# CESR MARKET ABUSE MANDATE:
# A Second Call for Evidence

**A Response by the FOA**

**March 2003**

(I\sally\Papers-completed\ CESR Market Abuse Mar 03)

# CESR MARKET ABUSE MANDATE:
# A Second Call for Evidence

## 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, supplying services into the futures and options sector (see Appendix 1).

1.2 The FOA welcomes being given this early opportunity to contribute to CESR's response to this second Mandate in the matter of market abuse, but would emphasise that, while the directive covers commodity derivatives, the definition of "regulated market" will not include commodity derivative exchanges until such time as the Investment Services Directive is implemented (assuming that it will continue to cover commodity derivatives as anticipated). Accordingly, the FOA would urge CESR to take full account of this fact in setting its timetable and priorities for addressing this and other issues.

1.3 In considering its approach to this Mandate, the FOA would urge CESR:

- To develop high-level, broad-based principles/criteria which give full recognition to the fact that trading/market practices in commodity derivatives are, for reasons of commercial necessity, different to those that prevail in the trading of financial instruments. The fact that there may be certain elements of commonality in the type of venue or in some of the methodologies do not, in themselves, justify inappropriate harmonisation which could be damaging to markets, products and/or participants
- To give full recognition to the fact that the products underlying commodity derivatives vary enormously ranging from "soft commodity"/farming products (e.g. crops, livestock) to base metals, power and energy products, each of which (and the practices by which they are traded) are fundamentally differentiated (e.g. degrees of volatility, perishability and settlement practices)
- To encourage/prioritise flexibility to facilitate a common approach by similar markets across member states (e.g. power) rather than by a single member state across its differentiated markets (e.g. all forms of commodity markets).

1.4 In view of para 1.3, the FOA would urge the CESR to adopt a "bottom up" rather than a "top-down" approach by reviewing a broad cross-section of products/markets/trading practices which are generally deemed by markets and their participants to be "acceptable" and then (b) developing principles and criteria for determining what would be an "accepted market practice" which would be sufficiently flexible to allow continuance of those practices i.e. to measure the need for flexibility in a practical way to ensure that there are no inadvertent consequences or unnecessary harmonisation which could be damaging to EU commodity markets and their users. The same approach should apply to addressing the issue of "inside information".

1.5 The FOA believes that it would be helpful to CESR to establish two separate practitioner working parties (bearing in mind that, understandably, there is not the same degree of knowledge about commodity products as there is about financial products in many competent authorities in the EU) comprising:

- senior representatives of EU regulated markets representing a cross-section of commodity products; and
- senior representatives from market participants <u>and</u> end users) who could also address dealing practise in OCT commodity derivatives)

Such working parties could be extremely useful in providing technical assistance to CESR in bringing forward its proposals (but recognising that the actual response to the mandate is a matter for CESR in the final analysis).

1.6 The FOA believes that such a practical approach to developing its response would:

(a) underpin CESR's commitment to the Lamfalussy principles of consultation, regulatory proportionality, and appropriate differentiation (and its oft-expressed view that a "one size fits all" is inappropriate).

(b) demonstrate the Commission's commitment to the importance of maintaining the EU international competitiveness of its markets, organisations and companies and avoiding an unnatural regulatory result which could place them at a significant disadvantage with third country organisations which may not be the subject of what may transpire to be disproportionate regulation.

1.7 For the avoidance of doubt, the FOA strongly supports the accepted principle of a defence based on the legitimacy of market dealings and the need for a clear interface between that principle and the criteria for what constitutes an "accepted market practice" on a particular regulated market.

1.8 In line with the principles set out in Para.1.3 of this response, as can be anticipated, the FOA does not believe that Level 2 should comprise a list of particular "accepted market practices" because:

- what is "accepted" in a particular market will vary as markets and products develop and change;
- many forms of "accepted market practice" may not be generated by rules, but are found in market usage, particularly in the context of OTC markets, and may, as a result, be overlooked (and the validity of them put therefore in jeopardy);
- new markets (e.g. some of the some of the new EU power markets) will be developing new "accepted market practices" which may not be reflected in the Level 2 requirements;
- the actual analysis and application of whether or not a market practice is "acceptable" depends upon the particular circumstances of individual cases.

