



## **Tradition Group**

253, Boulevard Pereire  
75017 Paris  
France

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

### **Directive on Markets in Financial Instruments CESR draft advice on the definition of financial services and instruments**

We welcome CESR's initiative to solicit comment on its draft technical advice to the European Council on level 2 measures regarding implementation issues concerning Directive 2004/39/EC on Markets in Financial Instruments (MIFID).

We also applaud and congratulate CESR in its efforts to further the Financial Services Action Plan by advancing integration in the single market in Financial Services and in so doing establish a truly level playing field for securities and associated markets in Europe.

We are pleased to have attended and participated in the public hearing in Paris on 19<sup>th</sup> November and some of the comments made in this response serve to reinforce the concerns raised in that open forum.

But firstly some background information about the Tradition Group; what it does and how and where it operates;

#### Tradition Group

Tradition Group is a French owned wholesale markets money broker, headquartered in Paris. The Group's activities predominately involve arranging transactions in cash deposits, foreign exchange, and a vast range of investment products including commodities and commodity derivatives. Most transactions are carried out OTC, however there is some on-market involvement particularly in cash equities and exchange traded futures and options. Clients are typically Market Counterparties (Eligible Counterparties) with some activity with Intermediate type customers. There is also some retail contact with private investors in Equities in both France and the UK.

Tradition Group is recognised as the third largest money broker in the world and intermediates thousands of transactions per day totalling billions of Euros in gross turnover. The European Group

employs 1034 people within Member States, Milan, Luxembourg, Frankfurt and Munich.

principally in offices in Paris, London, Brussels,

The Group's contribution to community wealth and prosperity is significant. In 2003 the Group's consolidated net turnover amounted to Euro 510 million over 50% of which was earned in Continental Europe.

### MIFID

At the meeting in Paris, concern was expressed over the timing of the implementation of the Directive (MIFID). 'Tradition' supports the view that implementation should be delayed for at least another 12 months to allow greater time for Regulators and Investment Firms to acclimatise to the implications of the new Directive and to make the necessary IT system changes which will differ between operations in different Member States.

We also echo the call for consistency, certainty and also flexibility. Consistency of application across all Member States is important in terms of creating the level playing field in investment services and also to make sure that artificial barriers to entry are not created thus disadvantaging some member states and not others. We believe it important that the timing of implementation is crucial and must be consistent across all jurisdictions.

We urge CESR to deliver its draft advice by promoting as much certainty wherever possible. The usage of tight narrow definitions where appropriate, so as to avoid ambiguity and uncertainty over application, is necessary.

We feel that it is also important to allow for some flexibility at national level to promote a pragmatic approach to implementation in various Member States. This is key in areas regarding the wholesale/retail split in order to provide the appropriate level of protections to the various classes of investor. Too much prescriptive overlap at the perimeters of the wholesale/retail space could affect the efficient workings of markets, stifle innovation and create barriers to entry for certain types of customers.

### CESR's Draft Advice

The Group would like to pass comment on CESR's draft advice as invited. As already stated a majority of Tradition's business is carried out with Market Counterparties (Eligible Counterparties) in wholesale OTC markets. In consequence we base our comments on the areas that affect us most, which are generally covered in Section II regarding Intermediaries.

### Section II Intermediaries

Definition of "investment advice" (MIFID Article 4(1) No 4)

Group impact:-

The Group as a whole does not give what is currently regarded as "investment advice", although authorised to do so in some jurisdictions. In the UK and France the Group does deal with retail clients in on-exchange traded equities where advice may be given. In the UK we have a company that provides internet based spread betting opportunities to retail clients in equities but these services are not provided on an advisory basis.

We support the view that the definition of "investment advice" should be drafted as narrowly as possible so that it does not become a 'catch all' and bring in ancillary comment which is not intended to create a tangible value to the provider.

We agree that the presence of some key words /expressions might distinguish “investment advice” from other types of communication including general recommendations, marketing communications, and information in general given to clients. We would also include in this general category what we term as ‘market colour’, which in wholesale markets is where commentary is given about the depth of market quotes, the extent of liquidity, and the strength of the bid/offer spread. We do not believe that ‘market colour’ should be included in the definition of “investment advice” as an investment service for the purposes of the Directive. Inclusion might prejudice the ability of wholesale market brokers to freely provide pre-trade transparency in voice brokered transactions and compromise the efficient running of associated capital markets.

Such key terms as ‘personal recommendation’ which as defined will include recommendations to ‘buy’ or ‘sell’ etc and reference to ‘transactions in financial instruments’ will help to provide the narrow definition required.

*Question 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?*

We agree with CESR in its decision to give the advice to the EU Commission not to include this issue. We believe that the appropriate protection may be already provided in Article 19 (4) where the exchange of information between client and investment firm, required to assess suitability prior to commencing a dealing relationship, should suffice.

