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M. Fabrice Demarigny
Secretary General
CESR The Committee of European
Securities Regulators
11 – 13 avenue de Friedland

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FRANKREICH

CESR's Draft Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

Dear Mr. Demarigny,

BVI[1] welcomes the opportunity to comment on CESR's Consultation Paper on draft technical advice on the implementing measures concerning several aspects of the Markets in Financial Instruments Directive 2004/39/EC (MiFID).

General Remarks

We would like to stress the fact that, according to Article 2 (1) h) MiFID, only asset management companies which are not engaged in fund management activities are subject to the Directive and, consequently, CESR's advice on possible implementing measures. According to Article 66, fund management companies are affected only insofar as Articles 2 (2), 12, 13 and 19 of the Directive are concerned.

The consultation deals with implementing measures with respect to several provisions of the Directive 2004/39/EC (MiFID) on level 2 of the so called Lamfalussy Process. Level 2 rules should be principle-based guidelines

[1] BVI Bundesverband Investment und Asset Management e.V. represents the interests of the German investment fund and asset management industry. Its 76 members currently manage more than 7,600 investment funds with assets under management in excess of € 980 bn. The units of these funds are held by some 15 million unit holders.

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leading to clarity and legal certainty, as laid down in the Commission's formal mandate of June 25, 2004, paragraph 2.3. The draft advice, however, shows an extremely high degree of regulation, the implementation of which, finally, will lead to considerable expenses for the investment firms without significant improvement of investor protection.

We therefore urge CESR to revise the level of detail in its technical advice, balancing the objective of establishing a set of harmonized conditions for the licensing and operation of investment firms and regulated markets and the need to avoid excessive intervention in respect of the management and organisation of investment firms (cf. the Commissions Mandate, page 5).

Specific Comments

II.1 Compliance and Personal Transactions (Box 1)

Paragraph 2(b) – Internal compliance policies and procedures

Investment firms are held to establish and maintain compliance policies and procedures, including a "code of conduct" referred to in paragraph 6, that are designed to ensure compliance with the investment firm's obligations under the Directive. It remains unclear what CESR concretely means by the term "compliance policy", especially when it comes to separation among the "compliance procedures" and the code of conduct. We propose to make clear what is exactly meant by the different terms used in order to avoid misinterpretations.

Paragraph 2(d) – Question 1.1: Independence of the compliance function

Especially amongst smaller investment firms, the requirement of an independent compliance function may become disproportionately onerous. Within an internationally operating group structure, an independent compliance function with every national branch would be inadequately burdensome irrespective of the size of the enterprise. Therefore, we think that this requirement should be subject to appropriateness and proportionateness in the view of nature, scale and complexity of the business concerned as well as other relevant factors (e.g. the corporate structure).

Paragraph 4(a) – Monitoring and assessment of policies and procedures

According to CESR's draft advice, the compliance function of an investment firm has to monitor and assess the adequacy and effectiveness of the firm's compliance policies and procedures. We urge CESR to make clear that this task needs not necessarily be

performed by the investment firms compliance function itself, but may also be effected by other independent departments. Otherwise, this rule would lead to unnecessary administrative burden for investment firms which already have implemented effective compliance supervision (e.g. by functions such as risk management, legal, controlling, data protection, etc.).

Paragraph 5 – Complaints handling

CESR's recommendations on complaints handling go far beyond the legal basis given by the MiFID (Article 13 (2)). In particular, we see no legal basis for information requirements on out-of-court complaints and redress mechanisms or implementing compensation policies. We suggest to confine the complaints handling provisions to record keeping of complaints and their handling.

Paragraph 6 – Establishing a code of conduct

With respect to the requirement to set up a code of conduct, the definition of "relevant persons", as laid down in Section I, is drawn too widely. It is highly desirable to acknowledge two categories of employees with different standards, depending on the relevance of the professional function for the financial service in question and the possible impact of misconduct, and to subject these categories to adjusted rules. There is no need to apply the same standards for personnel performing administrative functions as for management or senior staff.

Furthermore, we would like to point out that there is no clear distinction between "compliance policy" on the one hand and "code of conduct" on the other hand (cf. our comments to Paragraph 2(b)). In order to avoid double regulation, clear definitions of these terms are recommended.

Paragraph 7(a) – Personal transactions

The requirement to establish and operate mechanisms to prevent transactions of relevant persons "where the transaction conflicts or is likely to conflict with the investment firm's duties" is unfeasible in its wide scope of obligations. Instead, investment firms should be held "to take reasonable steps" to avoid such personal transactions.

Paragraph 7(b) – Personal transactions: Record keeping

It should be made clear that the record keeping requirements do not impose any general authorisation requirement on personal transactions. The authorisation requirements should be subject to the investment firm's policy decisions.

