

20 September 2006

Dear Mr Demarigny

CESR work programme on MiFID Level 3 work

I am writing on behalf of the Futures and Options Association (FOA) by way of responding to CESR's recent consultation paper (CESR/26-413) on its proposed streams of MiFID Level 3 work.

1. In terms of commenting on CESR's overall approach and the scope of its work, we anticipate that CESR will:

(a) *Take into account the primacy of meeting the Commission's current timetable for transition/implementation and enable regulated firms to rely upon the Commission's commitment to provide them with a clear nine months to implement the new MiFID requirements*

- Member state governments, regulatory authorities and financial service sectors of each of the [30] member states face a significant burden in terms of cost, personnel and other resources in implementing a directive which will have not only a major impact on customer relations, market practice, internal structures, documentation and systems and technology – but achieving all these changes within what is generally accepted to be a very tight timetable.
- This means that, firstly, if the current timetable is to be met, all the “stakeholders” in the process of change must adopt and take all essential steps to enable others to adopt a highly disciplined approach in terms of focusing only on policies, requirements and processes which are necessary; and avoid any “nice to haves” which will divert resource, generate unnecessary debate or delay progress. These kind of regulatory “add-ons” can be addressed post-implementation. A classic example of this kind of problem has been generated by FSA's unfortunate, but well-meaning approach towards price benchmarking in dealer markets, which is now a matter of public record, but which caused a number of institutions to divert precious time and resource to addressing a proposal which was not a “necessary” implementation obligation.
- CESR will, I am sure, be very conscious of the potential impact that Level 3 measures could have on the timetable for transposition and that any significant embellishments/permissible variations to Level 1 and Level 2 could slow the process of transposition or obstruct the process of developing implementation-critical IT solutions. In this context, it is anticipated that a significant number of member states may not be able to fulfil the January deadline even on a “copy-out” approach. **For this reason, the FOA would argue strongly for a “minimal change” approach in Level 3.**

(b) *Allow the better regulation agenda/the Lamfalussy principles to fully inform its approach to Level 3*

- The FOA anticipates that CESR will adopt an approach to Level 3 which will be consistent with the principles of better regulation i.e. be motivated by the need for regulatory action to be justified by demonstrable market failure or evidenced deficiencies in investor protection standards, taking into account the impact of cost-benefit/market impact analysis (as well as the “necessary to implement” test). We also anticipate that CESR will pay full regard to the fact that Level 1 and Level 2 measures are “principles-based” in large part¹ and, consistent with the parameters set by the Commission in their previous mandates to CESR, seek to avoid undue regulatory intervention in the valid exercise of the commercial discretion of firms when it comes to selecting procedures and processes that are best suited to them and their customers and to the markets in which they trade in order to fulfil the regulatory objectives placed upon them.

The FOA believes that these principles and the need to focus on matters that are either mandated by the Commission or necessary to fulfil the objective of harmonised implementation, apply to each of the three categories of work and the “other issues” referred to in para 4 of CESR’s consultation paper. We would urge CESR therefore **to draw a firm line between discretionary and non-discretionary work in this context and carefully allocate its work programme along these lines.**

(c) *In ensuring even-handed and harmonised implementation of the MiFID requirements, will accommodate the need for critically important market and product sensitive differentiation*

There is a real risk that Level 3 harmonisation and the inevitable accompanying standardisation of requirements and rules could result in a significant loss of flexibility which is critically important to firms dealing across a variety of diverse markets and financial instruments. The FOA would urge CESR, in looking to deliver harmonised regulatory requirements across the EU – a critically important part of establishing an efficient single market for financial services, to take fully into account the need for market sensitivity and to preserve the discretion given to firms to develop appropriate processes and procedures to accommodate that flexibility (and therefore more efficiently meet the needs of their clients/customers) for delivering on the required regulatory obligations. In other words, there may be circumstances where an individual member state is looking to impose an unnecessarily restrictive or market insensitive approach in a given area of implementation. In such circumstances, the FOA would hope that CESR would harmonise the requirements on the basis of enhancing flexibility rather than restricting it.

