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15th September 2004

Response to the Consultation Paper published by the Committee of European Securities Regulators (CESR) in relation to its Advice on possible implementing measures of the Markets in Financial Instruments Directive (MIFID)

Teather & Greenwood welcomes the opportunity to comment on CESR's Advice on implementing MIFID. We are an independent firm of UK stockbrokers whose services include corporate finance advice, corporate broking, research, market-making and institutional sales. We specialise in providing these services in relation to small and medium sized companies (SMEs). We are also a member of the Association of Private Client Investment Managers and Stockbrokers (APCIMS), whose comments on the consultation document we endorse.

We are primarily interested in the Advice in relation to Articles 13(3) and 18 (Conflicts of Interest) and are therefore limiting our comments to this section of the Consultation Paper, and more particularly to the impact on the production and distribution of investment research.

Our fundamental concern is, consistent with the need to manage conflicts of interest appropriately, to ensure that EU economies continue to benefit as much as possible from the information collection synergies which arise from combining corporate finance, research, market making and securities sales and distribution services in a single firm.

That concern is focussed on the primary and secondary capital markets for securities issued by small and medium sized companies (SMEs). This is the area in which a number of smaller UK brokers such as Teather & Greenwood operate. Such brokers float securities, provide corporate broking and advisory services to issuers, act as institutional brokers in relation to those securities, and provide market making facilities. These services have important complementarities in collecting and using information, which tend to drive its joint provision by in-house analysts who provide research, information, and advice to support all of them.

Firms such as ours play a central and fundamental role in the formation of capital and provision of liquidity in these markets. The research we produce on those companies to whom we provide corporate broking and advisory services is vital because in most cases we are the only firm that produces any research on those companies. Without that research (should, for example, regulatory change make it become too expensive to provide it), and the information it provides to the securities marketplace, liquidity and the consequent ability to raise new capital would drain away.

Taking too restrictive and prescriptive a regulatory approach to:

- (a) putting up information barriers between these functions; and
- (b) preventing those employees who are primarily involved in gathering information about companies and their markets, and analysing that information, (the research analysts) from providing appropriate services to other business areas in an integrated full-service firm; and
- (c) preventing research analysts from interfacing with staff in other business areas for the purpose of obtaining advice and non-confidential information to assist them in their own work

...will be liable to make the production of research in certain market sectors (particularly SMEs) so uneconomic that:

1. The flow of information to the securities markets will tend to be stifled; and thus
2. Liquidity will be adversely affected; with the effect that
3. SMEs will find it much more difficult to raise money on the capital markets for expansion and business development; and
4. EU businesses and economies will be put at a significant competitive disadvantage in relation to the rest of the world

We are pleased to see that CESR's advice explicitly recognises that multi-function integrated firms should not be required to disaggregate, presumably for reasons associated with the issues we have set out above. Our concern is that some of the detailed advice on organisational standards could lead to an unnecessary element of practical disaggregation which could cause significant damage to the small and medium capitalisation end of the EU's markets and businesses.

It is vital, for example, that integrated securities houses operating at this end of the market should be explicitly permitted to use an analyst's knowledge and information to assist the firm to research corporate finance business opportunities and to provide ideas to sales and trading staff. Similarly analysts should be permitted (under appropriate controls) to provide input in relation to securities offerings by corporate finance clients.

Our detailed comments below reflect the concerns we have referred to above.

Question 6.2

Option (a) is far preferable in that it preserves an appropriate degree of flexibility, taking into account the general points we have made above.

Question 6.3

The appropriateness or otherwise of information barriers between research analysts and other business areas within the firm depends on the nature of those barriers.

Whilst corporate finance staff, proprietary traders, institutional salesmen and investment managers must clearly be prevented from attempting to influence the recommendations made in investment research, care must be taken not to establish regulation which goes beyond this to the point where the information collection synergies are destroyed.

Thus, while there must be information barriers of some sort between analysts and other divisions, those barriers should not, on the spectrum towards complete separation, extend further than is necessary to achieve appropriate regulatory purposes.

Moreover, firms should be given flexibility in designing these barriers to meet appropriate regulatory principles – over-prescriptive regulation in this respect could inadvertently lead to economically dangerous functional separation.

Question 6.4

The second option, which exempts non-objective research from the full force of the conflict of interest management requirements, is overwhelmingly preferable.

This option is broadly in line with the regime established in the UK on 1st July 2004 which was designed to avoid forcible imposition of the full rigour of conflicts of interest management standards onto research in relation to SMEs. It achieved this by focussing those standards on research which is held out as being an impartial or objective assessment of the value or prospects of its subject matter.

The first option, by severely limiting the involvement of analysts in corporate finance/broking activities in the SME market, would significantly choke off vital elements of the support that small investment houses provide to SME corporate clients – such clients need a great deal of advice and guidance as part of the corporate broking and advisory package of services, and this cannot economically be provided without taking advantage of information gathering synergies which would be severely reduced by the first option.

In consequence, because of the huge cost increases involved in producing research on SMEs in a 'clean-room environment' the first option would inhibit the production of research on SMEs, and thus adversely affect liquidity and the price-formation process.

Draft Advice Para 8

Sub-paragraph (c), in proposing to make the remuneration of relevant persons principally engaged in one activity independent of the remuneration or revenues earned by relevant persons principally engaged in another activity, goes much further, in the case of analysts, than is appropriate. We strongly support the IOSCO proposal simply to prohibit analyst compensation from being directly linked to specific investment banking transactions.

We hope our comments are helpful. Should you wish to discuss any points or issues with us, we would of course be very happy indeed to do so.

Yours sincerely,

Roger Heron
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