afei Association Française des Entreprises d'Investissement

FEDERATION BANCAIRE FRANCAISE

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IMPLEMENTING MEASURES FOR THE DIRECTIVE ON MARKETS IN FINANCIAL INSTRUMENTS

First CESR Mandate

Observations of the French Association of Investment Firms (AFEI) and the French Banking Federation (FBF)

1. In July 2001 the European authorities began work on modernising the current Investment Services Directive, which dates from 1993. Although the new directive, now renamed the Financial Markets Instruments Directive (FMI), was not finally adopted until 21 April 2004, work on its implementing measures began officially on 20 January. On that date, the European Commission, in accordance with the Lamfalussy process, published a provisional First Mandate to the Committee of European Securities Regulators (CESR).

2. On 17 June, CESR published a consultation paper inviting industry professionals to submit their observations on its proposals regarding this First Mandate.

3. The French Association of Investment Firms (AFEI), which comprises nearly 130 investment service providers – mostly investment firms, but also credit institutions authorised to provide investment services, active primarily in the equity and derivatives markets – has been following the work on FMI implementing measures with great interest. For its members, and those of the French Banking Federation (FBF), the FMI directive is a key piece of legislation that will have a major impact on how they do business.

The Fédération Bancaire Française (French Banking Federation, FBF), the professional body representing over 500 commercial, cooperative and mutual banks operating in France.

4. AFEI and FBF congratulate CESR on the quality of its drafting. As we had requested, the Committee has strived to justify its suggestions systematically, and its proposed Level 2 and Level 3 implementing measures have been drafted as legal instruments, which greatly facilitates assessment.

We would suggest, however, that CESR should find a method (such as numbering each paragraph of the document) that would enable industry professionals to identify more easily the points on which they wish to comment.

5. AFEI and FBF are respectfully submitting a number of observations to this consultation. For greater clarity, CESR's numbering system has been retained. In the boxes shaded in grey (proposed Level 2 implementing measures), we have struck out the words we would like to see eliminated and inserted in boldface the words we believe should be added.

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I. Section I: Definitions

Implementing measure proposed by CESR:

2. "*Supervisory function*" means the function (if any) within an investment firm with responsibility for the supervision of its senior management;

6. The concept of "supervisory function" is overly general and ought to be stated more precisely. What exactly are the functions and powers assigned to the person responsible for this function? Is his role comparable to that of a chief executive or a member of the supervisory board?

Implementing measure proposed by CESR:

3. "*Relevant person*" in relation to an investment firm, means a manager, employee or tied agent of that investment firm, which for these purposes shall include any individual who falls within one or more of sub-paragraphs (i) to (iv) below: (…) (iii) an individual whose services are placed at the disposal and under the control of an investment firm or its tied agent under an arrangement between that investment firm or its tied agent and a third party;

7. The meaning of "*third party*" needs to be defined. In addition, "*relevant person*" is not an appropriate concept. A clear distinction ought to be made between

- "*relevant persons*" in the strict sense, which should include only persons linked to the investment firm by an employment contract, and
- "*external persons*", which should include persons not so linked ("*persons not directly employed or appointed by the investment firm"*).

Implementing measure proposed by CESR:

4. "*Personal transaction*" means a transaction in financial instruments that a relevant person effects himself or causes another person to effect, where that relevant person is acting: (i) outside of the scope of his professional activities; and/or (…) The following shall be excluded from the definition of a personal transaction: (iii) discretionary transactions, provided: (…)

8. The precise meaning of "outside of the scope of his professional activities" needs to be explained, and the term "discretionary transactions" needs to be defined.

II. Section II: Intermediaries

A. Compliance and personal transactions (Article 13§2)

- ***Policies and procedures to ensure compliance***[1]

Implementing measure proposed by CESR, modified by AFEI and FBF:

2. An investment firm must: (…)
(d) where appropriate and proportionate in view of the nature, scale and complexity of its business, ensure that the compliance function is independent, which includes ensuring that:
(i) the individuals in the compliance function are not involved in the performance of services or activities they monitor; and
(ii) ~~the budget and remuneration of the compliance function is linked to its own objectives and not to the financial performance of the business lines of the investment firm~~
The head of compliance may or may not be a member of senior management. If the head of compliance is a member of senior management, he or she should not have direct business line responsibilities. If the head of compliance is not a member of senior management, he or she should have a direct reporting line to senior management who do not have direct business line responsibilities.

9. AFEI and FBF wish to offer several observations.

- (d): The concept of independence referred to in the proposed measure ("*ensure the compliance function is independent*") needs to be precisely defined.
- (d) (ii) ("*the budget and remuneration of the compliance function is linked to its own objectives and not to the financial performance of the business lines of the investment firm*"): This point does not correspond to current practice at French investment firms. Granting a bonus to an individual in the compliance function is legal and raises no inherent difficulty, provided the bonus is discretionary and is linked to the person and the quality of his or her work. It would be better to limit the scope of the prohibition by forbidding only that the bonus be tied to a specific transaction carried out by the investment firm.

Specific questions for consultation:

Question 1.1.: Must the compliance function in every investment firm comply with the above requirements for independence, or should this degree of independence only be required where this is appropriate and proportionate in view of the complexity of its business and other relevant factors, including the nature and scale of its business?
Question 1.2.: May deferred implementation of requirements for independence be based on the nature and scale of the business of the investment firm?

[1] Page 14 of CESR consultation paper CESR/04-261b.

10. AFEI and FBF are not in favour of having the independence requirements apply only where "appropriate and proportionate" in view of the nature, scale and complexity of the investment firm's business. The compliance function must be independent of the functions it supervises, regardless of circumstances.

However, some investment firms obviously do not operate on a scale that would permit the head of compliance to perform only that function. In itself, the fact of performing several functions, with compliance being one of them, is not necessarily a violation of the independence principle that must guide the head of the compliance function. The real difficulty lies in the way that the compliance function is linked to business line responsibilities, whence our proposed modification.

Implementing measure proposed by CESR:

3. In establishing its internal allocation of functions, an investment firm must ensure that its senior management is responsible for compliance, including: (…) Where the head of the compliance function is not a member of senior management, he must have a direct reporting line to senior management (…)

11. The concept of "*direct reporting line*" likewise calls for further elaboration. It would be desirable to add that, for the reporting line to be appropriate, it must go to a person

- at a high level, and
- who has no direct business line responsibilities.

This idea is present in the definition of the compliance function that has emerged from the work of the Basel Committee, and CESR should draw on this.[2]

[2] See the consultative document published by the Basel Committee in October 2003 titled "The compliance function in banks", point 24, p. 5: "*The head of compliance may or may not be a member of senior management. If the head of compliance is a member of senior management, he or she should not have direct business line responsibilities. If the head of compliance is not a member of senior management, he or she should have a direct reporting line to senior management who do not have direct business line responsibilities, and should also have the right to report directly to the board of directors or a committee of the board, bypassing normal reporting lines, when this appears necessary.*"

Implementing measure proposed by CESR, modified by AFEI and FBF:

4. An investment firm must ensure that the compliance function:
(a) monitors and assesses on an ongoing basis the adequacy and effectiveness of the investment firm's policies and procedures and the investment firm's compliance with its obligations under the Directive and its the internal code of conduct, and ensures that the appropriate measures are taken in the event of non-compliance;
~~(d)~~ ***(b)*** provides advisory assistance and support in relation to compliance matters to the various business areas of the investment firm on problems concerning compliance with the investment firm's obligations under the Directive and the relevant persons' obligations under the code of conduct referred to in paragraph 6;
~~(b)~~ ***(c)*** reports on a frequent basis to senior management on the matters under (a); and
~~(c)~~ ***(d)*** reports on at least an annual basis a summary of the results of the monitoring and assessment to the senior management, the internal auditors (if any) and the external auditors (if any) of the investment firm.
In any case, the person in charge of compliance must be aware of point 4.

