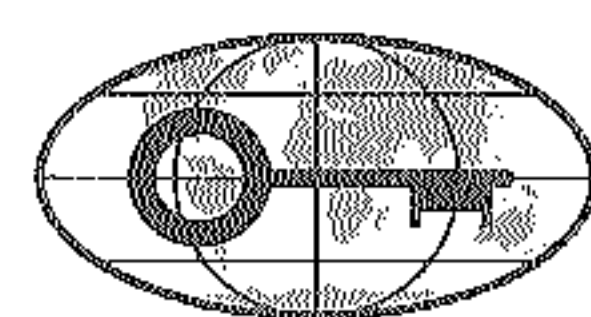




21<sup>st</sup> January 2005

Mr. Fabrice Demarigny  
Secretary General  
Committee of European Securities Regulators  
11-13 avenue de Friedland  
75008 Paris  
FRANCE

Dear Mr. Demarigny

**Response on the 2<sup>nd</sup> Set of Mandates relating to CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments**

The Tullett Liberty and Prebon group ("Tullett Liberty & Prebon") act as an interdealer broker arranging wholesale market trades, primarily in the international money, securities interest rate derivative and commodity markets either on a name give-up or matched principal basis. Tullett Liberty & Prebon entities in the UK are regulated by the Financial Services Authority ("FSA"), receiving and transmitting orders on behalf of or trading with global professional counterparties at mutually agreed prices in order to facilitate the execution of the trade by the clients. Our business is primarily arranging "Over-the-Counter" ("OTC") trades using various broking approaches and techniques as demanded by our clients including voice, a hybrid mixture of voice and automated trading system and MTF. We also arrange or enter into equity and some derivative trades on-exchange.

Our brokers and systems provide vital information, to wholesale market players, in the price formation process encouraging fairer prices, from liquid through to illiquid products, providing a truer reflection of supply and demand and help to reduce our clients' dealing costs. As "Wholesale Market Brokers" ("WMBs") we provide liquidity and increase transparency in the markets by using sophisticated and timely on-line price dissemination systems.

**We firmly believe that, in respect of many areas of the proposed Directive, a distinction should be clearly drawn between purely wholesale (professional) business and the retail markets.**

We would like to stress that all our wholesale market clients are professionals, dealing in the normal course of their business, either on a commercial or a financial basis. Our clients would not expect to be subjected to conduct of business protections that are designed to protect retail clients. They recognise that they are able to obtain keener prices, through WMBs, than would otherwise be available to retail clients or those with much higher credit risk. In name-passing trades, our clients are also aware that it is they who are responsible for both accepting the proposed counterparty to the trade and for executing the trade in accordance with their firm's own trading criteria. In matched principle transactions, Tullett Liberty & Prebon entities trade between market professionals so providing clients with anonymity thus enhancing liquidity.

The MiFID rules are focused on the retail sector and the provision of retail protections; we are particularly concerned that the rules are not easily adapted to, and are too prescriptive for, the workings of the pure wholesale markets. **In respect of Article 24, it is incongruous to allow eligible counterparties to seek the retail protections available within Articles 19, 21 and 22 when they are dealing in the purely wholesale inter-professional markets. Provided wholesale firms act in accordance with high-level regulatory principles, or general standards of inter-professional behaviour, there should be no need for detailed requirements.** It should also be fundamentally understood that, if a WMB firm or its brokers failed to observe the appropriate standards, wholesale clients would simply stop dealing with them and seek to conduct their business elsewhere.

We have doubts that the eligible counterparty proposals would be workable for the wholesale markets because of the need for a clear distinction between regulation of professional and retail investors. **The wholesale markets have no need for prescriptive rules to differentiate the provision of consumer protection. WMBs, for example, would not differentiate in their conduct of business; in providing a service to professional dealers; they do not, and should not, favour one client over another. The buyers and sellers in these markets would also be considered, by each other, as having the appropriate experience, expertise and knowledge to conduct trades on behalf of their respective companies.** Additionally, market practice determines that basic brokerage agreements between name-passing brokers and their clients are considered to be sufficient Terms of Business, so variation of terms for higher levels of protection would not apply (I refer Annex II). Terms of business are also issued for matched principal transactions.

