EUROPEAN SAVINGS BANKS GROUP
GROUPEMENT EUROPEEN DES CAISSES D'EPARGNE
EUROPÄISCHE SPARKASSENVEREINIGUNG

DOC 161/04

Brussels, 25 February 2004
JEA / ROB

European Savings Banks Group (ESBG)

Response to CESR's Call for Evidence regarding its Provisional Mandates under the Future Directive on Financial Instruments Markets (ISD 2)

Rue Marie-Thérèse, 11 • B-1000 Bruxelles • Tél: (+ 32 2) 211 11 11 • Fax: (+ 32 2) 211 11 99
E-mail : first name.surname@savings-banks.com • Website : http://www.savings-banks.com

Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 25 members from 25 countries (EU countries, Norway, Iceland, Bulgaria, Czech Republic, Hungary, Latvia, Malta, Poland, Romania, Slovak Republic) representing over 1000 individual savings banks with around 66,500 branches and nearly 770,000 employees. At the start of 2002, total assets reached almost EUR 4160 billion, non-bank deposits were standing at over EUR 2012 billion and non-bank loans at just under EUR 2095 billion. Its members are retail banks that generally have a significant share in their national domestic banking markets and enjoy a common customer oriented savings banks tradition, acting in a socially responsible manner. Their market focus includes amongst others individuals, households, SMEs and local authorities.

Founded in 1963, the ESBG has established a reputation as the advocate of savings banks interests and an active promoter of business cooperation in Europe. Since 1994, the ESBG operates together with the World Savings Banks Institute (WSBI, with 109 member banks from 92 countries) under a common structure in Brussels.

1. General Remarks

The European Savings Banks Group (ESBG) welcomes the opportunity to comment on what CESR should consider in its advice to the European Commission. It is indeed particularly important for the industry to comment already at this stage of the process, notably with view to the high number and the complexity of provisions for which CESR is requested to submit advice to the Commission. Furthermore, the implementing measures developed by the Commission will directly determine the precise requirements which investment firms across Europe will have to face, and are therefore of paramount importance.

The ESBG would like to make two general comments on the advice that CESR is required to submit to the Commission:

1.1 Importance of performing a cost-benefit analysis

On several occasions, the ESBG has stressed the importance for CESR and the Commission to perform a cost-benefit analysis before proposing implementing measures. Against this background, the ESBG particularly welcomes the fact that in section 2.3 of its provisional mandate, the Commission indicates that "*CESR should also pay particular attention to striking the right balance between the objective of establishing a set of harmonized conditions for the licensing and operation of investment firms and regulated markets and the need to avoid excessive intervention in respect of the management and organisation of 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*".

The ESBG strongly invites CESR to follow this guideline. Otherwise, there is a high risk that excessively burdensome legislation be created, which would pursue a theoretical objective of increased harmonization, but which would in actual fact not be beneficial in terms of investor protection or indeed increased cross-border business. Rather, overly prescriptive provisions might in fact lead to an increase in the costs for investment firms, which, in the end, the investors would have to pay.

1.2 Legal nature of the implementing measures

The ESBG has, in previous consultations, stressed the importance of the choice of the appropriate tool to enact level II legislation, i.e. Commission Directives or Regulations. The ESBG believes that while at first sight, the use of regulations might seem more appropriate in order to ensure a uniform application of the implementing measures across the EU, the choice of a regulation nevertheless also raises serious questions, particularly when concepts used in the level II implementing measures actually have different meanings in the different national legal jurisdictions[1].

As such, even if the choice of the appropriate instrument is not under CESR's responsibility, the Commission's decision to use regulations has nevertheless one important consequence on CESR's work: increased attention will have to be paid to make sure that the proposed advice are compatible with provisions existing in different national legal jurisdictions, which have not been harmonized (such as the national civil codes). Accordingly, the ESBG shares the view that whenever doubts arise regarding the compatibility of proposed measures with existing national legislation, the proposed use of regulations should induce CESR to issue less detailed provisions in its own recommendations.

2. Specific Comments linked to the Commission's provisional mandate

2.1 Section 3.1.1 – Compliance obligations and treatment of personal transactions (art. 13§2)

The ESBG is of the opinion that CESR should base its advice for the requirements relating to the compliance task on those requirements already laid down in Article 10 of the first Investment Services Directive (ISD 1[2]). As such, changes should be put forward only in those cases where the existing legal framework is *de facto* encumbered by certain shortcomings. We believe that this is, in general, not the case. The proposed approach would accordingly result in level II provisions, which would be similar to those that can be found in the national implementations of the provision on internal control procedures as defined in Art. 10 (2) (1)

[1] For more information on the practical problems linked to the use of regulations, see for example the ESBG Response of December 2003 to the Commission's Working Document on the implementation of Articles 5, 7, 10, 11, 14 and 15 of Directive 2003/71/EC (Prospectus Directive) - Working Document ESC 36/2003, available on the Website www.savings-banks.com.

of ISD 1 ("*sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing, and adequate internal control mechanisms including, in particular, rules for personal transactions by its employees*").

