



*European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken*

EUROPEAN ASSOCIATION OF COOPERATIVE BANKS¹ COMMENTS ON

**“CESR'S DRAFT TECHNICAL ADVICE ON POSSIBLE IMPLEMENTING
MEASURES OF THE DIRECTIVE 2004/39/EC ON MARKETS IN FINANCIAL
INSTRUMENTS”**

1ST SET OF MANDATES, 2ND CONSULTATION

DECEMBER 2004

¹ The 40 million Members that EACB represents serve 130 million customers' needs in more than 60,000 business points. Supported by 685,000 employees, EACB Members hold a market share of about 17% in the EU deposit market.

1. General

- *Limited content of the second consultation round*

The EACB welcomes the CESR's initiative to reopen a second consultation round although, at the same time, the Second Consultation Paper confines itself only to a limited number of individual issues. Whilst those topics which are addressed clearly indicate an open-minded and pragmatic discussion of comments submitted by market players, material issues, however, still remain unaddressed in the second round of consultations. This notably relates to:

- the requirements with regard to client information (Box 8, no. 7 and 9 of the First Consultation Paper), notably the question how far this may be provided in a standardised format,
- the requirements with regard to the client agreement (Box 9 of the First Consultation Paper) which, in our view, are excessively detailed,
- the ban on inducements or, respectively, the scope of their mandatory disclosure (Box 6, no. 9 to 11 of the First Consultation Paper).

In the light of the foregoing and for the sake of a transparent Consultation procedure, the EACB thinks that it is absolutely necessary that when handing in its final advice to the Commission, CESR should also publish a Review Paper which makes it clear why proposals by market participants have been adopted and why they have not been adopted (cf. also 3. d) iii) of the "Public Statement of Consultation Practices" by CESR dated December 2001).

CESR's consideration to ask the Commission for an extension of the deadline for submission of its advice receives the full support of the co operative banks. CESR needs to have enough time to deal with the comments submitted concerning the First Consultation Paper. The quality of CESR's advice must have absolute priority over rigid compliance with envisaged timetables. Moreover, this Association would strongly welcome it if the extension of the deadline offered by the Commission could also provide a window of opportunity for discussion of further controversial issues contained in the First Consultation Paper.

- *Level of detail inherent in the advice*

CESR points out that the First Consultation Paper is widely regarded as excessively detailed. We share this view. The EACB considers, even a full harmonisation does not require such detailed advice as were contained in the First Consultation Paper. Quite on the contrary: A too detailed advice may even curb competition by cobbling credit institutions to an extent where they can no longer meet the regulatory requirements with due respect for their own specific size, business activities and client structures.

Furthermore, it is becoming increasingly evident that, due to the resulting higher fixed costs, excessively detailed provisions would primarily come at the expense of smaller

and medium-sized/regional banks. There is a great danger that these institutions will henceforth no longer be in a position to offer investment services at competitive rates. Yet, this would not be in the interest of the investors either. The reason is that a reduction in the number of competitors and hence, less competition would incur higher costs for them.

We therefore feel it is of pivotal importance that in its respective advice CESR shall be mindful of the potential impact which this may also have on smaller and medium-sized/regional banks. Whenever there are doubts as to whether the envisaged requirements really lead to an improvement of investor protection or whenever there is a danger that the planned requirements can only be implemented at disproportionately high costs, any such advice should be dropped. The same applies to overlapping regulations as well as additional provisions which would fall under MiFID's scope of application. They should be dropped if and when there are already different and conclusive regulations at an European level (cf. EACB's comments on the First Consultation Paper dated 17 September 2004 for a more detailed discussion of this matter).

"CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments" on the 2nd Set of Mandates dated 21 October 2004 is a case in point for the theory that even when CESR limits its advice to essential matters, full harmonisation is absolutely possible. Hence, also concerning the first part of the Mandates, we would therefore like to strongly commend this way to CESR.