**Wholesale businesses should not be burdened with a “paper chase” in order to establish or re-establish a classification for new and existing clients in what is essentially a “light-touch” regime.** The requirement to obtain “express confirmation” from eligible counterparties is completely inappropriate and impractical for the wholesale markets. Our firms should not be required to ‘repaper’ existing clients who have already been papered under the existing ISD. We believe that this process would have no added value to the services that we provide and will only act as a burden and could disrupt the efficient and effective working of the professional markets.

We would also question the degree of response we are likely to receive from such clients under Article 24(3) despite the Article 24(5) implementing measures. Would we be required to obtain a response from each branch of a bank that we might separately deal with? What if some branches wanted retail protections and others did not, how could we treat them differently? Is “express confirmation” received when brokerage is paid for arranging the trade but formal agreement is still not forthcoming? We feel that it would be a simpler arrangement to allow regulated firms to provide one-way notices, with appropriate risk warnings, to any new body corporate that is seeking to deal in the wholesale markets.

**CESR should consider the fact that firms that wish to conduct wholesale trades in the professional markets understand that such trades are dealt on a “caveat emptor” basis. Any undertakings that meet pre-determined proportionate requirements, including quantitative thresholds should be capable of being treated as both an “eligible counterparty” and a “professional client” ‘per se’. The quantitative thresholds should be consistently applied within other Member States to ensure that checks are not onerous.**

**Two-way client classification/acceptance is far too onerous in the “light-touch” wholesale markets. Existing customers should be “grandfathered” into the new regime and this should include client classification under Article 71(6). Client notification, in respect of any new wholesale market clients, should be provided by way of a one-way notice warning them of the caveat emptor nature of the markets and stating the regulatory protections that will be lost. We do not believe that this process would prejudice consumer protections.**

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Tullett Liberty & Prebon would now like to pass comment on CESR’s draft advice as invited. As our business is carried out with wholesale professionals, in the wholesale markets, we base our comments on the areas that affect us most, which are generally covered in Section II regarding Intermediaries. As wholesale professionals, we have only responded to questions that we feel will impact on the professional markets.

## **SECTION II - INTERMEDIARIES**

Q 1.1 *Do you agree that advice on services, such as recommendation to use a particular broker, fund manager or custodian, should not be covered? **Yes***

We believe that the definition of “investment advice” should only be applied to Article 4(1)(4) and that Article 19(4) is not intended to cover advice on the use of a “service”.

Q 1.3 *Do you think it is reasonable to restrict “investment advice” to recommendations of specific financial instruments or is it necessary to cover generic information including financial planning and asset allocation services for financial instruments? **Yes***

Investment advice should remain restricted to a recommendation on one or more specific financial instruments. Generic advice or opinion is information that is already in the public domain. Dealers sometimes ask WMBs to give such comment or express opinions on general activity in the markets in order to add further colour or flavour to current market conditions.

- Q 2.1 Should “commodities” for this purpose be limited to goods? **Yes**
- Q 2.2 Alternatively, should an approach be taken that permits rights or property specifically mentioned in C(10) and other intangibles to be treated as “commodities” as well? **Yes**

The rights and property covered by Section C (10) of Annex I of the Directive and other intangibles should, in addition to commodities, benefit from the ISD passport. For example, in meeting their commercial obligations, certain commodity producers or distributors may also be involved in hedging the related freight capacity through freight derivatives. For such reasons it would seem impractical for there to be differentiation within the ISD (and the ability to passport) between goods, rights or intangible rights/assets. Tullett Liberty & Prebon are witnessing new markets developing in these areas and limiting the definition of commodities will only serve to present EU commercial barriers to hedging trades.

- Q 2.3 Should derivative instruments based on telecommunications bandwidth be considered to be within the scope of the Directive? **Yes**
- Q 2.4 If it should be considered within the scope of the Directive, should it be considered to be within the scope of paragraph C(7) or of paragraph C(10) of Annex I? **Yes**

Prebon agree with CESR that telecommunication bandwidth should be included as a means of keeping the Directive up to date in order to take account of developments in the markets.

- Q 2.5 If the definition of “commodities” is restricted to goods, should a requirement be imposed that there must be a liquid market in the underlying? **No**
- Q 2.6 If not, should a requirement be imposed that, in addition to being capable of delivery, the underlying must be capable of being traded and if so, should there be a requirement for a liquid market? **No**

We do not believe that it is a necessary condition that there be a liquid market in the underlying or that the underlying should be capable of being traded (as opposed to being capable of being delivered).