Furthermore, the ESBG believes that the level 2 implementing measures on the compliance obligations need to contain safeguards for a sufficient degree of independence in the compliance exercise. This could for instance be achieved by a provision indicating that this exercise is directly incumbent upon the investment firm's management.

Finally, concerning the definition of a **personal transaction** (indent 4), attention should be paid to include only those individual transactions where – in the execution of the order – there is a danger that the employee holds an advantage compared to an investment firm's client. As an example, in the case of transactions concerning shares of investment funds that are not listed ("open-ended funds"), such an advantage can be ruled out *a priori* because both an order coming from an employee and an order coming from a client will be subject to the share price determined by the capital investment firm, based on the net asset value.

2.2 Section 3.1.2 – Obligations related to internal systems, resources and procedures (art. 13(4) and (5) second subparagraph)

The ESBG firmly believes that limits should be fixed when it comes to the establishment of organisational requirements. As such, CESR should avoid issuing detailed recommendations on the organisation of investment firms: European investment firms are very heterogeneous by nature and abstract legal provisions could not reflect the entire range of different real world settings in which they are embedded. Accordingly, the "reasonable steps", which the investment firms have to take, should only exist in those provisions, which specify the obligations in clearer terms, as opposed to pinning down the last details regarding the precise way in which these obligations are to be met. By way of example, some of the obligations, which may be thus defined, are given in a non-exhaustive list:

- Providing safeguards against system failures;
- Providing sufficient staff for business operations;
- Providing sufficient resources for the compliance activity.

[2] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.

2.3 Section 3.1.3 – Obligation to avoid undue additional operational risk in case of outsourcing (art. 13 (5) first subparagraph)

The requirements with regard to the outsourcing of services should be designed in such a way that they would not curtail the possibility of cost-saving cooperation between investment firms. This could be achieved, for example, by stating that the transfer of investment services and ancillary investment services from an authorised investment firm shall not be defined as "outsourcing". On a more general note, and in order to provide legal certainty, the ESBG strongly believes that there needs to be a list defining what outsourcing actually means.

2.4 Section 3.1.4 – Record-keeping obligation (art. 13 (6))

When defining its recommendations for implementing measures concerning the record-keeping obligation, CESR should be particularly careful in keeping in mind the actual underlying objective of this obligation, namely, to allow the competent authority to verify the correct provision of investment services. Consequently, the record-keeping obligation should be imposed as long as the records may document potential breaches in the correct provision of investment services.

2.5 Section 3.1.5 – Protection of client's financial instruments and funds when a firm holds financial instruments and funds belonging to clients (Art. 13 (7) and (8))

The ESBG believes that the provisions concerning the protection of the financial instruments and funds of an investment firm's client should only be subject to minimum harmonisation, as any other approach would constitute an excessive interference with custodian law prevailing in the Member States. First, such an approach would lack a relevant European regulatory mandate. Second, the need for such an approach is not obvious: the wording of Art. 13 (7) of ISD 2 is identical to Art. 10 (2) (2) of ISD 1, the implementation of which has not, to our knowledge, given rise to particular problems.

2.6 Section 3.2 – Conflicts of interest (Art. 18 and 13 (3))

In its mandate on implementing measures for conflicts of interest, the Commission requests that CESR propose obligations which should be "*proportionate*" and which should "*take into*

account the risks inherent to the different services or activities with respect to the interests of the clients". The ESBG is therefore of the opinion that CESR's advice should be differentiated according to two factors: the type of investment services provided (e.g. investment advice or execution-only) and the frequency with which conflicts of interest may arise within an investment firm. Furthermore, in preparing its advice, CESR should pay particular attention to ensure that the proposed provisions are realistic and feasible. As such, detailed organizational provisions should be avoided, since such measures would fail to live up the heterogeneous structure and size of the European investment firms.

This can be illustrated with one example: Chinese walls. While the creation of Chinese walls is a necessity in the case of large, universal banks, this measure might not be the most appropriate one in the case of smaller investment firms. Furthermore, the development of implementing measures in this regard should be guided by the assumption, recognized in the Directive at the first level, that fully preventing conflicts of interest is not possible.

Finally, the ESBG believes that if CESR were to issue advice on information obligations in connection with conflicts of interests, it should bear in mind that such obligations should be limited to the "general nature" of a conflict. Any forthcoming disclosure obligation regulating the disclosure of details of contractual agreements between the investment firm and third parties would be incompatible with this premise. Furthermore, statutory or contractual confidentiality obligations may render the disclosure of such information virtually impossible.

2.7 Section 3.3.1 – Publicity and marketing communications (article 19§2)

The ESBG believes that when stipulating the requirements with regard to "marketing communication", it is necessary for CESR to use the competition rules and regulations as a benchmark in order to avoid the creation of a segregate law for investment firms only.