- *Relationship between Level 2 and Level 3*

We feel that a segregation of Level 2 and 3 of the Lamfalussy procedure might be possible. In our understanding of the Lamfalussy approach, Level 3 shall exclusively deal with harmonised application of those rules which have been previously defined at Level 1 and 2. The definition of new rules, however, shall be exclusively decided at Level 1 and 2.

- *Need for transitional periods*

The transitional periods addressed by CESR are for us of fundamental importance. Given the host of new provisions there seems to be a compelling need to give market participants enough time for an adjustment of their systems and procedures. This Association welcomes the most recent deliberations of the Commission (notably with a view to the technical innovations) to provide for a transitional period up until the year 2007. Experience has shown that, particularly for IT related processes, an adequate timeline is absolutely essential. By instance we should only like to mention implementation of Art. 20 of the 1993 Investment Services Directive. Here, a period of approximately 18 months elapsed between the date where the reporting obligations were laid down in national law up until the date where this was actually put into practice, i.e. until the first reports came in. Once all legal questions had been clarified, this 18 month window of time was needed for a preparation of the technical specifications and subsequent creation of the corresponding transaction reporting systems.

2. Independence of compliance

The co operative banks strongly support the assessment of the independence of compliance, CESR has committed itself to a functional approach. Yet, the same must also be applied to all other compliance requirements. Any "one size fits all approach" would create disadvantages for those investment firms which are SMEs and which only feature a limited degree of conflicts of interest and/or price sensitive information. Hence, we would like to strongly reiterate our request to CESR to issue advice which also allows SMEs to meet their compliance task in a way that takes into account cost-benefit implications. Yet, this requires as a precondition that there is a renunciation of detailed provisions and that the advice issued shall provide for the necessary flexibility allowing all investment firms to meet their respective compliance requirements in line with their size, organisation and client structure.

The question whether there should be potential waivers of the obligation to ensure independence of the compliance function for smaller investment firms cannot be answered in an abstract sense. What rather more counts is that for an investment firm compliance with this requirement will not be possible at a reasonable cost-benefit ratio. The decision on this matter should therefore be left to the discretion of the competent national authority. Any compulsory outsourcing obligation would frequently fail to deliver an adequate cost-benefit ratio. It would thus be inappropriate.

3. Record keeping obligations and the burden of proof

It is correct that investment firms shall have to keep records in a way which allows the competent authority to verify whether the investment firm has acted in compliance with the obligations under the MiFID. Yet, neither in relation to the authority nor in relation to the client must this lead to a reversal of the burden of proof. Otherwise CESR would deeply interfere with the civil law philosophy of national jurisdictions.

4. Tape recording requirement

We think that CESR's presentations on the efforts associated with a tape recording of orders made by telephone are not acceptable. CESR makes fairly brief reference to the fact that no sufficient data had been presented on the costs. Yet, it merely raises this issue in the context of the costs required for record-keeping. However, the potential costs required for retrofitting thousands and thousands of branches are far more relevant. Yet, this matter remains unaddressed.

The EACB considers that CESR should have first presented a clear case demonstrating that there have indeed been issues in the context of telephone order placement so that the obligation for tape recording would be objectively justified. Yet, to date there has not been the slightest attempt to do this. It appears doubtful whether there are indeed any such issues which would warrant the tape recording obligation. Some of our Members have indicated that the error rate for telephone orders in the field of retail clients shows an error rate of clearly below 1 %.

The industry is hardly in a position to come up with reasonable estimates of the costs involved. The simple reason for this is the present lack of technical specifications. These will still have to be finalised at Level 3.

Yet, despite the present absence of a clear technical specification, we should still like to highlight potential cost drivers: co operative banks offer mainly their (investment) services in a decentralised manner. This means that the client may call his advisor in the main branch or subsidiary branch of his bank in order to place his order with him. This is based on the co operative business model where the proximity and the closed relation with the customer are fundamental. In the foregoing cases, any compliance with a mandatory obligation to record telephone orders would only become possible if each and any branch of these local or regional banks were to put the logistics in place to make such recordings at the workplace of each single advisor. Given the subsequent record-keeping requirement, i.e. that the tape recording would then have to be stored for audit purposes, this would mean that merely linking each telephone to a conventional tape recorder would be deemed as an insufficient measure. Rather more, at Level 3, CESR would probably call for a technical system which would allow a systematic record-keeping system that is accessible to the auditor.