12. Several remarks may be made regarding this proposed measure.

- (b) (c) and (d): It would be more logical still if the order of points were as follows: (a), (c), (d), (b).

- Point 4 (c) and (d) do not necessarily come within the scope of the compliance function; it all depends on how the investment firm is organised. In many firms, the head of compliance is merely informed of these matters, which are handled by another department. This should therefore be stated explicitly.

- It should be borne in mind that the person in charge of compliance has an advisory function in addition to the supervisory function that he shares with the audit function, depending on the departmental boundaries within each investment firm. This dual function ought to be recognised more prominently, in order to avoid ambiguity and allow for flexible internal organisation of the compliance function.

- ***Code of conduct***

Implementing measure proposed by CESR, modified by AFEI and FBF:

6. An investment firm must establish a code of conduct for its relevant persons. The code of conduct is a set of principles designed to promote professionalism and integrity. As a minimum it should contain the investment firm's: (…)
(e) conflicts policy, **such as Chinese walls,** as provided for in the draft advice under Article 13(3).

13. As discussed below (see items 50 and 65), a distinction should be made between "external persons" on the one hand and "relevant persons", in the strict sense, on the other. Taking this approach, the code of conduct at issue here would be applicable only to relevant persons. For external persons (i.e. those outside the investment firm), the firm would ensure via the contract it signs with them that they comply with appropriate standards of conduct.

14. The description of the code of conduct makes no mention of the fundamental concept of Chinese walls. This is a regrettable omission, as Chinese walls are essential for preventing conflicts of interest. Express reference should be made to them in point (e).

- ***Personal transactions***

Implementing measure proposed by CESR, modified by AFEI and FBF:

7. An investment firm must:
(a) establish and operate mechanisms that take all reasonable steps to prevent its relevant persons who have access to price-sensitive information or ~~who are subject to conflicts of interest~~ ***"inside information"*** (such as **salespersons,** traders, analysts, corporate finance personnel, portfolio managers and compliance personnel) entering into a personal transaction in circumstances where that transaction conflicts or is likely to conflict with the investment firm's duties under the Directive or the relevant person has or is likely to have price sensitive information that is relevant to financial instruments to which that transaction relates;
(b) make a record of any notifications, authorisations and prohibitions given in connection with such mechanisms;
(c) ensure it receives prompt notification of the execution of any personal transaction or is otherwise able to identify it, and makes a record of it; and
(d) Points (a) and (c) are subject to pre-clearing / pre-approval by compliance or legal personnel.
~~(d)~~ **(e)** when it authorises such a personal transaction, ensure it receives prompt notification of the personal transaction or is otherwise able to identify it, and makes a record of it; and
~~(e)~~ **(f)** take reasonable steps to ensure that where a relevant person is prohibited from entering into a personal transaction, he does not (except in the proper course of his employment):
~~(i) counsel or procure any other person to enter into such a transaction; or~~
~~(ii) communicate any information or opinion to any other person if he knows, or ought to know, that such person will as a result, be likely to enter into such a transaction, or counsel or procure another person to do so.~~

15. Several remarks:

- (a): Reference to inside information is far more appropriate here than reference to conflicts of interest. Furthermore, employees in the sales department ought to be included in the list of persons who may have access to inside information.

- (c): Concerning the analyst's personal transactions, the proposed language is not strict enough. It would be more satisfactory to establish the principle that the analyst should not place any order for his own account in the financial instrument(s) of the issuer that he covers. The same prohibition should also apply to all financial instruments of the sector to which the issuer belongs.

- Additional point (d): Another point should be added to introduce the idea of prior review or pre-approval, not only for point (c) but also for point (a).

- (e): - The very general expression "*take reasonable steps*" imposes far too strict an obligation on the service provider. This expression should be replaced with more precise terms.
  - Points (i) and (ii) are already present in the code of conduct and should therefore be eliminated to avoid repetition.

8. ~~Where successive personal transactions by a relevant person are effected in accordance with pre-determined instructions, without any further intervention by the relevant person referred to under sub-paragraph 7(a), the mechanisms established under paragraph 7 are only required to apply to the issue of, and any subsequent amendment to, those instructions, provided that they are not required to apply to their termination without the disposal of any of the financial instruments acquired pursuant to them.~~

16. This point creates a substantial risk for the service provider and should therefore be eliminated. In practice, pre-approval should be required for all.

- ***Outsourcing pertaining to investment services and activities***

Implementing measure proposed by CESR, modified by AFEI and FBF:

9. Where outsourcing arrangements or intended outsourcing arrangements pertain to investment services and/or activities:
~~(a) paragraphs 4 and 6 to 9 of the advice on Article 13(5) of the Directive shall apply to such arrangements; and~~
~~(b) [where the outsourcing involves the delegation of the portfolio management function to a service provider located in a third country:]~~
~~OR~~
~~[where the outsourcing involves the delegation of the performance of any investment service and/or activity to a service provider located in a third country:]~~
~~OR~~
~~[delete paragraph (b) and rely on paragraphs 9(b) and (g) of the outsourcing advice, which is applicable to all outsourcings:]~~
(i) [that service provider must be authorised in its home country to provide that service and/or activity; and
(ii) there must be an appropriate formal arrangement between regulators that enables them to exchange material information concerning both cross-border outsourcings and the service provider].

17. AFEI and FBF prefer general rules on outsourcing that will be usable in every case.

Specific question for consultation:

Question 1.3*.: Should the current text of CESR Standard 127 be retained or should its scope be extended to the outsourcing of all investment services and activities or should paragraph (b) be deleted and reliance be placed on the status and responsibilities of the outsourcing investment firm?*

18. This question poses the problem of knowing what constitutes outsourcing. A precise definition should be given in order to distinguish outsourcing from delegation.

Here, AFEI and FBF favour the option of allowing the investment firm to make its own choices in terms of outsourcing, which, in any case, comes within the scope of the firm's general policy.

B. Obligation to avoid undue additional operational risk in case of outsourcing (article 13§5 first sub-paragraph)

General remarks:

19. AFEI and FBF believe it essential to have consistency between the various European regulators that are setting rules on outsourcing, namely the Committee of European Bank Supervisors (CEBS) on the one hand and the European Commission, as part of the implementation of the new Capital Adequacy Directive, on the other. Although the approaches taken by the different regulators are convergent overall, it must be said that the definitions are not identical. A preliminary comparison of the current proposals of the CEBS and CESR shows that the definitions put forward by these two bodies are not consistent. For example, unlike the CEBS, CESR does not propose to forbid the outsourcing of certain activities. The confusion that could result from different approaches would be contrary to the objective of having clear rules applicable throughout the EU and would probably lead to "over-regulation".