2.8 Section 3.3.2 – Appropriate information to be provided to the clients or potential clients (article 19§3)

Any definition of the appropriate information to be provided to the client should take account of the distinction made at the first level of the different types of investment services rendered. Furthermore, the ESBG believes that there is one type of information for which it is

particularly important to perform an in-depth cost-benefit analysis: this concerns the requirements for "repeat information". This type of information may involve a considerable amount of monitoring work, implying important costs for the investment firm. As such, the obligations in terms of information should be based on the actual information need on the part of the client, as opposed to mandatory, formulaic repetition after a specific time interval. As far as the specific content of the information is concerned, internal data concerning costs should be avoided, since clients and competitors of the investment firms should not be entitled to receive such information.

2.9 Section 3.3.3 – Client Records (article 19§7)

Article 19 (7) of ISD 2 explicitly states that the "*rights and duties* (…) *may be incorporated by reference to other documents or legal texts*". As such, the ESBG is of the opinion that any potential forthcoming obligations requesting the signature and keeping of each individual relevant document in a client file would be incompatible with this provision of the Directive.

2.10 Section 3.3.4 – Reports from the firm to its clients (article 19§8)

Performing an appropriate cost-benefit analysis is also of fundamental importance with a view to the definition of the appropriate reports an investment firm should provide to its clients. The ESBG believes that in this regard, the decisive criterion should be to enable the client to comprehend the logic behind the transactions performed.

2.11 Section 3.4 – Best execution obligation (art. 21)

The development of criteria to define the best execution policy is likely to be the most challenging task of CESR. The ESBG is of the opinion that a one-size-fits-all solution covering all individual cases is virtually impossible. For example, while for some clients execution speed might be more important than the search for the best price, the situation might be completely opposite for other clients. Whatever that orientation chosen by CESR, the ESBG would like to stress that as regards the search for the best price in particular, stringent requirements may considerably increase the costs for any given securities transaction.

2.12 Section 3.4.3 – Information to the clients on the execution policy of the firm (art. 21§3)

The ESBG believes that as regards the requirements in terms of information to the provided to the client concerning the execution policy of the firm, there should be no mandatory details the rationale of which is not easily comprehended by the client.

2.13 Section 3.5 – Client order handling rules (article 22)

In delivering its advice on client order handling rules, CESR should refrain from trying to cover each and every transaction. The only viable solution in this respect is the stipulation of principles.

2.14 Section 3.6 – Reporting of transactions (art. 25(3), (4), (5) and (5.a))

In the different Member States, the reporting systems established for the purposes of efficient tracking of insider trading have reached different degrees of sophistication. In particular, whilst stringent supervisory projects have resulted in highly complex, fully electronic systems in some Member States, this is not so much the case in other Member States. As a consequence, given the very high costs which would result from any interference with existing reporting systems (in particular with a view to the existing highly sophisticated systems in place in several Member states), the ESBG would suggest that CESR first carries out an initial stocktaking exercise of the current reporting systems within the different Member States. Based on the findings of such a stocktaking, CESR could then move on to the next step, i.e. a careful assessment of the most balanced and proportionate way towards the further harmonisation of the different national reporting standards. In the technical implementation of these deliverables, interested parties and the supervisory authorities should be granted maximum latitude and flexibility.

Along the same lines, the obligation for a competent authority to forward the information to the supervisory authorities of the most relevant market (Art. 25(3)) and the obligation to exchange reported information between the supervisory authorities (Art. 25(6)) should, under no circumstances, result in an obligation for investment firms to prepare their reports in an EU-wide standard IT format. Particularly in Member States with highly sophisticated IT

systems in place, the adjustment of these systems would incur an unjustifiable burden. Furthermore, such an undertaking would fall outside the scope of the Commission's responsibilities under Article 25(7).

2.15 Section 3.7 – Transparency obligations (art. 28, 29, 30, 43 and 44)

The ESBG would like to comment at this stage on measures to implement Article 28 (post-trade disclosure by investment firms). It is of fundamental importance that CESR, when drafting its implementing measures for this article, takes full account of the fact that Member States have very heterogeneous forms of off-floor equity trading. This ranges from systematic OTC trading through banks' in-house internalisation systems to very incidental fixed price deals which an investment firm closes with its private clients (for example in order to execute the client's purchase order concerning a non-liquid second-line via own holdings), including also own-account trading between banks.

CESR should accordingly take account of this diversity by way of flexibility and differentiation in the forthcoming reporting obligations. This particularly applies to the window of time within which the report has to be sent to the competent authority. In this respect, any forthcoming reporting obligations should be especially geared to provisions that can be met "on a reasonable commercial basis", as indicated in Art. 28(1). As such, the ESBG considers it of fundamental importance for CESR to perform an in-depth cost-benefit analysis prior to submitting implementing measures to Article 28.

2.16 Section 3.8 – Admission of financial instruments to trading (art. 40)

The ESBG believes that there is a compelling need for CESR to make its advice on measures to implement Article 40 (Admission of financial instruments to trading) compatible with the provisions contained in the Prospectus Directive and the forthcoming Transparency Directive. It is very important to avoid contradictory requirements. In particular, requirements with regard to the admission to trading of financial instruments are covered to a large extent by these two Directives.