By instance, based on first estimates for the cooperative banking sector in Germany, the introduction of an obligation to make tape recordings would generate an additional cost of EUR 3 for each order. A clear reduction of the costs would only be possible if cooperative banks were to outsource their order recording to an anonymous, central call centre. Yet, this would involve the need of relinquishing their decentralised business model; a business model which has been successful to date since it caters to the preferences of many clients. Furthermore, one central order recording system would mean such banks would lose their USP over their competitors, e.g. direct banks. Hence, such an interference with a bank's business policy is absolutely unacceptable. It furthermore also violates the interests of those investors who like the personal contact to their adviser.

The obligation to make tape recordings of telephone orders (compounded by potential further requirements that would be burdened by high fixed costs) would constitute a massive interference with competition for the co operative banks which are decentralized networks. It would come at the expense of small and medium-sized banks. Since, to date, no evidence has been produced which would indicate that there are indeed issues in this respect, any such obligations would furthermore constitute a complete misallocation of macroeconomic resources. Both are not acceptable.

In this respect, the EACB asks CESR to take into consideration the consequences for decentralized networks and the small and medium banks and to find out an appropriate solution concerning the mandatory tape recordings for telephone orders. An abandon of this advice shall be envisaged.

5. Outsourcing

The European cooperative banks strongly welcome CESR's presentations on outsourcing. Especially the clear commitment towards seeking to ensure the highest degree of convergence of all proposals with works conducted by CEBS is to be welcomed because it will probably help to prevent double burdens for credit institutions.

6. Conflicts of interest and the segregation of areas of business

We lend our unreserved support to CESR's presentations on this matter.

7. Investment research

The questions which CESR already highlighted in the First Consultation Paper imply that research which does not fully meet all IOSCO Standards shall be deemed as "non objective". With this approach CESR changes the approach adopted under the Market Abuse Directive. Under said Market Abuse Directive, it had been left to the companies' discretion whether they choose to disclose potential conflicts of interests (including those of their employees) or whether they seek to prevent such conflicts of interests *a priori* through internal precautions. In both cases, the investor interests are still being protected. Hence there is no need for additional requirements regardless of which nature they may be. Neither is there a need for brandishing research as being "non objective". We should like to point out that this is particularly not called for under the IOSCO Standards, either.

8. Transaction reporting

a) General

We already provided a detailed appraisal of CESR's proposals on Transaction Reporting in our comments dated 17 September 2004. Already back then we explicitly welcomed the fact that CESR plans to base its advice to the greatest degree possible on existing reporting systems and to avoid costly changes wherever possible. CESR's renewed commitment to this "general approach" in the Second Consultation Paper (cf. C., page 10) receives our unreserved support.

Furthermore, we also feel it is essential that the Consultation Paper provides a clear outline of those areas where CESR plans further measures at Level 3. Only once the overall direction and content of the measures planned by CESR at Level 3 are sufficiently clear can there be a final appraisal as to if and to which extent the envisaged Level 2 changes require a technical adjustment of existing transaction reporting systems.

In this context, we feel it is of pivotal importance to abandon any plans (at least in the short or medium term) to provide a standard definition of the term "transaction". The same applies to all other terms which would have an impact on the transaction reporting system (c.f. for instance under "trading capacity" the definition of "traded on a principal or proprietary basis" and "agency transaction" in Annex B). In order to take account of the heterogeneous civil and supervisory law traditions which have evolved organically across various Member States, this definition should rather more (at least for the time being) be left to the discretion of the national authority. Otherwise at Level 3 there would be a risk of a further "harmonisation push" potentially incurring costly adjustments of the system infrastructure.

