



The London Energy Brokers' Association

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Mr. Fabrice Demarigny
Secretary General
Committee of European Securities Regulators
11-13 avenue de Friedland
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FRANCE

Dear Mr. Demarigny

Response to CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Markets with regard to Best Execution

About the London Energy Brokers' Association

The London Energy Brokers' Association, LEBA, is the industry association representing the wholesale market brokers in the over the counter, OTC, and the exchange traded UK and liberalised European energy markets. These brokers intermediate, and facilitate bilateral contracts to be concluded, between banks, trading houses, commercial enterprises, public utilities, and integrated energy businesses, providing liquidity and price discovery to these markets as well as contributing liquidity to European exchange traded markets. The major products that they deal in are crude oil and refined petroleum products, gas, and electricity. LEBA firms are also pleased to be contributing towards the development of traded markets in EU emissions allowances and other environmental products.

These activities assist the development of tradable markets to support liberalised markets in the underlying European physical energy markets. Their business models range from pure ‘voice broking’ via telephone, to managing fully electronic trading platforms, including the hybrid model combining both voice broking alongside an electronic system.

We welcome this opportunity to comment further upon CESR’s Draft Technical Advice, and are pleased to observe CESR’s renewed determination to achieve genuine consultation and dialogue with all market participants.

Our members consider it imperative that European securities, debt, and money markets remain competitive and effective so that they can contribute towards efficient capital allocation throughout the EU and thus play their part in enabling European growth and prosperity. Given this importance, LEBA and member firms are pleased to have participated in recent regulatory dialogues upon these topics.

We limit our comments to high level observations upon Chapter 3 regarding best execution and order execution policies, (Articles 19 (1) and 21).

1. The appropriate level of regulatory intervention to maintain and further develop liquid, dynamic and competitive European financial markets

We believe that it is imperative that CESR, in drafting its advice to the Commission, continues to take into account the **appropriate level of investor protection, and thus regulation required, that various market sectors, asset classes, and customers require.**

In particular, it should continue to consider the scope and level of regulation applied by key regulators in other major developed economies. Thus an illiquid market with a large retail client participation (such as the second and third tiers of many national European equity markets) should receive maximum regulatory oversight, including a preponderance of ‘conduct of business’ rules; whilst a hugely liquid wholesale market serving professional and institutional participants (such as the European, and indeed, global, markets in diesel or heating oil) should receive the minimum regulatory oversight with a focus on appropriate high level principles, standards and norms.

2. The differing regulatory requirements of wholesale and retail market participants

LEBA firms believe that it is imperative that, as increasingly taken on board by EU Member State regulators, that CESR, in preparing its advice to the Commission, is particularly mindful that **wholesale and retail market participants place**

considerably different values on the actual costs and perceived benefits afforded to them by financial regulation.

Retail customers do not possess similar knowledge and experience of the products and services offered by investment firms, as do the firms themselves, and thus rely on conduct of business rules enshrined in financial regulation for their protection. This enables that the contracts between firms and individuals can be considered as fair and reasonable: however this protection often comes at a price – many institutions will charge retail clients more – either explicitly – or more likely bundled within their commission and / or their bid – offer spread, to help defray the costs of their order management systems, their credit risk, their compliance processes and systems and their increased administration. Additionally, these order management systems – designed to protect retail customers – often means that there is a time delay between the receipt and execution of retail business.

Wholesale market participants (both eligible counterparties and professional clients) have a similar degree of knowledge – at least in the products that they are trading – as their investment firm providers and thus do not need the level of protection naturally required by retail customers. They benefit from more timely execution and lower transactions costs: benefits which, as professional market participants, they value highly.

Wholesale market participants should therefore continue to have the ability to determine how they value the relative benefits of conduct of business protection, or more timely and cheaper execution, and thus decide whether they wish to avail themselves of all or part of relevant conduct of business type regulation – in particular – the regulations concerning, so called, “best execution”.

Within this context, it is imperative that CESR recognises that the balance of commercial power between LEBA member firms and their customers differs significantly from many other financial firms. Most financial firms possess greater knowledge and experience than their customers – and particularly where these customers are retail based, it is likely that the firm has more commercial power and expertise than their customer.

The customers of LEBA firms are typically significant financial or commercial institutions – with market expertise – and, most importantly – they face a highly competitive market of LEBA members, other brokerage houses, Exchanges, and ATS operators. As such, it is the customers of LEBA firms who typically possess the commercial leverage in their negotiations with LEBA member firms regarding all aspects of the service that they require – but in particular – the speed of execution and the price at which they are prepared to execute transactions. **The market thus already ensures that the customers of LEBA member firms receive efficient execution i.e. the perceived best price at the time – rather than a potentially lesser standard of prescribed “best execution”.**

We believe that it is essential that wholesale market participants remain able to determine the level of regulatory protection that they require, taking into account their own commercial interests.

