defined thresholds which, if exceeded, allow for deferred publication of transactions by firms subject to transparency requirements. For this purpose, it created several classes of shares in terms of average daily turnover to determine the exact delays for publication. In the case of particularly large blocks of shares, delays until the end of the third trading day next after the trade are possible.

Provision for deferred publication enables market participants to bear the risks of large trades since they are not required to disclose these immediately. Publication too early harbours the danger of "cornering". A market participant who has entered into a position could be undermined by other market participants in his intention to close the position. That goes for anonymous publication as well, as the market can still identify the traders concerned. This would lead to the danger of market participants no longer being prepared to expose themselves to the risk of a position. Such a reduction in the number of potential counterparties affects liquidity in block trading in particular. This would be detrimental particularly to institutional investors such as insurance firms or pension funds.

Article 19(2) of the MiFIR draft, in conjunction with Article 10 of the MiFIR draft, provides for deferred post-trade transparency of transactions in shares in certain cases. This provision is in principle to be welcomed. At the same time, Article 10(2) of the MiFIR draft should regulate more precisely which criteria must be taken into account when fixing the details at Level 2. We are concerned that unnecessarily restrictive rules could be adopted. For example, CESR proposed in its advice to the European Commission[8] that deferred reporting should generally take place no later than the end of the trading day (or beginning of the next trading day if the transaction is concluded after 3pm). These delays do not accommodate the risks associated with some transactions. The longer delays provided for today are only applied in exceptional cases, but it is precisely then that they are needed. It must be ensured that market participants can continue to make available liquidity in block trading in the future. To enable them to do so, the associated risks need to remain acceptable through adoption of appropriate delays. We therefore recommend that the wording of Article 10(2) of the MiFIR draft should take this into account.

[8] See CESR Technical Advice to the European Commission in the Context of the MiFID Review – Equity Markets (CESR/10-802) of 29 July 2010, p. 24/25, table 5.

Comments on MIFID review

Finally, we wish to point out that the scope of Article 19 of the MiFIR draft is not clear enough. We are against the inclusion of "other similar financial instruments". When putting the transparency requirements into practice, firms subject to them should be able to clearly define the financial instruments covered. This is not possible with the broad wording "other similar financial instruments". We also do not believe it is necessary to make the scope so broad to achieve the intended regulatory purpose. We therefore suggest deleting the words "or other financial instruments" in Article 19(1) and (2) of the MiFIR draft.

b) Post-trade transparency for transactions in bonds, structured finance products and derivatives

The existing post-trade transparency requirements in relation to other market participants for transactions in shares are to apply in similar form in future also to many other financial instruments, including bonds (Article 20 of the MiFIR draft). In regard to bonds, we are concerned even more than in the case of equity trading that the establishment of unreasonable transparency rules will cause liquidity in bond trading to dry up.

The purchase and sale of bonds, not only in the case of transaction large in scale, usually takes place in the form of bilateral transactions. Banks provide the market with liquidity by buying and selling bonds; for this purpose, they take risks on to their own books. That goes both for transactions with private investors and for transactions with institutional investors. If banks were to be required to disclose their transactions to other market participants too early, the risk of the market moving against them and of their only being able to unwind their positions at unreasonable prices would be too high. As a consequence, banks would avoid exposing themselves to such risks, so that liquidity would dry up. This would, however, be seriously detrimental to bond issuers, be they companies, the public sector or banks.

The aim must consequently be to achieve the best possible transparency. Appropriate scope for deferred trade reporting is therefore essential. The delays applying to transactions in shares today show that differentiated transparency solutions that meet market needs in terms of each class of products are required. The existing differentiated system provides good guidance. A differentiated approach is also required for transactions in bonds. CESR, on the other hand, proposed in its advice to the European Commission[9] that deferred reporting should generally take place no later than the end of the trading day. This delay is unsuitable for many transactions because of the risks associated with these. It must instead be ensured that liquidity does not dry up in this market either in future. The wording of Article 10(2b) of the MiFIR draft should take this into account. Instead of absolute volumes, thresholds should also be possible (above X and below Y EUR) for deferred trade reporting. In addition to the threshold arrangements provided for bonds and derivatives in Article 20(1) of the MiFIR draft, which we welcome, we believe that a higher threshold is required in each case to select the most liquid securities that are suitable for market transparency requirements. This additional threshold should be fixed by ESMA.

