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CESR LEVEL 2 Directive on Markets in Financial Instruments Response to 2nd Consultation Paper, 1st Set of Mandates
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1. INTRODUCTION

We welcome the opportunity to provide comments to CESR's 2nd consultation paper on the first mandate from the European Commission on the level 2 implementing measures of the Directive on Markets in Financial Instruments. We have carefully studied the redrafted proposal and gave our point of view to general measures as proposed by CESR. Based on our response to the 1st Consultation Paper, we welcome introduction of more principles-based approach relying in a more extensive way on the firms' duty of care and the firms' tailor-made compliance rules allowing for more maximum harmonisation approach. CESR did not give sight of the exact wording of the Level 2 advice (except for transaction reporting). Therefore, we were not in position to comment in more detail and to change or propose a different wording. For that reason, our previous comments to the 1st Consultation Paper on the 1 set of Mandates remain relevant and should be taken into account by CESR when reformulating their advice to the Commission.

While we fully agree with most of the approaches, we have to reiterate our suggestion that CESR should take consideration of when subsequently redrafting its advice: CESR reargued that respondents should try to quantify marginal costs in order to argue their case as regards to record keeping requirements of tapes. However, we reinsist on the fact that undertaking a cost-benefit analysis should be a regulatory duty not a firms' duty. We still expect CESR to justify its rules in terms of cost-benefit. This would be in line with the recommendations of the Expert Group on Securities¹, as well as with the mandate from the European Commission².

¹ "Where new rules are introduced, the underlying policymaking must be evidence-based. The new rules must bring benefit and not simply increase costs". Recommendations from the Post-FSAP Forum Group on Securities.

² CESR should "pay particular attention to striking the right balance between the objective of establishing a set of harmonised 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 the investment firms. The amount of detail included in the advice should be very carefully calibrated case by case; the advice should ensure clarity and legal certainty but avoid formulations which would lead to overprescriptive, excessively detailed legislation, adding undue burdens and unnecessary costs to the firms and hampering innovation in the field of financial services".

2. INDEPENDENCE OF COMPLIANCE

First of all, we fully agree that independence of compliance is key to ensure effective performance of its role. We also support CESR's approach considering independence of compliance from functional rather than organisational perspective as far as it should be understood as:

- Living to the investment firm a certain degree of flexibility concerning methods to ensure independence of compliance and
- Avoiding intrusion regulation on internal organisation and structure of intermediaries.

The second alternative on the basis of which requirement and methods to ensure independence of compliance should be appropriate and proportionate in view of the complexity, nature and scale of the business of the firm is therefore in line with CESR's approach to use wording "where possible" in their second consideration.

For the above reasons, we are not in favour of imposing unconditional requirement on "one man firms" to outsource the compliance function. This would go against CESR's flexible approach to adapt requirements for ensuring independence to the nature of the firm's business, which should also apply to small firms. Moreover, CESR stated in the explanatory statement of their first Consultation Paper as regards to smaller firms that "the outsourcing of the compliance function can be envisaged in appropriate circumstances"(page 12, paragraph 3).

Therefore, there is no need to provide CESR with criteria to clearly define "small" firms.

3. RECORD-KEEPING AND THE BURDEN OF PROOF

We very much appreciate CESR's acknowledgement that the intensity of obligations to keep records varies according to the nature and complexity of business carried by investment firms. However, we do not agree with CESR's statement saying that their proposal does not intend to reverse the burden of proof, but rather to introduce obligations of record keeping for the following reasons:

Firstly, the obligation of record keeping is already clearly introduced by the article 13 (6) of the Directive. Its reintroducing would not only be needless, but would also go against Commission's mandate.

Secondly, without additional clarification, CESR's proposal can only be interpreted as imposing on investment firms a general and separate obligation to be able to demonstrate that it has not acted in breach of its obligations under the Directive and the internal code of conduct. According to this provision an investment firm could be requested by the competent authority to provide such evidence at any time and in any circumstances. The current proposal does not provide investment firms with legal certainty and leaves to the competent authority too discretionary tool. CESR's statement according to which there is no assumption of guilt if investment firm fails to carry out its obligations does not change the situation.

