

REVISION OF THE INVESTMENT SERVICES DIRECTIVE

UNICE POSITION

UNICE welcomes the proposed revision of the 1993 ISD directive as part of the Financial Services Action Plan to create a genuine single European market in financial services. Since market developments have led to the evolution of a variety of different venues for trading securities outside regulated stock exchanges over the last decade, the regulatory framework is in need of adaptation. An updated regulatory framework will enable market participants and the economy as a whole to benefit more fully from the single passport for investment firms.

UNICE believes that the main consideration should be to achieve results in the best interests of investors and of European companies as users of the financial markets. The important considerations for European companies will be the effect of the proposals in the directive on the liquidity and price of company shares. The directive should demonstrably contribute to better access to capital for companies, the quality of price formation and greater liquidity in the European market through promoting the creation of a competitive environment. This should include the removal of barriers to entry into the market for securities trading and the development of innovative trading systems.

Competition between trading venues can make a significant contribution to market quality. There is a concern among some UNICE members that insufficiently regulated competition may lead to the fragmentation of liquidity. An adequate regulatory framework that promotes best execution of orders and transparency is necessary. In order to ensure better transparency of markets, UNICE agrees that post-trade reporting should take place promptly. For large trades we agree with delayed reporting.

UNICE also believes that execution-only trading services are to the advantage of investors since they are allowed to pay less for a service. Requiring a suitability test for this type of client is therefore not appropriate. There are differing views among UNICE members concerning what should replace the proposed abolition of the concentration rule. Such views

arise from the different character of existing markets with some markets having worked without a concentration rule for decades with no impact on the spreads or the liquidity of regulated markets, and others having used the regulated market as the main trading venue. It will be vital for legislators to understand thoroughly the technical consequences of policy decisions and to enunciate these clearly to companies as users. In any case, pre-trade information disclosure, best-execution obligations and customer consents must be adequately tailored to enable investors and brokers to trade outside regulated exchanges. The regulatory framework must enable coexistence of a choice between all trading systems according to their structures and business models. The proposed directive treats MTFs almost like regulated markets, thus imposing the costs of the regulated market business model (e.g. ability to obtain best price provisions), while CESR allows regulators to differentiate provisions depending on the characteristics of the MTF. There are different views within UNICE as to whether this is appropriate and on how MTFs should be treated, again based on national traditions. Nevertheless, UNICE members believe that both regulated markets and MTFs (provided that they comply with comparable rules) should be able to benefit from the presumption of best execution. Not all rules that are adequate for the regulation of regulated markets may be suitable for alternative order execution venues with different market models and cost structures.

Within UNICE there are also divisions over the issue of pre-trade transparency, reflecting the highly technical considerations involved and the diversity of market structures. While some members stress the importance of transparent information on price offers for the quality of price formation, other members are of the opinion that too much transparency can harm market quality in that it deters potential participants from entering the market. Again, however, the policy objective should be to obtain the best result in the interests of the investors and users of the market, in terms of liquidity and price.

Conduct of business and best-execution rules, on the other hand, if properly designed, can contribute significantly to providing investors with the best available execution on any trading venue. Best-execution rules can contribute to more competitive trading conditions for investors as they encourage intermediaries to consider different trading venues before execution. UNICE agrees with the principle of best execution as an effective means of investor protection and promoting price stability. However, the directive does not clarify how, for example, variables other than price such as speed of execution and overall trading costs would be taken into account. Retail clients and institutional investors may have different expectations as regards "best execution". UNICE agrees that there should be differentiation between professional and other investors in order to promote greater liquidity. Detailed pre-

defined criteria for best execution, however, as the Commission intends to lay down in a comitology procedure, may be counterproductive without a better understanding of and agreement on what the criteria should be. It is therefore essential that the Directive provides legal certainty to firms, users and investors as to the fact that best execution should not be regarded only in terms of price but should consider other elements such as speed, size, time, likelihood of execution and venues to which the firm has access. Furthermore, firms should be allowed to agree in a contract with the investors the venues which will be taken into account for application of the best-execution rule.

UNICE also supports the guiding principle in the proposed ISD that, for professional investors, firms should only comply with home country and country of origin rules (in the case of the provision of services to clients). This will promote more cross-border competition by providing legal certainty for both investors and firms.