Association of Foreign Banks (AFB)
Futures and Options Association (FOA)
International Capital Market Association (ICMA)
International Swaps and Derivatives Association (ISDA)
London Investment Banking Association (LIBA)
Securities Industry and Financial Markets Association (SIFMA)

Initial Response to FSA Consultation Paper 06/19: Reforming Conduct of Business Regulation; and Consultation Paper 06/20: Financial Promotion and Other Communications

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Introduction

This response sets out the initial comments of AFB, FOA, ICMA, ISDA, LIBA, and SIFMA on CP06/19 and CP06/20. In addition to the specific questions and the copy-out of MIFID text that FSA has highlighted for comment by 28th November 2006, we also comment on a range of other proposals and interpretations which have a bearing on the transposition and interpretation of MIFID provisions.

We have as requested provided as definitive answers as possible to FSA's 'bold' questions (those it identified as for comment by 28th November 2006), and on FSA's copy-out of MIFID text. But given the shortness of the consultation period, we may need to make supplementary comments if further points emerge, including on questions relating to how FSA interprets the copy-out text. We may also need to make supplementary comments on both 'bold' and 'non-bold' questions, and on the draft Handbook text, depending on the content of forthcoming CESR consultations on some of the matters covered by the CP.

To be helpful to FSA, we have also provided comments as far as possible on 'non-bold' questions and other parts of the draft Handbook text. In some of these areas, however, our comments are provisional, and we may again need to make supplementary comments on the 23rd February 2007 timescale.

We have also not examined every aspect of the revised definitions in detail, although we note that text appears to be missing from the fourth line of limb (b) of the definition of "durable medium."

Summary of key points

We draw FSA's attention in particular to the following key points. They need to be read in the context of our response to the CP as a whole.

1. We welcome FSA's broad approach in the CP, under which it intends to follow intelligent copy-out and the principle-based approach. However, we express concerns about a number of respects in which FSA goes beyond this approach, for example as regards certain superequivalences, the approach to MIFID Level 2 Article 4, and financial promotion. We are also concerned about the complexity of the structure of the draft NEWCOB, which we fear will make it difficult for many firms, particularly smaller ones, to use.

2. FSA should incorporate some of the material in the CP in the Handbook as Guidance, where it has an important bearing on the scope of the obligations, for example in the context of best execution and the definition of limit orders. We have also identified some Recitals from the MIFID legislation which FSA should incorporate in the Handbook because it is important for the interpretation of the new requirements.

3. FSA should take a consistent and market-sensitive approach towards the interpretation of 'express consent', 'express instruction' etc, under which 'express' consent, confirmation, or instruction can be given by any express, as opposed to implicit, demonstration: in writing, orally, or by actions, including continuing to deal on the basis of a one-way notification.

4. Inducements: It is important that FSA takes a purposive approach, and interprets the coverage of inducement provisions in line with existing FSA requirements.

5. Client categorisation: It is important that FSA does not impose quantitative criteria where they are not relevant to the service provided by the firm, and ensures appropriate treatment of group holding companies.

6. Financial promotions: We think that FSA's approach is more complex than it need be (see also point 1 above). FSA should follow the intelligent copy out approach, without substantial additional requirements, and also provide scope for firms to apply MIFID financial promotion provisions to non-scope business as well.

7. It is very important that FSA does not interpret or apply suitability or appropriateness provisions more widely than is necessary, particularly in wholesale markets. FSA should give full weight to the extent to which communications are not, or are agreed between the parties not to be, investment advice. FSA should not require specific records to be kept of suitability or appropriateness assessments, especially for professional clients.

8. We welcome, with some specific qualifications, FSA's interpretations and proposals on implementation of the best execution provisions. FSA should state clearly that best execution does not apply to corporate finance or stock lending.

9. We suggest that FSA should review carefully whether, in order to avoid setting an example to other Member States for invoking Level 2 Directive Article 4 superequivalence, the use of dealing commission provisions and other measures could be framed as guidance.

10. We are concerned that FSA's approach to conflict management in non-independent research would be a superequivalent use of guidance to impose additional restrictions.

Chapter 1: Overview

Q1. Do you have any general comments on the way in which FSA propose to transpose the relevant requirements of MIFID?

Consistent treatment across the EEA

FSA should encourage a consistent approach to the treatment of issues across the EEA, particularly where variations may remain (such as client classification). This is particularly important for firms with branches, which will need to take account of both home and host State requirements.

We also remind FSA of the importance, as a practical matter and to avoid subjecting branches to unnecessarily complex regulation, of agreeing with other EEA regulators to apply MIFID Level 1 Article 32.7 in a way that ensures that all of the services that a branch provides within the host State, whether to clients located in that State or on a cross-border basis, are subject to the rules of, and regulated by, the branch State regulator. A consistent approach along these lines is particularly important since there are indications that the head offices of some EEA firms are telling their London-based branches that their home State regulators expect such branches to apply home State conduct of business rules to business undertaken by the branch with customers outside the branch's host State. The need for consistent branch regulation is a further reason to avoid superequivalent requirements where possible.

It will be important to minimise the extent to which FSA's made Rules may be subject to further changes as a result of the outcome of CESR's planned consultations on certain conduct of business matters.

Express consent, confirmation, or instruction

We think that FSA should adopt a consistent and market-sensitive approach to the interpretation of 'express consent', 'express confirmation', and 'express instruction', under which 'express' consent, confirmation, or instruction can be given by any active demonstration: in writing, orally, or by actions, including continuing to deal on the basis of a one-way notification. We ask FSA to include this confirmation in the Feedback statement.

In CBA paragraph 9.1.6 FSA states that 'express consent' (to execute orders outside a RM or MTF) 'requires and active (two-way) demonstration of consent…but does not extend to requiring clients to return signed paperwork' and that 'existing processes' mean that costs should be minimal.

In paragraph 16.87 FSA states that an 'express instruction' (not to disclose limit orders)'must be a clear positive act instructing the firm, i.e. it cannot be implied', and that 'the instruction can be made in any form, such as in writing, through an electronic notification, or by a verbal instruction'. However, Chapter 16 has no discussion relating to the requirement for express consent relating to firms' execution policy.

In paragraph 7.56 FSA states that 'express confirmation' (of client status) is 'some form of active demonstration of consent' which 'cannot be obtained by silence or lack

of objection, that it is 'up to firms to determine how best to obtain that acknowledgement', but that 'a client continuing a previous course of dealing after being sent a 'one way' notification by a firm would not constitute an active demonstration of consent'.

We disagree with FSA's statement in paragraph 7.56 that continuing a previous course of dealing after one-way notification would not be an express consent. We think that 'a clear positive act in any form' is much closer to what MIFID intends. The 'express' nature of the consent needs to be contrasted with an 'implied' consent, and not interpreted on the basis of an arbitrary distinction between an 'active' instruction and the 'passive' giving of an order. Indeed, in many ways giving an order is a more distinct expression of intention than a verbal notification. It is important not to require extensive repapering because many existing terms of business include amendment clauses that enable consent to be obtained by prior notice. It is also important not to undermine the flexibility that FSA is proposing to enable professional parties to choose whether or not to enter into formal terms of business.

A market-sensitive approach is particularly important given that portfolio managers or order transmitters do not seem to need to obtain their clients' consent to their order execution policies, since the requirement for consent is contained in Article 21(3), which is not imported into Article 19 of MIFID Level 1 by virtue of Article 45 of the Level 2 Directive (the last paragraph of which states only that portfolio managers/order transmitters shall provide appropriate information to their clients on their order execution policy, with no mention of the need for consent). It would be counterintuitive if dealer firms with professional clients were required to obtain their consent to the order execution policy, but firms with retail clients did not have to do so.

It is important to note that, in respect of unsigned terms of business, arbitrators often take the view that a "course of dealing" is sufficient to allow the documents to be treated as agreed to by the client; although we recognise that there may be a number of implicit conditions before this can be relied upon:

a) that the client is not under pressure to agree: for example, the client is not in a position where he cannot refuse to trade, or is not subject to a trading deadline (e.g. a requirement to close out the trade to avoid a delivery situation) where failure to do so could result in a financial risk;
b) that the appropriate person in the client should have received the notification, i.e. a person who would understand the notification;
c) that the legal arrangements of the jurisdiction of the client are such that they allow documents to be agreed to without signature.

We recognise that many firms, depending on their willingness to take legal risk, may prefer to document and obtain clients' written agreement. The choice, however should rest with the firm.

Chapter 2: General approach

The CP does not clarify FSA's thinking about how the provisions of NEWCOB will be treated under Section 150 FSMA. The general position under that Section is that a contravention by a firm of a rule is actionable at the suit of a private person – as currently defined in SI 2001/2256 – who suffers loss as a result of the contravention (subject to the defences applying to actions for breach of statutory duty). Under Section 150(2), however, designated rules can be excluded, and FSA's Principles for Businesses have been treated in this way. There are two questions at this stage:

i. First, whether the "rights of action exclusion" should be applied to other new rules which are drafted at a comparable level of generality. On this, it will be important for FSA to articulate its policy for determining when the exclusion should be applied going forward, and the options should be discussed with the industry first. This is not a MIFID implementation matter as such – Section 150 FSMA is a super-equivalent provision not required by the Directive – but we have raised the matter in this response because we consider that these discussions should start sooner rather than later.

ii. The second, more pressing, point is whether there are rules due to be *replaced* by MIFID provisions which are *currently* excluded under Section 150(2): in such a case we would assume that FSA will use its powers to provide that the "replacement requirements" are excluded as well so as in practice to maintain the status quo. If this assumption is incorrect, we trust that FSA will let us know without delay.

We also note that FSA does not define non-MIFID business; such business could, of course, comprise activities that fall within the scope of MIFID that are carried on my a MIFID-exempt firm, or activities that fall outside the scope of MIFID but within the scope of FSA regulation. We believe that such a distinction should be made where appropriate, particularly if there are issues under Article 4 of the MIFID Level 2 Directive, relating to extending MIFID requirements to MIFID-exempt business .

Q2. Are there any additions to the list of deferred matters in Annex 5 which FSA should consider in the second quarter of 2007?

This is a question which we will need to consider further on the 23rd February 2007 timescale.

Q3. Do you have any comments on FSA's general approach to reforming COB regulation or FSA's analysis of the implications for firms and consumers?

See our comments on Chapter 1 and on this Chapter, above. This also is a question which we will need to consider further on the 23rd February 2007 timescale.

Q4. Do you have any comments on FSA's general approach to using Article 4 to retain parts of FSA's existing COB regime?

We will need to comment further on this question, and on FSA's specific justifications for using MIFID Level 2 Directive Article 4, in the light of the

justifications for FSA's proposed superequivalences when it publishes them. Only FSA's proposed Article 4 superequivalences on use of dealing commission provisions and addition details on derivative contract notes affect the wholesale markets. See our comments on use of dealing commissions under Chapter 16 below, and on FSA's proposed Article 4 superequivalences affecting derivatives markets under Chapter 21 below. We consider that it is difficult to argue that retaining the use of dealing commission provisions as a Rule is absolutely necessary to the standard of Article 4, given the general inducement rules.