- Q 2.7 Should there be an initial filter to exclude contracts, which are likely to be spot contracts? **Yes**  
If so, do you agree with the proposed approach of excluding contracts whose settlement period does not exceed the lesser of two business days and the generally accepted settlement period in the relevant market? **No**

We believe that spot transactions should not be treated as being covered by C(7) of Annex I

However, we do not agree with CESR’s proposed approach of excluding contracts where settlement periods do not exceed the lesser of two business days and the generally accepted settlement period in the relevant market. The criteria should be based on “spot delivery” in that particular market. i.e. the shortest practicable period for physical settlement that has been agreed and is accepted by market participants as market practice.

Trades conducted under the conditions would provide a primary filter in removing transactions that would not fall within section C of Annex I, because there is an intention to physically deliver the underlying.

- Q 2.8 Should the status of the parties to the contract only be relevant for determining whether the exemptions in Articles 2(1)(i) and (k) or should it also be taken into consideration as an indicative factor for determining whether there is a commodity derivative as opposed to a commercial contract for the supply of commodities?
- Q 2.9 Should commercial merchants be required to rely on the intention to deliver test or should the producer and user indicating factor apply to them as well? If so how can a commercial merchant be differentiated from a speculator?
- Q 2.10 Do you agree with an approach under which the status of the contract for both parties is based on a consideration of the status and/or intent of either of the parties?
- Q 2.11 If both elements of (2) are present should this be conclusive or indicative ? If indicative, if only one is present is that still an indicator?

It is for each counterparty to a contract to determine whether or not they require authorisation based on the Directive and the appropriate exemption criteria. However it would be indicative, for example, that a

producer would be subject to commercial considerations and that a bank would be entering a trade for financial reasons.

In the case of a WMB arranging a trade between counterparties, there is a need to know the intention of both counterparties to determine whether or not the trade falls within Annex I C7. Some of our clients would not appreciate questions from us related to their dealing motives. Consequently it may be difficult for us to demonstrate that their main business is dealing on own account in commodities and/or commodity derivatives in order that we can then treat their trades as exempt under Article 2(1)(l) and (k). We have also had conversations with certain commodity traders that indicate that some would not want to have to make an election, at the point of dealing, as to whether trades were conducted for commercial or investment purposes.

A WMB may arrange a physical forward sale and purchase trade but price change, or other circumstances, may determine that the producer (seller) and/or the consumer (buyer) must hedge out the trade during the day or at some later date. Although we had been involved in arranging the initial physical trade, it does not necessarily follow that we would be involved in the overall structured trade or any future or partial hedge of the physical trade and therefore should not be relied upon to distinguish between the two scenarios in such an instance.

Under current proposals, WMBs would not be comfortable that, for anything other than a spot physical transaction, the transaction has been conducted for commercial purposes or otherwise exempt from Annex I C7. As discussed in paragraph 5 of this response, there would be no practical differentiation in the way that a WMB would treat either the counterparties or the investment or non-investment trade for conduct of business purposes.

**Because WMBs may not be privy to the ultimate intentions of the counterparties we would, under current proposals, need to treat forward trades as covered under the Directive.**

Q 6.1 *Do Market Participants agree that the quantitative thresholds for undertakings to request treatment as eligible counterparties should be the same as the thresholds for professional clients? Yes*

We agree with CESR's proposal that there should be consistency across Member States in the criteria for defining the quantitative thresholds and that these should equate to the requirements within the Directive Annex II 1(2) definitions of the professional regime.

**We strongly believe that the quantitative thresholds should allow for the inclusion of companies that may be small but are specialised trading subsidiaries of large corporate structures.**

**The quantitative thresholds should also include provisions that would allow certain small independent professionals users to access the market.** Professional markets should be available to them when it is clear that such companies are operating in the course of their business, they have the appropriate knowledge and understanding of the risks, and the size and nature of the trade is commensurate with wholesale market trades. It would be for the other proposed party to the agreement to take steps to ensure that they have appropriately accounted for and can manage the credit risk.

We believe that it would be onerous for firms to be required to check on different quantitative thresholds within other Member States and suggest that the CESR response recommends that the same thresholds apply across the EU. Applying a further requirement to identify clients as professionals in the wholesale markets imposes a severe cost and compliance burden which is not commensurate to providing appropriate protections to retail clients.

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We hope that you find our comments useful and look forward to receiving feedback in due course.

Yours sincerely



Clifford Fry  
Compliance Officer