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2 September 2004

Dear M Demarigny

**Ref: Call for Evidence on CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments**

ICAP welcomes this opportunity to respond to the Committee of European Securities Regulators' ("CESR") call for evidence on possible implementing measures of the directive 2004/39/EC on Markets in Financial Instruments.

ICAP is the world's largest inter-dealer broker and is very active in all the major European financial, energy and hard commodities markets, providing specialist intermediary execution services to clients throughout the whole of the EU in the wholesale segment of those markets. ICAP companies operate several MTFs and are members of all the largest EU exchanges.

**Q1.1 Independence of Compliance function**

ICAP agrees with the issues already identified by CESR's call for evidence; in that there need not be an "independent" compliance function in all firms. This is due to several important points:

- All firms' primary responsibility is to remain in compliance with applicable law and regulation; how this is best achieved should be the product of an assessment of the compliance requirements of the firm by its responsible management.
- Smaller firms would be unfairly penalised if the requirement was made mandatory, and more significantly, for a well run firm with open lines of communication and internal controls an independent function is both difficult to maintain and would not necessarily advance regulatory aims.
- Even in medium sized firms there can be significant benefit in an experienced operations officer or other business related professional at a senior level having compliance responsibility, as they will have a better overview of the practical conduct of the firm's business, and potential compliance implications.
- Compliance is both a tool of regulatory oversight but if used effectively is also a business enabler, allowing firms to provide efficient and competitive services in accordance with applicable regulation.

- Any discretion of competent authorities to recommend or require firms to have an independent compliance function should be appropriate and proportionate in view of the complexity, diversity, client base and size of the business.

### **Q1.3 Outsourcing of Investment Services**

CESR Standard 127 does not fully contemplate the full spectrum of Investment services that are now included in MiFID. In particular the new activity of being an MTF operator poses a different set of issues in relation to the draft language in paragraph 9 of BOX 1. In addition, the suggested wording would prejudice firm groups that have intra-group structures or which provide internal services to each other. This is because:

- MTFs and regulated markets rely on superior technology for the provision of their services, and it would be a competitive barrier for European MTF operators or exchanges to be prohibited, delayed or restricted from choosing or changing their technology contractors now or in the future.
- MTF and regulated market operators already accept the responsibility for the service they provide to their clients, and should not be restricted from selecting technology providers from jurisdictions outside the EU.
- In the worst case, the draft advice, if implemented would force MTFs to operate from outside the EU.

Outsourcing of certain functions should not be restricted or require cross regulator notification if it is subject to appropriate selection, oversight, systems and controls established and maintained by the investment firm. The issue must be one of effective management of risk and use of any outsourced aspect of a service – to have any general restriction on firms would create a barrier to competition and choice for MTF operators and regulated markets that want the best international IT, and would affect perfectly legitimate intra-group structures.

### **Q6.2 Conflicts of interest**

To establish a complete list of mandatory steps that must be taken to prevent, minimise or manage conflicts of interest would prohibit a purposive and effects based assessment by competent authorities and firms' management. As already mentioned, it is the primary responsibility of business management to identify conflicts or potential conflicts and then the most appropriate and effective means of managing/preventing them.

In order to develop a genuinely effective policy on conflicts of interest there must be some differentiation made on the basis of the services provided, the nature of the assets or transactions involved, the status and experience of the client and the relevant business model.

A list of examples of measure that may be used to manage or avoid conflicts is illustrative but should not be made exclusive – to do so would pre-judge the means of

firms to exercise management judgement, competent authorities to exercise oversight judgement and EU business to develop innovative means of dealing with conflicts in a developing market space.

### **Q6.3 Investment Research**

It is not always necessary to separate the market research function from trading or broking activities, as in many cases firms will produce research and statistical analysis as an incidental or ancillary service to the main business.