We are concerned at a more general level about the length of FSA's list of proposed Article 4 superequivalences. This is because an aggressive approach to Article 4 by FSA, especially if the justifications are not robust in terms of Article 4 itself, may encourage other Member States also to propose their own long lists, and thereby make it more difficult to control other Member States' use of Article 4.

FSA should consider using guidance or industry guidelines as an alternative to superequivalent Rules

We are also concerned that some of FSA's proposed Guidance may imply additional requirements to which Article 4 controls may be applicable. See in particular our comments on conflict of interest management for non-independent research under Chapter 17 below, and on Paragraph 7.69 (constraints on firms' ability to continue to deal with clients who have requested opt-up or opt-down); NEWCOB 10.5.1R (suitability records); NEWCOB 11.3.3G (requirement to consider whether transaction is in the interests of the client where appropriateness test applies)

Chapter 3: Structure and contents of NEWCOB

Q5. Do you have any comments on the proposed NEWCOB structure?

The structure of NEWCOB is complex, and may be particularly problematic for smaller firms to follow. This is the case, for example, for aspects of the application provisions (see comments on Chapter 5 below) and for the financial promotion provisions (see comments on Chapter 9 below). The complexity is disappointing given the importance FSA has given to the simplifying aspects of NEWCOB.

Chapter 5: Application

As FSA acknowledges, the application provisions are complex and hard to follow. NEWCOB 1.1.1R states the general rule, which NEWCOB 1.1.2R and NEWCOB 1.1.3R modify. NEWCOB 1.1.2R refers to a series of Appendices, so that for example Appendix 1 Part 3 modifies the territorial scope by reference to extensive guidance in Appendix 1 Part 4. It may be particularly difficult for smaller firms to work the application of the rules out for themselves in this way.

Each chapter should commence with clear application provisions, which, if necessary, signpost relevant sections.

The application provisions do not always specify a clear boundary. NEWCOB 1.1.1 states that NEWCOB applies to the listed activities "and activities connected with them", an undefined phrase which is potentially very broad, and which FSA should delimit.

There also appear to be some errors. NEWCOB Appendix 1, Part 2 wrongly omits NEWCOB 10 from the provisions that do not apply to firms that bring about or enter into transactions with eligible counterparties. (It is also the case, of course, that NEWCOB 6 and NEWCOB 7 do not apply to eligible counterparties, although here the provisions themselves are delimited).

Chapter 6: COB obligations

General requirements

FSA proposes to copy out MIFID Level 1 Article 19(1) and (3), extending the scope of Article 19(1), but not the Article 19(3) information requirement, also to non-MIFID business for retail clients. FSA proposes, however, an information requirement for retail clients in relation to derivatives, warrants, and stocklending, given the risks of those products (NEWCOB 2.2.2R(4)).

Q7. Do you agree with FSA's proposed implementation of MIFID Articles 19.1 and 19.3?

Whilst we support the approach to the implementation of MIFID Level 1 Article 19(1) and the principle of copying out Article 19(3) in NEWCOB 2 and then cross-referencing to the detailed rules relating to its implementation, we think that:

a) cross references to the specific rules (transposed from the Level 2 implementing provisions) should be included within NEWCOB 2.2.2R; and
b) the guidance at NEWCOB 2.2.3G is too general (see above) and the cross references incomplete (e.g.. there is no cross reference to the risk disclosure provisions in COB 15.3.2R).

We are not commenting, at this stage, on the extension of the MIFID Level 1Article 19(3) requirements to non-MIFID business carried on for retail clients in relation to derivatives, warrants and stock lending activity.

Q8. Do you agree with FSA's proposals for section 2.1 of NEWCOB?

Yes.

Inducements

Comment on Chapter 6:

The key initial period during which FSA is consulting the industry on CP06/19 (i.e. by 28 November) ends before CESR's consultation on inducements begins (expected in December). We may need to comment to FSA further on the points covered in CP06/19 in the light of CESR's planned consultation.

Paragraph 6.21ff. FSA states that MIFID introduces inducement provisions broadly similar to COB, and that it does not foresee great market impact. We broadly agree with FSA's judgement of the effect and impact of these provisions. However, FSA goes on to argue that MIFID provisions go wider than COB, applying to all payments, fees, and non-monetary benefits, regardless of materiality. We do not think that it is the case that MIFID provisions should be interpreted as applying to a wider range of payments and benefits than COB, since:

a) Article 26 of the MIFID Level 2 Directive should be interpreted in a purposive way, so that it applies only to payments, fees, and other benefits that are intended to induce someone to act contrary to the client's interests;
b) Article 26 needs to be read in the light of its Recital 40, which we therefore think that FSA should include as Guidance in the Handbook;
c) 'Proper fees' should be interpreted broadly as excluding any payment which represents a commercial return for services or a contribution to services provided.

Paragraph 6.23. We welcome FSA's helpful comments on the ability of firms to disclose information about inducements in summary form.

Paragraph 6.29. FSA draws a distinction between COB Rules, which permit firms to offer, receive or accept a benefit provided that it is unlikely to conflict to a *material* extent with any duty that a firm owes to its customers, and MIFID provisions, which relate to "all payments and receipts of fees, commissions and non-monetary benefits". We do not think that FSA should see this as a change. Simply because MIFID does not use the word 'material', it does not mean that materiality is not relevant. By its very nature, an inducement is an attempt to get someone to act in a way that they would not otherwise have done. Materiality is therefore *inherent* in the concept of an inducement, since matters which are immaterial are not likely to induce anyone to act in a different way. We consider that the criterion of materiality is consistent with MIFID and can therefore be retained.

It is important to distinguish a situation where an inducement is being provided to induce someone to act in a different way from how they would otherwise have done, from where a firm is properly remunerating a third party for their part in providing service, or is being properly remunerated by someone else.

For example, in the commodity markets, it is not unusual to have introducing broker (IB) agreements, which allow for a return commission arrangement. Typically such agreements will allow for the return of commission to the introducing broker out of the executing broker's earnings from that client. Currently, such arrangements are notified to the client and the client may, on request, be provided with further information. Such arrangements should not, however, be regarded as inducements, as there is no overall benefit (income), since they operate as if the introducing broker alone dealt with the client. Such IB agreements are in place because of language or timeframe constraints, as well as because the executing broker has a more detailed knowledge of the market.

Firms may also have agreements (often intra-group) where executing brokers are remunerated on a cost-plus basis, in which case the benefit is independent of the client's trading - there could well be a bonus element but that is on general performance rather than individual clients – again, in such cases, it should not be considered that there is any form of inducement.

As another example, in the MTN market, a firm might be looking to issue a specific structured note to a client. If the client requested that the note be of a certain credit quality, the firm would find an appropriate issuer to issue the note. The issuer would expect to take some form of 'fee' or 'benefit' out of the deal, normally through a

preferential funding rate achieved via a swap with the firm. The rate that the firm lost on the swap would be priced into the model that it used to value the note, so that the client ended up paying for the issuer's funding. The firm would buy the note from the issuer at a certain price and might sell it on to the client at another. If there was a large issue and intermediaries or sellers were used, the note might be sold to the sellers at one (discounted) price and they sell on to the client at another. This model works because the clients are looking to achieve a certain level, or profile, of return and as long as they achieve this return they are content. The firm could also have an idea about the value of the note at the start, and might also be actively marketing it to clients. Inducement provisions should not apply in this situation, because the relevant 'fees' or 'benefits' represent a commercial remunerations for the participants' contributions to the service. Furthermore, even though the enhancement test could be passed because without the involvement of the participants there would be no note for the client, the disclosure of information could be very complex.

FSA should build on NEWCOB 2.3.6G (Recital 39) to adopt a broad interpretation of the new requirement in NEWCOB 2.3.1R that an inducement must be designed to enhance the quality of the service to the client, so that, for example, the ability to provide the service at all represents an enhancement of its quality. If FSA has any concerns about such an interpretation, we would be grateful if it would discuss the matter with us.

Comments on draft Handbook text:

NEWCOB 2.3.1R: FSA has copied out MIFID Level 2 Directive Article 26 incorrectly. Article 26 applies only "in relation to the provision of an investment or ancillary service to a client". FSA's wording, "in relation to designated investment business…", is much broader, and would inappropriately extend MIFID inducement provisions beyond where the firm is acting in a capacity to which they are appropriate. See also our comments above and below on the need to restrict inducement provisions to circumstances where the fee, commission, or non-monetary benefit is intended to induce a party to act in a way which materially conflicts with a duty owed to clients. FSA should ensure accurate copy-out of Article 26.

In line with its proposed intelligent copy-out approach, we think that FSA should insert in NEWCOB2.3 Guidance corresponding to Recital 40, along the following lines: "2.3.1R permits investment firms to give or receive certain inducements only subject to specific conditions, and provided they are disclosed to the client, or are given by the client or a person on behalf of the client".

NEWCOB 2.3.5G: We do not agree that non-monetary benefits should include direction or referral of business to another person. It is an element of certain firms' business models that they would be, in certain circumstances, happy to take on business at little or no cost (income) because of the additional volume and liquidity it could generate. Such referral arrangements whilst not very common, happen in certain commodity markets but are fully disclosed through the client agreements. FSA should delete NEWCOB 2.3.5G

NEWCOB 2.3.17R: FSA proposes to require firms to keep a record of all inducements given for five years. This provision is superequivalent to MIFID

requirements. We consider that as a general principle FSA should rely on the requirement for firms to maintain records to evidence compliance with requirements under MIFID, rather than specifying that particular records should be kept where MIFID does not require them.

Q9. Do you agree with FSA's proposed approach to implementing the MIFID inducement provisions?

See our comments on Chapter 6 and the draft Handbook text above. FSA should follow a purposive approach to MIFID inducement provisions, interpret 'inducements' in line with the existing FSA practice, copy out MIFID Level 2 Directive Recital 40, and not interpret the requirements as implying significant change to the existing regime.

Q10. Do you think that there will be 'non-monetary' benefits that you currently provide/receive and which are permitted under COB that you consider will not be permitted under NEWCOB?

Provided that FSA interprets the provisions purposively as set out in our comments above, we do not think that there will be.

Q11. Do you agree with FSA's proposed approach to implementing the MIFID inducement provisions in relation to retail non-MIFID business and firms?

We agree with FSA's proposal not to extend the 'enhancement' or information requirements to non-MIFID business.

Provision of services through the medium of another firm

Paragraph 6.38. We welcome FSA's proposal to follow broadly the approach set out in its August informal DP.

Paragraph 6.48. We welcome FSA's proposal to retain COB4.1.5 'agent as client' provisions.

Q12. Do you agree that COB2.3 should be retained to allow MIFID firms to rely on information provided by non-MIFID firms?

Yes.

Q13. Do you agree that a provision equivalent to COB 4.1.5 should be retained to allow firms to treat a person acting as agent as their client in certain circumstances?

