



December 17, 2004

Via CESR's website: www.cesr-eu.org

The Committee of European Securities Regulators
17 Place de la Bourse
75082 Paris Cedex 02
France

**Re: CESR's Advice on Possible Implementing Measures of the
Directive 2004/39/EC on Markets in Financial Instruments
Ref: CESR/04-603b (November 2004)**

Ladies and Gentlemen:

Bloomberg L.P. ("Bloomberg") and Bloomberg Tradebook Europe Limited ("Bloomberg Tradebook Europe") appreciate the opportunity to comment on CESR's second consultation regarding its advice to the E.U. Commission (the "Commission") on possible implementing measures of the Directive 2004/39/EC on Markets in Financial Instruments ("MiFID").¹

CESR's second consultation is further evidence of the soundness and practicability of the Lamfalussy Process. In keeping with the Lamfalussy Process, CESR has invited interested parties to comment, has carefully considered those comments and in doing so has initiated a dialogue with market participants that plays a central role in its deliberations. That in itself is a significant accomplishment for which we wish to congratulate CESR.

In our letter to CESR of September 16, 2004, we responded to a wide range of questions in CESR's first consultation (CESR/04-261b). In response to this second consultation, we will confine our comments to (i) outsourcing of operational functions, (ii) criteria for determining liquidity, (iii) transaction reporting and (iv) the negative burden of proof. The comments we offer here are in addition to the ones we offered in September.

Outsourcing of Operational Functions. With respect to outsourcing, CESR supports parity with the UCITS Directive, but only with respect to the delegation of individual

¹ Ref: CESR/04-603b (November 2004).

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portfolio management. We are not sure we fully understand CESR's position regarding outsourcing of operational functions. CESR endorses the highest degree of convergence, where possible, with the work of the Committee of European Banking Supervisors ("CEBS") and other international forums on outsourcing, but CESR has not offered no further details on this important issue.

We note CESR's concern that investment firms not adversely affect either their regulatory responsibilities or their obligations to their clients in outsourcing operational functions. We think that concern may best be addressed, however, by requiring the outsourcing firm to (i) exercise due care in making the selection of a service provider, and (ii) monitor the service provider's conduct prudently.

We suggest, moreover, that CESR need not and should not promulgate detailed rules of the kind proposed in paragraph 9(a) through (g) in Box 3 of its first consultation. Several organizations currently are addressing issues arising from outsourcing. CESR pointed to the Consultation Paper on High Level Principles on Outsourcing issued by the Committee of European Banking Supervisors ("CEBS") on 30 April 2004.² In addition to that paper, there is a consultation paper by the International Organization of Securities Commissions ("IOSCO") issued in August 2004³ as well as outsourcing guidance to the financial sector issued on the same date by The Joint Forum.⁴

In view of these recent initiatives, investment firms may ultimately face several highly detailed and duplicative regulatory regimes. We commend CESR for its recommendation in the second consultation that the highest degree of convergence should be ensured, where possible, with works conducted by CEBS and other international forums for outsourcing. We note that CESR's recommendation leaves open the scope and detail of regulation that may yet be imposed upon the outsourcing of operational functions. We would respectfully recommend that CESR defer to Level 3 further consideration of detailed rules only after considering and harmonizing duplicative standards and recommendations already in place or soon to be adopted.

² See CEBS CP 02 April 2004.

³ See *Principles on Outsourcing of Financial Services for Market Intermediaries — A Consultation Report of the International Organization of Securities Commissions Standing Committee on Market Intermediaries* (August 2004), available at: <http://www.iosco.org>.

⁴ See *The Joint Forum — Outsourcing in Financial Services* (2 August 2004). The Joint Forum includes the Basel Committee on Banking Supervision, the International Organization of Securities Commissions ("IOSCO") and the International Association of Insurance Supervisors. The Joint Forum developed its principles in conjunction with the work of the IOSCO Technical Committee.

If CESR nevertheless advises the Commission to adopt the draft implementing measures in paragraph 9(a) through (g) contained in Box 3 of the first consultation, we respectfully suggest that those measures should be prospective only. This area of regulation is quite complex. A large number of investment firms are conducting business in reliance upon existing outsourcing arrangements. In view of those factors, we believe CESR should grandfather existing outsourcing arrangements so that the firms having such arrangements would not have to reconfigure them in light of any new standards.

