Letter from LIBA, AFEI and ESF to David Wright in advance of the MOG on 21 January 2008

Dear David

Report to the MOG 21 January 2008

I am writing to give your our views on the Code of Conduct process in advance of the MOG meeting on 21 January. I shall be grateful if you would make this letter available to all other participants and place a copy on the MOG's website. This letter is written on behalf of LIBA and ESF with the support of AFEI. We have shared drafts with the sectoral associations, FOA (listed derivatives) SIFMA/EPDA/ICMA (fixed income) and ISDA (OTC derivatives) and our views are broadly consistent, particularly in relation to the proposal to extend the voluntary approach (paragraph 4 below).

1. Service unbundling and accounting separation implementation

   We very much look forward to hearing about this from the infrastructures. We understand that the infrastructures have faced some challenges and we stand ready to continue to work with them so as to seek to ensure that the additional information provided as part of their efforts to meet this commitment is accurate and useful to us. At the time of writing, we have had no new information since the last meeting of the MOG.

2. Terms of reference for the external audit procedure

   We remain concerned that users will not receive sufficient information to enable us to police the Code effectively. We would very much welcome a statement by the Commission clarifying the extent to which the Commission (DG Market and DG Comp) and the relevant competent authorities in Member States (both financial sector supervisors and, where relevant, competition authorities) will make the results of their dialogue available to market users.

3. Code implementation so far

   - Price transparency

   We have no complaints; we have not yet completed our analysis of the 2008 price lists.

   - Access and Interoperability

   In October, we cautiously welcomed the access requests that had been made over the summer. Please refer to the report dated 5 October – and published on the MOG website – for further details. Since then, we have had little fresh information; the suspicion is beginning to grow that the Code is being used as a tool to slow down

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progress. LIBA would like to see timed, costed commitments and we will be considering how best to take this work forward with the infrastructures.

- General assessment

Generally, we feel that the implementation of the Code of Conduct in cash equities so far can be accounted a success. There are a number of areas in which further work is under way; there are a number of projects which have been begun which are scheduled for completion in the next 12 to 24 months. There are also projects for which we do not yet have firm dates. Continued dialogue and monitoring will be required to bring this work to a conclusion.

We welcome the fact that Chi-X and the EMCF service offered by Fortis have signed the Code.

We think that clearer success criteria might be helpful for the continuing work in equities and, subject to the outcome of the discussion of item 4 below, other instruments.

We continue to believe that infrastructures and users will need to give priority to work on cash equities, at the same time as devoting resources to the development of solutions to the questions raised by the proposal to extend the Code to other asset classes.

4. Extending the Code to other asset classes

First, it is worth recording that LIBA and its members have consistently supported voluntary action by the industry where such action offers a reasonable prospect of success within an acceptable time scale. That said, of course different asset classes need to be handled differently and any Code extension should be sensible and proportionate. The context is ever increasing competitive pressure in a market which is global in scope.

Secondly, we now believe that listed derivatives should take priority over fixed income securities in the extension of the Code. There are three main reasons for this:

- Firms have been concerned that the cost of trading listed derivatives has been, quite simply, too high;
- Exchanges and clearing houses have listened to our concerns but have not translated what they have heard into action; and
- In the fixed income markets, there is already a choice of settlement provider and a degree of interoperability between the main providers.

Thirdly, we would not support an extension of the Code to over-the-counter derivatives. This is for three main reasons:

- The OTC derivatives market does not rely on central market infrastructure in the way that the listed derivatives and fixed income markets do;

- There is no *prima facie* evidence of market failure; and
- We believe that the barriers to new entrants offering new processing solutions are not high.

Fourthly, at the last meeting of the Monitoring Group, LIBA and other commentators were concerned to ensure that any extension to the Code would be proportionate and tailored to the very different function of clearing and settlement as it applies to listed derivatives. LIBA members recognize the value of building on what has gone before and re-using existing material. We also recognize that the outcome may be a separate Code. We would emphasise therefore, as FOA has done, the importance of market participants being closely involved in the development of the Code. This is not a task for infrastructure providers alone, as happened in the case of the cash equity Code.

Fifthly, LIBA acknowledges the importance of the international competitiveness of EU markets. We continue to believe that, in the case of listed derivatives, the extension of the voluntary approach exemplified by the Code of Conduct for cash equities must strike a sensible, proportionate and cost-effective balance between addressing the concerns of the users and enabling the EU's markets to compete with rival platforms and infrastructures outside the EU. Like FOA, LIBA believes that any 'industry solution' will have to be credible, robust and proportionate; there is a risk that a solution which is acceptable to the infrastructure providers will not be sufficiently robust and durable to meet the concerns of market participants.

Finally, there are a number of important lessons from the process so far which we should bear in mind when we discuss an extension of the voluntary approach. We would highlight the following:

The legal, fiscal and regulatory barriers to a competitive securities market in Europe, offering real choice to users, need a firm, agreed action plan. These issues need to be addressed urgently otherwise it is highly likely that the same obstacles will be encountered as with cash equities; we feel that there is a risk of lesser achievements if action is not taken.

If the Code is to be extended then a clear roadmap and timetable must be agreed and published for each asset class which should be monitored by the Commission, in conjunction with the users.

The Monitoring group will need to continue to consider the impact of other initiatives on the Code, including T2S and the work on removing barriers.

I hope this is helpful; as always, please do not hesitate to contact me if I can be of any further assistance.

Yours sincerely
John Serocold
Director