Yes.

Customers introduced to clearing firms by introducing brokers and overseas introducing brokers

Q14. Do firms agree with FSA's approach to dealing with scenarios currently covered by COB5.8? Do any additional risks or concerns for firms or investors arise under this proposal?

Our initial view is that, as there can be a lack of certainty over regulatory requirements in relationships involving an introducing broker and a clearing broker, some specific guidance should be retained in the Handbook. We would be happy to discuss this area with FSA in more detail.

Exclusion of Liability

Q15. Do you think removing the 'exclusion of liability' rules would have a detrimental impact on consumer protection?

We consider that other consumer protection measures mean that the exclusion of liability rules could be removed without detriment to consumer protection.

Chapter 7: Client categorisation

Comments on Chapter 7

Paragraph 7.2 states that FSA proposes to extend MIFID client categorisation terminology to retail non-MIFID business, whereas, as set out in NEWCOB3.2.1G, this applies to all clients. No amendment is needed to the Handbook text.

Paragraph 7.13. FSA proposes to adopt MIFID client terminology for non-MIFID business, but with greater flexibility on criteria (including turning off quantitative criteria for opting up retail clients). FSA should, if legally possible, be more flexible and take the same broad approach to MIFID client terminology: in particular, in order to avoid inappropriate restrictions on firms' judgement of relevant clients' knowledge and expertise, for MIFID business the quantitative criteria should apply only when they are relevant to the service offered.

Paragraph 7.16. FSA states that the CP does not cover MIFID categorisation at the professional/ECP border for non-MIFID business, which is to be covered in a consultation in the second quarter of 2007. We urge FSA to pre-consult informally before the second quarter, along similar lines to the August 2006 client categorisation informal discussion paper, to give firms an early sense of FSA's thinking. Firms' client re-classification work is likely to be well advanced by the second quarter, and it will be important to ensure that any consultative proposals that emerge at that stage do not impose significant changes to their approach. Early FSA assurance that this would not happen would be very helpful. Furthermore, since the consultation for non-MIFID business has been delayed, we ask FSA to allow an additional six months (i.e. until 1st April 2008) to enable affected firms to respond properly to the consultation and ready themselves for the changes. All waivers and transitional provisions for non-MIFID business should also be carried forward to 1st April 2008

Q16. Do you have any further comments on the application to non-MIFID business of the client categorisation proposals set out in FSA's August CC Paper?

See our comments above.

Paragraph 7.25. We welcome FSA's intention to take a purposive approach to unclear terms.

Paragraphs 7.32-7.34. We note FSA's conclusion that MIFID is clear that the large undertakings test must be applied on a strict company basis in relation to MIFID business, although subsidiaries classified at present as intermediaries can be grandfathered into the professional category. For the purposes of this test, it is important to bear in mind that holding companies effectively prepare two sets of accounts: one for the holding company alone, and another which reflects the value of the holding company's subsidiaries. Since the consolidated financial statements of the group provide a truer statement of the size of the undertaking than the holding company's, firms should be able to look to them for the purposes of the size test. This reflects current market practice. If FSA disagrees with this conclusion, we would be grateful if it would discuss the matter with us.

Paragraph 7.47. We welcome FSA's proposed purposive approach to the interaction between Annex II.1(1)(i) other institutional investors and Annex II.1.4 other institutional investors. It is important that unregulated other institutional investors are not unduly constrained from choosing ECP status.

Paragraph 7.48. We welcome the helpful clarification in NEWCOB 3.2.3(3)R that for a trust, the client is the trustee, not the beneficiary.

Paragraph 7.56. FSA states that 'express confirmation' in Article 24.2 (24.3?) means some form of acknowledgement or active demonstration of consent. We welcome FSA's confirmation that it should be for the firm to determine how best to obtain the confirmation. We do not agree that an active continuation of dealing in response to a one-way notification by the firm should not constitute an active demonstration of consent. See also our comments under Chapter 1 above on the need for FSA to adopt a consistent and market-oriented approach to the interpretation of provisions that require 'express' confirmation or consent.

Paragraph 7.69. FSA states that if a firm refuses to agree to an opt-up or opt-down, it may not carry on providing services in the original category unless the client agrees to withdraws the request. We think that this interpretation would be superequivalent to the MIFID legislation, which does not mention it. It will be important to respect the general legal interpretation that if an offer to modify a contract is not accepted, dealing may proceed on the previous contractual basis.

Paragraphs 7.70-7.72. We welcome FSA's approach under which a requirement for written agreement applies only when the client requests recategorisation as professional, but not when it is done at the firm's initiative.

Paragraphs 7.73-7.76. We welcome FSA's interpretation under which Annex II.1.4 professionals can choose ECP status if they satisfy Annex II.II quantitative, qualitative, and procedural criteria. It should also be possible for a firm to assess the knowledge and experience of an Annex II.1.4 professional without needing to consider the quantitative criteria where the nature of the service means that the quantitative criteria could never be satisfied (see also our comments on paragraph 7.13 above and NEWCOB 3.5.3R below).

Paragraphs 7.93ff. FSA confirms its interpretation of 'client' and 'activities' v 'services' from the August informal DP, but modifies it to align with the treatment of client orders in Chapter 16. Although FSA rejects the argument that some of the criteria for 'client' status that it set out in the informal DP were too broad, it will nevertheless be important for FSA to interpret them, as FSA stated in the informal DP, in the overarching context of the 'client relationship', and of any documentation that makes clear the basis of that relationship. See also our comments under paragraph 16.26 below that an agreement between the parties should be conclusive as regards professional clients.

Paragraphs 7.102ff. FSA proposes to delete the IPC chapter, but consult in 2007 on retaining provisions on transactions at non-market prices.
Q17. Do you agree with FSA's proposal that the IPC should be deleted from the FSA Handbook?

This is a question which we will need to consider further on the 23rd February 2007 timescale, bearing in mind that, while the IPC is in need of revision, retaining it may provide a more complete source of information and guidance than any sporadic guidance that might replace it.

Comments on draft Handbook text

NEWCOB 3.5.3R FSA's wording applies 'each of the following criteria'. This is not an accurate copy-out of the MIFID text, which states that 'in the course of the…assessment…two of the following criteria should be satisfied'. It is important that the quantitative criteria do not impede the firm's assessment of the client's knowledge and experience where the nature of the service means that the quantitative criteria can never be satisfied.

NEWCOB 3.6.4G. Given its importance to firms' classification of customers, the provision that elective ECPs include equivalent undertakings from third countries should be framed as a Rule rather than Guidance.

NEWCOB 3.7.8G. We welcome FSA's confirmation that reclassifying an ECP or professional as retail does not necessarily mean that it will become an eligible complainant under DISP.

NEWCOB 3.8.2R. We consider that as a general principle FSA should rely on the requirement for firms to maintain records to evidence compliance with requirements under MIFID, rather than specifying that particular records should be kept where MIFID does not require them.

Chapter 8: Communications to clients

Comments on CP06/20

Paragraph 3.10. FSA states that the MIFID requirements on firms to 'ensure' certain matters mean that it does not propose to carry forward the current 'reasonable steps' standard, justifying this course in paragraph 1.33 of the CBA ('incremental compliance costs of minimal significance') by reference to the assertion that firms already apply requirements as if they were absolute. Nevertheless, in order to avoid imposing unrealistic standards on firms, and in view of the fact that FSA sees no change from the current position, FSA should make a statement that it will interpret 'ensure' to take account of the circumstances of the case and what is reasonable.

1MQ.1: For MIFID-scope business, do you agree with FSA's interpretation and approach to the implementation of MIFID provisions for all information in NEWCOB 4?

See our comments above on the need for an appropriate treatment of 'ensure', and below on specific provisions.

4MQ.1: Do you agree with FSA's proposals relating to all information in NEWCOB 4 for non-MIFID scope business?

This is a question which we will need to consider further on the 23rd February 2007 timescale

*4MQ.2: At present firms must take **reasonable steps** to communicate in a way that is clear, fair and not misleading. Do you agree with FSA's proposal that all firms should ensure that all information they address to customers in relation to relevant business **is** fair, clear and not misleading?*

No. See our comments above: FSA should interpret 'ensure' to take account of the circumstances of the case and what is reasonable.

Comments on draft handbook text

NEWCOB 4.1.3R. We note that whilst this Rule reflects Recital 46 of the MIFID Level 2 Directive, it does not include the list of types of marketing communication to which "it would not be appropriate to apply such [fair, clear and not misleading] conditions." We ask that Recital 46 be reproduced in full.

NEWCOB 4.2.3G. The reference to Recital 31 appears to be incorrect. We believe that the text should, instead, refer to Recital 46 (see above) but, if so, we consider that the guidance is, in part, unnecessarily duplicative of NEWCOB 4.1.3R. Since there is no particular reason why Recital 31 of the MIFID Level 2 Directive should be transposed as a Guidance while Recital 46 of the MIFID Level 1 is transposed as a rule, we think that the non-duplicative material from NEWCOB 4.2.3G should be incorporated in NEWCOB 4.1.3R as a Rule.

NEWCOB 4.3.8G. This additional FSA guidance should appear under 4.3.2R and not at the end of the chapter.

NEWCOB 4.3. Whilst we note that 4.3.1R provides that this section applies to information addressed to…retail clients, given the lack of clarity in the NEWCOB application provisions, we consider that the references to "clients" in the section (e.g. 4.3.6R; 4.3.7R) should be to "retail clients" only.

Chapter 9: Financial promotion

Comments on CP06/20

We are concerned that FSA's proposals are in danger of complicating rather than simplifying the financial promotion regime, and departing from principle-based regulation. For MIFID business, we do not think that FSA need do more than copy out the relevant Articles from the Level 2 Directive. There are problems of interpretation and application in the detail of the MIFID provisions, but they do not justify the level of additional complexity that FSA proposes. FSA and HMT would also need to ensure that the proposed Rules that go beyond intelligent copy-out are consistent with what the Commission said in its recent ESC Working Document 64/2006: "MIFID and Marketing/Selling Restrictions".

For non-scope business, we think that it would be preferable, at least in the short term, to retain the existing rules.

However, we think that firms should also be permitted to apply only the MIFID rules to non-scope business. We think that it would be possible to achieve this despite the remaining limitations on FSA's rulemaking powers in the financial promotion field following the entry into force of the Financial Services and Markets Act 2000 (Markets in Financial Instruments) (Modification of Powers) Regulations, for example by the following route:

FSA would restructure NEWCOB 4 and NEWCOB 5 so that there are rather simple chapters containing just the MIFID rules on communications and financial promotions, with a separate chapter on financial promotions, similar to the current rules. The MIFID rules would apply to MIFID firms for MIFID business. The Financial Promotion rules would apply to non-MIFID firms for all business and to MIFID firms for non-MIFID business. However, FSA would use the waiver with consent procedure to switch off non-MIFID rules for non-MIFID regulated activities in the case of firms that elect to apply the MIFID rules to the promotions in question. MIFID firms would elect to apply the MIFID chapter to all their designated investment business (and to switch off the Financial Promotion chapter), in which case the MIFID rules on communications would apply to all such business except for communications that are either (a) not financial promotions or (b) exempt promotions (to respect the limits of section 145, as amended). This would mean that a firm opting into the regime would be able to behave as if the MIFID rules applied to all designated investment business.