This is the only approach which would meet CESR's declared objective of confining itself to proposing a framework of general minimum conditions. Also a large majority of market participants advocated – at least in the short to medium term – in favour of such an approach (cf. item 8 page 11 of the Second Consultation Paper; cf. also our Comments to the First Consultation Paper dated 17 September 2004). We would therefore welcome it if in the course of its Level 2 recommendations CESR would clarify that – at least in the short to medium term – it has no plans for providing a definition of terms that are relevant for the transaction reporting system.

The EACB sees a risk for further harmonisation beyond those implementing measures that will be specifically adopted at Level 2, especially in respect of Annex B. Annex B directly only affects the data exchange between authorities. CESR also points out that information exchange between authorities falls under their own issue and “would not require any further involvement of investment firms” (cf. page 23). But the provisions under Annex B for the data exchange between the authorities are partly more detailed than the mandatory information level for investment firms under Annex A. How should authorities meet the additional requirements under Annex B unless they have previously received the data by the reporting parties? Further, the optional reporting of individual fields provided for Annex A has not been wrapped to Annex B. We therefore ask CESR to adapt the requirements of Annex B to those of Annex A.

Also if and when the additional requirements under Annex B can be met by authorities without involvement of the reporting parties we kindly ask for a critical review whether these are indeed indispensable for data sharing between authorities. Especially the requirement to change non-harmonised codes into a “clear name” seems not necessary because even in this case an automated evaluation by other authorities would hardly be feasible.

b) Minimum content of a transaction report (Annex A)

We welcome the fact that CESR has complied with market participants' request and that it has limited the mandatory fields, *inter alia* by designating a number of fields as optional. From our point of view, a further limitation is, however, absolutely essential. This applies notably in the following cases:

- Under **"Instrument Identification"** we propose waiving the mandatory reporting of the "series code for derivatives" (cf. paragraph 3, additional bracket in the description of the field). The Eurex alone already has more than 47,000 of such series; under the present proposal, in future these would have to be exclusively maintained solely for reporting purposes. In line with the limitation to the minimum content, this information is also dispensable since every derivative can already be clearly identified by the fields "Maturity Date", "Derivative Type", "Put/Call" and/or "Strike Price". For derivatives, we therefore propose at least considering a waiver for reporting the "series code" if and when the derivative is already identifiable through other fields.
- Under **„Price“** we propose in the first paragraph deleting the passage “excluding items like commission and accrued interest“. The chosen definition is problematic because the price can be a net price (including the commission) or the gross price (exclusive

commission). What is material for this is the agreement made with the client. The general reporting of the gross price would notably force considerable technical adjustments upon reporting parties in Member States where currently reporting is based on client statements (gross or net). This is due to the fact that the aforementioned change in the reporting regime would, in future, rule out a general transaction reporting based on the client statements.

- Hence, there should be no mandatory obligation to identify **Counterparties** until there is a standard (international) code for this. Without such a standard code it remains unclear how an evaluation by other authorities would be possible. We therefore propose to only include this field on an optional basis.

c) **Branches abroad**

Concerning the branches abroad, CESR points out that in future these branches would have to send the information to the competent authority of the host Member State. This leads to a situation where - for each branch - reporting parties would have to secure integration with the local standard market practices for reporting of the Host Member State. Due to the highly heterogeneous reporting infrastructure which still exists across Europe, this would lead to prohibitive additional costs and a huge logistical burden. Co operative banks should therefore like to once more strongly advocate providing for a transitional regime modelled on present practices until there is any further harmonisation of the reporting systems in the EU (cf. also our comments dated 17 September 2004, Annex 1, Point 11 b)).

d) **Relationship between Level 2 and Level 3**

We would like to reaffirm once more that Level 3 shall and must only deal with interpretation matters and not with the creation of new requirements. The latter is exclusively reserved to Levels 1 and 2. In our view, CESR does not make consistent enough use of this principle (cf. e.g. the question concerning the need for a service level agreement which should now only receive its final clarification at Level 3). A shift to Level 3 is simply unwarranted and would not even be justified by an alleged greater level of flexibility. After all, the rationale for creating Level 2 was the very need to potentially carry out changes whenever necessary.

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