Criteria for Determining Liquidity. In the second consultation, we believe CESR has struck a sensible balance between using liquidity proxies and, where the proxy approach proves inaccurate or no longer valid, applying an alternative approach based upon the computation of volume (number of shares traded in a defined period of time) and/or turnover (volume times the price per share) for each individual financial instrument concerned. CESR also proposes to extend this process to shares of IPOs.

At CESR's open hearing of November 19, 2004 on its second consultation, commenters raised concerns about the application of liquidity measures to companies making initial public offerings. It was aptly stated that there should be no gap between the initial public offering of a security and the time when reliable secondary market data becomes available. We note that CESR has proposed, for IPOs taking place in more than one Member State, for the competent authorities of the Member States concerned to come to a mutual agreement as to which of them should be considered the competent authority of the most relevant market in terms of liquidity for an initial period of time.

We are concerned that CESR's proposed solution would, among other things, require a mechanism for resolving disputes and might well not avoid delay in providing transparency for trades in the secondary market immediately arising after the IPO. Particularly in light of the need stressed at the November hearing to avoid such delays, we would suggest that consideration be given to imposing instead a predictive, mathematical standard based on such factors as the total market capitalization of the issuer, valued at the IPO price, and, if a more refined standard is thought desirable, the particular industry or industries in which the issuer is engaged. For example, if the issuer will have a market capitalization of € 100 million, the liquidity measure might be based on the standards that apply to other issuers of like capitalization or, possibly, a subset of such issuers in the same or similar industries. The use of presumptive measures such as should avoid delays in providing for secondary market transparency and would, we expect, be basically even-handed and predictable.

We note that CESR recommends that there be no public identification either of the most relevant markets in terms of liquidity or the competent authority of those markets for a specific financial instrument. CESR states its proposed prohibition is necessary to avoid interfering with competition between markets and to avoid an unwanted impact on the securities industry. It is not clear to us, however, how public dissemination of this information would be harmful to the securities markets. Certainly, to the extent this information is useful

or otherwise valuable to market participants, it will find its way to the market and we believe it should be allowed to do so.

Reporting Transactions. We believe the primary consideration applicable to the reporting of transactions should be transparency — ready access to the transactional data from all market centers that is essential for making investment decisions. Transparency and accessibility of pre- and post-trade data are the cornerstones of MiFID. With this in mind, it seems to us the key question is: can the last-sale data required by MiFID be gathered and disseminated in a cost-effective way from its various sources to make it profitable for data vendors such as Bloomberg to form a unified data stream, including consolidated data, that would support effective transparency across all market centers?

If data vendors cannot gather, consolidate and disseminate last-sale data as a cost-effective and profitable undertaking, CESR may have to consider authorizing the establishment of a central utility to assume this vital function. In our view, the experience in the United States, where the use of a central consolidator has led to high cost without commensurate benefits — argues against this alternative.⁵ If data vendors are to be the principal aggregators under MiFID, data must be accessible and in a standard protocol.

For data to be accessible it must be competitively priced. MiFID permits investment firms to sell the data they are required to provide to the competent authority either

⁵ In fact, the U.S. Senate Committee that developed the U.S. national market system amendments to the Securities Exchange Act of 1934 aptly warned in 1975 against the risk of having data consolidation be delegated to a monopolist and stressed that if a monopoly consolidation model were to prevail, strict control over the fairness and impartiality of its operation and over its pricing would be essential:

The Committee believes that if economics and sound regulation dictate the establishment of an exclusive central processor for the composite tape or any other element of the national market system, provision must be made to insure that this central processor is not under the control or domination of any particular market center. Any exclusive processor is, in effect, a public utility, and thus it must function in a manner which is absolutely neutral with respect to all market centers, all market makers, and all private firms. Although the existence of a monopolistic processing facility does not necessarily raise antitrust problems, serious antitrust questions would be posed if access to this facility and its services were not available on reasonable and nondiscriminatory terms to all in the trade or if its charges were not reasonable. Therefore, in order to foster efficient market development and operation and to provide a first line of defense against anti-competitive practices, Sections 11A(b) and (c)(1) would grant the SEC broad powers over any exclusive processor and impose on that agency a responsibility to assure the processor's neutrality and the reasonableness of its charges in practice as well as in concept.

Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs to Accompany S.249, S. Rep. No. 94-75, 94th Cong., 1st Sess. 11-12 (1975).

directly or through reporting entities. Data vendors that wish to consolidate and disseminate data will purchase it from investment firms, market centers and reporting entities. If the cost of data to vendors is high, it will be reflected in the cost to investors. If the cost of essential market data becomes unduly expensive for investors, the result would be to frustrate the fundamental goals of accessible and affordable market data. We respectfully suggest that CESR take steps at Level 2 to ensure that the prices charged for market data not operate to inhibit access by investors and vendors seeking to consolidate data. In addition, we believe it would be appropriate for CESR at Level 2 to recommend to the Commission measures to ensure against exclusive data distribution contracts and other schemes or arrangements whose terms and conditions would stifle competition and innovation in the provision of market data and work to frustrate the goals of MiFID by unduly limiting access to and/or distribution of transaction data.

The second essential condition for encouraging data vendors to act as aggregators of market data is the establishment of a standard protocol. We respectfully suggest that the principal objective, ready and affordable access to data from all market centers, implies a need for uniform standards of minimum content for transaction reports applicable across all market centers in all Member States and a common formatting protocol for the data. In the second consultation, CESR proposes a set of general minimum conditions for reporting transaction data. The conditions identified by CESR provide a useful foundation. We are concerned, however, that the lack of a common protocol, or at a least a commitment to move toward one within a clear timeframe, may prove an insurmountable barrier to the cost-effective consolidation and dissemination of last-sale data. In addition, we note that CESR reports that the possible convergence between national reporting systems is a medium-to-long-term objective. We respectfully suggest that the objective should be viewed as more pressing than that.

We understand CESR's deference to existing arrangements for transaction reporting and the desire to avoid requirements that would involve radical and costly changes to existing arrangements. We nevertheless recommend that CESR consider taking a more affirmative hand in fostering and establishing the conditions necessary for effective consolidation and dissemination of last-sale data. In this regard, we recommend that CESR consider appointing an expert group to study the possibility for future convergence at the E.U. level among the reporting systems of all the Member States. Currently, a number of protocols are supported in the marketplace inside and outside the European Union; it would be useful to settle on a single protocol for all E.U. markets. Convergence would involve expense and some complex logistics, but those disadvantages would be far outweighed by the advantages. Convergence not only would enhance the regulatory function, but also would further unify the securities markets by increasing transparency. That would in turn guard against the fragmentation that was feared to result from the movement away from concentration requirements. CESR also can pursue further initiatives at Level 3.

Where there might be divergence among regulators in implementing standards and discrepancies in their application, we think CESR would be uniquely situated to establish an ombudsman to resolve such differences. More immediately, however, we respectfully

recommend that CESR take affirmative steps to advance the development of a common reporting protocol, which would facilitate effective consolidation of the data and advance significantly the overall goal of pre-trade and post-trade transparency.

The Negative Burden of Proof. CESR states that its proposal with respect to record keeping does not intend to reverse the burden of proof but, rather, to introduce obligations of record keeping. We wish to express our unqualified support for CESR's decision not to reverse the burden of proof. As we noted in our September 16 letter, neither the Level 1 principles of the MiFID Directive nor the Commission's mandates for Article 13(6) provide any authority for reversing the burden of proof. Nor should the fact that the reversal of the burden of proof is contained in CESR Standard 10 be construed as authority for the proposal.⁶ We think CESR correctly concluded that the record-keeping obligations of investment firms under MiFID can be monitored with adequate and consistent audit trails.

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In closing, we wish to reiterate our support for the Lamfalussy process and CESR's procedures for facilitating participation by interested parties in the Level 2 process. We hope our responses to CESR's second consultation prove useful in its deliberations. If you should have any questions or would like additional information, please let me know.

Respectfully submitted,

Alexander Clode by R.D.B.

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⁶ See *A European Regime of Investor Protection — The Harmonization of Conduct of Business Rules* (Ref: CESR/01-014d, April 2002), Section 1.3, Compliance and Code of Conduct, Standard 10.