

THE PASSPORT UNDER MIFID

FBF'S RESPONSE

EXECUTIVE SUMMARY

1. The French Banking Federation (FBF) is the professional body representing over 500 commercial, cooperative and mutual banks operating in France. It includes both French and foreign-based organizations.

2. Since the MiFID is probably the most important directive of the FSAP in terms of technical, legal and structural adaptations it involves on both retail banking networks, corporate and investment banks and investment firms, the FBF welcomes the opportunity to give input into CESR's public consultation on the passport under MiFID. The application of the European passport principle is a key element on which the analysis of the success of the Directive will be evaluated. That's why the FBF would like to make four general statements.

3. **First statement: clarity has to be given quickly to the banks.**

It is essential that CESR together with the European Commission in their respective functions provide clarity on this issue as close to the date of transposition of MiFID as possible so as to smooth the considerable efforts of industry to be compliant with the Directive by 1 November 2007.

4. **Second statement: the regulators have to agree, without any ambiguity, on the solution which would be implemented about the transaction reporting and the application of the conduct of business rules.**

From FBF's point of view, it is essential that the Securities regulators across Europe agree on a simple, clear and certain position about the transaction reporting and the application of conduct of business rules. Every actor of the financial market need legal certainty about the application of the European passport in order to avoid any litigation with the regulators, with their clients. The view of the FBF is that any litigation which could show that the application of the MiFID is not certain and depends on specific interpretations of local regulators would be detrimental to the integration of the markets and the freedom given by the Directive (freedom to provide services on a cross border basis and freedom to create a branch).

5. **Third statement: the transaction reporting has to be made to the authority of the country where the operation is booked.**

Regarding the transaction reporting issue, the FBF will obviously give to CESR its position at the occasion of the consultation paper published on the 2nd of February and dedicated to this issue; nevertheless, the FBF states that it must be clear that the transaction reporting depends on the good and efficient communication of information between the regulators. Thus it is essential that the banks would have to report the transaction to a single regulator. About this regulator, the FBF estimates that it should be the authority of the country where the transaction is booked.

From a practical standpoint, FBF would favour a unique trade reporting entity appointed by the regulators: all transactions would be reported to this entity which would then dispatch trade reporting to the relevant regulators.

6. Fourth statement: the application of the conduct of business rules to the branches must be agreed by the regulators and based on a choice between two solutions.

The FBF underlines that the consultation paper is drafted from a supervisory perspective. Thus it does not address the impact of its proposals upon the cross border activities of EEA branches of banks. Naturally, from the banks' perspective, this is a fundamental point which requires clarity and an important degree of legal certainty before banks can prepare to be fully compliant with MiFID by the implementation deadline.

The FBF recalls that the responsibility for branch supervision under MiFID is, according to the Directive text, divided between the home and host supervisor. Organisational matters will, in the vast majority of cases, be dictated purely by Head Office and therefore will fall under the auspices of the home regulator.

About the application of conduct of business rules, FBF members have different views: Some of them highlight that the simplest way has to be favoured: *i.e.* only one set of conduct of business rules has to apply for branches in relation to all branches business; as a consequence, it involves the application of the host state rules.

Some of them consider that a distinction has to be made between the business done by the branch with clients located in the country of the branch – in such a case, host states rules apply entirely -, and the situation where the branch provides services to clients located in another country than the state of location of the branch – in such a case, home state rules apply.

As a consequence, the FBF does not favour any of these two solutions consider that the regulators must agree without any ambiguity on one solution among these two.

7. As a conclusion of the executive summary, the FBF would like to express to wishes.

First, the FBF supports supervisors focussing on the practical ways to foster a common supervisory culture so by extension welcomes this pragmatic approach to this current issue. The success of the implementation of the MiFID depends largely on the common view the regulators will have on the most sensitive and important matters on this directive. Thus the FBF wishes that such practical focussing will lead to practical solutions.

Second, the FBF indicates that the issues linked to the cross border activities of credit institutions are not limited to the case where the firm and the client are located in the EU. One particular issue of utmost importance should be addressed in the CESR consultation: **it must be clarified that a credit institution (or an investment firm) located outside the European economic area (EEA) providing a service to a client located within the EEA, be required to set up a subsidiary or a branch within the EEA.** In such case, this subsidiary or branch should be licensed by the local supervisory authority and should comply with MiFID rules.

This is crucial for two main reasons:

- A client located in the EEA must be protected by the MiFID rules, whatever the location of the investment services providers;
- It will ensure the same level playing field for EEA and non EEA firms.

DETAILED COMMENTS

8. Before answering the questions, the FBF would like to develop its position on how the French banking industry sees the application of the European passport principle.

Concerning the transaction reporting

9. As it is stated above, the FBF considers to be essential for the smooth operation of the passport and achieving a proportionate supervisory regime under MiFID relates **to which supervisory authority transaction reports are sent**.

In the consultation paper the question where the service is provided depends on the location of the client. For example, if the client is located in the host Member State, the service has to be provided according to the rules of that host Member State. However, if the service is provided cross-border then the service must comply with the home Member State rules of the firm.

