



**PROVISIONAL MANDATE TO CESR FOR TECHNICAL ADVICE ON POSSIBLE
IMPLEMENTING MEASURES CONCERNING THE FUTURE DIRECTIVE ON
FINANCIAL INSTRUMENTS MARKETS**

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1. Introduction

1.1 The Futures and Options Association (FOA) is the industry association for some 160 firms and institutions which engage in the carrying on of derivatives business, particularly in relation to exchange-traded transactions, and whose membership includes banks, brokerage houses and other financial institutions, commodity trade houses, power and energy companies, exchanges and clearing houses, as well as a number of firms and organisations supplying services into the futures and options sector (see Appendix 1).

1.2 The FOA supports the joint industry response submitted to CESR on behalf of a number of trade associations.

1.3 The purpose of this paper is to highlight the importance of the need for CESR:

- (a) to differentiate, wherever appropriate and proportionate, between different classes of products and institutions to give effect to the “key objectives” mandated by the Commission and set out in para 2.3, particularly in relation to commodity derivatives business;
- (b) to give full effect to the Lamfalussy principles of good regulation (of which this consultation is a part) and the need for proportionality in the regulation of special commodity dealers as reflected in and which motivated the incorporation of the review provisions of Article 60 in the Financial Instruments Markets Directive;
- (c) to avoid unnecessarily proscriptive or excessively detailed technical advice;
- (d) to exercise its discretion (where it is empowered to do so) on the basis of whether technical advice is actually necessary and, if it believes that it is necessary, whether that discretion is best exercised in Level Two or in the context of the development of pan-EU regulatory standards/rules in Level Three.

The FOA makes these points because there are no specific references to the underlying need for *proportionality/differentiation* in either the Principles in para 2.1 (apart from a general reference to the Lamfalussy Report) or the objectives set out in para 2.3. On the other hand, consultation is rightly mentioned in some detail in para 2.2. This appears to be a disproportionate approach which underpins the perception that, despite the balanced policy “sound bites”, there is an in-built prejudice against sectoral differentiation in regulation, even where justified.

1.4 The FOA is mindful of the Commission’s recognition in the fifth indent of para 2.1 that CESR “will determine its own working methods”, but notes the emphasis on the creation of “expert groups” and, in the context of this notation by the

Commission, believes that CESR should establish an expert commodity group or sub-group for the purposes of:

- (a) monitoring and measuring the delivery of proportionality of its regulatory approach to commodity derivatives business at both Levels Two and Three;
- (b) securing technical input into its deliberations and decisions in an area of financial services activity which is of key importance to member states, but in respect of which there is, within financial service competent authorities, relatively little knowledge and experience;
- (c) ensuring that a regulatory framework designed principally for banking and securities business goes with the grain of commercial efficiency and will not needlessly obstruct the competitiveness of organisations whose core business is not financial services business or investment business but in commerce.

- 1.5 As a last general comment, the FOA would urge CESR to review current regulatory practice in this area and seek input from the EU's commodity markets and participants before "shoehorning" commodity markets and participants into existing financial services regulation.

2. Specific comments on areas in which CESR's technical advice is sought

Article 13: organisational requirements

- 2.1 The FOA would emphasise the Commission's advice that these obligations "shall apply" in an appropriate and proportionate manner, taking into account the various risks inherent to the different services or activities, to all types of investment firms. CESR advice should be proportionate ... (and) avoid excessive detail".

This requirement to be proportionate, in the view of the FOA, should take into full account the fact that organisations engaged in commodity derivatives business are usually engaged also in non-investment services business (which is often at the core of their business activities), their client base consists largely of commercial and industrial companies and that commodity derivatives, unlike other financial instruments within the scope of the Directive, are based on an underlying product which is not itself a regulated financial instrument. This means that, in some respects, "what is appropriate in terms of a firm's organisational requirements" for international investment banks may not be appropriate for commodity organisations engaged in financial services business which are either already caught within the scope of the Directive or may be caught on the expiry of the exemption for specialist commodity dealers.

- 2.2 In setting requirements for the protection of clients' financial instruments and funds, full account should be taken of the Recitals as well as of Article 13(8) and (9) when defining client funds and accommodating "different arrangements and internal controls" (para 3.25).

More specifically, the FOA does not believe that implementation measures need to be introduced in this area aside, for example, from securing a commonality in approach towards the disclosure of information to ensure that customer consents are informed and based on a consistency of information across the EU.

Article 3.3: conduct of business obligations

- 2.3 A risk-based approach to business conduct regulation cannot be achieved without a proper understanding of the services being offered to customers, the integrated nature of commodity dealings, the underlying commercial activities and the expertise of the commodity dealing commercial and professional customer base. That is not to say that many of the high level overarching provisions would not be relevant (e.g. client communications to be “fair, clear and not misleading” or the need to give to appropriate information to customers or the maintenance of records, etc.), but the more detailed these requirements become, the greater the regulatory due diligence to ensure that they are not inappropriate or disproportionate for such differentiated forms of business and organisations.

In this context, any technical advice offered by CESR should not, in any event, impose a greater regulatory cost burden or a fundamentally differentiated regime from the overarching EU business conduct standards developed by FESCO, save where mandated by the Directive or justified by the need for proportionality.

Article 3.4: best execution

- 2.4 The FOA has no particular reservations over the criteria envisaged by these provisions, providing full account is taken of the difference between retail and professional clients and to the factors set out in para 3.4.1 in determining what is “best”.
- 2.5 FOA would emphasise the fundamental importance of taking full account of the cost implications for firms if they are to be required to provide excessively detailed information to clients or potential clients or to take into account overly proscriptive factors when reviewing their execution arrangements. Indeed, if the detail to be provided to customers is excessively onerous, the information is unlikely to be even ready by them. Bearing in mind the current plethora of execution venues and the need to develop an appropriate and proportionate burden of due diligence, the use of the words “the best possible result” sets an unreasonable standard and imposes an excessive cost which, at the end of the day, will be borne by consumers.

Para 3.7: transparency obligations

- 2.6 The FOA is concerned that the overarching factors set out in the opening paragraphs to 3.7 – while worthy objectives in their own right – attach no apparent importance to the need to maintain commercial confidentiality or the need for exceptions or the need to facilitate a different approach as between direct market participants and the public at large. While some recognition is given to the need for differentiation in the succeeding paragraphs, these additional factors are not of secondary importance and should be given equal place in the introductory paragraphs.

- 2.7 There is no recognition of the constraint that these provisions apply only to securities dealings and that the technical advice should be cast accordingly. If CESR is minded at any stage to consider the merits of whether or not to extend the proposed transparency obligations to commodity derivatives, it would be important to secure prior and informed market advice as to what level of transparency would be appropriate, bearing in mind the fundamental differences between securities and other regulated financial instruments and markets, particularly commodity markets.

Paras 3.9 and 3.10: obligations to co-operate in exchange information

- 2.8 No recognition in these obligations (or cross-references) is given to the importance of:
- (a) preserving, where appropriate, the confidentiality of commercially sensitive information;
 - (b) requiring competent authorities to be diligent in ensuring that any request for information is properly founded and justified and is not a “fishing expedition” or an abuse of power (e.g. where an enabled authority seeks the information in order to pass it to another authority for its own purposes); or
 - (c) the need for caution in the case of requests of information from competent authorities based in countries with a less than acceptable human rights record.