Paragraph 7(e) – Prohibition of entering into personal transactions

There is no way to eliminate any possibility of employees entering into personal transactions. This is especially the case if the employee conducts transactions via investment firms which are not linked to the employer. In order not to demand the impossible from investment firms, it should be made clear that the requirements of Paragraph 7(e) are adequately incorporated if the contracts of employment comprise a respective prohibition.

II.2 Obligations related to internal systems, resources and procedures (Box 2)

Paragraph 5(a) – Risk management policy

The voting of Paragraph 5(a) is too broad. It implies that all risks that are connected with the investment firm's business have to be covered by a risk management policy. This would imply that even risks which are not linked to the specific investment firm's business are subject to risk management procedures. We therefore urge CESR to restrict this rule to those risks which are relevant for the respective investment service.

Paragraph 6(a) – Information processing system

We agree with CESR that investment firms have to implement information technology resources to retain, store and access data. We do not think, however, that the firm should also make sure that this technology permits adequate search applications, since this could tempt the supervisor to demand the implementation of a certain search system. It is both crucial and sufficient that the competent authority is able to access and search the data, which should be reflected by the wording of the advice.

II.3 Operational risk in connection with outsourcing (Box 3)

Paragraph 1 – Definition

The wording of the draft recommendation extends the advice to all outsourcing arrangements. This scope is not covered by Article 13(5) of the MiFID. We recommend to make clear that basically the level 2 advice concerning outsourcing refers only to activities referred to in Article 13(5).

Paragraph 3 – Scope of application – minimum requirements

The draft advice qualifies several functions as vital to be included in the scope of application: On the one hand accounting, back office, human resources, etc., on the other hand "services related to" internal audit, compliance and risk management. The range of "services related" to these functions remains unclear. We recommend to give an exhaustive definition of these services.

Paragraph 4 – Intra-group outsourcing

It appears inadequate to extend the full set of rules of this advice also to intra-group outsourcing. In particular, the reference to Paragraph 9 is too far-reaching (e.g. concerning the requirement for a "comprehensive exit strategy"). The proposed level of regulation on intra-group outsourcing would lead to factitious and inefficient business structures. We urge CESR to substantially reduce the requirements for intra-group outsourcing.

Paragraph 9 – Relevant measures

(b): The draft advice has asked for evaluation of "concentration risks" in terms of other firms using the same service provider. This requirement should be dropped since there are no practical means to assess or monitor concentration risks.

(d)v: The obligation for the service provider to disclose "material development" should be restricted to those developments which directly impact the outsourced functions.

(d)ix: The draft advice requires investment firms to designate methods to measure and procedures to report the quantitative and qualitative performance by the service provider in the service level agreement. We do not deem this regulation helpful. Setting all these measures in writing would impair the investment firm's freedom to modify its methods and procedures. They should therefore not be part of any written agreement between the investment firm and the service provider.

II.4 Record keeping obligations (Box 4)

Paragraph 2(b): Telephone recordings

We do not consider mandatory recordings of telephone conversations with retail customers appropriate or helpful. The steps necessary for an investment firm to comply with this rule would be considerable both for setting up the respective systems and maintaining them and

are out of all proportion to the value of evidence in the rare cases of possible disagreement on the content of a client's order.

Furthermore, the broad recording requirements will most likely come into conflict with the national legislation on data protection of most member states unless the client gives his explicit consent to the recording of this data.

It should therefore be left to the investment firm's decision in line with the national legislation on data protection by which means and to what extend to log the communication with the customer.

Paragraph 2(d): Protection against data alteration

Technical systems which effectively prevent or mark any alteration of (electronical) data are extremely complex and costly. Especially smaller investment firms will be swamped by the burden to implement such systems. We therefore propose to limit this burden to the appropriate and proportionate level with respect to the investment firm's means.

Paragraph 4/Question 4.1: "Proof of innocence"

This proposed advice implies a reversal of the burden of proof for misconduct on behalf of the investment firm which lacks any legal basis. Apart from the fact that it is virtually impossible for somebody to prove that he has *not* done something, the result conflicts with one of the most basic principles of European legislation, i.e. that every-body has to be deemed innocent unless proven guilty. Therefore, we strongly object the implementation of the proposed Paragraph 4.

Annex - Minimum list of records to be maintained

We think that the proposed list of records that have to be maintained as laid down in the Annex is far too prescriptive and inflexible to constitute a part of Level 2 regulation, especially given the variety of investment firms which will be subject to the regulation (e.g. "sell side" vs. "buy side"). We therefore recommend to drop the annex entirely or use it solely for guidance purposes. At least it should be pointed out that the minimum list of records to be maintained is limited to information which either refers to direct communication with the customer or internal records. It should be made clear that information which has no connection with a certain customer relationship (such as advertisements or investment research) is not subject to record keeping.

