



The London Energy Brokers' Association

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

Dear Mr. Demarigny

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

About the London Energy Brokers' Association

The London Energy Brokers' Association, LEBA, is the industry association representing the wholesale market brokers in the over the counter, OTC, and the exchange traded UK and liberalised European energy markets. These brokers intermediate, and facilitate bilateral contracts to be concluded, between banks, trading houses, commercial enterprises, public utilities, and integrated energy businesses, providing liquidity and price discovery to these markets as well as contributing liquidity to European exchange traded markets. The major products that they deal in are crude oil and refined petroleum products, gas, and electricity.

Their activities assist the development of tradable markets to support liberalised markets in the underlying European physical energy markets. Their business models range from pure 'voice broking' via telephone, to managing fully electronic trading platforms, including the hybrid model combining both voice broking alongside an electronic system.

We welcome this opportunity to comment further upon CESR's second set of Mandates with regard to the Markets in Financial Instruments Directive, and are pleased to observe CESR's renewed determination to achieve genuine consultation

and dialogue with all market participants. Our members consider it imperative that European energy markets remain competitive and effective in the light of increased competition from North American and other jurisdictions, and thus contribute towards physical security of supply considerations. LEBA and member firms were pleased to attend the CESR public hearing in Paris, and to have participated in recent dialogues with the regulatory authorities. On this occasion, we limit our comments to Section I regarding definitions and to Section II regarding intermediaries.

General comments

1. The appropriate level of regulatory intervention to preserve competitive European financial markets

We believe that it is imperative that CESR, in drafting its advice to the Commission, continues to take into account the appropriate level of investor protection, and thus regulation required, that various market sectors and customers require. In particular, it should continue to consider the scope and level of regulation applied by key regulators in other major developed economies. Thus an illiquid market with a large retail client participation (such as the second and third tiers of many national European equity markets) would receive maximum regulatory oversight, including a preponderance of ‘conduct of business’ rules; whilst a hugely liquid wholesale market serving professional and institutional participants (such as the European, and indeed, global, markets in diesel or heating oil) would receive the minimum regulatory oversight with a focus on appropriate standards and norms.

2. Definition and scope of commodities

As CESR recognises, the accurate definition and scope of commodities and commodity derivatives is of vital importance to the development of pan European markets in commodities. WMBA supports in principle the pragmatic approach that CESR has taken to this issue.

We support the joint association paper on this topic submitted by the International Swaps and Derivatives Association, the Futures and Options Association, the European Federation of Energy Traders, Eurelectric, and the Wholesale Markets Brokers’ Association.

3. The differing regulatory requirements of wholesale and retail market participants

LEBA firms believe that it is imperative that, as increasingly taken on board by EU Member State regulators, that CESR, in preparing its advice to the Commission, is particularly mindful that **wholesale and retail market participants place considerably different values on the costs and benefits afforded to them by financial regulation.**

Retail customers do not possess similar knowledge and experience of the products and services offered by investment firms, as do the firms themselves, and thus rely on conduct of business rules enshrined in financial regulation for their protection. This enables that the contracts between firms and individuals can be considered as fair and reasonable: however this protection often comes at a price – many institutions will

charge retail clients more – either explicitly – or more likely bundled within their commission and / or their bid – offer spread, to help defray the costs of their order management systems, their credit risk, their compliance processes and systems and their increased administration. Additionally, these order management systems – designed to protect retail customers – often means that there is a time delay between the receipt and execution of retail business.

Wholesale market participants (both eligible counterparties and professional clients) have a similar degree of knowledge – at least in the products that they are trading – as their investment firm providers and thus do not need the level of protection naturally required by retail customers. They benefit from more timely execution and lower transactions costs: benefits which, as professional market participants, they value highly.

Wholesale market participants should therefore continue to have the ability to determine how they value the relative benefits of conduct of business protection, or more timely and cheaper execution, and thus decide whether they wish to avail themselves of all or part of relevant conduct of business type regulation as described in Articles 19 to 22, and Article 24.

We welcome CESR’s pragmatic approach to this issue as evidenced in the suitability criteria required to satisfy A19(4) – and recommend that wholesale market counterparties continue to be allowed the greatest flexibility possible to commercially determine the level of protection required. Empirical evidence suggests that wholesale market participants historically have tended to choose the benefits of immediate execution and smaller transactions costs.

In determining those clients and potential clients who can be considered as professional clients we recommend that appropriate qualitative tests be developed alongside the existing quantitative tests, which may discriminate against those firms – often smaller firms – who choose to finance their business through the increasing range of off balance sheet mechanisms such as leasing and invoice factoring.

4. A rigorous Cost Benefit Analysis is required

Given the substantial compliance costs – especially during the period leading up to, and shortly following implementation of, related to the Directive – and with the implementation of other Directives implemented under the Financial Services Action Plan, we strongly commend that all major areas of implementation are subject to rigorous cost benefit analysis.