20. Regulations on outsourcing must take into account the extreme diversity of both the functions that can conceivably be outsourced and the firms that are subject to regulation. The rules must be appropriate not just to large institutions that have substantial resources and potentially pose a systemic risk to the markets, but also to "small" firms.

Under these circumstances, AFEI and FBF believe that the regulation of outsourcing ought to rest on broad general principles rather than excessively detailed standards. The risk with detailed standards is that they will lead to regulation that is inappropriate to certain categories of outsourced activities and/or certain regulated institutions.

Implementing measure proposed by CESR, modified by AFEI and FBF:

7. An investment firm must provide the competent authority with **information on the nature of** ~~prior notification of its intention to enter into~~ outsourcing arrangements falling within paragraph 2 ~~and make available all relevant information, enabling the competent authority to effectively exercise its supervision in respect of the provisions referred to in this advice.~~

21. AFEI and FBF are opposed to a requirement whereby an investment firm wishing to outsource an activity must notify the regulator beforehand. Under these circumstances, we believe that the regulator's role might be ambiguous and could disrupt negotiations between the parties. In our view, the firm ought to inform the regulator of the activities that have been outsourced and demonstrate that the firm is capable of controlling the risks associated with that decision.

C. Record keeping obligation (article 13§6)

Implementing measure proposed by CESR, modified by AFEI and FBF:

2. In complying with the obligation in Article 13(6) of the directive, an investment firm must: (…)
(c) keep records in such a way, including the format, organisation and completeness of such records, ~~that they may be readily reproduced on paper~~, and that the competent authority is able to readily access them and search them and reconstitute each stage of the processing of all transactions and instructions by the investment firm.

22. It is not always possible to make records available on paper or in a form reproducible on paper. And even when it is possible, the cost of doing so may be prohibitive (example: recorded telephone calls). In what way would making a document available in electronic format be unsuitable for the purposes of regulatory oversight?

Specific question for consultation:

Question 4.1.: *Should there be a separate obligation for the investment firm to be able to demonstrate that it has not acted in breach of its obligations under the Directive?*

23. CESR proposes to introduce a standard that reverses the burden of proof, and we find this unacceptable. It is a particularly complex task to prove a negative. We remind CESR that it is up to the regulator to demonstrate that an investment firm has acted in breach of its obligations.

Implementing measure proposed by CESR, modified by AFEI and FBF:

Annex - Minimum list of records to be maintained

Allocation of aggregated transactions in a series of transactions all executed within one business day which includes the time each transaction is made *(on executing an aggregated transaction)*
An aggregated transaction that includes a client order
Identity of each client; whether transaction is in whole or in part for discretionary managed investment portfolio and any relevant proportions (*on executing an aggregated transaction*)
Aggregation of one or more client orders and an own-account order which includes the intended basis of allocation (*before the transaction is executed*)
Allocation of an aggregated transaction that includes the execution of a client order which includes the date and time of allocation; relevant designated investment; identity of each customer client and the amount allocated to each client; (*date on which the order is allocated*)
Re-allocation which includes the basis ~~and reason for any re-allocation~~ at the time of the re-allocation.
Temporary holding by an investment firm of a client's financial instruments which include client details and any action taken by investment firm (note also the requirements under paragraph 11 of the draft advice under Articles 13(7) and (8) (for duration holding).

Client financial instruments held or received by or on behalf of a client or which the investment firm has arranged for another to hold or receive which include full details (note also the requirements under paragraph 11 of the draft advice under Articles 13(7) and (8) of the Directive) (*on receipt*)
Financial instruments held for clients used for stock lending activities which include the identity of financial instruments held for clients that are available to be lent, and those which have been lent (note also the requirements under paragraph 9 of the draft advice under Articles 13(7) and (8), where applicable) (*on receipt*)

24. AFEI and FBF would like to be certain that investment firms have the option of keeping records in different formats (online data, paper, magnetic tape), according to each institution's policy.

25. In addition, the following concepts are not clear:

- "*allocation of aggregated transactions in a series of transactions all executed within one business day*";
- "*aggregated transaction that includes a client order*";
- "*aggregation of one or more client orders and an own-account order*";
- "*re-allocation*";
- "*temporary holding by an investment firm of a client's financial instruments*".
  (Does this refer to a suspense account? If so, this provision should be aimed only at brokers. In any case, AFEI and FBF believe this concept must be clarified.)
- "*client financial instruments held or received by or on behalf of a client or which the investment firm has arranged for another to hold or receive*";
- "*financial instruments held for clients used for stock lending activities*."

Specific question for consultation:

Question 4.2*.: What should the nature of the record keeping requirement be in relation to*
i) capital markets business such as equity IPOs, bond issues, secondary offerings of securities;
ii) investment banking business such as mergers and acquisitions; and
iii) general financial advice to corporate clients in relation to gearing, financing, dividend policy etc.

26. AFEI and FBF would prefer the record-keeping rules to be drawn up in a general way, without making the distinctions proposed in this question. These distinctions do not appear to be appropriate. It should also be borne in mind that, in practice, only final documents are retained. Indeed, some confidentiality agreements or policies expressly require the destruction of different versions of contracts or other documents, excepting the final versions.

D. Safeguarding of client assets (article 13§7 and 13§8)

General remarks:

27. Regarding protection of client assets, AFEI and FBF wish to make three main comments.

- CESR proposes that investment firms that are not themselves credit institutions should deposit their clients' funds in a specific individual or omnibus account at a credit institution or central bank. We believe such a requirement would not strengthen client protection. Moreover, it would impose a substantial operating cost on investment firms, especially those that are internationally active and deal in several currencies. In our view, it is preferable to require investment firms to have internal procedures that enable them to verify at all times that credit balances on client accounts are not being used to finance other activities of the firm.

- AFEI and FBF subscribe to the objective of requiring external segregation of securities between own-account activity and client activity, in cases where clearing and settlement systems do not guarantee that securities belonging to clients are never used to make up a deficiency on an own-account transaction. We would point out, however, that such a requirement poses major technical problems because securities settlement systems – e.g. France's systems – are not yet able to implement effective segregation at reasonable cost.

- Lastly, we feel that the client information requirements are much too burdensome.

***Question 5.1**.: Where the jurisdiction in which financial instruments have to be held regulates the holding and safekeeping of financial instruments, should investment firms be required to subdeposit their clients' financial instruments with such institutions in all cases or are there cases in which overriding considerations to the contrary mean that it would be permissible to use an unregulated depository?*

28. AFEI and FBF believe that investment service providers should be free to choose where their clients' assets will be held.

***Question 5.2**.: Which appropriate systems and controls an investment firm has to put in place to ensure that only financial instruments belonging to clients who have given their consent are used in those arrangements?]*

29. Investment firms should be required to manage the holding and safekeeping of client assets in a comprehensive fashion, so long as internal procedures make it possible to reconcile positions.

***Question 5.3**.: Should a requirement be imposed that the records of the investment firm must indicate for each client the depository with which the relevant clients' assets are held, or is it sufficient that the investment firm should maintain records of the amount of each type of asset held for each client and of the amount of each type of asset held with each depository and ensure that the aggregate figures correspond with each other in accordance with paragraphs 11(c) and 13(b)?*

30. The investment firm must be allowed to limit its liability by contract in the case in which the depository is in default.