Paragraph 2.34. FSA states that for MIFID firms carrying on MIFID business, Financial Promotion Order exemptions will not be available, and NEWCOB rules will apply. FSA expects some firms to have to reconsider their business models, especially regarding the one-off, high net worth, sophisticated investors, and sale of a body corporate exemptions. We will need to consider further on the 23rd February 2007 timescale how significant the effect might be.

Paragraph 3.8. It is important that the Handbook text is clear that, while ECPs can request that fair, clear, and not misleading requirements apply, the firm needs to agree to that request for them to do so.

Paragraph 3.11. We welcome FSA's conclusion that there is no significant market failure calling for the application of fair, clear, and not misleading requirements to professional clients or ECPs.

Paragraph 3.15. We welcome FSA's common sense approach to the interpretation of terms.

Paragraph 4.21. We welcome FSA's proposal to rely on guidance rather than maintaining prescribed format rules, as an example which it should follow elsewhere where it is proposing to retain superequivalent rules.

4.34ff. In view of the problems inherent in the timing of the 'may be suitable' test for direct offer financial promotions (particularly via websites) of derivatives and warrants to retail clients - which must be made before the firm sends out the direct offer - we welcome FSA's proposal to not carry forward the direct offer definition in NEWCOB. We also concur with FSA's proposal to apply the MIFID appropriateness test in the place of the 'may be suitable' assessment for all transactions in these instruments for retail clients arising from certain financial transactions (see our response to Chapter 14).

Paragraph 4.67. FSA and HMT would need to ensure that the proposed retention of the UCIS regime is consistent with what the Commission said in its recent ESC Working Document 64/2006 "MIFID and Marketing/Selling Restrictions", and to consider whether the retention would need a MIFID Level 2 Directive Article 4 notification.

1MQ.2: For MIFID-scope business, do you agree with the way in which FSA propose to implement MIFID provisions relating to scope financial promotions in NEWCOB 5?

No: see our comments above. FSA should follow a straightforward copy-out approach.

4MQ.3: Do you agree with the way in which FSA have applied financial promotion provisions to non-MIFID scope business in NEWCOB 5?

No: see our comments above.

4MQ.4: Do you agree with our new approach to direct offer financial promotions?

Yes (see our comments under Chapter 15)

4MQ.5: Do you have any other comments on issues raised by this CP?

Not at this stage, though we will need to consider this question further on the 23rd February 2007 timescale.

Comments on draft Handbook text

NEWCOB 5.1.2G: FSA should not specify that "Generally, this chapter applies…". The boundary of its application should be precise.

NEWCOB 5.4.1R. Should cross-refer within NEWCOB, not to MIFID.

NEWCOB 5.4.1R(1)(b): (replacement of direct offer provisions). This provision appears to impose additional information requirements on promotions relating to non-MIFID business. It should not do so.

Chapter 11: Information about the firm, services, remuneration

Paragraph 11.62. This paragraph states that "MIFID introduces different status disclosure requirements for all firms (including wholesale as well as retail firms) within its scope." However, as the status disclosure requirements in Article 30(1) of the MIFID Level 2 Directive as transposed in NEWCOB 7.1.4R(1) and (4) apply only in respect of retail clients, we assume, unless advised otherwise, that the CP text is in error.

Q26. Do you agree with FSA's proposals for implementing these additional disclosure requirements from MIFID?

We agree with FSA's copy-out approach to the additional disclosure requirements and welcome the flexibility over the manner in which the information is provided to customers.

Q27: Do you agree with FSA's proposal to remove the excessive charges rules at COB 5.6?

We concur with the proposal to delete the excessive charges rule as we believe that the mischief this rule is intended to prevent is covered in more general terms by the Principles.

Q28. Do you have any comments on FSA's approach to statutory status disclosure?

Notwithstanding the apparent contradiction with respect to status disclosures for firms dealing with or for professional clients, we do not see the need for two similar status disclosure requirements for MIFID and non-MIFID business. We also consider the application of NEWCOB 7 and GEN 4 potentially confusing, for example:

(a). NEWCOB 7 applies to firms carrying on designated business with or for retail clients (regardless of whether or not it is within scope of MIFID) while GEN 4 has now been disapplied (in GEN 4.1.1R(5) for MIFID business (or equivalent business of a third country firm): hence non-MIFID firms with retail clients will have to comply with both NEWCOB 7 and GEN 4, rather than GEN 4, as indicated in the CP;

(b). NEWCOB 7.1.5G refers firms to GEN 4 Annex 1 for the appropriate forms of words for status disclosures, yet the whole of GEN 4 has been disapplied for MIFID business.

Branches of EEA firms may be faced with differences between the detailed formats and requirements of statutory status disclosure required by their home State and host State, and we urge FSA to work with other regulators on practical solutions that minimise inconsistencies between detailed requirements for such firms.

Comments on draft Handbook text

NEWCOB 7.1.4.R(5). Given that appointed representatives are not 'registered' under the Financial Services and Markets Act, we consider that this requirement, although being transposed from Article 30(1) of the MIFID Implementing Directive, should be modified.

Chapter 13: Client agreements

Paragraph 13.8. We welcome FSA's proposal to remove the regulatory requirement for terms of business for professional clients and see this as a pragmatic regulatory simplification and liberalisation. Whilst we agree that firms are likely to continue to enter into agreements with clients for legal certainty, the proposal will provide important flexibility as to how firms make disclosures and obtain consent. We also welcome FSA's statement in Annex 1, paragraph 6.8 of the CBA that the additional flexibility will "permit tailored disclosure of information that is relevant to a firm's particular circumstances". We think, however, that FSA should provide a table summarising provisions requiring disclosure to and/or consent from retail and professional clients.

Paragraph 13.9. We agree that there is no regulatory need for written two-way agreements (although in certain jurisdictions, without a signed agreement, firms are not able to enforce agreements locally). We also note that FSA "has not found any evidence that supports the assertion that client signature provides significant additional comfort that the client has read and understood the terms of the agreement nor the disclosures contained within" (Annex 1, paragraph 6.8 of the CBA).

We therefore concur with FSA that, as stated in the CBA (page 51 of Annex 1), "the 'express' consent required under MIFID does require an active (i.e. two-way) demonstration of consent by the client but that this does not extend to requiring clients to return signed paperwork." As FSA will appreciate, it is important that the references to "express consent" within NEWCOB are interpreted as an active demonstration of consent, for example, entering into or carrying on a course of dealing. We therefore welcome the statement in Annex 1, paragraph 6.6 of the CBA that FSA "have left it to firms to decide how to evidence the consent of their customers."

We refer FSA to our comments under Chapter 1 above on the need for a consistent and market-sensitive approach to the interpretation of "express" consent. For example, we consider that the necessary confirmation should be deemed to have been given in the event the client starts to trade with a firm, and that this would constitute an "active demonstration of consent" and not amount to "silence."

Whilst firms "will not be required to 'repaper' their client base" (Annex 1, paragraph 6.4 of the CBA), it would be helpful if firms that have appropriate variation clauses in their terms of business could provide any new disclosures required by MIFID in a one-way notice (with an appropriate notice period). We would ask FSA to give a statement to this effect in its Feedback Statement.

Q30. Do you agree with FSA's proposal to copy out MIFID client agreement proposals into NEWCOB and not add additional COB-based requirements?

Yes.

Chapter 14: Suitability

Comments on Chapter 14

Paragraphs 14.12-14.14. FSA sees continuity between COB and MIFID suitability requirements, but states that 'Firms may need to modify existing processes' to comply with new suitability requirements for professionals. FSA's implementation of MIFID's extension of the suitability obligation to professional clients should give due regard to the sophistication of professional clients in the wholesale market. Suitability is an area where MIFID Connect guidelines are under development. It will be particularly important (especially in the light of FSA's statement in paragraph 14.19 that extension to professionals may bring about significant costs) for firms to be able to agree with clients, in their terms of business or through a separate notification, that the firm will not be providing investment advice, and that suitability requirements will therefore not apply. It would not be appropriate to force firms and their clients to adapt current practices, at significant cost without improving the quality of the service, without evidence of market failure.

FSA states that a firm may be unable to proceed with a transaction if the client does not supply information. We think that this is an incorrect interpretation of MIFID, under which if the client declined to supply information, the firm would proceed to the non-advised services rules.

Paragraphs 14.22-14.24. We welcome FSA's statement that the requirement relates only to 'relevant information', taking account of the client's experience and knowledge, and calibrated to the product or service.

Paragraph 14.26. FSA states that firms undertaking business for professional clients 'may want to consider whether any new obligations could arise in relation to scenarios such as marketing roadshow Q&A sessions, brainstorming with clients, market speculation, market 'colour/context' conversations, risk management/hedging, or discussions of trading strategies'. FSA proposes no additional guidance on these issues, but refers to PERG guidance, and the need for firms to be mindful of the nature of communications with clients. In most of the circumstances that FSA describes, it is difficult to see how a suitability obligation could arise, either because the communication would not be presented as suitable for a particular person or based on a consideration of their circumstances, or because the firm would not have a client relationship with the addressees. The reference to the specific nature of the communications and the client's relationship with the firm in the context of determining whether a suitability assessment is required is helpful from this point of view, and supports our argument under paragraphs 14.12-14.14 above that firms should be able to agree with professional clients in their terms of business that investment advice will not be provided.

Q31. Do you agree with FSA's proposal to use the MIFID requirement as the nucleus of the NEWCOB 10 regime?

We note that FSA will consult in 2007 on suitability and professional clients as regards non-MIFID business, but that (paragraph 14.7) it is not proposing to extend suitability in professional markets beyond what MIFID requires. In the light of our

comments under this Chapter about the need for FSA to apply MIFID suitability requirements in a way which is adapted to the needs of wholesale markets, does not impose excessive burdens or costs on firms dealing with professional clients, and which does not impose superequivalent requirements (for example as regards record-keeping) for either professional or retail clients, we agree with FSA's conclusion that suitability should not apply to non-MIFID business with professional clients, and we think that it would be preferable to consider the question of whether to apply the MIFID approach to suitability also to non-MIFID business, on the basis of thorough impact assessment, only once MIFID requirements have been implemented.