*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 bi-lateral nature of the relationships or bi-lateral contacts between the firm and its clients? In the latter case which criteria would you use to differentiate between a ‘personal recommendation’ and a ‘general recommendation’ or a ‘marketing communication’?*

Clearly it is difficult to draw the line here. Whilst we agree that it is acceptable (and logical) to predicate that a personal recommendation should be suited to, or based on a consideration of, the client’s personal needs and circumstances there is an argument that this may cause difficulties when say, for instance, offering new and innovative products to investors. So perhaps some recognition of the bi-lateral nature of the relationship may be appropriate.

*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.*

We have already argued for a narrow definition and commented that advice should be restricted, as far as possible and in all respects, to the ‘specific’ category and not be extended to cover generic information, including ‘market colour’ or (at this stage) financial planning and asset allocation services. We acknowledge it is important that the client is able to react directly and immediately to a specific recommendation whereas he/she still has to make his/her mind up about recommendations of a general or planning nature and which allow some time for further consideration.

Inevitably there will be some greying at the margins and it may be that the definition can, in some circumstances, only be tested on a case-by-case basis.

In general we concur that the draft level 2 advice given in BOX 1 has struck the right balance on this issue.

**Group Impact:-**

‘Tradition’ has significant interest in the commodity derivatives markets, particularly in energy products through operations which are placed globally, particularly in the UK and USA. Investment services are generally voice brokered and carried out OTC.

We believe that the upgrade of products included in the list of financial instruments in section C of Annex 1 to MIFID to include commodities and commodity derivatives is correct and appropriate. The ability to give investment firms in member states the benefit of using the ‘European Passport’ for cross border provision of investment services in commodity derivatives is welcomed. The revision will also now allow remote access to trading screens domiciled within the community and thus allow for greater financial inclusion and support liquidity in growing areas of commercial and speculative trading.

*Question 2.1 – Should “commodities” for this purpose be limited to goods?*

We are persuaded that the definition of commodities should be restricted to tangible goods. This would include forms of energy such as Gas and Electricity which although invisible, are semi-tangible and have the ability to physically affect persons in both positive and negative ways (for example to promote well-being or cause injury including death).

*Question 2.2 – Alternatively, should an approach be taken that permits rights or property specifically mentioned in C 10 (Annex 1 Section C) and other intangibles to be treated as “commodities” as well?*

No. We think that the term commodities should not apply to pure intangibles, including (in our opinion) climatic variables, freight rates, emission allowances, inflation rates, and official stats. Transactions in these rights or property should only be treated as financial instruments, in terms of the Directive, where they are not carried out for commercial purposes.

*Question 2.3 – Should derivative instruments based on telecommunications bandwidth be considered to be within the scope of the Directive?*

We are ambivalent on this question and bow to the consensus view.

*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 Annex1?*

If included, it should be regarded as a pure intangible commodity (rights) and reside accordingly in C (10).

*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?*

We believe that this would introduce a difficulty in defining what is and what is not a liquid market, and suspect that there are many markets where there is a greater amount of liquidity in the derivative than in the underlying. On balance we feel that the restriction should not apply. However we would raise the issue of how derivatives contracts could be effectively ‘marked to market’ if the market in the underlying is weak

*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*

No.

*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?*

Yes. Usually contracts for spot delivery are commercially driven. Also there is an intention to deliver and a corresponding ability to accept delivery. Consequently we agree that there should be an initial filter to exclude spot contracts.

No. We suggest that the minimum settlement period of two days is dropped from the advice and propose that the approach of excluding all spot contracts regardless of the settlement period be adopted, i.e. the approach of ‘excluding contracts whose settlement period is that generally accepted for spot transactions in the relevant market’.

*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) apply 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?*

No, the status of the parties to the contract should not only be relevant to the exemptions in Article 2. In our view it would also serve as a useful indicator of whether there is an underlying intention to create a commercial contract as opposed to a commodity derivative. We view this as indicative but not wholly conclusive.

We believe that this might be a ‘perimeter’ issue regarding whether commercial firms might stray into the investment business arena and thereby require regulatory authorisation. Therefore it might be better to rely upon the ‘intention to deliver and the intention to accept delivery test’ rather than apply blanket exemptions driven by customer status (producer, users, commercial merchant). Such a test would allow producers and users to participate in speculative trading and come within the meaning of the Directive and regulatory authorisation if they so wished.

*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?*

Yes. It is our opinion that the ‘intention to deliver to test’ should be effectively applied to the trading counterparties of the contract whether they are commercial merchants, producers, users or otherwise. This would encompass all classes of counterparty including Investment Banks and Credit Institutions that quite clearly have no intention of making delivery and have no ability to accept it.