In particular, the potential for a ‘paperchase’ with all wholesale investment firms ‘repapering’ all of their wholesale clients with new contracts and / or requests for counterparty classification **causes significant concerns for our member firms**: the potential scope for wide scale confusion and legal uncertainty post implementation where two way agreements are not returned could lead, potentially, to disorderly markets. Historically, empirical evidence from our wholesale member firms, suggests that many wholesale counterparties take a significant time, following due compliance and legal consideration, to return the required agreements.

5. Impact of MiFID upon other FSAP Directives

MiFID definitions, and the timing of their implementation, will impact upon other FSAP Directives, in particular the Market Abuse Directive (MAD) and the Capital Requirements Directive (CRD). We believe that in order to enable firms to successfully comply with the requirements of both MiFID and the CRD, that there continues to be strong co-ordination between the Expert and Consultative Working Groups considering both Directives. Of particular concern to wholesale energy market participants is the scope and interaction between MiFID and CRD.

6. Wholesale market information

Wholesale markets function efficiently by enabling factual information, technical analysis and market commentary “market colour” to be circulated and known by many participants to assist their knowledge and decision making. Common practice within the wholesale markets is that participants do not assume that this flow of information is investment advice, even when firms are asked to provide their interpretation of this information flow. When formulating its advice to the Commission, we strongly recommend that CESR takes this into account, so that wholesale practitioners remain able to provide this market colour without it being considered as investment advice.

7. Implementation timing

Whilst not a topic on which CESR is directly consulting, (other than in Annex 1), given the substantial legal and compliance processes which firms will need to follow in order to achieve satisfactory compliance with the Directive; and the extensive nature and thus the industry resources required for the associated IT systems development and ‘roll out’; we support the dialogue between the European Securities Committee and the Commission to determine if further resources (in particular, time) are warranted for both transposition and / or implementation of the Directive. In the event that the implementation date is extended, we would ask that – in order to allow firms to complete their systems enhancement – that as much time as possible is allocated to implementation rather than transposition.

Specific Comments

Please find below, our responses to the specific questions posed in the consultation paper:-

Question 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.

Question 1.2

Do you agree with the approach that a personal recommendation has to be held out as being suited to, or based on a consideration of, the client's personal situation or do you consider this criterion to be unnecessary or ambiguous and would like to refer to the bilateral nature of the relationships and bilateral contacts between the firm and its clients?

We believe this question should be considered as relevant to retail share dealing.

However, we believe that it is the bilateral commercial contract between the firm and the client which should be considered.

In the latter case which criteria would you use to differentiate between a "personal recommendation" and a "general recommendation" or a "marketing communication"?

We believe this question should be considered as relevant to retail share dealing.

A marketing communication contains factual information, on products and services.

A general recommendation provides specific and timely information on financial instruments, without specifically considering the recipients' personal circumstances. A personal recommendation provides specific and timely information on financial instruments, and recommends actions taking into account the recipient's personal circumstances.

Question 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?

Investment advice should be restricted to recommendations of specific financial instruments.

With regard to the definition of financial instruments relating to commodities – and the response to questions 2.1 to 2.11, the Wholesale Markets Brokers' Association, supports the joint association paper submitted by the International Swaps and Derivatives Association, the Futures and Options Association, the European Federation of Energy Traders, Eurelectric, and the Wholesale Markets Brokers' Association.

Question 2.1.

Should "commodities" for this purpose be limited to goods?

Question 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?

We support the comments contained in the above joint paper, but with regard to questions 2.1 and 2.2 specifically:-

Yes, we agree that 'commodities' for these purposes can be limited to goods, providing that:

- (i) the measures implementing paragraph C(10) make clear that the physically-settled transactions in other intangible deliverables are (as in paragraph C(7)) only treated as financial instruments where they are not for commercial purposes and otherwise have the characteristics of derivative financial instruments;
- (ii) for the reasons mentioned in CESR's consultation paper, that electricity is included;
- (iii) the measures implementing C(10) include open-ended categories capable of covering unspecified intangible deliverables and other derivatives.

Question 2.3.

Should derivative instruments based on telecommunications bandwidth be considered to be within the scope of the Directive?

Question 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?

We believe that derivatives on telecommunications bandwidth should be considered to be within the scope of the Directive and, on the basis set out above, under paragraph C(10) of Annex 1

Question 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?

Question 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?

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

Question 2.7.

Should there be an initial filter to exclude contracts which are likely to be spot contracts? 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?

We agree with CESR that physical spot transactions should be treated as not being covered by paragraph C(7).