NEWCOB 10.5.1R. This provision is superequivalent to MIFID, which requires (MIFID Level 1 Article 13.6) only that firms keep records sufficient to enable the competent authority to monitor compliance. For participants in the professional markets in particular it would be disproportionate and burdensome to require firms to record the suitability assessment for each transaction. FSA should therefore delete NEWCOB 10.5.1 (1) and (2), and certainly not apply it to professional clients In accordance with MIFID Level 1 Article 13.6, it should be possible for firms to record the procedures and staff training by which the firm complies with any suitability obligations that may arise. Furthermore, FSA should give due consideration to the practicalities of recording the investment objectives of professional clients, and for elective professionals, their financial capacity to bear risks, taking account of the following facts:

a) A typical professional client will pursue a wide range of specific short-term trading strategies within a broader long-term investment objective.
b) Professional clients are often unwilling to reveal their trading strategy or investment objectives to a firm in full.
c) The content of the dialogue between a firm and a professional client tends to be focused on a narrow range of products specified by the client. Any advice is generally limited to a client's preferences relating to certain product features (e.g. payout, maturity, leverage), market conditions, and timing.
d) Dialogue between a firm and a professional client typically takes place at speed.
e) Professional clients will typically be in discussion with several firms, in which case it would not be appropriate to attribute a client's eventual investment decision solely to the advice of the firm with which it trades.

Chapter 15: Non-advised services

Comments on Chapter 15

Paragraph15.5. NEWCOB 11.2.1R is a welcome confirmation of MIFID provisions.

Paragraph 15.6. We consider that the additional guidance FSA proposes in NEWCOB 11.2.5G, 11.2.6G, 11.2.7G, and 11.2.8G is helpful.

Paragraph 15.7. We note FSA's proposal not to extend the appropriateness test to non-MIFID firms and/or non-MIFID business (except in the circumstances discussed below). Given that the appropriateness test is a new requirement, we concur with this position and believe that FSA should carry out a full impact analysis to determine the appropriateness and proportionality of such additional requirements, should this position change.

Paragraph 15.8. As discussed above, in view of the problems inherent in the timing of the 'may be suitable' test for direct offer financial promotions (particularly via websites) of derivatives and warrants to retail clients, which must be made before the firm sends out the direct offer, we welcome FSA's proposal to simplify requirements in this area by not carrying forward the direct offer definition in NEWCOB. On the basis that an appropriateness test provides a better reflection of the realities of on-line investment services involving derivatives and warrants - and given the arguments put forward in paragraphs 8.32 and 8.33 of the CBA (page 47 of Annex 1), our initial response is to concur with FSA's proposal to apply the MIFID appropriateness test in the place of the 'may be suitable' assessment for all transactions in these instruments for retail clients arising from certain financial transactions, although we may need to consider the matter further on the 23rd February timescale. See also our comments under Chapter 9 and CP06/20 above.

Paragraph 15.9. We note that FSA is seeking views on the possibility of extending the appropriateness test to all non-advised retail transactions involving derivatives and warrants. We think that FSA should carry out a full impact analysis if it is considering making more formal proposals.

Paragraph 15.11. We welcome FSA's proposal to implement MIFID in a way which imposes no information-gathering or appropriateness requirements for professional clients.

Paragraph 15.15. FSA states that its CBA (paragraph 8.17) suggests significant one-off and ongoing costs from appropriateness. Given that paragraph 8.17 of the CBA identifies the possibility of significant market impact, it will be particularly important for FSA to interpret appropriateness obligations in a proportionate and market-sensitive way, and not in way which overimplements the MIFID provisions, for example by imposing superequivalent record-keeping requirements or restrictions on firms' ability to provide services if clients decline to provide information.

Paragraphs 15.20-15.21. We welcome FSA's proposal for an outcomes-focused, risk-based approach, calibrated according to the expertise of the client.

Q37. Do you see any points of uncertainty in how the MIFID appropriateness requirements may apply to your business model(s)? If so, what?

This is a question for individual firms, but at this stage, we do are not aware of any points of uncertainty.

Q38. Do you agree with FSA's decision generally not to extend the appropriateness requirement beyond what MIFID requires?
Yes.

Q39. Do you agree with FSA's proposal on application of the appropriateness requirement to the specified financial promotions of derivatives and warrants?
Yes.

Q40. What are your views on the possibility of extending the appropriateness test to all non-advised retail transactions of derivatives or warrants?

We would wish to see the results of an impact analysis before addressing this question.

Comments on draft Handbook text

NEWCOB 11.2.1R(2)(b). We recognise that appropriateness - in common with "suitability" - comprises two elements: an information gathering exercise and an appropriateness assessment. Given that NEWCOB 11.2.1R(2) applies at the stage where a firm is "assessing appropriateness" we understand that the practical effect of NEWCOB 11.2.1R(2)(b) is that firms may assume that the products or services offered or requested are appropriate for professional clients, and therefore that no record-keeping requirement arises under NEWCOB 11.7.1R in relation to professional clients either. We would be grateful if FSA would discuss the matter with us if it does not agree with this interpretation.

Further to the above, we consider that our interpretation is supported by Recital 59 to the MIFID Level 2 Directive which provides guidance to the effect that a firm complies with its entire "duty" under article 19(5) of MIFID (to assess appropriateness) if a client is "presumed to have the necessary experience and knowledge in order to understand the risks involved in relation to" a product or investment service in respect of which they have entered into a course of dealings before the implementation of MIFID.

NEWCOB11.3.3G. This Guidance states that a firm should consider whether the transaction is in the best interests of the client, if the client asks it to proceed despite a warning. This provision is superequivalent to MIFID requirements. FSA should therefore delete it.

NEWCOB 11.4.2R. We welcome this helpful guidance.

NEWCOB 11.5.3G. The Guidance on personalised communications is helpful, in particular 11.5.3G(4), which would enable firms to rely on announcements made, for example, at roadshows or brainstorming sessions.

Chapter 16: Dealing and managing

Best execution

The key initial period during which FSA is consulting the industry on CP06/19 (i.e. by 28 November) ends before CESR's consultation on best execution begins (expected in December or January). We may need to comment to FSA further on the points covered in CP06/19 in the light of CESR's planned consultation.

We have discussed with buy-side associations the interaction between best execution and client status. We agree with buy side associations that the question of whether or not best execution applies should not affect other client protections, including those relating to conflict of interest management and protection of client assets. We think that it is proper that buy side firms should be entitled to the right level of protection as clients, even where best execution does not apply because they are ECPs, or as otherwise agreed. It is important for the Handbook and FSA's other interpretative material to support this position. In this response we have suggested two means by which this can be achieved: by inserting in the Handbook material from the CP that clarifies that the question of whether best execution applies does not affect general client protections, and, where best execution does apply, by giving full weight to MIFID's provision that following client instructions fulfils a firm's best execution obligations.

Paragraph 16.15. We agree with FSA's proposal not to apply MIFID best execution provisions to non-MIFID business.

Paragraph 16.22. FSA states that some clients that can now agree to forego best execution will no longer be able to do so. See our comments under Chapter 7 above , and elsewhere under this Chapter, on the need for FSA to adopt as flexible an approach as possible to enable clients to choose that best execution does not apply.

Paragraphs 16.23ff. FSA states that best execution may not apply where the firm performs an 'activity'. For dealing on own account, this depends on whether the firm is dealing with a 'client', and whether it is 'executing a client order' or carrying on a 'service', which depends on the responsibilities undertaken to the customer. FSA states that in practice, firms may refer to terms of business: as to whether the customer looks to deal on basis of a published quote, or asks the firm to execute an order on its behalf. We agree.

In this context, it will be particularly important for FSA to interpret 'quote' in a broad sense, to encompass, for instance, structured notes and the process of assembling and pricing structured derivatives (see also NEWCOB 12.2.5G).

Paragraph 16.25. It would be helpful if FSA were to include some of the language about the role of the firm's terms of business in determining whether best execution applies as Guidance in the Handbook.

Paragraph 16.26. FSA states that a customer may be a 'client' (subject to other protections) without giving an 'order'. We agree, and we also agree with FSA's

statement in paragraph 21 of its legal opinion on this matter: "in this event the firm, though not owing a duty of best execution, will be subject to the obligations to ensure the fair management of any conflict of interest". We agree that whether a client relationship exists may be determined by reference to a range of indicia. However, for professionals, we do not agree that this cannot be achieved solely by reference to terms of business. For professionals, the terms of the agreement between the parties should be conclusive in this regard. See also our comments under paragraph 16.27 below on the need for FSA to incorporate some of the material in paragraphs 16.26 and 16.27 in the Handbook as Guidance, since it has an important bearing on the scope of the obligation, and therefore needs to be captured in more enduring form than the CP text.

Paragraph 16.27 FSA states that best execution does not apply where a customer is relying on its own due diligence, including in relation to dealers providing continuous quotes or RFQ services. We agree. Because a dealer will not always know whether or not a customer is, for example, polling several dealers, it is particularly important for dealers to be able to rely on terms of business, as explained in our comments on paragraph 16.26 above. We think that FSA should incorporate some of the material in paragraphs 16.26 and 16.27 in the Handbook as Guidance, since it has an important bearing on the scope of the obligation, and therefore needs to be captured in more enduring form than the CP text (see our comments on draft Handbook text below).

Paragraphs 16.28-16.32. FSA states that best execution applies where an investment manager requests it, and the firm agrees to provide it, that a firm may stipulate that access to a quotation service is available only to those who do not seek best execution, that this approach is possible for wholesale and retail markets, that the customer decides for himself, and that a firm responding to a customer's acceptance of a quote is not executing orders, subject to a requirement for full information to the customer about the basis on which the firm is dealing. We agree. We think that FSA should incorporate some of this material in the Handbook as Guidance , since it has an important bearing on the scope of the obligation, and therefore needs to be captured in more enduring form than the CP text (see comments on draft Handbook text below).

Paragraphs 16.33-16.34. We note that FSA holds to its view that accepting a requested quote may not be a 'client instruction'. We think that FSA's General Counsel's Division's advice "Best execution: orders", and the statements in paragraphs 16.26 and 16.27 about the status of quotes and RFQ facilities, have largely resolved the concerns that we had on this issue. However, to the extent that best execution may continue to apply to such facilities, it will be important, as FSA implies by its reference to "instructions in order to avoid the best execution requirements" and "an instruction on terms given by the firm" that FSA applies this restriction only in the context of the anti-avoidance, anti-inducement Recital 68, as copied out in NEWCOB 12.2.21G. Paragraph 10 of the General Counsel's Division advice states clearly that putting out a price on its own is not suggesting the content of an instruction to the client, and for the client's instruction to fall foul of MIFID rules, the firm must have specifically invited the customer to deal when it ought reasonably to have known that the suggested instruction would prevent the firm from obtaining the best possible result. In an RFQ model, it is the client's own specific choice to deal at the quoted price on the quoted terms. The client has the right to give that specific instruction, and the firm must respect it. As set out in NEWCOB 12.2.21G, only

when the firm knowingly induces the client to instruct it in a way that would prevent the firm from obtaining the best possible result should there be any question that the firm should not follow the client's instruction. An appropriately broad interpretation of 'client instruction', encompassing, where best execution applies, both responses to quotes and the instructions on the basis of which a firm assembles a structured product, is particularly important to enable firms to respond to clients' needs in these markets where best execution does apply. If FSA disagrees with our analysis, we ask it to discuss the matter with us.

