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

DOC 645/04 (vers 1.3)

Brussels, 03 August 2004
JEA

European Savings Banks Group (ESBG)

Response to CESR's Call for Evidence regarding its Final Mandate under the Directive on Markets in Financial Instruments (MiFID)

Ref.: CESR / 04-323

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Profile European Savings Banks Group

The European Savings Banks Group (ESBG) represents 24 members from 24 European countries representing 968 individual savings banks with around 65,000 branches and nearly 757,000 employees. At the start of 2003, total assets reached almost EUR 4,355 billion, non-bank deposits were standing at over EUR 2,080 billion and non-bank loans at just under EUR 2,195 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. The first Consultation Paper on Possible Implementing Provisions on the Markets in Financial Instruments Directive (MiFID) presented by CESR under its first mandate dated 17 June 2004 features an extremely high degree of detail. The ESBG strongly recommends that CESR reconsiders this approach. Under section 2.3, the Commission calls for an equilibrium between the envisaged regulatory goals (harmonisation, investor protection) and the necessary flexibility needed by investment firms. The more detailed the rules on Level 2 are, the less flexibility remains for the investment firms.

Section 3.1 – List of Financial Instruments

Pursuant to Article 4 of the MiFID, the Commission requires CESR to advise on possible implementing measures for a definition of commodity. The ESBG is of the opinion that in the case of OTC commodities, a criterion should be that one of the two counterparties should be an investment firm. As such, should none of the two counterparties be a financial institution, then the instrument should not fall under the scope of the Directive.

Under section 3.1 paragraph 2, CESR is invited to advise on conditions under which several financial instruments should be determined not to be for a *commercial* purpose. Referring to the former paragraph, we believe that this should be the case when the counterparty of the investment firm performs the transaction on a private basis.

Regarding the definitions of *climatic variables* and *inflation rates*, in section 3.1 paragraph 4, CESR should pay particular attention in making sure that appropriate and robust statistical data are used to define these parameters prior to using them as underlying financial instruments.

Finally, under section 3.1 paragraph 5, CESR is invited to advise on categories for items not otherwise mentioned in Section C. In this context, the ESBG's main recommendation would

be to invite CESR to refrain from developing too many categories, and proposes to develop only categories for those cases where this proves absolutely necessary.

Section 3.2 – Definition of "Investment advice"

Drawing the appropriate distinction between the different categories of communications with the client is a particularly difficult exercise. It is important to notice that under the new Directive investment advice is regarded a core business. The ESBG believes therefore that the central criterion in the definition of investment advice must be the presence of a personalised ("tailor-made") recommendation to the client. An advice is personalised if it takes into account the individual circumstances of the client, meaning his knowledge and experience, his financial situation and his investment objectives.

A "general recommendation" on the other hand does not take into account the individual situation of the client but will only provide advice on a general level given to more than one client. A "market communication" lacks any specific relation to the client. "Information given to the clients or from" and simple offers are forwarded without being adjusted to the client's specific situation.

The definition for tied agent could be drafted according to the definition of "tied insurance intermediary" in Article 2 (7) of the Directive 2002/92/EC on insurance mediation (OJ L 9/3, 15/01/2003).

3.3.2.1 - Suitability test (Article 19 (4))

Asking for information:

The reason for asking the information considered by Article 19 (4) is that it should help investment firms find the right basis for advice. Concerning the information which would have to be obtained pursuant to this, one possible solution would be the breakdown into three categories:

- Personal financial situation
- Knowledge and experience in the investment field
- Investment objectives

Regarding the financial situation the final analysis shall concentrate on the information about the amount of assets and income that the client is prepared to set aside for an investment.

When seeking for information on the client's knowledge and experience concerning the types of financial instruments, CESR should again try to avoid adoption of excessively narrow provisions for the differentiation of the types of financial instruments. A possible list of transaction types could contain the following:

- Bonds,
- UCITS,
- Shares,
- Structured products,
- Warrants,
- Derivatives.

In order to obtain information on the client's envisaged investment objectives, the main means should be to identify the client's risk profile and the investment horizon he is aiming for. CESR could circumscribe possible investment strategies and investment goals by listing some examples (not exhaustive):

- Home building schemes,
- Saving schemes,
- Specific purchase plan,
- Funding of education for children,
- Provision for old age.

Hereby, clients should have the possibility to articulate their investment goals proactively. In this regard it is therefore essential to ask the client for his expectations concerning the investment horizon.

Using the information:

The criteria concerning the suitability of an investment to a client cannot be laid down in an abstract manner but only under due consideration of the peculiarities of the respective individual case at hand. Any forthcoming provisions with regard to the 'suitability test' in the context of investment advice should therefore seek to reflect the criteria of 'advice that is suitable for the investor and the investment'.

The term 'suitable for the investor' explains the need for advice that fits the investor's specific situation. First of all, this requires a thorough analysis of the investor's situation; as already described such an analysis should take into account the client's investment objectives, his experience and his financial situation. The outcome of the analysis has to be incorporated in the advice. The benchmark for the advice is the client's best interest. Criteria for advice that is 'suitable for the investor' cannot be laid down in abstract terms; but have to be made on a case-by-case basis.