(d) *In determining and prioritising the proposed work programme, will take into full account whether or not there has been demonstrable market*

¹ Reflecting a speech made by Charlie McCreevy, European Commissioner for Internal Markets and Services in Dublin at the end of June in which he said “The rules we have developed are principles-based – not a box-ticking exercise. They put the onus on firms to behave, on regulators to supervise and act – always – in the best interests of their clients ... This means that national supervisors will be required to cut back any rules that go beyond the MiFID, unless they can be rigorously justified in terms of consumer protection or market integrity”

or regulatory failure, failures in appropriate investor protection requirements and whether any proposed changes are properly justified by market impact/cost benefit analysis

- (e) *Take into account the impact on firms' resources and the cost implications of a stream of regulatory change post-transposition and, in this context, it is noted that a significant amount of work is scheduled to take place in 2007, some of which may cause firms to, in effect, recalibrate the implementation steps, processes and actions already put in place in order to come into compliance with the new requirements before November.*

2. In terms of specific comments on the work programme, the FOA supports the joint response sent by LIBA, but would make the following additional comments which are restricted to those areas that fall within its remit as a trade association:

(i) Work in connection with upcoming Commission report

In general terms, the FOA supports the proposed timetable, subject to the following observations:

Capital requirements for commodity firms/Appropriateness of the exemption under Article 2.1(k) and (i)

The FOA supports the need for this work to be done and, while it recognises that this will be the likely timing, would urge, where possible, the work to accelerate and be combined with work on the business conduct regulation of specialist commodity dealers. The overall timing should pay regard to the long lead times necessary to introduce, as appropriate, new EU legislation to accommodate Level 1/Level 2 changes, that may result from the MiFID/CRD review.

Possible extension of the pre- and post-trade transparency obligations of the transactions in classes of financial instruments other than shares

The FOA believes that the Commission's current Call for Evidence on this issue will set the parameters for future work by CESR in this area and it is not anticipated that CESR will be intending to pre-exempt that process. While the FOA recognises that CESR's consultation paper is not seeking views on issues at this stage, but simply looking for comments on its proposed programme for work, the FOA would take the opportunity of reiterating the "better regulation" factors made at the beginning of this response, particularly with regard to CESR's consideration as to whether it is necessary to extend transparency requirements developed for share dealing to other markets.

(ii) Work in connection with other Level 3 committees (3L3)

Each of these areas of work and the accompanying timetables are supported.

(iii) Other areas of work

In our view, the "better regulation" agenda has particular application in the context of these proposed additional areas of work and, in each

case, each such area of work should be subject to careful analysis to ensure that they actually need to be taken forward and, to the extent that they are, the process and the result are in compliance with the “better regulation” principles.

Aspects related to functioning of the passport of investment firms in regulated markets

The FOA believes that:

- (a) legal certainty in this area is critically important in terms of credible and safe implementation of the single market in financial services; and to delivery of the forward strategic planning and position of EU financial institutions post-MiFID; and
- (b) work in this area should commence therefore as soon as possible, bearing in mind particularly the confusion surrounding the regulatory treatment of branch business and the legal uncertainty and possible competition problems that may be generated by staggered implementation.

Best Execution

CESR will be all too familiar with the industry furore that was generated by the FSA's DP on price benchmarking in dealer markets, which demonstrated the critical importance of maintaining a flexible market approach and observance of the principles-based approach towards factor selection in professional markets that is accommodated in MiFID Level 1 and Level 2. For this reason, while the FOA recognises the importance of developing “convergent views regarding application of Best Execution requirements to non-equity markets, that process of convergence must accommodate the effective exercise of firms discretion (and avoid constraining acceptable market practices) in measuring the quality of execution in such markets. For this reason, the FOA believes that any work in this area should focus on harmonising across member states a market / product sensitive approach to measuring Best Execution.

In summary, the FOA hopes that CESR's work programme for Level 3 will be motivated and informed by the timetable pressures faced by member states and regulated firms, the better regulation agenda and the need to balance regulatory harmonisation with product differentiation.

If you would like to discuss this response further, please do not hesitate to give me a call.

Regards
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