Paragraph 16.38. It would seem sensible to apply a common best execution standard, whether a portfolio manager transacts directly with dealers or gives an order to a broker. We refer FSA also to our comments under Chapter 1 above on the need for FSA to avoid imposing a higher standard of 'express consent' on professional clients of brokers than on retail clients of portfolio managers, by ensuring that it does not interpret NEWCOB 12.2.26R too restrictively.

Paragraph 16.43. FSA proposes additional guidance on the role of price in NEWCOB 12.2.9G: "…Ordinarily, we would expect that price will merit a high relative importance in obtaining the best possible result for professional clients. However, in some circumstances for some clients, orders, financial instruments or markets, the policy may appropriately determine that other execution factors are more important than price in obtaining the best possible result." We agree with the proposed guidance.

Paragraph 16.46. FSA proposes no guidance on benchmarking, but it thinks it is a valid approach to best execution compliance in some circumstances. We agree with this approach.

Paragraphs 16.47-16.49. FSA states that firms can use internal models that take account of the firm's own book and the like, but refers to Level 2 Directive Recital 69. We agree with this approach.

Q41. Do you agree with FSA's proposal to copy out MIFID's best execution requirements in January 2007?

Yes, subject to the inclusion of wording from paragraphs 16.25, 16.26,16.27 and 16.31 as additional Guidance [see above].

Q42. Do you agree with FSA's proposal to add guidance on the role of price in Best Execution?

Yes.

Q43. Which of the three options in relation to best execution for UCITS portfolio managers creates the most appropriate and proportionate regulatory regime? Why? See our comments on paragraph 16.38 above, although we may need to comment further on this question on the 23rd February timescale.

Comments on draft Handbook text

FSA should incorporate the following material from the text of the CP into the Handbook as Guidance.

a) Paragraph 16.26 and Paragraph 16.27: "A client who transacts with a dealing firm which, for example, provides ongoing access to its published quotes or request for quote service will not be giving an 'order' for the purposes of best execution provisions. A dealing firm is not required to deliver best execution if the customer is relying on its own due diligence in deciding to buy or sell a financial product from or to a firm. This will apply in respect of all dealers including those which provide continuously published quotes or a 'request for quote' service."

b) Paragraph 16.31: "In such cases the dealing firm responding to the customer's acceptance of the quote is not executing orders as such, and so a firm will not need to comply with MIFID's provisions for fair and prompt execution relative to other client orders and a firm's trading interests. However, in these circumstances the customer may still be a client of the firm and hence be owed some of MIFID's other client facing protections."

c) Paragraph 16.25: "It will normally be possible to determine by reference to the firm's terms of business whether in relation to any transaction the customer is looking to deal merely on the basis of a published quote, or is asking the firm to execute an order on its behalf."

We think that FSA should copy out into the Handbook the provisions of MIFID Level 1 Articles 14.3 and 42.4, to the effect that best execution does not apply to transactions carried out under RM or MTF rules between their members.

Client order handling

Q44. Do you agree with FSA's analysis that the risk of client detriment from the removal of the prescriptive rules in COB concerning 'prompt' allocation of client orders is small given other MIFID provisions?

Yes.

Q45. Will the MIFID requirement for prompt delivery after settlement present any material operational difficulties for your business?

No, although it will be important for firms to be able to take into account the normal practices in the market concerned.

Q46. Do you agree that clients may benefit from later allocation because it allows firms to minimise clients' transaction costs and/or because it allows clients to participate in average pricing? Can you provide specific examples?

Yes. Some funds when dealing under give-up agreements will want all their trades grouped into as few trades as possible as it is easier for them to deal with as well as potentially reducing the amount of administration.

Comments on draft Handbook text

Consistently with our comments on paragraph 16.31 above, in order to delimit the scope of NEWCOB order-handling provisions, FSA should incorporate the following material from the text of the CP into the Handbook as Guidance.

a) Paragraph 16.31: "In the cases dealt with in [Guidance based on Paragraphs 16.27/16.31] the dealing firm responding to the customer's acceptance of the quote is not executing orders as such, and so a firm will not need to comply with NEWCOB's provisions on order handling. However, in these circumstances the customer may still be a client of the firm and hence be owed some of NEWCOB's other client facing protections."

Limit order display

Paragraph 16.78. We welcome FSA's proposal to waive publication obligations for limit orders which are large in scale compared to NMS.

Paragraphs 16.82. FSA's proposal to exclude stop orders and contingent orders from the definition of 'limit orders' is helpful. We think that FSA should incorporate this material in the Handbook as Guidance, since it has an important bearing on the scope of the obligation, and therefore would benefit from being captured in more enduring form than the CP text (see comments on draft Handbook text below).

Paragraphs 16.87. FSA proposes that client consent not to disclose a limit order should be by a 'positive act' in any form, and that it cannot be implied. See also our comments under Chapter 1 above on the need for FSA to adopt a consistent and market-oriented approach to the interpretation of provisions that require 'express' confirmation or consent.

Paragraphs 16.89 – 16.92. FSA proposes similar controls over firms' publication of limit orders as for market transparency information in CP06/14, including, apparently, some additional points from CESR's 20th October CP. We refer FSA to our comments on both CPs, in particular on the risks of regulating on the basis of potential but unproven market failure, the system implications of intervention in formats, the risk of delay as result of a requirement for independent error checking, and the need to avoid gold-plating or intervening too far in competitive interactions in the market for transparency information. We may need to comment further on these issues in the light of further developments in CESR's consultation.

Q47. Do you require any further clarification or guidance on the obligation to publish client limit orders?

As noted above in our comments on paragraph 16.82, and below in our comments on the Handbook text, it would be helpful if FSA could include some of the text from the CP in the Handbook as Guidance.

Q48. Are there any other types of order which should also be excluded from the definition of limit orders?

We do not think that other types of order need be specifically excluded.

Q49. Do you agree that we use the power to waive the requirement to display client limit orders to the public in respect of limit orders larger than NMS?

Yes.

Comments on draft Handbook text
FSA should incorporate the following material from the text of the CP into the Handbook as Guidance:

a) Paragraph 16.82: "MIFID defines a 'limit order' as an order to buy or sell a financial instrument at its specified price limit or better and for a specified

size. 'Stop orders' and 'contingent orders' do not fall within the MIFID definition of 'limit orders' and, consequently, these types of orders will not need to be published. This recognises that it would not be in the best interest to have either stop or contingent orders displayed and executed as soon as possible."

b) Paragraph 16.83: "A 'stop order' is an order to buy or sell a share once the price of that share reaches a specified price, known as the stop price. When the specified price is reached, the stop order becomes a market order. The intention of a stop order is not to execute at the current prevailing market conditions, but rather, it is to limit a loss or protect a profit in volatile market conditions."

c) Paragraph 16.84: "A 'contingent order' is an order whose execution depends upon the execution and/or the price of another security."

Personal transactions

Q50. Do you agree with FSA's proposal to copy out the MIFID personal transaction requirements and to apply them to non-MIFID business?

We will need to consider this question further on the 23rd February 2007 timescale.

Use of dealing commission

Paragraphs 16.108 – 16.119. FSA states that it proposes to maintain existing requirements, 'modified to be compatible with MIFID'. FSA argues that MIFID inducement provisions do not adequately address market failures. It states that retaining use of dealing commission Rules may result in higher costs than copy-out, but FSA argues that the costs are justified by market failure and investor protection benefit, and the fact that one-off costs have already been spent. FSA also argues that the Rules are compliant with MIFID Level 2 Article 4, because they address a specific risk that MIFID does not: preventing higher charges for end-investors; reducing excessive consumption of services; and avoiding recurrence of market distortions.

As set out above in our response to Q4, we are concerned that an aggressive approach to Article 4 by FSA, especially if the justifications are not robust in terms of Article 4 itself, may encourage other Member States to propose their own lists, and thereby make it more difficult to control superequivalence.

We suggest that FSA should consider framing the use of dealing commissions as guidance on MIFID inducement provisions, as an alternative to superequivalent Rules.

Q51. Do you agree with FSA's proposal to carry forward the use of dealing commission provisions in NEWCOB?

See our comments above. We think that FSA should consider other options for retaining the material which do not involve a superequivalent Rule.

Miscellaneous dealing requirements

Q52. Are there any aspects of COB7.10 that in your view should be retained in NEWCOB? Would any of these provisions be more appropriately expressed as industry guidance?

We will need to consider this question further on the 23rd February 2007 timescale.

Chapter 17: Investment research

Paragraph 17.8. FSA proposes to copy out MIFID provisions, but also include guidance:
(a) that the MIFID dealing ahead prohibition may apply where the analyst or another person has knowledge of the intention to produce or disseminate independent research; and
(b) on the need for conflict management procedures in relation to non-independent research, but also to retain the substance of guidance on means and timing of publication, and FSA also proposes to replicate existing MAD disclosure requirements.
We comment in response to Q54 below on our concerns about the guidance in (b).

Paragraph 17.22. FSA states that it will take account of the European Commission paper on interaction between MIFID and MAD, due in November 2006. We may need to comment further on the implications of the Commission's paper when it appears.

It would be helpful if FSA could confirm that where the disclosure requirements under MAD and for independent research under MIFID are satisfied, it is not necessary for firms to apply the NEWCOB 5.3.2R(2) requirement for 5 years' past performance data.

Q53. Do you agree with FSA's proposed approach to implementing the MIFID requirements on research?

See our comments on this Chapter above and below.

Q54. Do you have any comments on FSA's discussion of the labelling and dealing ahead issues in relation to non-independent research?

Given the statement that firms must now include in non-objective research under NEWCOB 13.3.2R(2)(b), which is transposed from article 24(2) of the MIFID Level 2 Directive, we believe that NEWCOB 13.3.4G(1) is super-equivalent and should either be amended or deleted. As drafted currently, we believe that the guidance could require a MIFID Level 2 Directive Article 4 notification.

We are concerned by FSA's statement, in NEWCOB 13.3.4G(2), in respect of non-objective research, that "it will always be appropriate" for a firm to manage potential conflicts of interest "rather than solely relying on disclosure." For example, as FSA will be aware, sales notes and similar non-independent research aimed at firm's professional clients is often produced on trading desks, sometimes by staff who are also traders. In these circumstances, it is not possible to take "organisational steps" to separate the producers of the sales notes physically from the trading desks. The potential conflicts are an inherent part of business which cannot be managed away; instead they should be disclosed to the professional recipients of the sales note who, we would also argue, understand fully the nature of this non-objective research and the potential conflicts that could arise. We consider, therefore, that NEWCOB 13.3.4G(2) is superequivalent to MIFID and should be deleted or redrafted. We also refer FSA to the comments we made in response to CP06/9 on the need to avoid

limiting the proper application of MIFID's provisions on prior disclosure as a means of accommodating conflict where reasonable management measures do not eliminate the risk to clients.