II.6 Conflicts of interest (Box 6)

Paragraph 9: Inducements

We see no legitimation from the MiFID to demand for inducements to be helpful for the investment firm in the provision of services to its clients. The sole aim of Articles 18 (1) and 13 (3) is to avert conflicts of interests which might interfere with the client's interests. The client's interests are the only benchmark for assessing the legitimacy of an inducement under the scope of the MiFID.

Paragraph 14: Disclosure – customer's consent

Again, we see no legitimisation from the MiFID to demand from the investment firm to "obtain the client's consent" concerning the existence of certain conflicts of interests policies and procedures. This requirement is even not necessary since the information on the potential conflict will have to reach the customer before ordering the relevant service.

Paragraphs 15 to 17: Investment research

The regulation on conflicts of interest in the area of investment research will compete with the relevant provisions of the Market Abuse Directive 2003/06/EC and Directive 2003/125/EC implementing the market abuse directive as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest. This regulation, which has to be implemented by EU member states by October 12, 2004, provides for a full set of rules for handling conflicts of interests with respect to investment research, either by avoiding these conflicts or by disclosing them. We suggest to abstain from any additional and possibly differing regulation on this matter.

II.7 Fair, clear and not misleading information (Box 7)

We would like to point out that the MiFID, being an core element of the Commission's Financial Services Action Plan of 1999, aims at promoting the single market within the EU, a key feature of which is a true level playing field for financial operators. Both EU legislation and Level 2 measures on financial instruments and products must not distort competition among UCITS and other investment products. We therefore urge CESR to always keep in mind the importance of a level playing field, especially in the area of transparency, irrespective of the legal form a certain investment service might assume. This is why CESR's rules on market communication, reporting and advice must be comparable, to the extent possible, for all comparable financial instruments and products and thus provide for an equal treatment in every respect.

Paragraph 13: Simulated historic returns

Paragraph 13 bans simulated historic returns from information provided to a (potential) retail client. Even though we agree with CESR that the use of simulated historic returns for marketing purposes should be restricted, we see a legitimate need for such calculations in certain cases, e.g. when it comes to demonstrate the characteristics of a certain new investment strategy under realistic conditions. Instead of banning to communicate simulated historic returns, we therefore propose to make those communications subject to an accompanying disclaimer which points out the simulation character.

Paragraph 14 b) ii): Presentation of past performance

Whilst in general a minimum reference period for information on past performance of one year may be appropriate, there are cases when an even shorter period should suffice, especially when a new product can not yet look back at a track record of one year. At least in these cases, it should be acceptable to present the past performance of the period available.

II.8 Information to clients (Box 8)

Paragraph 1: Information "in writing"

Paragraph 1 of the draft advice comprises that the information required under Article 19 MiFID has to be effected strictly "in writing". We think that this interpretation is not covered by the wording of the directive. Even though we agree that, in most cases, customer information in written form is reasonable, the means of providing information to the customer should not be confined to the written form. In the interest of swiftness, especially in case of communication via telephone, it must remain possible to provide relevant information by other means, including orally. We therefore urge CESR to abstain from this requirement.

Paragraph 4: Standards for telephone communication

We think that the information requirements for telephone communication, as laid down in Paragraph 4 of the draft advice, goes far beyond the extent which can be deemed necessary and appropriate. This is especially the case with Paragraph 4 lit. a), detailing that a certain set of information has to be communicated "at the beginning of any conversation", even if this information is already perfectly clear to the customer. Therefore, rather than setting up a new set of rules for telephone communication, we recommend to simply refer to the rele-

vant provisions of Directive 2002/65/EC on the distance marketing of consumer financial services.

Paragraph 6: Minimum information contents

Paragraph 6 lays down a multitude of information elements which have to be provided to the (potential) customer, some of which raise doubts about their usefulness or simply lack a legal basis in the MiFID (e.g. information on whether the firm is registered or on out-of-court redress mechanisms). We therefore urge CESR to thoroughly revise these requirements, keeping in mind the competing provisions of Directive 2002/65/EC on the distance marketing of consumer financial services.

Paragraph 8: Information on commissions, charges, fees

Lit. b) asks for an estimate on the amount of fees charged by 3rd parties. Following this provision might prove to be difficult, since the investment firm itself often has no influence on these 3rd party charges. We therefore propose to replace this estimate by disclosure of the fact that 3rd party charges may incur.

Since the consultation deadline on the draft advice concerning best execution (Box 11) and market transparency (Boxes 13 and 14) has been extended to October 4, we are planning to comment on these issues at a later date.

We hope that our comments are helpful for CESR's future work on implementing measures of the MiFID and remain at you disposal for any in-depth discussions of the issues raised.

Yours sincerely

BVI Bundesverband Investment und Asset Management e.V.

signed:
Stefan Seip
Director General

signed:
Marcus Mecklenburg
Vice President