In regard to greater definition it might be pertinent to defer to the documentation created at the time of the establishment of the bi-lateral relationship between the trading parties. It could be possible that the supporting documentation and following trade confirmations will serve to indicate the underlying purpose of the contracts that are intended to be carried out between the parties to which the bi-lateral agreement refers, i.e stipulate whether for commercial or investment purposes.

*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?*

See 2.9 above. For the test to work the status of the contract should be based on the intent of both parties and not either of the parties.

*Question 2.11 – If both elements of (2) [Section 2 of draft advice in Box3 i.e 1) the legal capacity and 2) the necessary permits or licenses, to make or take delivery of the commodity to which the contract relates] are present should this be conclusive or indicative. If indicative, if only one is present is that still indicator?*

If both elements [legal capacity and ability to make/take delivery] are present then this should be construed as only indicative of a commercial contract and not considered conclusive. It is possible that both parties to a trade could have both elements in their corporate permissions but will also trade commodities, in which they are totally familiar, on a speculative basis.

If the single element to take/make delivery is present then this should be taken as indicative (as it would be reasonable to assume that the customer also has the legal power to act), but legal capacity alone should not be taken as indicative.

General Obligation to act fairly, honestly and professionally and in accordance with the best interests of the client (Article 19.1).

Group impact:-

Affects all Group companies and in particular those dealing with retail clients. This basic principle is enshrined across the broad spectrum of Tradition operations either in compliance manuals, codes of ethics and conduct and corporate governance under senior management arrangements, systems and controls.

*Question 3.1 –Do you agree with the proposals on portfolio management? Should any other issues be addressed under Article 19 (1)?*

We see no reason why portfolio management services should not be included under the General Obligation to act fairly in Article 19 (1).

We note CESR's intention to address issues regarding 'best execution' and 'order handling' in the next phase of consultations. We welcome that opportunity to engage with CESR in dialogue on these protections, which we feel are predominately retail in nature and which primarily concern the execution of equity transactions on a regulated market or similar.

In particular we foresee particular problems regarding any attempt to make them applicable to wholesale markets arranging business. In wholesale money markets these types of retail investor protections are not applicable to market players, however it could be construed that the Directive encourages Professional Counterparties to expect them. (see comment Eligible Counterparties Page 8 below)

Suitability test (Article 19 (4))

Group impact:-

Only those firms dealing with retail clients (4 firms)

*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 his 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 have no fixed position on this question. In practical terms we would treat each case on its merits, apply common sense, and look at the problem of whether to act or not on a risk based objective. In general terms we see no reason why our opinion should differ from the level 2 guidance put forward by CESR in Box 8

#### Appropriateness test (Article 19 (5))

Group impact:-  
Only those firms dealing with retail clients (4 firms)

As per the previous sub-paragraph we see no reason why we should differ from CESR draft guidance in Box 9.

#### Execution only (Article 19 (6))

Group Impact:-  
Will affect all Tradition companies that deal with retail clients in on-exchange traded equities and other 'non-complex financial instruments', and companies that engage in name passing money broking (reception and transmission of orders) when dealing with clients that are not classified as Eligible Counterparties (in practice likely to be very few, if any).

We agree with the basic principle here that when a firm is executing or arranging transactions in on exchange traded shares and 'other non-complex financial instruments' for retail customers, then the requirement to carry out the 'appropriateness test' under Article 19 (5) is switched off.

We agree that in defining 'non-complex financial instruments' there should be an allowance made for innovation and that new products should not be classed as 'complex' just because they are variations of 'non-complex' products already covered in Annex1 Section C.

We feel that there is no definitive test for what is 'complex' and what is not and note that the definition may vary according to the knowledge of the customer and the class of asset traded. Clearly this is not a straightforward issue and we would encourage CESR to carry out some further work in this area

We are unsure that the proviso for the 'carve out' is only available upon the condition that the service is provided 'at the initiative of the client or potential client'. We agree that it is reasonable to assume that the service will be provided at the initiative of the client unless certain conditions indicating otherwise prevail.

*Q 5.1 – In determining criteria [as per Draft level 2 advice in Box 1], should CESR pay more attention to the legal categorisation or the economic effect of the financial instrument?*

We believe that CESR has provided enough detail and a proportionate balance in its draft 2 level advice in Box 10. We see no need to further include caveats regarding legal categorisation or economic effect. We think that transactions in dispute regarding the complex/non-complex issue will be resolved on a case by case basis taking advice from ordinary market participants and considering normal market practice.

*Q 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 agree on the philosophy that the service should not be deemed as being provided ‘at the initiative of the client’ if undue influence is put upon the customer [by the provider] to trade in a particular way or in a particular stock. It would seem sensible that if the customer is influenced in any undue way by the provider then the suitability test should apply.

However, a conflict may arise over whether personal communications from providers to investors are intended to influence the client, or are of such a general nature as to not.