If this is not CESR's intention to reverse burden of proof, we would suggest to introduce further precision that in case of doubts as to compliance of the investment firm with its obligations, it should first be up to the competent authority to demonstrate the breach of rules by firms and not up to investment firms to demonstrate that breach of rules did not take place.

4. TAPE RECORDING REQUIREMENT

CESR maintain that to make their arguments convincing, market participants should provide evidence of the marginal cost of keeping records of tapes for 1 year. By insisting on that, CESR still disregard the fact that:

- Undertaking a cost-benefit analysis is a regulatory duty not a firms' duty (see introduction).
- The conflict between the 1 year period and the article 6 of the EU Data protection Directive requiring a purpose on processing, a proportionality test and a deletion of data once those data do not serve any longer to the objectives of the undertaken transaction³ constitutes a sufficient reason to review and allege the time period for keeping records of tapes (see our previous position paper).
- We do not see any need, nor positive impact of 1 year period for keeping tapes on the objective of protection of investors. If the client objects to have its personal data retained for one year, the account manager cannot do anything about it and the transaction risks to not to be concluded. If the transaction is concluded and effectively disputed by the client afterwards, it is likely that the client will complain promptly upon receipt of the confirmation and the 1 year period does not seem reasonable from the client's protection point of view.
Therefore, we still propose CESR to rely more on principles-based approach and to require the firm to retain the data as long as it is necessary to satisfy a specific and justifiable objective such as enabling the client to contest any problem with the transaction. Based on our own experience and procedure, 1 month-period would be adapted either to investors' protection objective without negatively impact on our business.
- From the feasibility point of view, sometimes it would simply be impractical and impossible for certain orders to be registered as the transaction is not concluded during trading hours.

In order to avoid the negative impact on investment firm's business we also suggest to use the wording: "*where appropriate*".

5. OUTSOURCING OF INVESTMENT SERVICES

We believe that outsourcing firm should retain regulatory responsibility for the outsourced function with appropriate emphasis on due diligence to be carried out by the investment firm in appointing a service provider, therefore supporting the option (c). We also generally agree with CESR's proposal to ensure highest degree of convergence, where possible, with works conducted by CEBS, IOSCO as well as with the provisions of the UCITS Directive. CESR should not however repeating UCITS's provisions and pay attention on the fact the MIFID's scope of action is larger and the convergence of all that measures should not appear as inappropriate and lead to excessively detailed measures.

Without further precision on level 2 measures, we are not able to provide more detailed comments.

6. CONFLICTS OF INTEREST AND THE SEGREGATION OF AREAS OF BUSINESS

We fully agree with CESR's general approach putting emphasis on the objective of prevention and management of conflicts of interest. Indeed, it would not be realistic to impose on the investment firms the obligation to achieve result of avoiding conflicts of interest. CESR's statement listing examples to deal with conflicts of interest should not be considered as exhaustive which is also fully in line with our previous comments.

³ See in particular Article 6 of the 1995 Data Protection Directive: "personal data must be kept in a form which permits identification of data subjects for no longer than is necessary for the purposes for which the data were collected or for which they are further processed".

We have to make a precision that our preference for principles over prescription already expressed in our previous response is not well served with unclear principles: Although we hope that CESR will leave a certain degree of flexibility to investment firms as regards the means to manage conflicts we do not understand CESR's careful approach reflected by its intention to leave to investment firms only "some discretion" regarding methods for managing conflicts of interest or their "may" wording. Indeed, more flexibility investment firm is granted as to these methods, the more effective investment firm's compliance with the objective of effective managing conflicts of interest will be.

Thus, we support the alternative of relying on the general obligation in the article 13.3 of the MIFID requiring an investment firm to take all reasonable steps to prevent conflicts of interest and to leave measures that firms may use to comply with the general obligation to their discretion.