10. The FBF estimates this situation does not make sense when it comes to transaction reporting, *i.e.* to which supervisory authority the report must be sent, since the bank would have to differentiate between which supervisor receives the report, home or host, according to the location of the client.

There are three principle reasons why the French banks consider that such criterion is not relevant:

- Firstly, this situation is not that envisaged by the European Commission from the outset. It would not facilitate supervisory convergence *per se* and/or contribute positively to fulfilling the aims of MiFID.
- Secondly, the FBF fears that under the current situation as foreseen by reading the consultation paper on passporting would lead to a high default rate which is to the detriment of an efficient industry and an appropriately protected consumer alike.
- Finally, the costs of establishing a system where by banks would have to report on a differential basis according to the location of the client would in no way be matched by any realisable benefits.

11. The French Banking Federation thus states the transaction reporting has to be made to the authority of the country where the operation is booked. The booking is a simple, practical and certain criteria which avoids any double reporting, which allow regulator to control in a easier way the conditions of the executed transaction and which is relevant from a prudential point of view.

The FBF will develop its position in its response to the consultation paper dedicated to transaction reporting.

The passport under MiFID and conduct of business rules

12. The first message the FBF would like to highlight is that several criteria has been envisaged by the regulators and by the industry in order to identify which conduct of business rules would apply to the relation between the branch and its clients: the characteristic performance test, the solicitation of the client.

13. Concerning the *solicitation* of the client, the FBF is convinced that these criteria are the most irrelevant for the following reasons:

- First, it would potentially lead to the application of 30 conduct of business rules when the branch has clients from every countries of the EEA (27 members of the European Union plus Iceland, Lichtenstein and Norway). Such consequence is completely impracticable for the credit institutions;
- Second, it creates a unsolvable problems whether there was an active solicitation of the client or not.

14. Concerning the *characteristic performance* test, the FBF underlines that if it can be used in many situations since it will lead to designate the conduct of business rules of the branch.

15. Another approach, which is favoured by some FBF members, would be to apply one set of conduct of business rules to the activities of the branch, irrespective of the location of the client. The application of this approach is obviously simple and practical for the investment service providers. Furthermore, investors dealing with a branch generally expect to do that business under the regulatory rules where the branch is located, all the more that they don't even know, in most cases, if the investment provider is a branch or a subsidiary before the beginning of their relationship. If there is a legal difference in the application of conduct of business rules, subsidiaries will be governed by one set of conduct of business rules while branches are governed by another. This means there is not a level playing field with regard to structure on this particular issue.

Last but not least, the local (*i.e.* host state) regulator is best placed to investigate and monitor the activity of the branch with regard to conduct of business rules because it is located in its state.

Another solution is possible, according to some other FBF members.

16. As far as the Directive states that "*The competent authority of the Member State in which the branch is located shall assume responsibility for ensuring that the services provided by the branch within its territory comply with the obligations laid down in Articles 19, 21, 22, 25, 27 and 28 and in measures adopted pursuant thereto*" (article 32 (7)). Some FBF members interpret this provision in the following way: given that some service may be provided within the territory where the branch is located, some service may be provided outside this territory.

Thus the most relevant way to interpret this provision, from a legal point if view, is that in the cases where the client of the branch is located in the same country, the host state conduct of business rules apply entirely. In the other cases, where the client is located in another country, the home state conduct of business rules shall apply.

17. The FBF's position is that these two interpretations are possible.

QUESTIONS

Question 1: As regards article 31 (3) do you agree with the above regarding what should be the date from which a firm can start to provide cross-border investment services in to the host Member State under a passport? If not, for which reasons?

18. The FBF agrees with CESR's proposals as regards the date of notification and would like CESR to recommend the following:

- the one month suggested deadline stated in Article 31 (3) should be considered as the maximum time available to consider a notification and all efforts should be taken to ensure that firms receive their MiFID passport in the host state without delay; and
- applicant banks should not have to wait until their permission has been updated on the register in the home state before commencing operations under the MiFID passport in the host state. Rather, the home state should inform the bank that it can begin to operate under the passport at the point at which it informs the host state supervisor.

19. Furthermore, the FBF considers that regulators should adopt a transparent approach to the notification process. Where there are legitimate reasons to delay a notification these should be stated to the firm and the subsequent correspondence processed without delay. It would be to the detriment of the efficiency of Europe's market and its consumers if administrative delays were to prevent firms from legitimately seeking to operate under the MiFID passport from 1 November 2007.

Question 2: Concerning article 32(6) do you agree with the referral of the firm by the home regulator to the host regulator's or CESR's website when applying for a branch passport, when necessary?

20. See response to question 1. Additionally, we consider that it would be efficient for the banking and supervisory communities alike if CESR were to set out on its website links to all the relevant requirements in relation to Member States' specific commercial considerations.

Question 3: Do you agree with the proposal set out in paragraph 24?