It would appear that the subject of ‘undue influence’ is already comprehensively covered in the Directive on unfair business-to-consumer practices in the Internal Market (UCPD) and that further level 2 advice may be unnecessary.

We are ambivalent on the choice, but on balance would prefer that CESR offer advice in regard to MIFID on the basis that the ‘at initiative of the client’ proviso is mentioned in the article and that further explanation will only serve to provide greater clarity.

#### Transactions executed with eligible counterparties (Article 24)

Group impact:-

Article 24 will have a great impact upon the Group’s business in all member states. It will affect all firms and all activities carried out. It will be of major significance to UK brokerage firms where the MIFID thresholds for qualifying as Eligible/Professional Counterparties are set higher than those currently set by home state regulation.

We agree that it is entirely appropriate to exempt firms from the investor protections of articles 19, 21 and 22 when dealing with Eligible Counterparties (Article 24 (2)). We believe that this approach should be consistent across all Member States including those to which the eligible counterparty regime is innovative.

We would argue that the exemption in 24 (2) should also apply to Professional clients. For in certain jurisdictions, for example in the UK, the term Professional Client indicates that the customer has the necessary knowledge and understanding to be treated as an Eligible Counterparty (Market Counterparty).

We also feel that further problems could arise out of the fact that the Directive gives Eligible Counterparties (by way of opt-down) and Professional Clients the ability to request, on a trade-by-trade basis, the investor protections created in Articles 19, 21 and 22. This, we believe could lead to confusion in certain wholesale markets where the mechanisms to provide retail protections either upon request or in general do not exist.

We would argue that there is not enough clarity in the advice outlining the similarities and differences between the eligible and professional regime, and how the two regimes default towards or away from each other. We feel that the advice is not comprehensive enough on this and request that CESR work towards further definition in this area.

We are further concerned that given the choice, some professional clients that ordinarily operate in the wholesale markets, might not accept the opt-up to Eligible Counterparty status. We believe that letters sent to such clients informing them of their ‘loss of customer protections’ will be misconstrued. We perceive that such communications will end up resting with those operation’s legal departments and legal advisors. As we believe that these departments will not necessarily recognise the economic advantages (for example wholesale access, transactions in size and finer



market pricing) of accepting the eligible counterparty status, they will recommend that the opt-up is declined (why give away protection if you don't have to?). This, in our opinion, will put wholesale market firms in a difficult position and may force them to disallow access to such clients, or reject existing customers, on the basis that they are asking to be over protected.

Consequently it will also prove commercially awkward for wholesale market firms to have to explain why the concept of say 'best execution' cannot be applied to their transactions which may be construed by the customer that in some way he will receive an inferior or inappropriate service.

To propose a solution we believe that it would benefit the efficiency of European Wholesale Capital Markets if CESR could take the opportunity in its advice (or in the next phase of consultation) to pronounce on this to relieve the burden from individual firms.

We also perceive a difficulty with the implementation of Article 24 (3) which determines that investment firms must defer to the status of "other undertakings meeting pre-determined proportionate requirements, including quantitative thresholds" (Professional Clients and customers opted-up to professional status), as determined by the law or measures of the Member State in which the undertaking is established. We believe that this might lead to confusion for firms when dealing with clients that will be, or already are, classified as Eligible/Professional in the home state of the investment firm and where the client is precluded from accepting this classification by law or measures of the Member State in which it is established.

In general we urge CESR to allow national regulators the leeway to form a pragmatic and balanced view regarding implementation of this regime so that the efficiency of community wholesale markets is not impaired. In particular arrangements in the advice for 'Grandfathering' the status of existing customers are unclear, and the CESR text is largely silent on this issue. Consequently we think that there is a strong argument for allowing national regulators the ability to grant transitional arrangements where appropriate.

*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 believe that the quantitative thresholds for eligible counterparties should be the same as for professional clients but think that the limits set in the Directive are too high. We would have preferred limits set as follows:

- Balance sheet total of Euro 12,500,000
- Net turnover of Euro 25,000,000
- Own funds of Euro 2,000,000

We believe that lower thresholds would have provided for greater financial inclusion to wholesale markets through the eligible counterparty regime.

We have no further comments to make in regard to the rest of CESR's draft advice in connection to section III Markets section of the paper.

We hope that you find our comments useful and look forward to receiving feedback in due course. If you need to contact me you can phone on 0044 207 422 3539 or e-mail on [dennis.mccombie@tradition.co.uk](mailto:dennis.mccombie@tradition.co.uk)

Yours sincerely

A handwritten signature in black ink, appearing to read "Dennis McCombie". The signature is fluid and cursive, with the first name "Dennis" written in a larger, more prominent script than the last name "McCombie".

Dennis McCombie  
Head of Compliance.