***Question 5.4**: If the client's assets may be held by a depository on behalf of the investment firm, should:*
(a) the investment firm be (i) prohibited from purporting to exclude or limit its responsibility for losses directly arising from its failure to exercise all due skill, care and diligence in the selection and periodic review of the depository; and (ii) required to accept the same responsibility for a depository that is a member of its group as it accepts for itself; or
(b) must the contract between the investment firm and the client state that the investment firm will: (i) in any event be wholly liable for any losses the client suffers where the investment firm is directly or indirectly linked to the depository, and (ii) be liable in whole or in part, according to the circumstances, for any such losses unless the investment firm shows that it has exercised all due skill, care and diligence in the selection and periodic review of the depository?

31. Same remark as in point 30.

E. Conflicts of interest (Article 18 and 13§3)

- ***General remarks***

32. AFEI and FBF believe it necessary to ensure that the implementing measures proposed here are consistent with those of the implementing directive (2003/125/EC dated 22 December 2003) for the Market Abuse directive, which addresses conflicts of interest in investment research exclusively.

We observe that conflicts of interest are considered only from the standpoint of client, relationship. Is this indicative of deliberate intent on CESR's part?

Implementing measure proposed by CESR, modified by AFEI and FBF:

Section I – Definitions:
c) CESR proposes using the following definitions of certain terms used in the draft advice to facilitate its comprehension and simplify its structure:
10. "interested person", in relation to an investment firm, means a relevant person or any person directly or indirectly ~~**linked by control to**~~ ***controlled by*** that investment firm;

33. We find the wording unclear. It would be better to replace the expression "linked by control" with "controlled by". Also, is this point really meant to apply to individuals only? This whole issue warrants further elucidation.

- ***Identification of conflicts***

Implementing measure proposed by CESR, modified by AFEI and FBF:

2. In complying with its obligation under Article 18(1) the investment firm must pay special attention to at least the following areas of business, particularly where the firm or a person directly or indirectly linked by control to the firm performs a combination of two or more of them: (…)
- Corporate finance business, **according to the Directive on Markets in Financial Instruments** including underwriting and/or selling in an offering of securities and advising on mergers and acquisitions.
- **Investment research.**

34. Two remarks:

- The expression "*corporate finance business*" calls for a definition, since neither the FIM nor other European directives use this term.
- It is vital that investment research be included in the list of activities that may lead to conflicts of interest.

3. The investment firm must maintain updated record of the categories of interested persons, areas of business, type of financial instruments and transactions that have been identified as ~~potential sources of~~ ***as effective*** conflicts of interest according to the criteria in paragraphs 1 to 2 above.

35. AFEI and FBF wish to make three comments:

- This catalogue of conflict-of-interest situations, which makes reference to persons, areas of business and financial instruments, goes totally against the principle of Chinese walls.
- The reference back to paragraphs 1 and 2 makes the wording of this point less readily comprehensible.
- Lastly, it must be said that the concept of "potential sources of conflicts of interest" is overly broad in scope. Could not every one of an investment firm's employees be considered to fall within that scope? We propose that the scope should be narrowed by using the concept of "effective" conflicts.

- ***Conflicts policy***

Implementing measure proposed by CESR, modified by AFEI and FBF:

8. [The arrangements set out in the conflicts policy must, to the fullest extent possible, include the following methods, unless the investment firm is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients]
OR
[Without prejudice to paragraph 7, the following are examples of arrangements that may, depending on the circumstances referred to in paragraph 5, be effective methods of providing an appropriate degree of independence in respect of persons engaged in different business activities:]

(a) establishing information barriers between activities other than those listed in paragraph 2;

(b) separating supervision, such as requiring persons principally engaged in activities servicing different client groups or otherwise representing different interests (including those of the firm) that may come into conflict, to be supervised by different ~~senior executives~~ ***senior management who do not have direct business line responsibilities;***

(c) making the remuneration of relevant persons principally engaged in one activity independent of the remuneration of, or revenues earned by, relevant persons principally engaged in the other activity;

~~(d) limiting undue influence from either within or outside the investment firm, for example, by preventing relevant persons principally engaged in one activity from having inappropriate influence upon relevant persons principally engaged in the other activity~~;

(e) limiting involvement in extraneous activities, for example, by preventing relevant persons principally engaged in one activity from having joint involvement in the activities of relevant persons principally engaged in another activity, where such involvement may lead to poor conflicts management; and

(f) limiting the opportunity for clients of the investment firm in relation to one activity to unduly influence relevant persons engaged in another activity.

36. AFEI and FBF prefer the wording of the first option, which is more general but still concise. However, if CESR chooses this option, it would be desirable to modify it as indicated.

Point (b) has serious consequences for small firms. As for point (d), we would like it to be eliminated because it is too strict. It should be borne in mind that when executive committees meet, representatives of the different business lines compare their assessments; the Chinese walls are thus breached.

Specific questions for consultation:

Question 6.1*.: Should other examples of methods for managing conflicts of interest be referred to in the advice?*

37. The answer is no: the document is comprehensive enough as it is.

Question 6.2.:

(a) Should paragraphs 8(a) to (f) (or the final list of measures for managing conflicts of interest adopted in response to question 1) be stated as examples of arrangements that may, depending on the circumstances referred to in paragraph 5, be effective methods of providing an appropriate degree of independence in respect of persons engaged in different business activities?

(b) Alternatively, should there be a requirement for an investment firm to include these measures in its conflicts policy to the fullest extent possible unless it is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients?

(c) If the answer to question (b) is yes, which of these measures should be subject to the requirement referred to in that question?

38. AFEI and FBF believe it preferable to keep paragraph 8, points (a) to (f), as a list of examples, in order not to lengthen a document that is already quite comprehensive.

- ***Investment research – Contents of written policy***

Implementing measure proposed by CESR:

15. Where an investment firm issues investment research, its conflicts policy must specify the types of investment research issued by it.

16. Where the investment firm publishes or distributes investment research, its conflicts policy shall include the following minimum requirements in relation to the preparation of that research:

(a) analysts must not trade securities or related derivatives ahead of publishing research on the issuer of those securities;

(b) analysts must not trade in securities or related derivatives of an issuer they review in a manner contrary to their existing recommendations, except in special circumstances subject to pre-approval by compliance or legal personnel;

(c) analysts must not accept any inducements from issuers, or others with a material interest in the subject matter of investment research, other than minor gifts or hospitality below a value specified in the conflicts policy;

(d) the investment firm must not promise issuers favourable research coverage, specific ratings, or specific target prices in return for a future or continued business relationship, service or investment;

(e) issuers, or others (other than the investment firm's relevant persons) with a material interest in the subject matter of investment research, may only be permitted to review draft research for the purpose of verifying the accuracy of factual statements made in that research. This draft research must not include the recommendation or the target price; and

(f) Subject to paragraph 17,

(i) ~~[information barriers must be established between analysts and the firm's other divisions]~~ **OR** [information barriers must be established between analysts and the corporate finance division (if any)];

39. Point i “OR”: the conflict exists primarily vis-à-vis the corporate finance division, but it is impossible to exclude all the other departments, which should be expressly delineated.