21. The FBF does not agree with the proposal set out in paragraph 24 since the requirement to meet "certain specific domestic commercial provisions" is super equivalent to Article 32 (6) and could be considered as a barrier to entry. We believe that the provision set out in Article 32 (6) for a firm to establish a branch and commence business within two months of submitting an application is pro-efficiency and realistic. Such guidance from CESR could potentially undermine this aim and endanger the smooth operation of the MiFID passport as a whole.

Question 4: What are your views on the exposition given in paragraphs 31-36 above? What grounds do you have to support your views?

22. The FBF agrees with CESR that regulators and firms should share a common interest in supporting any such practical arrangements that help ensure that branch operations are controlled and supervised properly, in order that the required MiFID standards of protection are delivered. The FBF also agree with CESR when it states that the key proposals that emerges is that the respective home and host regulators agree among themselves, and communicate their views to relevant firms, on how best in practice to carry out branch supervision.

Question 5: Do you agree with the practical supervisory challenges as identified by CESR? Are there any others that you envisage may occur and could benefit from consideration by CESR?

23. The FBF agrees with the practical challenges CESR identifies.

Question 6: Do you agree with the suggested desired outcomes? Are they capable of being shared for the benefit all stakeholders?

24. The FBF agrees with the desired outcomes and reiterates the previous comment that certainty, especially at the planning and implementation stage is of paramount importance to Europe's banks. The desired outcomes CESR sets out are the correct ones and in doing so brings us closer to achieving greater certainty.

Question 7: Do you agree with the broad 'criteria' outlined above and as set out in more detail in Annex 2, against which CESR will evaluate possible solutions? Do you have any comments? Are there any others you would suggest that could be material when considering the relative merits of different practical solutions?

25. The FBF welcomes CESR's identification of possible success criteria with which to evaluate possible solutions to dealing with the supervisory challenges under MiFID presented by branches. The FBF members consider it positive that CESR focuses on the cost to firms and the cost to supervisors when considering the efficiency of the practical arrangements. The FBF suggests that CESR should include banks in its dialogue about what would and would not constitute success on an ongoing and systematic basis.

Question 8: Do you have any comments on the possible solutions identified above? Do you have any others that you feel could help?

26. The FBF agrees with CESR's general statement, or agreed goal, that "*the common standards created by MiFID provisions, together with enhanced understanding between regulators and convergence in supervisory practices should help ensure that [...] cross border business operates smoothly.*" However, whilst this is the aim the FBF feels an indication of how this will work in practice between 30 EEA competent authorities, and importantly the degree of commonality between the practices, is necessary.

Question 9: Do you agree with the broad evaluation and conclusions as outlined in paragraphs 50-55 above? What does your own evaluation suggest? What evidence base can you provide to support your conclusions? Two blank tables are provided at Annexes 3(i) and 3(ii) for respondents to use to create their own 'tick lists' to help formulate their own evaluation. CESR would welcome completed copies together with supporting analysis as part of any feedback to this consultation.

27. The FBF does not support the case by case approach. Since one of the objectives of MiFID is to have an effective and enabling European passport which facilitates the uptake of pan-European operations a clear European wide policy of which rules are to apply is necessary. The implied ongoing discussions with multiple regulators regarding which rules firms are operating under would be very inefficient.

28. Similar considerations apply with regard to transaction reporting where currently firms are generally reporting transactions executed by a branch to their host state regulator and it is likely to cause confusion to have to change this. These practical considerations are not only sizeable but they cannot easily be overcome by systems changes or other arrangements. The transaction reporting issues, in particular, may require substantial IT investment if firms have to switch the regulator to whom they have to report and/or include additional fields to meet home state extra reporting requirements.

29. There should be a consistent policy that all European regulators adopt and such an approach should not be done on a case by case basis as this would lead to confusion, not only to firms and regulators, but also to customers. The cost of negotiation would be significant and therefore ultimately impact on the client.

30. The FBF supports CESR's suggestion in paragraph 55 that the home regulator should be able to outsource or delegate supervisory tasks regarding a branch to the host regulator, whilst remaining legally responsible for the branch's supervision.

Questions 12 to 15

31. At this stage the FBF has no comment to state on the issues relating to tied agents, cross border activities of MTFs and representative offices.

Question 16: Do you agree with the proposal of mapping ISD to MiFID proposed in Annex 1? What changes or possible alternatives would you suggest?

32. The FBF expresses the desire to have legal certainty in respect of liability banks would have vis-à-vis their clients under the following scenarios:

- the Member State of the inwardly passporting firm was late in implementing MiFID but the host state implemented MiFID on time;
- the Member State of the outwardly passporting firm implemented MiFID on time but the host state implemented it late; and
- both home and host state were late implementing MiFID.

Question 17: Do you consider the suggested approach appropriate and/or do you see other issues that should be handled in this protocol?

33. The FBF welcomes further harmonisation by way of a protocol between competent authorities. We recommend that CESR has recourse to dialogue with stakeholders, and especially the supervised community, to ensure that its aims are realised and that it takes account of the most up to date feedback from the market on the operation of the MiFID passport.