We are pleased that DG-Markt recognises that CESR must have regard to various factors including the retail or professional nature of the customer, and other criteria when forming their advice. *DG Internal Market requests CESR to provide technical advice on possible implementing measures...on the criteria that the investment firm should take into account when executing client's orders for determining the relative importance of the factors such as price, costs, speed, likelihood of execution and settlement, size and nature of the order and any other relevant consideration. Those criteria should take into account the retail or professional nature of the client.*

3. The strong presumption to hold senior managers responsible rather than to describe highly detailed processes

We believe that maximum discretion as to the application of CESR's advice should be left to the Commission, to Member States, and to the senior management of financial services firms, respectively, as appropriate, to ensure that a genuine risk based approach, taking into account all relevant factors, can be taken towards ensuring that the objective, of providing adequate information and protection to investors is achieved, whilst enabling innovation and freedom of choice and, at the same time, minimising regulatory burdens.

We believe that the Level 2 measures should provide sufficient guidance to senior managers and Member State regulators to ensure that markets operate efficiently and that regulatory approaches are broadly harmonised: managers require sufficient clarity to know what regulatory outcomes they must achieve. **However, we strongly believe that senior managers should have discretion as to how they achieve these objectives:** this enables **freedom of choice and innovation** in managing their resources and minimising their risks; and prevents a 'box-ticking' mentality – which often leads to a focus on required processes rather than necessary outcomes – from developing.

Thus we ask CESR to advise the Commission to consider putting more emphasis on holding the senior management of financial services firms accountable for the outcome of their firm's policies and practices and less emphasis on developing overly prescriptive administrative or supervisory detail. **Firms' senior management can then consider how to apply the broad principles to their various customers, the various asset classes that they trade, and to the various products that they offer to their customers.**

A 'one size fits all' approach to best execution requirements across all customers, all asset classes, all execution venues, and all products will stifle innovation and market development and be overly costly and overly burdensome. Whilst firms

are naturally concerned regarding the cost of regulations compared to the benefits that they perceive – it is the potential for burdensome regulation – which impedes upon efficiencies – that particularly concerns the senior management of LEBA firms: a reduction in the efficiency of their firms relative to competitors in other financial services markets – will make it far harder for them and for EU financial services markets to compete effectively with others such as those in the US or Asia.

Thus we are very pleased to support CESR's view (in paragraph 41) that...*These discussions support CESR's initial conclusion that prescriptive Level 2 measures are unlikely to provide a workable regulatory solution and that flexible principles are therefore more appropriate.*

In particular, we recommend that CESR's advice recommends that the Commission allows Member States to **dis-apply detailed best execution requirements to asset classes and products where the nature and structure of these market would make it inappropriate and / or overly burdensome to implement them.**

It is worth commenting that requiring that financial services firms – and their senior management – follow appropriate high level principles rather than detailed processes is a higher – rather than a lower – threshold for firms to achieve: it is normally easier to find a way to tick a box numbered A:27 (iii) (for example) rather than to have to explain how your firm ensures that it treats its customers fairly.

4. Specific comments upon order execution policies

LEBA firms are supportive of order execution policies *per se*, given that firms currently have processes to manage their execution of customer orders. However, we contend that **where customers are themselves financial services firms, that those firms themselves should ensure that they are satisfied with the scope and range of execution venues** supplied by their broker.

Given the professional nature of wholesale markets, the customer will normally either be indifferent to the execution venue – he will expect a trade to be executed almost immediately, and at the best available price at the time – or he will direct as to where his trade should be executed.

Clearly, when a customer requests an execution venue, the firm should follow his instruction, however it is unlikely that on a case by case basis that the customer will want to know his execution venue, at least, pre trade.

Thus financial services firms dealing for other financial services firms should be required to **disclose the range of execution venues to which they can access directly, but not the method nor algorithm by which they select – in real time – which venue to use, as this may well contain proprietary information, which gives them competitive advantage.**

Nor should there be a requirement to disclose the percentage of client orders directed to particular execution venues, as this again, may disclose commercially sensitive information.

Thus disclosure by a firm to another financial services firm should be sufficient to discharge a firm's obligation regarding the information to be provided to clients or potential clients.

Should you have any observations, or further questions on the comments made in this submission, please do not hesitate to contact me on + 44 (0) 207 827 2800 or at istevenson@wmba.org.uk

Yours sincerely,

Ian Stevenson

Chief Executive