40. How can it be that no reference is made here to the Market Abuse directive and its implementing measures?

41. Points 15 and 16: The proposals on the topic "*Investment research – Contents of written policy*" ought to refer to the Market Abuse Directive and implementing directive 2003/125/EC of 22 December 2003, concerning fair presentation of investment recommendations and mention of conflicts of interest, in order to avoid redundancy or, on the contrary, to leave no points unaddressed – all the more so since the vocabulary used (for similar concepts) is not always the same, thus creating a risk of confusion.

Specific questions for consultation:

Question 6.3:
(a) Is it appropriate for an investment firm that publishes or issues investment research to maintain information barriers between analysts and its other divisions?
(b) If so, which divisions should be separated by information barriers in order to prevent analysts' research from being prejudiced?

42. The question posed here seems to have been largely overtaken by events, since regulators will be requiring investment firms that publish investment research to comply with the principles set forth by the International Organisation of Securities Commissions (IOSCO) in September 2003.

43. However, provided they comply with the general requirements regarding conflicts of interest (*Art. 13.3 and 18*), investment firms may fail to comply with one or more of those principles (*cf. §16.f*) under certain conditions. Those conditions (described in the two proposals above) reflect the differences of opinion that persist following a debate that pitted advocates of one approach, who wanted to apply those principles only to "objective" research, against opponents of that approach, who held that all research should obey those principles. AFEI and FBF tend to favour the latter position. Once conflicts of interest are handled in an appropriate manner (with Chinese walls, disclaimers and disclosures on research reports, and regulatory audits), all research is objective, and no derogation is possible.

Question 6.4*: Should the derogation from the requirements in paragraph 16(f)(i) to (v) be available if:*
(a) the investment firm complies with the requirements in paragraphs 17, 18 and 19 of the first option set out below; or
(b) the investment firm complies with the requirements in paragraph 17 of the second option?

44. As indicated for question 6.3, once conflicts of interest are handled in an appropriate manner (with Chinese walls, disclaimers and disclosures on research reports, and regulatory audits), all research is objective, and no derogation is possible.

F. Fair, clear and not misleading information (Article 19§2)

General observations concerning Article 19:

- Proposed implementing measures that go far beyond the mandate given by the European Commission

45. On principle, AFEI and FBF are in favour of a high degree of harmonisation at the European level, and for this reason we share CESR's desire to go into relatively great detail in these implementing measures.

46. That said, in the case of the proposals relating to Article 19, the level of detail goes far beyond what was asked of CESR (cf. European Commission mandate, pages 49, 54 and 60 of the CESR consultation paper).

Is there not a risk that providing such a large quantity of information to a non-professional investor (not yet even a client, that is to say, a "potential client") will be harmful, if the investor does not know what to make of it? Does the fact of giving a person a lot of information mean that he is necessarily well informed? In the light of the proposed implementing measures, we think not.

From the standpoint of the investment firm, there can be no doubt that the more detailed the list of disclosure obligations, the greater the risk of subsequent litigation, even for the most diligent institutions.

While the rules proposed here have the legitimate purpose of protecting non-professional clients, they should not become a "weapon" that those clients could use systematically to attack a firm for omitting some item of detail. At no point is there any recognition of the idea that the level of disclosure should be suited to the extent of the client's understanding, whereas that idea is a fundamental element. The measures proposed by CESR are undiscerning in this respect.

- A problem of method

47. It would be possible to reduce the volume of text greatly – and thereby shorten and simplify the rules – since the same list of mandatory information is repeated by CESR in several places for no real reason.

48. AFEI and FBF suggest that there should be a single section on "general information to be provided". For special cases or situations, only the additional principles should be itemised, without repeating the general principles (cf. §69).

- Disappearance of the principle that client competence should be assessed

49. It is highly regrettable that no account is taken of the client's level of competence. Quite aside from the cost to the investment firm, it serves no purpose to bury the client under an avalanche of information that is not useful to him because he already knows it. For this reason, AFEI and FBF would like to see CESR adopt a provision similar to the one that exists in France, under which financial institutions have an obligation to tailor the information they provide to the level of skill of their clients.[3]

- Consistency with existing regulations

50. **Rules on prevention of money laundering.** We find it inappropriate that there should be no difference in treatment between a new client (potential client) and an existing client (cf. §13 and 65). This distinction is all the more important since current rules on prevention of money laundering (the "know your customer" procedure) require special treatment of new clients, such as gathering information about the person before entering into a business relationship.

51. The question that arises is whether the financial institution, required to immediately supply a certain volume of information to the potential client, will subsequently be able to refuse to enter into a contract if the information that it later receives from that client is unsatisfactory. The client could argue that the contractual relationship effectively began when the institution sent the detailed information. The mere fact of having a contract with a prospect does not mean that person will actually become a client. There is therefore no point in sending potential clients all the envisaged information. On the other hand, it is obvious that the contract cannot be signed so long until the client has received all the information.

Draft Level 2 advice

1) In this advice and the advice under Article 19(3), references to an investment firm addressing, directing or making a communication or otherwise communicating or providing information include an investment firm causing a third party to do so.

52. Concerning the "general obligations", the regulations should make reference to a list of them (cf. box 2 of the CESR paper) later in the document, without repeating the same items in full each time. This would shorten and simplify the text.

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[3] **Article 3-3-7 of the CMF General Regulations:** *"When a customer envisages carrying out a transaction that differs from those he generally does, either by nature or in terms of the instruments concerned or the amounts involved, the authorized provider asks him to explain the objectives of the transaction.*
In the light of such explanation, the authorized provider supplies the customer with information useful to understanding the envisaged transaction and the attendant risks.
The authorized provider adapts this information according to its assessment of the customer's professional competency, as referred in Article 3.3.5. In particular, it takes into account whether the customer is one of the persons referred to in paragraph 3 of Article 2.4.12 or a qualified investor, as defined by existing regulations.
The authorized provider supplies the above information before completing the transaction. At the same time, it asks the customer to take appropriate measures to ensure that the positions resulting from the transaction can be monitored appropriately."

53. The concept of *"retail client"* needs to be given a precise definition. This is the key concept in developing policy on what information should be provided to such clients.

Implementing measure proposed by CESR:

Specific obligations
11) Information on financial instruments and investment services provided by an investment firm to a retail client or potential retail client must not state or imply that the performance of investment services or of the financial instruments is guaranteed unless there is a legally enforceable arrangement to meet in full the retail client's claim under the guarantee.

54. The concept of "*legally enforceable arrangement"* is not clear. How is it to be understood in the context of guaranteed investment products (collective investment schemes)?

Implementing measure proposed by CESR, modified by AFEI and FBF:

13) **When** an investment firm ~~may not~~ use**s** simulated historic returns in information provided to a retail client or potential retail client**, it must be stated clearly that the figures refer to the past and may not constitute reliable guidance on returns from that financial instrument and/or investment service in the future.**

55. In our view, the principle should not be a blanket prohibition on providing historical information. Rather, when information of this kind is provided, there should be a requirement to draw the client's attention to the fact that such data cannot be taken as assurance of future results.