The term 'suitable for the investment' refers to those requirements that have to be fulfilled in order to ensure that the specific securities' and derivatives' transactions in question fit into the content and scope of the advice. The advice shall contain any information that shall have or may have material impact on the investment decision for or against the execution of the transaction. The information needs to be unambiguous, logically structured and must be provided in a suitable format. The scope of the information, firstly, depends on the client's prior knowledge and, secondly, on the nature of the envisaged transaction. In order to complement the client's individual situation, the information should optimally be given in those areas where the client is lacking the necessary knowledge. Further requirements are an analysis of opportunities and risks, an assessment of comparing features, as well as an adequate choice of a financial instrument out of the overall range of comparable products offered by the investment firm.

3.3.2.2 - Information about the client knowledge and experience in the investment field (Article 19 (5))

Asking for information:

Regarding section 3.3.2.2 paragraph 1 of CESR's mandate, we refer to our recommendations under section 3.3.2.1 where the criteria for assessing the minimum level of information under Article 19 (4) are described. The same recommendations should be used to define the minimum level of information under Article 19 (5).

Using the information:

Whether a service or a product is appropriate for a client may only be assessed on the basis of the client's knowledge and experience; except for the cases of investment advice and portfolio management, the investment firm should limit the questions on these two aspects. Investment firms should be entitled to apply their own criteria when assessing whether a service or a product is appropriate for the client. This topic should not be included in the scope of Level 2 provisions. Investment firms need to have sufficient leeway to organise their business operations.

According to Article 19 (5) the Directive stipulates that the warning may be provided in a standardised format i.e. only on an optional and not on a mandatory basis. The ESBG would like to point out that it should be possible to give the warning also orally. The minimum content of this warning should be restricted to the information that the investment firm considers the business transaction is not suitable for the investment objectives as envisaged by the client. Only a condensed warning will fit the purpose and meet the practical requirements. It is worth highlighting that, Article 19 (5) does not contain any further preconditions on order execution. This is understood by the ESBG as follows: Should a client issue an order despite a warning, the investment firm may execute such an order without any further qualifications. It is evident that this shall not have any impact on potential information obligations according to Article 19 (3).

3.3.3 - Execution only (Article 19 (6))

Non-complex instruments:

Regarding the definition of criteria for determining what is to be considered a non-complex instrument for the purposes of 'execution only' client orders, the ESBG would like to focus on recommendations concerning criteria for the definition of the term *other non-complex financial instruments*. Since Level 1 mentions a whole range of non-complex financial instruments, only those instruments may qualify as other non-complex instruments that allow a client to understand and compare their underlying mechanisms. The ESBG believes that this criterion is only met in the case of index certificates and discount certificates. These certificates resemble shares, i.e. financial instruments that have been categorised as *non-complex* at Level 1.

Admissibility of advertising:

The only derogation from the information duty pursuant to Article 19 (5) MiFID for execution-only transactions pursuant to Article 19 (6) indent 2 exists in those cases where the service is provided at the initiative of the client or potential client. The Directive's Recital 30 explains that an investment service shall generally be regarded as having been provided at the initiative of the client (apart from specified exceptions). Furthermore Recital 30 stipulates that this shall remain unprejudiced by any prior advertisement that was geared towards a larger group of clients. An explicit reference in the implementing provisions on Article 19 (6) MiFID that such advertisement does not automatically cancel the 'execution only' privilege would seem judicious.

Content of the warning:

Similar to what has been said regarding the content of the warning under Article 19 (5), the ESBG would appreciate it if the content of the warning according to Article 19 (6) would again be limited to the content of the text of the Article.

Section 3.6 – Eligible counterparties

Principally, the ESBG is not convinced that technical implementing measures for Article 24 are really necessary at Level 2. Given the fact that Article 24 only supplies the Commission with the option to use the comitology procedure, it should be carefully considered if it is really preferable to have detailed rules at Level 2. It should be further reflected whether it would be better if market participants agree upon appropriate procedures for e.g. qualifying for "protective" treatment pursuant under Article 19 (2) or obtaining approval pursuant to Article 19 (3).

Section 3.7 – Transparency

In its explanation to the mandate, the Commission states that "*the Directive follows an objective approach (...) refraining from linking the provision of the service on a systematic manner to the use of any specific technical or automated mean*". Referring to the Level 1 texts and to the discussions at Level 1 of the process on the definition of systematic internaliser, we believe that it is not appropriate for the Commission to "refrain from linking the provision of the service on a systematic manner to the use of any specific technical or automated mean". On the contrary, we believe that the use of a system especially designed for the automated matching of orders should be a necessary (although no sufficient) criterion to determine whether an internaliser should be viewed as systematic or not. More specifically, we believe that it should always be assessed whether specific marketing communication is to be used to promote the service of "systematically internalising orders".

The ESBG does not believe that these criteria should be further clarified at Level 2, but rather at Level 3 of the process. In any case, it should be taken into account that the aim of the pre trade transparency regime is not to regulate conventional forms of incidental off-exchange trading (such as telephone interbanking trading) which have proved to be useful in many Member States. Thus, Recital 53 should serve as an underlying "guideline" when further elaborating on the definition of "systematic internaliser".