Friday, 3 September 2004

Mr. Fabrice Demarigny
Secretary General of CESR
11-13, avenue de Friedland

Dear Mr Demarigny,

CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments – Conflicts of Interest and Market Transparency Proposals.

Barclays Capital welcomes the opportunity to contribute to the debate on the regulatory standards and controls to be applied in Europe. Whilst the scope the CESR Consultation Paper is very broad, we have chosen to contribute to the areas where our business specificities warrant an interest distinct from that of other firms.

Theses areas are:

- Art. 13(3) & Art. 18 on Conflict of Interest; and,
- Art. 28, 29, 30, 44 & 45 on Market Transparency.

Barclays Capital is already involved in various initiatives with respect to the Market in Financial Instruments Directive ("MiFID"). As you are aware, we are actively assisting CESR and the Commission in their better understanding of commodity derivatives, an area in which we are one of the strongest City players and with which CESR will deal as part of its second mandate.

We hope that the present response, as well as our various concrete initiatives, will provide a valuable contribution to your better understanding of the diversity of the financial services industry and the practical functioning of markets when developing regulatory standards. We remain available to discuss in greater details any or all of the topics raised in the following should you have any questions.

We present our response in three parts. Firstly, we provide essential background on our business model, which will make clear why we have been consistent stand-alone contributors to the ongoing debate on Conflict of Interest. In that respect, the arguments developed in the second part build on the previous contributions that we have made to address FSA proposals in relation to Conflict of Interest. In the third part, we wish to say a few words on your Market Transparency proposals, the impact of which is also dependent on the type of business that we do.

Part 1: Our business

Barclays Capital does not produce equity research nor have a private client base for equities. Our sole focus in the production of research is the provision of credit, convertible, economic and commodities related research to the wholesale market. Although our firm is not very active in managing or arranging equity issuances (other than convertible and exchangeable bonds), we are one of the market leaders in

managing and arranging debt issuances. This is illustrated by the fact that in 2002 we were ranked the number one manager of Sterling Bond issuances, number two manager of Eurobond issuances, number three manager of European Corporate Bonds and number five on the Global All Debt League table by market share.

In December last year, we responded to the UK Financial Services Authority's Consultation Paper ("the CP") on Conflicts of Interest. In summary, we supported a number of the proposals in the CP. However, we had significant concerns with certain aspects of the proposals, insofar as they had been tailored following the "one size fits all" model. The FSA decided to apply its prescriptive conflict of interest regulations across the financial services industry as a whole notwithstanding their being targeted to equity businesses.

We firmly believe that the conflicts of interest present in the equity markets are not equally applicable in all assets classes. The differing structure of the markets in the other (i.e. non equity) asset classes, such as bonds, are so fundamentally different that certain conflicts which might exist in the equity market simply do not exist elsewhere.

In that respect, we welcome CESR's stated intention to provide advice "capable of application to investment firms of different size and type"; to "avoid setting rules that could not be of universal application"; and to seek to "set out flexible principles of general application across the whole range of business models". As you say, this approach is "consistent with encouraging innovation in financial products and business models". We do hope that this view will prevail in practice as a result of the present consultation, as well as in the forthcoming stages that the MiFID has yet to go through (e.g. Level 3). Given that CESR's purpose is harmonisation between member states, it is to be hoped that the final version of its advice will be reasonable and that Member States will choose not to remain superequivalent to the future requirements when they come into force.

Part 2: Our response to your Conflict of Interest Draft Advice

In addition to what has already been said by various UK trade associations, we would like to make the following comments:

- In several instances, CESR's proposed advice reverses the burden of the proof and puts the onus on firms to demonstrate that they have not acted in breach of the regulatory requirements. We believe that this would impose additional costs on all firms while bringing no benefits at all. It is impractical to have to demonstrate that all appropriate measures have been taken to avoid conflict of interest and relatively easy to spot a failure or potential failure. Traditionally, the latter has been one of the main functions of regulatory authorities. Asking firms to do the former in addition to the regulator continuing to do the latter will not provide any observable benefits.

- In that context, the answer to question 6.1 has to be as follows:

    - We would view it as more sensible for the measures in paragraph 8 to be listed as examples rather than binding arrangements that firms have to implement "unless they can demonstrate that alternative arrangements are more effective". This solution would be more in-keeping with CESR's stated objective to provide a flexible framework.