Implementing measure proposed by CESR, modified by AFEI and FBF:

14) If information provided by an investment firm to a retail client or potential retail client:
a) refers either to the past performance or to a forecast of the future performance of a financial instrument and/or investment service, this information must be relevant to the financial instrument and/or investment service being promoted and the source of the information must be stated;
b) contains a reference to **relevant** past performance of a financial instrument and/or investment service.
i) it must be clearly expressed that the figures refer to the past and that they may not constitute reliable guidance as to the performance of that financial instrument and/or investment service in the future;
ii) the reference period must be stated and must not be less than one year;
iii) where a benchmark is used to compare returns, it must be identified and its reference period must be relevant, clear and sufficient to provide a fair and balanced indication of performance of the investment service or financial instrument being promoted;
iv) if the return figures are not denominated in local currency, the currency used must be stated and reference shall be made to the currency risk for the return in local currency; and
v) the information for the comparison should be based on net performances or if it is based on gross performances, commissions, fees or other charges have to be disclosed; (…)

56. Point 14 (b): The proposed explanation, which is too detailed, could usefully be replaced by referring to "relevant" past performance. The comparison must be objective and usable.

57. AFEI and FBF believe the regulations ought not to provide a weapon that retail clients could employ to systematically attack an institution that might have forgotten some small details. At no point is there any recognition here of the idea that the level of disclosure should be suited to the extent of the client's understanding, whereas this is a fundamental element. The measures proposed by CESR appear to lack discernment in this respect.

Implementing measure proposed by CESR:

15) Any estimate, forecast or promise contained in information provided by an investment firm to a retail client or potential retail client on financial instruments and/or investment services must at least: a) be clearly expressed; b) state the assumptions on which it is based; c) be relevant; and d) not mislead the client.

58. This point is an essential one: in a way, the principle says all that needs to be said.

G. Information to clients (Article 19§3)

Implementing measure proposed by CESR, modified by AFEI and FBF:

Timing and form of information provision

4) In the case of voice telephone communications with a retail client or potential retail client:
a) the identity of the investment firm and the commercial purpose of the call initiated by the investment firm shall be made explicitly clear at the beginning of any conversation with the retail client or potential retail client; and
b) subject to the explicit consent of the retail client or potential retail client only the following information needs to be given:
i) the identity of the person in contact with the retail client or potential retail client and his link with the investment firm;
~~ii) a description of the main characteristics of the relevant investment services and/or financial instruments;~~
~~iii) the total price to be paid by the retail client to the investment firm for the financial instruments and/or investment services, including all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service or, where an exact price cannot be indicated, the basis for the calculation of the price enabling the retail client to verify it;~~
~~iv) notice of the possibility that other taxes and/or costs may exist that are not paid via the investment firm or imposed by it;~~
~~v) the existence or absence of any right of withdrawal and, where a right of withdrawal exists, its duration and the conditions for exercising it, including information on any amount that the retail client may be required to pay to exercise (or as a result of exercising) that right.~~
~~The investment firm shall inform the retail client or potential retail client that other information is available on request and of what nature this information is. In any case, the investment firm shall provide the full information in writing immediately after starting to provide the service to the retail client.~~

59. Point 4 ii: This point is so obvious that it seems superfluous. How can the client become interested if the service or product is not described to him? On the other hand, this formulation must not conceal an obligation to provide an excessive number of details. In practice, that would ultimately eliminate the possibility of telephone solicitation. A client whose interest is aroused by a proposal made over the phone will subsequently have to receive all the information that he needs to reach a decision.

60. Points 4 iii, iv and v: Requiring the investment firm to provide an excessive amount of information amounts in practice to prohibiting the use of telephone solicitation. In the case at hand, it does not seem absolutely necessary to provide this information at the same time as the telephone conversation, which in any event cannot be considered as sufficient to establish a contract.

In this matter, it would be sufficient to stipulate that no contract can be established until the client has received the information specified here.

61. As a general matter, AFEI and FBF question how the measures proposed here fit together with the current regulations on prevention of money laundering.

Implementing measure proposed by CESR, modified by AFEI and FBF:

6) The information about the investment firm to be provided to a retail client or potential retail client under Article 19(3) includes the following:

Information about the investment firm

a) the identity and the main business of the investment firm;
b) the geographical address at which the investment firm is established and any other geographical address relevant for the retail client's relations with the investment firm;
c) the investment firm's telephone number or other appropriate contact details;
d) the fact that the investment firm is authorised and/or registered and the name of the competent authority that has authorised and/or registered it;
e) where the investment firm is registered in a trade or similar public register, the register in which the investment firm is entered and its registration number or an equivalent means of identification in that register;
~~f) a general description of the services to be provided by the investment firm and the types of instrument to which such services relate so that the retail client or potential retail client is able to assess the scope of the investment firm's responsibilities;~~

Information about methods of redress

g) the existence of guarantee funds or compensation arrangements, not covered by Directive 94/19/EC of 30 May 1994 on deposit guarantee schemes or Directive 97/9/EC of 3
March 1997 on investor-compensation schemes;
h) whether or not there is an out-of-court complaint and redress mechanism for the retail client that receives the investment services and, if so, the methods for having access to it;
i) an outline of the firm's conflicts policy;
j) the language or languages in which any documents referred to in Article 19(7) and the information required under Article 19(3) will be supplied; and
k) the language or languages in which the investment firm, with the agreement of the retail client, undertakes to communicate during the provision of the investment services.

62. Point 6(f): This point belongs in the general terms and conditions for opening an account.

63. *Information about method of redress:* AFEI and FBF do not understand why this section is organised in this way, with the various points at different levels.

Implementing measure proposed by CESR, modified by AFEI and FBF:

7) The information about:
- the investment firm's services;
- financial instruments; and
- costs and associated charges,

to be provided to a retail client or potential retail client under Article 19(3) includes the following:
a) a description of the main characteristics of the relevant financial instruments and/or investment services, including:
i) the nature of the financial commitment;
ii) whether or not the instruments involved are:
(1) illiquid; and/or
(2) ~~traded on a regulated market or an MTF, unless such a reference would be inappropriate in view of the nature of the financial instruments or the arrangements made for the retail client to liquidate his investment; and~~
iii) the risks involved
b) if the retail client envisages undertaking transactions in warrants or derivatives, the information provided must include an explanation of their characteristics (especially the leverage effect and the liquidity and volatility of the market);
c) the total price (including the relevant currency) to be paid by the retail client to the investment firm for the financial instruments and/or investment services, including:
i) all fees, commissions charges and expenses; and
ii) all taxes paid via the investment firm related to the transaction, the financial instrument or the investment service or, where an exact price cannot be indicated, the basis for the calculation of the price enabling the retail client to verify it;
d) the arrangements for payment and for performance;
e) notice of the possibility that other taxes and/or costs may exist that are not paid via the investment firm or imposed by it;
f) the existence or absence of any right of withdrawal and, where a right of withdrawal exists, its duration and the conditions for exercising it, including information on any amount that the retail client may be required to pay to exercise (or as a result of exercising) that right; and
g) any limitation on the period for which the information provided is valid.

64. Why repeat yet again the list of basic information to be provided? A reference to the general conditions would suffice (cf. §48 and 69).

H. Client agreement (Article 19§7)

General remarks by AFEI and FBF:

65. As indicated above (cf. §13 and 50), AFEI and FBF find it inappropriate that there should be no difference in treatment between a new client (potential client) and an existing client.