NEWCOB13.2.5(5) would prevent sales staff from seeing draft research ahead of publication. It copies out MIFID Level 2 Directive Article 25(2)(e), and therefore is not amendable. However, in order to avoid disruption to current market practice, it would be helpful if FSA could consider what scope there might be to exclude from the prohibition sales staff who have crossed the wall.

Chapter 19: Providing Product Information to Clients

We note that whilst the 'References' section of Chapter 19 states that the draft rules implementing the proposals in this chapter are in NEWCOB 14, the relevant text actually appears in NEWCOB 15.

Comments on draft Handbook text

NEWCOB 15.3. A reader assuming erroneously, but quite understandably, that 'product information' is an issue for retail firms, would not be persuaded otherwise by the interpretation provisions at NEWCOB 15.1. Hence, we believe that many readers of the CP will not be aware that NEWCOB 15.3.1R actually applies to professional clients. It would be helpful if guidance could be added that cross-refers to NEWCOB 15.3 from the provisions on the appropriateness assessment in NEWCOB 11.
As discussed under Chapter 5, we consider that each chapter should commence with clear application provisions, which, if necessary, signpost relevant sections.

NEWCOB 15.3.2R. We welcome FSA's statement in paragraph 12.40 of the CBA for NEWCOB 14 and 15 that "the flexibility in the MIFID standard when it comes to professional clients should afford firms some room for manoeuvre in deciding how detailed such warnings should be."

In particular, as the second limb of NEWCOB 15.3.2R applies "where relevant to the specific type of designated investment concerned and the status and level of knowledge of the client", we assume that, in practice, it will rarely be applicable to professional clients. Hence, we envisage that under limb 1 of NEWCOB 15.3.2R, firms will, in general, provide their professional clients with a statement, at account take-on, of the product(s) they wishes to trade and a basic (but in 'sufficient detail' for the client) description of their nature.

NEWCOB 15.3.2R(2). Recital 45 of the MIFID Level 2 Directive, states that: "It is possible that for some financial instruments only the information referring to the type of an instrument will be sufficient whereas for some others the information will need to be product-specific." We think that FSA should include this material in NEWCOB 15.3.2R(2).

NEWCOB 15.3.8R. The requirements to provide a description of the nature and risks of designated investments are contained in article 31 of the MIFID Level 2 Directive. Whilst Article 29(2) of the Level 2 Directive provides that the information required in Articles 30 to 33 must be provided to "retail clients or potential clients" "in good time before the provision of the investment service…" the similar provision (in Article 29(3)) in respect of professional clients applies only to the information required in articles 32(5) and (6), which is transposed in NEWCOB 7.1.7R(3). NEWCOB 15.3.8R(1), therefore, incorrectly transposes article 29(2) and should be redrafted to limit its application to retail clients.

Q63. Do you agree with FSA's proposal to copy out MIFID rules on customer understanding or risk and delete the existing rules and guidance?

Yes, subject to the above comments.

Chapter 21: Reporting information to clients

21.8. FSA proposes to retain existing rules that go beyond MIFID (and may need Level 2 Directive Article 4 notifications) on disclosing to clients additional details on derivative contract notes; disclosure of currency conversion, declared rights not paid, allotted, or otherwise effective, mark-ups and mark-downs when firm acts as principal and under best execution obligations; assets loaned and charged; additional information on portfolios containing a contingent liability investment. See our concerns under Q4 above on FSA's proposed use of Article 4 notifications.

Comments on draft Handbook text

We think that FSA should include in the Handbook text which copies out Recital 49 of the Level 2 Directive, since it provides helpful clarification and flexibility about how reporting requirements apply.

NEWCOB 17.1.1. In many instances firms use the existing opt-out in order not to provide professional clients with trade confirmations. In some cases the information is available to the client by other means such as electronic confirmations, but a significant number of clients have also specifically asked not to receive such confirmations. In order to avoid a costly requirement for firms to provide confirmations in a durable medium, which would have no utility for the clients concerned, we think that FSA should consider what scope there is to interpret the 'adequate reports' language in NEWCOB 17.1.1. to enable professional clients to continue to opt out of receiving confirmations.

NEWCOB 17.2.1R(1)(b). We note that FSA proposes to define "trade confirmation information". However, we do not consider that the proposed definition - "the information identified in column (1) of the table in COBS 17 Ann 1R(1)" – is helpful and would prefer the rule to be cross-referenced directly to COBS 17 Ann 1R(1). Should FSA consider there is a need to define trade confirmation information, we still consider that a cross reference to Ann 1R(1) should be included in NEWCOB 17.2.

NEWCOB 17.2.4G. We think that FSA should expand this Guidance to include MIFID business, since there are many instances where confirmations are sent to agents on the client's instructions for good reasons, for example a SPV may require that its confirmations be sent to an asset manager or to an administrator. Such an approach would be consistent with the NEWCOB 17.1.1R requirement that the client receives *adequate* reports.

NEWCOB 17.4.1R(1). Given that Article 19 of MIFID Level 1 is disapplied for transactions with eligible counterparties by Article 24(1) of MIFID Level 1, we assume that the Level 2 requirement to provide clients with client asset statements, which implements the client reporting requirements in article 19(8) of MIFID, does not apply in respect of eligible counterparties, notwithstanding that they fall within the scope of the custody/client money rules.

We think that FSA should not apply NEWCOB 17.4.1R(1) to firms that operate the 'Alternative Approach' to client money. Such firms hold client money only:

a) if there is a settlement failure of a Delivery Versus Payment transaction within the designated time period, or
b) because coupon or dividend payables have yet to be paid away, or
c) they receive a mystery nostro receipt that cannot be assigned to a trade within the designated time period.

These amounts tend to be small and are desegregated from the client money bank account after a matter of days, once the settlement issue has been resolved between the client and the firm. The 'Alternative Approach' client money systems and processes are therefore designed to view, interrogate and report client money items on a transaction by transaction basis. They are not designed to view, interrogate and report client items on a client account basis. We think that 17.4.1R should apply only to those firms or parts of the firm that operate the 'Normal Approach' to client money, since there is no benefit to clients in providing an annual statement of client money balances held under the 'Alternative Approach'.

NEWCOB 17.4.2R We think that assets rehypothecated by prime brokers should not be treated as client assets, and therefore not be subject to provisions on disclosure that they had been the subject of securities financing transactions, and of benefits accrued. Whether the prime broker has taken assets by transfer of title or pursuant to a right of use provision, the position at English law is that the assets no longer belong to the client, as taking by transfer of title or using them severs all proprietary and equitable rights of the client in exchange for a contractual right to the redelivery of equivalent assets from the broker. Recital 27 of MIFID Level 1 is clear that where a client transfers full ownership of financial instruments or funds to a firm for the purpose of securing or otherwise covering its obligations, such financial instruments or funds should no longer be regarded as belonging to the client. Where an asset has been rehypothecated by the prime broker (i) full ownership has as a matter of law passed to the prime broker; and (ii) it has passed pursuant to a security interest. Therefore, it can no longer be regarded as an asset owned by the client. When the firm uses the financial instrument in a securities financing transaction, it will do so at a time when the firm, not the client, owns it. If FSA disagrees with our analysis, we would be grateful if it would discuss the matter with us.

NEWCOB 17 Ann 1R(1). We believe that the text at the top of the second column (from the left) should refer to the rules which require the information to be provided e.g. NEWCOB 17.2.1R rather than the current, circular, cross reference to "SUP 17 Ann 1", which we believe may be incorrect, given that the rules are in COB17 and, if so, circular.

NEWCOB 17 Ann 1R(1). The "periodic information" column should state that it refers only to the periodic information required under article 41(2)(h) of the MIFID Implementing Directive in respect of "each transaction executed during the period" and that the other periodic information requirements are contained in Ann 1R(2).

NEWCOB 17 Ann 1R(2). For completeness and to improve clarity, the table should contain a row for "information on each transaction executed during the period (in accordance with SUP 17 Ann 1R(1))."

NEWCOB 17 Ann 1R(2). We assume that this table is repeated in error.

Q68. Do you agree with our proposals to retain the existing COB requirements set out in paragraph 21.8?

We note that FSA proposes "to retain some of our existing rules that go beyond what is required under MIFID in limited cases…". We have the following comments:

a) Whilst FSA states in the CP that it proposed to retain "disclosures to retail clients of additional essential details in respect of derivative and option contract notes", the draft provisions in NEWCOB 17 Ann 1R(1) (items 19 to 24) are not limited to retail clients but apply in respect of trade confirmations to professional clients. Whilst we believe that this is probably an error, we wish to state for the record that, absent the current 'opt-out' provisions, we oppose the application of these superequivalent additional disclosure requirements to professional clients.
b) We also note that FSA recognises that it "may need" to notify its superequivalent client reporting requirements under Article 4 of the MIFID Level 2 Directive. As noted in the previous paragraph , we question whether the case is sufficiently proven in respect of the retention for professional clients, to justify the use of Article 4 or whether, in the interests of a level playing field and absent the current 'opt-out' provisions, FSA should apply only the MIFID requirements to professional clients?

We therefore do not support the retention of the additional requirements set out in paragraph 21.8 for professional clients.

Chapter 23: Specialist regimes

Comments on Chapter 23

In respect of Energy Market Participants (EMPs) and Oil Market Participants (OMPs), we note that FSA proposes to remove the current concessions that apply under COB and apply full NEWCOB rules to the MIFID business of such firms. Any disapplications in COB which apply to explicitly non-MIFID activities will be carried forward into NEWCOB. See also our comments on Annex 5 on the timetable for the consultation on the application of NEWCOB to the non-MIFID business.

23.34. While customers of these firms will, therefore, be afforded more regulatory protections under NEWCOB, we believe a likely result of these changes is that some firms will choose to minimise the cost of compliance by limiting the range of customers with whom they do business to those that can be classified as professional clients. Retail client participants in the market are likely to find that their new protections come at the cost of a more limited range of firms with which to conduct their business.

Q72. Do you agree how FSA proposes no longer to apply the current conduct of business concessionary provisions to the MIFID business of firms under the regimes for energy and oil market activity, corporate finance business and stock lending?

With respect to OMPs and EMPs, we recognise that FSA is bound to apply MIFID conduct of business requirements to the MIFID business of these firms and recognise that the inclusion of existing disapplications for non-MIFID activities is the furthest extent to which FSA can continue to provide these concessions to EMPs and OMPs.

Q73. Do you agree with FSA's proposal to include guidance that will replicate the effect of the current corporate finance contact and venture capital contact exclusions?

Yes, however, we feel that guidance should also be given for OMPs and EMPs, that is relevant in the commodity markets. The FOA would be happy to discuss with FSA the production of more useful and market-specific guidance.

Chapter 26: Transitionals and Waivers

Paragraphs 26.1ff. We welcome FSA's policy to 'seek to introduce lengthy transitional provisions except where excluded by Directives'. FSA states that it will not be possible to make transitional provisions or grant waivers for MIFID or other EU implementing rules, and that in practice this will mean that 'in most cases, it will not be possible for [FSA] to make transitional provisions, or grant waivers, of rules which implement MIFID, or any other EU directive, for business that falls within the scope of the directive'.