Also completely new is the planned extension of the post-trade transparency requirements in Article 20 of the MiFIR draft to transactions in, among other things, structured finance products and derivatives. It must be borne in mind that all structured finance products are individually designed and not standardised. Because of their individual structure, price information disclosed after trading is rather meaningless since completely identical instruments do not exist and conclusions about the market value of other

---

[9] See CESR Technical Advice to the European Commission in the Context of the MiFID Review – Non-Equity Markets Transparency (CESR/10-799) of 29 July 2010, p. 4/5.

instruments are virtually impossible. The informational value of post-trade prices for market participants is therefore very limited. Transparency, i.e. details of trades concluded, could even be harmful for the market as structured products cannot automatically be compared with each other. Slight differences in the design of products may have significant economic implications for a product. If, therefore, only market data on similar but not identical products are available under a more stringent transparency regime, interested market participants run the risk of making their decisions on an incorrect basis. It is, moreover, not clear how transparency is actually to be established for these financial instruments. The details are only to be fixed at Level 2. Given the considerable differences between the financial instruments covered by Article 20 of the MiFIR draft, we believe that a differentiated approach is advisable at Level 1 and suggest, firstly, gearing the wording of Article 20 of the MiFIR draft more strongly to the existing differences between financial instruments and, secondly, making it more concrete.

As regards the need to allow firms to trade against their own books also when using the newly introduced category of "organised trading facility", we refer to section I containing our general remarks.

11. Transaction reporting

Functioning financial markets require functioning supervision. To monitor trading, particularly to keep an eye on prohibited insider transactions, supervisors need details of transactions concluded. Since the entry into force of MiFID, the requirement to report transactions has been regulated by Article 25(3) of MiFID. This provision is supplemented by Article 13(1) and Annex I, table 1 of European Commission Regulation (EC) No. 1287/2006.

These rules were transposed into German law by means of Section 9 of the German Securities Trading Act and the Securities Trading Reporting Regulation. The annex to the latter contains the form to be used for filing reports, showing how the details of trades have to be transmitted to BaFin. The data record enables reporting institutions to report all transactions concluded by them to BaFin in a standardised electronic format, irrespective of how the transactions were executed. BaFin can therefore automatically see all the details of a transaction, no matter whether it was concluded on- or off-exchange, for clients or for own account, through the intermediary of commission agents or brokers or directly. Complicated transaction chains can also be tracked with the help of the data record. All transactions in securities and derivatives admitted to trading on a stock exchange and all transactions in 'pure' open market securities are reported to BaFin. In 2010, BaFin received around 5.15 million reports from reporting institutions every trading day. These are automatically analysed and examined for abnormalities. In this way, consistent market supervision is ensured.

Article 23(8) of the MiFIR draft says that the data set required for reporting will be harmonised at European level in future. We recommend bearing in mind in connection with the envisaged stronger harmonisation that high-quality supervision can only be achieved in all EU Member States if reporting institutions can submit high-quality reports. To enable them to do so, key terms such as "transaction" first need to be defined clearly at Level 1 as these are essential for generating clear reports. It must then be ensured that more strongly harmonised reporting requirements make allowance for nationally designed types of transaction. The rule that the reporting data record should be geared to the type of transaction must apply in future as well. Otherwise it is to be feared that use of established transaction types such as intermediate commission-based transactions, which are not common in all EU Member States, will no longer be possible due to their "unreportability". It should therefore also be ensured at Level 1 that the reporting record to be developed at Level 2 satisfies such requirements. This is the only

way to make sure that, firstly, clients have continued access to established transaction types and, secondly, that BaFin can continue to perform high-quality supervision in future as well.

Article 22(2) of the MiFIR draft requires the operators of regulated markets, MTFs and OTFs to record certain data relating to orders and refers in this respect to Article 23(1) of the MiFIR draft, which provides for an obligation to report the details of a transaction that are ultimately to be specified further via the harmonised EU data set. Article 23(3) of the MiFIR draft, which says that reports should include a designation to identify clients, thus also plays a role. When it comes to reporting a trade, the requirement to indicate a client ID is not a problem: it is already indicated today under Section 9 of the German Securities Trading Act. Article 22(2) of the MiFIR draft refers to the reporting of trades, and not orders, however.

We wish to point out in this connection that no obligation whatsoever to indicate a client ID when routing an order to a trading venue is necessary today. The order which the bank routes to the venue contains only data relating to the order. Purely client-related data such as the client ID is included after execution of the order during processing by the bank through which the client placed his order, but not on the regulated market, MTF or OTF. It is not clear what reasons there could be for calling this tried and tested system into question. Transmission of client details to trading venues is not necessary for execution of orders, but would lead instead to massive interference in order execution processes at both banks and trading venues. We see no need for this and therefore suggest including clarification in Article 22(2) of the MiFIR draft that makes transmission of client data unnecessary in future as well.