Implementing measure proposed by CESR:

Basic retail client agreement (…)

3) The retail client agreement must be clear and easily understandable by the client.

66. This point is essential. It would gain by being highlighted.

Implementing measure proposed by CESR, modified by AFEI and FBF:

4) The retail client agreement must contain the following items as a minimum
a) the identity of each of the parties (including any trade registration number or equivalent of the investment firm);
b) the geographical address and telephone number or other appropriate contact details of the investment firm;
c) the identity and geographical address of any relevant representative of the firm established in the client's Member State of residence;
d) the address and/or other contact details that are to be used by the investment firm to contact the client;
e) the names of any persons authorised to represent the client for the purposes of the agreement, in particular the names of the natural persons authorised to represent a client who is a legal entity;
f) a description of any withdrawal right or cooling-off period;
~~g) the firm's general terms of business for investment services and, where appropriate, ancillary services [including any particular terms concerning e.g. margin requirements or potential obligations where securities may be purchased on credit];~~
~~h) a general description of the relevant investment services and, where appropriate, ancillary services to be provided by the firm and the types of financial instruments to which such services relate;~~
i) the types of orders and instructions that the client may place with the firm, and the media for sending them [(e.g. by telephone, e-mail or post)];
j) the information to be given by the firm to the client regarding the performance of services including the type, frequency and rapidity of the information to be sent [e.g. regarding order execution or portfolio evaluation];
k) the forms of communication to be used between the investment firm and the client for sending and receiving orders, instructions and information generally and any alternative media to be used when normal media are unavailable;
l) full details of the firm's fees and prices for the relevant investment services and, where appropriate, ancillary services, including information on how they are to be calculated, the frequency with which they are to be charged and the manner of payment;
~~m) the fact that the firm is authorised and the name of the competent authority that has authorised it;~~
n) the law applicable to the contract and the competent national jurisdiction, as ascertained to the best of the knowledge of the firm or as agreed between the parties;
o) where such a procedure exists, a description of the mechanism for settling disputes between the parties such as an out-of-court complaint and redress procedure;
p) the duration of the agreement and the procedures for amending, renewing, terminating or withdrawing from it;
q) the actions that the firm shall or may take to dispose of or appropriate any assets of the client in the event the client does not honour his obligations [(e.g. payment of money due to the firm)], including the timeframe for doing so and the information to be given to the client in such circumstances;
r) the languages in which the client can communicate with the firm.

67. Points g), h) and m) relate not to the terms of the contract itself but to the information that must be provided beforehand to a client that wishes to enter into a contract.

Implementing measure proposed by CESR:

7) The retail client agreement must state that any material modification of the contract by the investment firm to the detriment of the client, [e.g. regarding fees,] requires the prior notification of the client, and the contract must provide a sufficient opportunity for the client to terminate the agreement at no additional cost (other than the payment of fees and expenses due under the existing client agreement).

68. This requirement goes without saying. We wonder, however, whether there are laws in other Member States that would allow one of the parties to the contract to modify it unilaterally. This is certainly not possible in France.

Implementing measure proposed by CESR, modified by AFEI and FBF:

~~9) In good time prior to providing the services of reception/transmission and/or execution of orders involving warrants or derivatives to a retail client, an investment firm must enter into a signed agreement in writing with the client within in the meaning of paragraph 1 containing (or incorporating by reference) all the relevant provisions of the basic retail client agreement as well as the following additional provisions:~~
~~a) the types of instruments and transactions envisaged. The contract must mention in particular whether the relevant instruments are admitted to trading on a regulated market or not and whether the client intends to undertake transactions giving rise to contingent liabilities. It must refer to the documentation provided by the firm to the client on the envisaged instruments and transactions for information purposes;~~
b) the obligations of the investment firm with respect to the envisaged transactions, in particular its reporting and notice obligations to the client.~~ The contract must provide for the immediate confirmation of derivatives transactions and the immediate notice to the client of his payment obligations as they arise, as well as the procedures to be used for such confirmation and notice;~~
~~c) the obligations of the client with respect to the envisaged transactions, in particular his financial commitments toward the firm and the time allowed for honouring such commitments. The contract must provide adequate information on any margin requirements or similar obligations, regardless of the source of such requirements [(e.g. an exchange or clearing house or the firm itself)], and must indicate how margin will be calculated and charged, the assets [(cash, securities or other)] accepted as margin, the frequency of margin calls and timetable for delivery or payment of margin by the client. The contract must require immediate notification to the client of any change in margin requirements;~~
~~d) an appropriate warning calling to the client's attention the risks involved. The warning must reflect the transactions envisaged, in particular where potential losses may exceed the amounts invested, as well as the experience, knowledge and financial situation/capacity of the client or type of client involved, and must be given due prominence in the contract.~~

69. The information to be provided on derivatives and warrants seems far too detailed. The general information required is the same as for other instruments, and the only item specific to these products is the prospectus that must be given to the client. This specific case could therefore be

summarised and replaced by a requirement to provide general information plus the prospectus (the contents of which may also be validated by the regulator of the prospectus contents, where desired) (cf. §48).

Implementing measure proposed by CESR, modified by AFEI and FBF:

~~10) In good time prior to providing the service of portfolio management to a retail client, an investment firm must enter into a signed agreement in writing with the client, within the meaning of paragraph 1, containing (or incorporating by reference) all the provisions of the basic client agreement except the items referred to in paragraph 4(i), as well as the following additional provisions:~~
~~a) the management objectives, including the level of risk agreed upon, and any specific constraints on discretionary management [resulting from the client's personal circumstances…or his request to exclude certain types of investments…];~~
~~b) the types of financial instruments that may be included within the portfolio and types of transactions that may be carried out in such instruments, including any limits. If the investment firm is mandated to invest in financial instruments not admitted to trading on a regulated market, derivatives, illiquid or highly volatile instruments, or to undertake short sales, purchases with borrowed funds, securities repurchase or lending agreements, or any transactions involving margin payments, deposit of collateral or foreign exchange risk, the contract must state so explicitly and provide adequate information on the scope of the firm's discretionary authority regarding these instruments and transactions;~~
~~c) for information purposes with respect to the client, an appropriate benchmark, based on financial indicators produced by third parties, in common use and consistent with the management objectives, against which performance will be compared. Where it is not feasible to establish a benchmark in view of specific client objectives, this must be stated clearly in the contract and an alternative measure of performance must be indicated;~~
~~d) the basis on which the financial instruments are to be valued at the date of valuation. The contract must state whether the instruments are to be valued with respect to a market price (opening or closing price, bid/ask or offer or mid-market price or other, including the methodology for dealing with currency conversions), or where relevant by reference to indicators such as yield curves or other pricing models and the methodology to be used to value equity instruments that are not admitted to trading on a regulated market or MTF;~~
~~e) all appropriate details regarding any delegation of the management of all or part of the assets in the client's portfolio, where this is envisaged. The contract must state that the delegator retains full responsibility for the protection of the client's interests, and that the client will be informed prior to any material change regarding the delegation of portfolio management.~~

70. The reasoning here is the same as above: replace with a reference to the general information to be provided plus a standard management agreement (which could require validation by the regulator).