## *Appendix 1*

# FOA MEMBERS

### FINANCIAL INSTITUTIONS

Abbey National Treasury Services Plc
ABN AMRO Futures Ltd
ADM Investor Services International Ltd
AMT Futures Ltd
Banc of America Futures, Inc.
Banca d'Intermediazione Mobiliare IMI Spa
Bankgesellschaft Berlin AG
Barclays Capital
Bear Stearns International Ltd
BNP Paribas Commodity Futures Ltd
Caboto IntesaBci Sim S.p.A London Branch
Cantor Fitzgerald International
Cargill Investor Services Ltd
Carr Futures Inc.
Charles Schwab Europe
City Index Ltd
CMC Group Plc
Commerzbank AG
Credit Lyonnais Rouse Ltd
Credit Suisse First Boston (Europe) Ltd
Cube Financial Limited
Daiwa Securities SMBC Europe Ltd
Deutsche Bank AG
Dresdner Kleinwort Wasserstein
Easy2Trade Direct Ltd
FIMAT International Banque SA
Fortis Clearing London Ltd
Gen Re Securities Ltd
GNI Ltd
Goldman Sachs International
Greenwich Europe Ltd
Gulf International Bank (UK) Ltd
Halewood International Futures Ltd
HBOS Treasury Services Plc
HSBC Bank Plc
IFX Markets Ltd
IG Index Plc
Investec Bank (UK) Ltd
JLT Risk Solutions Ltd
JP Morgan Securities Ltd
Lehman Brothers International (Europe)
Macquarie Bank Ltd
Man Financial
Merrill Lynch Pierce Fenner & Smith (B&D) Ltd
Monument Securities Ltd
Morgan Stanley & Co International Ltd
Mizuho Securities USA, Inc.
Nomura International Plc
Prudential-Bache International Ltd
Rabobank International
RBS Greenwich Futures

Refco Overseas Ltd
S E B Futures
Schroder Salomon Smith Barney
SG London
Standard Bank London Ltd
The Bank of Nova Scotia
Tokyo-Mitsubishi International Plc
Tullett Liberty (Securities) Ltd
UBS Warburg LLC
Wachovia Securities International Ltd
Westdeutsche Landesbank Girozentrale

## EXCHANGE/CLEARING HOUSES

Automated Power Exchange UK Ltd
Chicago Board of Trade
Chicago Mercantile Exchange
Eurex Frankfurt AG
Euronext
FINEX Europe
International Petroleum Exchange Ltd
ITG Europe
London Clearing House Ltd
New York Mercantile Exchange
OM London Exchange Ltd
Singapore Exchange Ltd
The South African Futures Exchange
The Tokyo International Financial Futures Exchange

## SPECIALIST COMMODITY HOUSES

Amalgamated Metal Trading Ltd
Engelhard International Ltd
Koch Metals Trading Ltd
Manro Haydan Group
Metdist Trading Ltd
Mitsui Bussan Commodities Limited
Natexis Metals Ltd
Phibro GMBH
Sempra Metals Ltd
Sucden (UK) Ltd
Toyota Tsusho Metals Ltd
Triland Metals Ltd
TRX Futures Ltd

## ENERGY COMPANIES

Accord Energy Ltd
AEP Energy Services Ltd
BNFL Magnox Generation
BP Oil International Ltd
British Energy Power and Energy Trading Ltd
Cinergy Global Trading Ltd
ConocoPhillips Company
Duke Energy International (Europe) Ltd
Entergy-Koch Trading Ltd
First Hydro Company
Innogy Plc
London Electricity Group
National Grid Company Plc

Powergen UK Plc
RWE Trading GMBH
Scottish Power Energy Trading Ltd
Shell International Trading & Shipping Co Ltd

## FUND MANAGERS

Close Fund Management
Deutsche Asset Management Ltd
M & G Investment Management Ltd

**PROFESSIONAL SERVICE COMPANIES**

Baker & McKenzie
Barlow Lyde & Gilbert
BDO Stoy Hayward
BPP Professional Education
Burr & Company
Cap Gemini Ernst Young UK Plc
Clifford Chance
CMS Cameron McKenna
Deloitte & Touche
Denton Wilde Sapte
DLA
Dewey Ballantine
EDS
Exchange Consulting Group Ltd
Exchange Systems Technology Ltd
FfastFill
Field Fisher Waterhouse
FOW Ltd
Freshfields Bruckhaus Deringer
Future Dynamics Ltd
Henry Davis York
International Securities Market Association
Katten Muchin Zavis Rosenman
KPMG
Landwell
Linklaters
Lovells
Norton Rose
Options Industry Council
Pekin & Pekin
Penna Consulting Plc
Reech Capital Plc
Richards Butler
Rolfe & Nolan Plc
Rostron Parry Ltd
Simmons & Simmons
SJ Berwin & Company
SunGard Futures Systems
Taylor Wessing
Thomson Financial
Travers Smith Braithwaite
Wilmer Cutler & Pickering
Wragge & Co