In principle, spot contracts do not fall within the description of "options, futures,

swaps, forwards and any other derivative contract", for the reasons set out in CESR's discussion of the meaning of derivative contract.

However, we do not agree with CESR's proposal to limit the exclusion for spot contracts to contracts whose settlement period does not exceed the lesser of two business days and the generally accepted settlement period in the relevant market.

In our view, the advice should instead refer to the longer of those two periods. This recognises that, in line with CESR's discussion of the meaning of derivative contract, the directive is drawing a distinction between the primary cash markets for commodities and their derivative markets. The fact that the minimum delivery period varies from market to market is merely a reflection of the diversity of markets and their differing settlement characteristics, often based upon technical factors in the underlying physical markets, such as how long it takes for a physical cargo to reach its destination. CESR should not arbitrarily impose criteria appropriate for the foreign exchange market on other markets with different settlement practices.

Question 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?

We consider that the nature of a party's business should be taken into account as an indicative factor when determining whether a contract falls within paragraph C(7). It is clearly highly relevant to the issue of whether or not the transaction has a commercial purpose. However, again, it is essential that a party to a contract can assess whether it needs authorisation or not by reference to its own status (and intentions), regardless of the status (or intentions) of the other party.

Question 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?

We believe that commercial merchants should be able to rely on the fact that they intend to make or take physical delivery.

Question 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?

Yes, we believe that the status of the contract for a party should be based on a consideration of the status and /or intention of that party.

Question 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 ?

If both 3(a) and (b) – from BOX 3 – are included, we believe that this should be conclusive.

Question 3.1.

Do you agree with the proposals on portfolio management? Should any other issues be addressed under Article 19(1)?

WMBA readily agrees that when providing investment services to clients that firms should act honestly, fairly and professionally.

We agree with CESR that with regard to portfolio management, that any further implementing measures should only apply to retail investors.

We believe that eligible counterparties and professional clients possess knowledge, experience, commercial negotiating resources and competing investment service providers such that they should not be required to pay for the additional protections offered to retail clients in paragraphs 2 to 8, as referenced in Article 19(1).

Question 4.1

Do market participants think that adequate investment advice or portfolio management service is still possible on the basis of the assumption that the client has no knowledge and experience, the assets provided by the client are his only liquid assets and/or the financial instruments envisaged have the lowest level of risk if the client is not able to or refuses to provide any information either on his knowledge and experience, his financial situation or its investment objectives? Or would this assumption give a reasonable observer of the type of the client or potential client the impression that the recommendation is not suited to, or based on a consideration of his personal circumstances?

We believe that once a firm has sufficient information to enable it to determine that a potential client should not be considered as a retail client then, as CESR recommends, the firm should be able to deem that the envisaged product or service is appropriate for the professional client. However, until this determination can be made, the firm should not provide investment advice or portfolio management services.

Question 5.1.

In determining criteria, should CESR pay more attention to the legal categorisation or the economic effect of the financial instrument?

We consider this a question of relevance to investment firms providing services to retail clients.

Question 5.2.

Do you think that it is reasonable to assume that a service is not provided “at the initiative of the client” if undue influence by or on behalf of the investment firm impairs the client’s or the potential client’s freedom of choice or is likely to significantly limit the client’s or potential client’s ability to make an informed decision?

Alternatively, do you think that the consideration of this overarching principle is not necessary because the use of undue influence could be subject to the general regulation under the UCPD and that CESR should base its advice more strictly on Recital 30 or refer entirely to this Recital advising the Commission that it is not necessary to adopt Level 2 measures in this area?

We consider this a question of relevance to investment firms providing services to retail clients.

Question 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? Please provide the reasons for your position.

We strongly contend that there should be a lower quantitative threshold between for professional counterparties. This will prevent market participants being excluded from direct participation in the market on the basis of their corporate structure.

The quantitative tests proposed by CESR are appropriate for eligible counterparties recognising that these organisations, can be presumed – often as authorised institutions – to possess sufficient knowledge and experience and as such can benefit from a reduced level of investor protection.

However, with regard to professional counterparties, as Annex II notes, “these clients should not however, be presumed to possess market knowledge and experience comparable to [eligible counterparties] .” Firms thus need to assess – qualitatively – the market knowledge of the counterparty.

The quantitative tests applied to eligible counterparties will prevent sophisticated professional users from directly accessing the market, thus reducing market liquidity. As an example, a small airline, managed by market knowledgeable individuals, but financed by off balance sheet instruments (such as aircraft leasing and invoice factoring) may find it difficult to directly access the financial markets in order to effectively hedge its interest rate, foreign exchange, and jet fuel exposures.

Should you have any observations, or further questions on the comments made in this submission, please do not hesitate to contact me on +44 (0) 207 827 2800 or at istevenson@wmba.org.uk

Yours sincerely,

Ian Stevenson

Chief Executive