Examples would include research provided by brokers when the broker has no direct interest in the underlying securities (i.e. because it only charges commission as opposed to making a trading profit or loss). It must also be remembered that research in relation to different assets has differing sensitivities – research on illiquid, unlisted or new issued shares is more sensitive to potential conflicts than research on eurozone interest rates (which an inter-dealer broker in euro government bonds may produce free of charge to its clients. A similar point can be made for currency exchange rates).

### **Q6.4**

It may be appropriate for information barriers to be maintained between analysts and the corporate finance division of a firm when there is any possibility of a conflict of interest – i.e. only where the securities that are the subject of the research are issued by clients of the corporate finance division. Subject to this qualification, ICAP's preference is for the First Option for paragraph 17, although there should obviously be no conflict of interest if the firm in question has no corporate finance division, or the research is not based on subjective views of a company's performance or potential (e.g. interest rate or currency research).

### **Q4.1 Record keeping (Article 13(6)):**

Placing the obligation to demonstrate that it has not breached the Directive, does not address itself to whether the firm has actually complied with its record keeping obligations (i.e. it is possible for a firm to comply with the requirements, and prove that it has done so, but it may not be able at all times to prove that it has not breached them – this does not further regulatory aims and places a significant additional burden on firms).

### **Telephone Records**

Currently it is very common in the trading and broking environment for firms to record conversations between themselves and other counterparties or clients for the purposes of commercial dispute resolution. It is difficult to see what advantage telephone recording provides to regulatory supervision without the ability to listen to all the recordings on an ongoing basis in conjunction with other data applicable to the relevant market at the time. There is still a very large volume of business transacted by telephone and firms would incur significant costs to store "tapes" (most likely digitally stored on computer servers designated for the purpose). The purchase and maintenance of servers would place very significant financial burdens on firms

without there being any evidence that it will advance regulatory aims, or provide a meaningful tool for surveillance.

**Terms of business (Article 19(7)) BOX9:**

ICAP advocates clear and unambiguous terms for retail clients but does not agree with CESR's very prescriptive approach. This is because it will cause firms to be less flexible in the terms they offer clients and will create a standardised and "non-negotiable" contract for clients to sign. The risk is that clients will therefore have less choice and flexibility in the terms they wish to negotiate, and will be faced by a longwinded document that they must sign before receiving even the most simple investment services.

ICAP is also very concerned by the suggestion that there may also be a requirement for a written contract for professionals in the future, and is concerned that it will place EU businesses at an immediate competitive disadvantage to their US counterparts.

**Client Order Handling (Article 22) BOX11:**

**Q2**

In many markets that are brokered via telephone the time it would take to re-confirm every order to every professional client would create an absolute barrier to efficient and timely execution of that order.

This is true of many inter-professional market segments, including transactions in EU government and corporate bonds and short dated interest rate swaps traded between eligible counterparties. In such cases traders have a large amount of information about price, and factors that affect price from a variety of separate data sources (data vendors, brokers and broker price dissemination systems, MTFs etc).

In such instances any failure of orders to be executed in accordance with instructions would fall within the realms of an error or a commercial dispute between eligible counterparties.

More significantly, as the scope of MiFID now includes certain commodities transactions as "financial instruments", these inter-professional markets would also be affected. The result would be that EU based intermediaries, and their clients would be unable to achieve timely execution in fast moving markets and therefore could not compete with their US or Asian counterparts.

This same practical difficulty applies to the application of paragraph 17 (Record Keeping), were it is often not possible for a broker to record orders instantaneously due to the fast moving nature of certain professional markets. As technology develops the ability for traders and their brokers to confirm orders will no doubt become a feature of inter-professional markets, but primarily as a result of participant demand and expectation of increased automation (straight through processing, or "STP").

EU professional intermediaries would be placed at a severe competitive disadvantage if they are required to comply with these provisions in relation to their eligible counterparty or relevant professional clients. This would obviously also have direct effects on those market participants themselves.

ICAP appreciates the opportunity to address the issues raised in the CESR call for evidence and looks forward to further discussion with CESR on its advice to the European Commission.

Yours sincerely,

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01 Sept 04