We note FSA's statement as to legal restrictions imposed on it with regard to transitional provisions and waivers. However, mindful of the enormous challenges faced by many firms in order to become MIFID and NEWCOB compliant by 1st November 2007, it will be important for FSA to be tolerant and understanding of circumstances where firms are unable to be fully compliant in all respects by that date. This may be particularly true for firms whose head offices are outside the UK and which, to a greater or lesser extent, are reliant upon changes in the systems, controls and procedures driven and controlled by head office. Even within the EEA it seems likely that some Member States will not have implemented MIFID by 1st November 2007, which will have an inevitable impact upon the timetable for implementation to be followed by those firms regulated by such member states.

It follows from the remarks above that we welcome FSA's stated policy to introduce lengthy transitional provisions along the lines outlined in paragraph 26.10. Phased implementation, as proposed, will help firms to manage their MIFID implementation projects more effectively and efficiently, and less resource intensively.

In practice it appears to us that as FSA moves more towards a more principles based regime concerned more with outcomes and less with process this should inevitably lead to the need for fewer waivers in any event. However, we also consider it vital for FSA to liaise directly with firms, as well as providing guidance on waivers that affect a significant number of firms, in order to ensure an orderly changeover.

26.10, 4th bullet: The presumption of knowledge and experience should apply to suitability as well as appropriateness

Q80. Do you have any comments on the proposed approach to NEWCOB transitionals and waivers?

See our comments above. Within the limitations imposed upon FSA in respect of implementation of EU directives we strongly welcome FSA's proposed approach.

Q81. Are there any areas, other than those mentioned in paragraph 26.10, where you think it would be helpful to make transitional provisions?

Given the length of CPs 06/19 and 20 it is too soon for firms to have fully considered all the detailed content of NEWCOB and we will comment on this question on the 23rd February timescale.

Q82. In which areas, if any, do you think it possible that you may need to apply for waivers?

Given the length of CPs 06/19and 20 it is too soon for firms to have fully considered all the detailed content of NEWCOB and we will comment on this question on the 23rd February timescale.

Chapter 28: Unfair Commercial Practices Directive implementation

Q83. Do you have any comments relating to the implementation of UCPD for financial services ?

We do not have any comments at this stage.

Chapter 29 : Organisational Requirements not covered in CP06/9

Record-keeping

29.12ff. FSA proposes to create a unified set of high-level record-keeping requirements for common platform firms, through intelligent copy out, and to draw up a list of minimum records. It will be important to ensure that the minimum list of records does not unduly limit the flexibility for firms to determine how they meet the general record-keeping obligations under MIFID Level 1 Article 13.6.

Q84. Do you agree with FSA's proposals for a high-level record-keeping requirement for common platform firms?

Yes.

Chapter 30: Training and competence: making the sourcebook MIFID-compliant.

Q89: Do respondents agree with FSA's proposal to disapply all of the existing TC rules for inwardly passporting EEA MIFID firms and deal with any implications as part of the wider review?

We accept that FSA "can no longer apply any TC rules to EEA MIFID firms passporting into the UK" (paragraph 30.10). We also support the proposal to "deal with any implications as part of the wider review". We urge FSA to consider all issues that are pertinent to the existing TC regime during this review, and to make a single set of proposals to deal with these issues rather than taking a piecemeal approach. However, we are of the view that FSA needs to take care that the right message is conveyed to firms and the public when making these changes. It must be clear that FSA is maintaining standards on training and competence issues. The lessons learned from the handling of the deregulation elements of the Money Laundering Sourcebook need to be taken into account.

In addition it needs to be made clear that FSA will continue to have regard to the level of staff competence when assessing firms' overall ability to undertake their activities. Although FSA will no longer have the ability to apply the TC regime to these firms, it will retain the ability to ensure that they have the responsibility to promote competence in those employed in UK financial services and thus assist the industry with maintaining the high standards for which it is known and upon which at least part of the UK markets' reputation is built.

Q90: Do respondents have any views on the potential competition issue between UK firms and inward passporters in terms of its likely extent and the nature of its impact on firms or other stakeholders and whether any changes are necessary?

FSA has stated that these issues will be raised as part of the wider TC review. We support such an exercise as this does require more research than we have been able to undertake in the time available to comment on the proposals. It is important that the FSA continues its strong support of training and competence across the industry. As FSA is aware from the comments on CP05/10, we have reservations about disapplying TC for wholesale activities.

The industry will take time to put in place acceptable "voluntary" TC requirements once the proposed changes have come into effect in November 2007. This timetable will stretch beyond that date and FSA must maintain its oversight during this transition period. It is important that the UK's high standards are maintained so that those wishing to undertake business in the UK will voluntarily subscribe to those standards and failure to do so will be seen by the industry as a detriment to their doing business. We consider that FSA's continued involvement in TC is essential until this is the case. This will lead to most passporters wanting to continue to ensure these standards are maintained . It is important that these changes are not seen as an opportunity to cut costs which could lead to a reduction in standards. We are sure that with co-operation between the industry, FSA and other interested parties standards will be maintained and continue to improve. We await the outcome of FSA's research for confirmation of this.

Q91: Do you agree with FSA's proposal to remove the current requirements for passing exams within specified time limits (and the associated record-keeping guidance) for both MIFID and non-MIFID firms?

We see this as consistent with MIFID requirements. We agree that it needs to be applied to both MIFID and non-MIFID firms.

It would be helpful if FSA made it clear that firms need to have a policy about how long individuals should remain under supervision, and that it would not wish to see individuals remaining supervised on an indefinite basis. Firms will need to ensure that their staff are competent, and will need to determine which examinations are required for new employees, and the time they will permit for passing them.

Q92: Do you agree with FSA's proposal to amend the record-keeping retention requirements in the TC Sourcebook to five years for MIFID business only?

We see this as consistent with MIFID requirement to ensure MIFID compliance. We consider that firms are unlikely to differentiate between MIFID and non-MIFID business in their record retention processes.

Q93: Do you agree with FSA's proposed minor rule amendments which are required to align TC with the rest of the Handbook as regards the proposed new client categorisation regime and to remove references to private customers which are no longer needed?

This would seem to be an appropriate course of action. We have reviewed the new client categorisations and refer you to our comments on Chapter 7 above. We await the CP on the new TC requirements expected in February 2007 and will comment then on any minor changes as necessary.

Chapter 31: Dispute Resolution

Q94: Do you agree the draft New DISP text provides a better focus on the key aspects of fair and timely complaint resolution?
We do not have any comments at this stage.

Q95: Do you agree with FSA's removing: a] the five-day requirement for acknowledgement; b] the four-week requirement for a holding reply; and changing c] firms' publicising obligations?
We do not have any comments at this stage.

Q96: Do you agree with FSA's proposed approach on complaint handling and record-keeping for: a] MIFID firms' MIFID business; b] MIFID firms' non-MIFID business; and c] non-MIFID firms and CCJ and VJ participants?

Given the focus of the firms we represent on professional and wholesale markets, we have not studied FSA's proposals in detail, but it appears that, along with additional guidance material, FSA has broadly copied out MIFID's provisions on complaints handling.

Q97: Do you agree with the proposed change to the DISP criteria for 'eligible complainants'?
We do not have any comments at this stage.

Q98: Do you find the application provisions sufficiently clear? Can you suggest a better presentation for them?
We have no particular comments on this question at this stage.

Q99: Do you agree with our view of straightforward transition to 'New DISP', or are there complications we have not allowed for?
We have no comments at this stage.

Chapter 32: Transaction Reporting requirements for non-MIFID firms

32.5. FSA proposes to apply transaction reporting obligations similar to MIFID when managers of CISs and pension funds execute reportable transactions.

Q100: Do you think that FSA's proposed approach contains sufficient Handbook guidance for firms to determine whether they should:
(a) report transactions to FSA; or
(b) approach FSA for individual guidance on their reporting obligations?
If not, then what further guidance do you think FSA's Handbook text should contain? Do you think it would be more appropriate for this guidance to go in FSA's Transaction Reporting Users Pack?

We refer FSA to the support that we gave in our response to CP06/14 to the draft guidance in SUP 17.2.2 G to determine which entity "executes" a transaction under MIFID Level 1 Article 25.3, and the need for similar guidance to provide clarity on which trades need to be reported by whom.

Annex 1. Cost-benefit analysis

15.14. FSA states that for corporate finance 'best execution, client order handling and most of the detailed reporting to clients MIFID obligations will have *limited* application. It is important for corporate finance firms that the Handbook text is clear that, as FSA stated in paragraph 2.15 of DP06/3, a corporate finance firm 'is unlikely to need to comply with the requirements because there is no 'order' from a client to be executed. We assume that this remains FSA's interpretation, since the matter is not addressed at all in the body of the CP, as we would have expected it should be if FSA intended that this activity should be included within the scope of best execution: if not, we would be grateful if FSA would discuss the matter with us.

15.23. This paragraph implies that best execution and COB rules apply to stock lending. But the activity is never conducted on the basis of an order, so best execution should not apply, regardless of the client's ECP status (it is not the case that stocklending is always conducted with ECPs). If FSA disagrees, we ask it to discuss the matter further with us.

Q101: Do you agree that the extension of the MIFID categories to retail non-scope business will lead to only minimal costs arising from more clients being placed in categories will higher protection than currently? If not, please state your reasons and provide your estimates for the one-off and additional ongoing costs.
This is a question for firms to answer individually.

Q102: If you are a non-scope firm, is this option something you are likely to consider?
This is a question for firms to answer individually.

Q103:Do you expect the MIFID personal transaction requirements and their extension to non-scope business will materially affect your business? If so, what are your estimates for the one-off and additional ongoing costs?
We do not have any comments at this stage.

Q104: Given our proposals and your firm's business models, do you believe your firm would have a requirement to submit transaction reports? If yes, what costs do you expect to incur?
This is a question for firms to answer. See also our response to CP06/14.

Annex 5 – timetable and consultation process

Paragraphs 10 and 12. Deferred non-scope matters include: non-MIFID venture capital and corporate finance; commodities and energy/oil market activity; sports and leisure spread betting; non-MIFID investment research]

We note that the non-MIFID business of EMPs and OMPs falls under the timetable for the deferred review. Paragraph 10 notes that the review of non-MIFID NEWCOB rules will be carried out in Q1 2007, with final rules produced in Q2 for implementation on 1st November 2007 in conjunction with the MIFID elements of NEWCOB. We are unable to agree with this proposal as we feel that the timescale indicated does not provide firms with sufficient opportunity to respond to the

NEWCOB requirements and enact internal changes. We instead propose that the implementation of non-MIFID NEWCOB rules arising from this deferred review is itself deferred until Q1 2008 to give effected firms sufficient time to ready themselves for the changes.

See our comments under Chapter 7 above on the need for an early indication of FSA's thinking on client classification for non-MIFID business.