Finally, we take a critical view of Article 23(9) of the MiFIR draft. High-quality supervision can, in our opinion, only be ensured by national supervisors. We therefore believe that it would be better to first allow sufficient time to observe and evaluate application of the changed reporting rules in practice. A period of two years is not enough to conduct a proper examination. We therefore suggest deleting Article 9. Alternatively, the period in question should be extended to at least four years.

12. Algorithmic trading

We welcome the European Commission's intention to regulate algorithmic trading (Article 4(30) and Article 17 of the MiFID II draft). The Commission is evidently thus seeking, in particular, to strengthen supervision of high-frequency trading. This is an understandable aim in our view, and we regard many of the requirements for algorithmic trading as reasonable. For example, we regard the required registration and supervision of all traders as appropriate, along with the establishment of certain organisational requirements in respect to risk management, resilience of trading systems, compliance with trading limits and prevention of generation of erroneous orders. The prohibition of market abuse must of course apply to all types of trading.

At the same time, we welcome the stronger harmonisation in Article 51 of the MiFID II draft of the use and design of **circuit breakers** to temporality halt trading in financial instruments. These are necessary to allow fair and proper price determination. If a trading venue does not have adequate safeguards, the result may be sharp price fluctuations that do not accurately reflect the market situation. We believe that, together, suitable rules for algorithmic trading and circuit breakers are the right way to protect all market participants against unjustified price fluctuations.

The Commission's proposal that algorithmic trading strategies should continuously post firm quotes during trading hours and provide liquidity to the market goes much too far, however. It not only ignores

the fact that algorithmic trading reacts to certain market situations but would also effectively establish an unlimited market making requirement without any compensation. This would also go well beyond the obligations of real market makers. Such a requirement would mean that algorithms would no longer be used. The consequences would be less liquidity, along with bigger spreads between bid and offer prices. Moreover, the arbitrage that takes place today to overcome fragmented markets would no longer be possible. Ultimately, poorer prices for all market participants, be they private investors or institutional investors such as insurance firms or pension funds, would be likely. This approach should therefore not be pursued any further.

We therefore suggest deleting Article 17(3) of the MiFID II draft.

In addition, the scope of the rules for algorithmic trading in Article 4(30) of the MiFID II draft needs to be corrected as the definition in sentence 1 also covers purely passive systems which, like best execution policy, are confined to meeting regulatory requirements or merely carry out clients' instructions. In these cases, additional regulation is not necessary in our opinion from a technical standpoint. The exemptions proposed by the Commission in sentence 2 should be supplemented accordingly. We therefore suggest wording Article 4(30) of the MiFID II draft as follows:

30) "[...] Algorithmic trading" mans trading in financial instruments where a computer algorithm automatically determines individual parameters of orders such as whether to initiate the order, the timing, price or quantity of the order or how to manage the order after its submission, with limited or no human intervention. This definition does not include any system that is only used for the purpose of routing orders to one or more trading venues or for the confirmation of orders **or to execute client orders or to fulfil any legal obligation through the determination of a parameter of the order;**"

13. Provision of services by third-country firms; Article 41 ff of MiFID, Article 36 ff of MiFIR

The rule that the provision of services from outside the EU to Member States of the EU should only be possible if a branch is maintained within the EU is unnecessarily burdensome. Supervision of such service offerings via registration by the competent authorities would preferably have to be made possible at any rate where the provider concerned is in turn a branch of an investment firm already registered in an EU Member State. In the latter case, the provider is not a "third-country" provider but a fully consolidated provider under supervisory law who is controlled and supervised mainly from within the EU. Already existing client accounts should not at any rate be burdened by the introduction of such a provision, however, but should benefit from a grandfathering clause.

14. Collateral

We see no reason for the new provision in Article 16(10) of the MiFID II draft. We understand it to mean that transfer of title to financial instruments, e.g. as in the case of assignment as collateral, is no longer to be possible in future. On the other hand, the pledging of financial instruments, including the lien provided for under German banks' standard terms and conditions of business, would continue to be possible, as in this case no transfer of title takes place (until realisation of the pledged financial instruments). We believe that the wording of the current version of MiFID should be retained. Recital 27 thereof states that, after their transfer to the investment firm for the purpose of securing obligations, financial instruments "should ... no longer be regarded as belonging to the client".

Enclosures