CESR's approach according to which information barriers, such as Chinese Walls, should not be mandatory, but other means should at least be as effective constitutes too high and impractical standard. As Chinese Walls can be considered as one of the most effective means serving the purpose, it would be not realistic to ask investment firms which can not or do not need to put in place Chinese Walls to put in place at least as effective method as Chinese Walls.

7. INVESTMENT RESEARCH

We still disagree with CESR on the need to complement with their advice what is already required under the Market Abuse Directive and its implementing measures⁴. Furthermore, we see no indication in a direct or indirect fashion in articles 13.3 or 18 nor in the Commission's mandate that would enable CESR to provide advice on conflicts of interest arising on investment research.

8. METHODS AND ARRANGEMENTS FOR REPORTING FINANCIAL TRANSACTIONS

We very much support the possibility for a waiver for direct reports by the investment firms. We currently undertake those reports via the facilities of a regulated market and would like to continue doing so.

However, the paragraph 3 still refers to the fact that the arrangements "could be considered" as sufficient to allow the waiver thus not making clear that those arrangements would effectively be sufficient. We do not understand why CESR keeps on leaving a level of uncertainty as to whether the arrangements are sufficient to allow for the waiver, especially that this possibility is clearly introduced by the Article 25 (5) of the Directive, leaving no place for doubt.

We also think that CESR should take into consideration the fact that their Level 3 recommendations are still too extensive. If CESR agrees on the minimum condition for reporting channels in order to be approved (paragraph 1) and there is an agreement that these reporting channels must be approved by the competent authority (paragraph 2) there is no need for further examination of responsibility issues regarding transaction reports in their first proposed Level 3 recommendation or further discussion on how competent authorities are expected to waive the obligation in their third proposed Level 3 recommendation.

⁴ Directive 2003/6/EC of 28 January 2003 on insider dealing and market manipulation, OJL 96 of 12.4.2003 and Directive 2003/125/EC of 22 December 2003 on the fair presentation of investment recommendations and the disclosure of conflicts of interests, OJL 339 of 24.12.2003

9. CRITERIA FOR ASSESING LIQUIDITY IN ORDER TO DETERMINE THE MOST RELEVANT MARKET IN TERMS OF LIQUIDITY

As already stated in our previous response, the use of proxies to determine the most relevant market in terms of liquidity seems a good approach since it is easy to understand.

We also support CESR's proposal to not to make public a list of competent authorities of the most liquid markets for a given financial instrument, which would have a negative impact on competition issue.

In relation to 3rd country debt issuers, we would like to reiterate our proposal to solve the "lack" of European domicile" for 3rd country issuers by using the approach of the Prospectus Directive since by July 2005 all those 3rd country issuers should have a chosen European home Member State.

10. THE MINIMUM CONTENT AND THE COMMON STANDARD OR FORMAT OF THE REPORTS TO FACILITATE ITS EXCHANGE BETWEEN COMPETENT AUTHORITIES

We admit that it may be premature in the short or even medium term to harmonise technical agreements on transaction reporting. However, we still see no justifiable reason for not being able to agree on an uniform content of the transaction reports. Therefore, we still believe that CESR should make supplementary effort in terms of harmonised content of the report, especially that the article 25.3 and 4 requires, in our view, maximum implementing measures (see our previous comments).

Therefore we do not agree with CESR when they say that the implementing measures should set out the minimum information subject to transaction reporting.

As already stated in our previous comment, we find it surprising that CESR is able to agree on an harmonised content for purposes of exchange of information (Annex B) but it is not able to agree on an harmonised content for purposes of transaction reporting by investment firms (Annex A).

In relation to the client identification code, we understand that both CESR Members and market participants remain divided as to whether "client/customer identification" field should be included in the list of information required in the transaction reporting from investment firms.

We therefore welcome CESR's conclusion that investment firms need only report this information if it is required by national law in the Member State of the competent authority to which they are reporting.