    - No additional examples are needed but we suggest that a further bullet point (g) should make it clear that firms are free to implement alternative arrangements as and when such arrangements might be appropriate in the context of a firm's particular business operations. In order to achieve this, the mention of "any alternative arrangements relevant to the business" in a further bullet point should suffice. This answers question 6.1.

    - CESR providing a list of binding arrangements would be the worst-case scenario for a firm. A firm would then have to follow requirements that might not be appropriate to its business. On the other hand, it would bring no advantages from a firm's perspective as there would still be a risk

that while providing for all the items of the list, the firm could still be deemed non-compliant. In one word, such a provision would present both the disadvantages attached to a principle-based approach and those that normally come with inflexibility.

- In paragraph 16, we object to CESR preventing analysts from attending pitches and participating in roadshows without any limits to the scope of this prohibition. We believe that research analysts should not be active participants in deal specific roadshows, e.g. sitting on the stage with the investment banker and the company. However, we do not see that there would be any apparent conflict if the analyst was merely present, e.g. sitting in the audience. To prohibit a research analyst from passively attending a pitch would actually inhibit the him/her from actively performing his specified role which is to keep informed and research what is going on with companies that are contained in his coverage universe. This inhibition would be even more pronounced if the analyst were banned from attending no deal-specific roadshows. We request that you modify your guidance and state that passive attendance would be acceptable.

- With respect to question 6.3, we believe that it would be more appropriate to segregate analysts from certain areas of the firm as opposed to segregating them from the rest of the firm as a whole. In fact, we believe that some form of separation should be put in place as and when conflicts arise. As it is CESR's intention to provide a flexible and principle-based framework, it should be left to firms to make appropriate arrangements for themselves, according to their business activities. While there has been appropriate segregation between research and investment banking business in order to maintain high standards, we feel that there is no need for a similar segregation to exist between research on the one hand and sales and trading on the other hand. Overly segregating analysts from the business side makes the job of being an analyst less attractive. This is currently the case in the UK, as, following recent regulatory changes by the FSA, 13 of Barclays Capital's best analysts have chosen to leave research and move to another career within finance. We believe market mechanisms to be the best way to correct anomalies in most cases. Over time, firms producing truly independent research will retain their clients and attract new clients from competitors. If further segregation were needed to make research more independent, surely firms would provide for it of their own initiative for fear that they should lose all its clients to their competitors.

- As far as paragraph 17 is concerned, we prefer the second option: rather than making derogations to 16(f) prescriptive, it is better to state that a paper is not investment research. We disagree that we should have a list of items within the conflict management policy with which the firm does not comply. More generally requirements for further information to be provided to the client and to keep an intra-day record of all conflicts that might arise during the period are far too prescriptive and not asked for by our clients whose interests CESR proposes to serve. This is particularly true in our case, as we have professional clients, who are experienced users aware of the workings of investment banking. In its advice, CESR should allow for less stringent requirements to apply according to the nature of the counterparty.

Part 3: Our response to your Market transparency Draft Advice

CESR's intention is for pre- and post- transparency requirements to apply to equity markets only. We think it entirely appropriate to exclude other markets from the transparency requirements.

Article 65 says that the scope of application of transparency requirements should be reviewed after a certain period of time so they could be made applicable to all financial market rather than just to equity markets. That is why we would like to endorse explicitly several points that have already been put forward by trade associations.

It is clear that heavy disclosure requirements would be counterproductive as they would make the market illiquid. Hence it is important to focus on disclosing what is strictly necessary for the markets to function efficiently, on a "need to know" basis, and without forcing any information on to customers for whom this information would not be useful, e.g. those who do not access the market directly but, rather, access it via a broker. This would also help reduce the huge costs that systems changes always entail. Details on

these costs have been sent to CESR via responses from trade associations, to which we have contributed. We will not repeat them in the present response.

We hope that the above is useful and would welcome any enquiry on your part, on any or all subjects raised in our present response or on any other topic relating to CESR's advice on the Directive.

Yours sincerely

Marianne Selby Smith,
Compliance Manager