Implementing measure proposed by CESR, modified by AFEI and FBF:

~~13) The retail client agreement referred to in paragraph 10 must allow the client to terminate the agreement with immediate effect, subject only to the completion of all transactions already commenced and the time necessary to liquidate the portfolio where this is required by the client. The agreement must require that the investment firm provide at least two weeks' notice (or such longer period as agreed by the parties) before terminating the agreement, provided however that where the portfolio cannot be liquidated (where so required by the client) within this timeframe, the agreement may be extended for the necessary additional period, and provided that where the client so agrees after being informed of the firm's intention to terminate, the agreement may be terminated in the timeframe agreed between the parties. In both cases contemplated by the two previous sentences, the termination must take place on terms that are fair and reasonable for both parties.~~

71. A reference to the general information to be provided and the standard management agreement validated by the regulator would suffice.

I. Reporting to clients (Article 19§8)

Implementing measure proposed by CESR, modified by AFEI and FBF:

Contract notes and confirmations

2) No later than the first business day following the execution of an order for a retail client, or receipt of confirmation of execution of such an order by a third party, an investment firm must send to the retail client in writing, a contract note or confirmation notice which includes the following information:
a) the name of the investment firm;
b) the name of the retail client's account;
c) the time of execution, if available, or a statement that the time of execution will be supplied on request;
d) the date of execution;
e) the nature of the order (such as subscription, buy, sell or exercise);
f) the regulated market or MTF on which the transaction was carried out or the fact that it was carried out outside of a regulated market or MTF;
g) the financial instrument and the quantities involved in the transaction;
h) the unit price applied and the total consideration;
i) whether the retail client's counterparty was the investment firm itself or any person in the investment firm's group;
j) the commissions and expenses charged; and
k) the time limit and procedure for the settlement of the transaction, e.g. details (name and number) of the bank account and financial instruments account (unless such arrangements have been notified to the client in advance) .

Implementing measure proposed by CESR as modified by AFEI (cont.):

~~3) If an order from a retail client is not executed within one business day of its receipt, an investment firm must send a written confirmation of the order to the retail client. The order confirmation notice must include client order details, date and time of reception and, where applicable, date and time of transmission. If an investment firm has only been able to execute part of an order from a retail client, the contract note or confirmation for the executed part of the order may also function as the confirmation of the unexecuted part of the order.~~

72. AFEI and FBF consider this requirement to be far too burdensome for intermediaries, especially if the order was not executed could still be executed on the following day (for example, when no time limit has been set on how long the order remains valid).

73. For practical reasons, namely to avoid tedious letter-writing and allow clients to be informed more quickly, sending electronic messages or posting information on the institution's website should be the favoured choices.

For this reason, intermediaries should not be required systematically to send clients information in hard-copy form. If notification on paper is required, it should be limited to confirmation of day orders (valid for one day only).

Implementing measure proposed by CESR:

Notification obligations
13) If an investment firm does not accept an order for a retail client, or decides not to carry one out, it must notify the client immediately.
14) If an investment firm is unable to carry out an order for a retail client, it must notify the client as soon as possible.

74. These requirements appear very difficult to implement in practice. AFEI and FBF suggest that further thought be given to these obligations, which are hard to fulfil and which in practice are already dealt with in the contracts.

J. Best execution (article 21):

75. Our comments on this point will follow in a separate paper before the 4th of October.

K. Client order handling (Article 22§1)

76. AFEI and FBF have nothing to add regarding CESR's proposals, which are in line with current market practices.

III. Section III: MARKETS

A. Pre-trade transparency requirements for regulated markets (Article 44) and MTFs (Article 29)

77. Our comments on this point will follow in a separate paper.

B. Post-trade transparency requirements for regulated markets (Article 45), MTFs (Article 30) and Investment firms (Article 28)

78. Our comments on this point will follow in a separate paper.

IV. Section IV: COOPERATION AND ENFORCEMENT

A. Transaction reporting (article 25)

- ***Methods and arrangements for reporting financial transactions***

General remarks:

79. AFEI and FBF are in agreement with the broad outlines of CESR's proposals on transaction reporting. However, we wish to draw CESR's attention to two technical difficulties that might arise.

- The time of day of the transaction is not always available when an order has been executed in several parts and the client has requested a single response.

- We wonder why investment firms are asked to indicate the identity of the client. This information is internal to the firm and in this context provides little relevant information to the regulator. It could not be considered useful if each client had to be identified on an EU-wide basis (a requirement that would be totally unrealistic from a technical standpoint).

Questions:

***Q15.1**: Should competent authorities be able to waive the requirement for investment firms to report transactions in electronic format? Should such an exemption be limited to exceptional cases, and what cases would those be in your view?*

80. Investment firms should be exempted from having to report in electronic format when there is no appropriate electronic system for doing so. In France, for example, off-market transactions are currently reported by fax.

***Q15.2**: In respect of bond markets and commodity derivatives markets, new systems for reporting financial transactions will probably have to be put in place in many Member States, in order for investment firms to be able to meet the requirements of the Directive and Level 2 advice. (Note that Article 20(1)(b) of ISD1 already requires investment firms to report all the transactions covering bonds and other forms of securitised debt to competent authorities, though Member States have the right to provide that this obligation only applies to aggregated transactions in these instruments.) To what extent should the implementing measures allow market participants more time to implement these proposals ("transitional regime")? What could be legitimate reasons for such a possibility?*

81. AFEI and FBF are in favour of allowing more time for implementing transaction reporting in debt instruments and commodity derivatives because the corresponding systems are not currently operational. The additional time allowed should be long enough to permit adaptation of systems for this purpose.

***Q15.3**: To what extent should CESR investigate the possibility for future convergence between national reporting systems? What are the advantages and disadvantages of harmonising at EU level the conditions (including format and standards) with which all the reporting methods and arrangements have to comply in order to be approved, instead of, as proposed by CESR, harmonising the conditions at a national level? What impact might harmonisation have on existing national reporting channels, national monitoring systems and on the industry?*

82. AFEI and FBF are broadly in favour of convergence between national reporting systems in order to permit convergence of the internal systems of firms that trade on multiple national markets. However, convergence can be achieved only gradually, in collaboration with the industry, in order to minimise investment costs.

- ***Assessing liquidity in order to determine the most relevant market in terms of liquidity***

83. AFEI and FBF approve of the "proxy" method proposed by CESR for determining the most relevant market in terms of liquidity.

- ***Minimum content and common standard/format of transaction reports***

84. We have no observations to make on this point.

B. Obligation to cooperate (Article 56§2)

- ***Substantial importance - factors to be taken into account***

85. AFEI and FBF are not in a position to favour one criterion over another. It is certain, however, that assessment of "substantial importance" in a cross-border market must look at multiple criteria and objectives in order to take account of the particular characteristics of each market and the nature of the financial instruments involved.

CESR's proposal to draw up a list of quantitative factors appears to be one conceivable solution.

C. Cooperation and Exchange of Information (Article 58)

- ***Level 2 advice***

86. We have no observations to make on this point.

- ***Level 3 recommendation***

87. In general, AFEI and FBF are in favour of creating a common database to be used by regulatory authorities, even though implementation of such a tool will require a relatively substantial technological and financial investment.

For this reason, and considering the technical hurdles usually encountered when implementing this type of database, the directive transposition should be extended so that authorities have enough time to put one in place.