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First part of our response to CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments

Dear Mr Demarigny,

The Association of German Banks welcomes the opportunity to respond to CESR's advice on possible implementing measures of the directive 2004/39/EC on markets in financial instruments. Enclosed please find the first part of our response. We will submit the second part on 4 October 2004.

The Association of German Banks represents some 240 private commercial banks and 11 regional associations, as well as the special mortgage bank and ship mortgage bank associations. Measured in terms of business volume, these banks hold a share of around 40 % of the banking market as a whole. They have a total of some 180,000 employees.

The Association of German Banks is a member of the *Zentraler Kreditausschuss* (ZKA), the joint committee of the central associations of the German banking industry. We fully support the Joint Comments of the ZKA which you will find enclosed.

Should you require any further information, please do not hesitate to contact us at any time.

Yours sincerely,

Thomas Weisgerber Dorit Bockelmann Enclosure

Z E N T R A L E R   K R E D I T A U S S C H U S S

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Comments
of the
Zentraler Kreditausschuss[1]
on CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instrument
Part 1

Published by the Committee of European Securities Regulators (CESR) on June 17th, 2004

[1] The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the publicsector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Hypothekenbanken (VdH)*, for the mortgage banks. Collectively, they represent more than 2,500 banks.

<u>Preliminary notes</u>

For the German banking industry, the technical implementing measures of the Directive on Markets in Financial Instruments (MiFID) are of utmost importance. It is these Level 2 provisions which will form the specific legal foundation for the future practice of securities trading. We therefore regard the Consultation Paper presented by CESR as a document with potentially wide-ranging implications for day-to-day operations of our members.

Against this backdrop, we feel the need to reiterately call for two principles:

- Firstly, strict compliance with the limits of the competencies at Level 2 under the Lamfalussy approach, i.e. **compliance with the regulatory scope specified at Level 1.**

- Secondly, the performance of a critical **cost-benefit analysis,** which ensures that the proposed rules not merely lead to overprescriptive red tape driving up the costs of investment services without simultaneously adding to investor protection or the efficiency of the European capital market. When laying down investor protection provisions, one issue should not be overlooked: At the end of the day, it will be the investor himself who will have to pay for his protection.

I. <u>General remarks</u>

1. Compliance with the regulatory scope laid down by the MiFID

The mandate granted by the Commission for the preparation of recommendations concerning possible technical implementing measures at Level 2 of the MiFID asks CESR to perform extremely comprehensive work within a very short period of time. This incurs the risk that the practical implications of proposed regulations will not be weighed carefully enough. This danger has materialised in the Consultation Paper submitted on 17 June 2004. The latter is largely - presumably also and especially due to the limited scope of time available - based on the document "*Standards and Rules for Harmonising Core Conduct of Business Rules for Investor Protection*" which had been previously prepared by CESR. Under two aspects, this appears problematic:

Firstly, the adoption of the MiFID has changed the underlying basis for CESR's work. Level 1 of the MiFID creates an entirely new framework for investor protection. This change is not taken into account if pre-existing standards are simply being transposed.

Furthermore, the standards developed by CESR were never intended for adoption in a legally binding text. Indeed, they are far too detailed for such an approach.

2. Need for a cost-benefit-analysis

Furthermore, we feel that the CESR recommendations illustrate one general fallacy: CESR appears to believe that the quality of investment services can only be improved through tight supervisory provisions that are as detailed as possible. In our view this is not the case. First and foremost, in order to enhance the quality of investment services, an effective competition is needed. Yet, a "straightjacket" of supervisory rules rather aborts this very competition. Particularly for smaller investment firms, the proposed regulatory amendments are likely to drive up the costs for their services so that they will no longer be capable of providing these services at competitive rates. Against this background, it is very unfortunate that CESR has apparently largely renounced to a cost-benefit analysis of its proposals. The Consultation Paper's recommendations which, in our view, feature an excessive degree of detail, suggest that - when measuring the envisaged regulatory objective against the necessary flexibility for investment firms - CESR invariably opted for a closely meshed regulatory regime; this means that CESR has failed to comply with the Commission's request to strike the right balance between these two requirements.

In this context, let us briefly recall item 2.3 under the mandate of the European Commission to CESR dated 20 January 2004 (c.f. below). Here, the Commission calls upon CESR to merely set out "*ground-rules*" i.e. *"the right balance between the objective of establishing a set of harmonised conditions... and the need to avoid excessive intervention in respect of the management and organisation of the investment firms"*. Furthermore, the Commission points out that the *"amount of detail … should be very carefully calibrated case by case"*. Last but not least, the Commission feels that the recommendations should *"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"*.

When stipulating its recommendations, we strongly call upon CESR to take into account the provisions under the MiFID and the Commission's mandate.

II. Key aspects (Executive Summary)

Before addressing the Consultation Paper in greater detail, we would like to highlight a number of fundamental aspects which, in our view, show that the regulatory scope established under the MiFID has been ignored and which also indicate a complete absence of prior cost-benefit analyses:

1. Virtual impossibility of providing information to clients in a standardised format (BOX 8, item 7 and 9)

Art. 19 (3) allows investment firms to provide the client with the necessary information in a standardised format. This facilitation is - either deliberately or inadvertently - being ignored by the recommendations. The wording contained in Box 8 under item 7 and 9 renders the provision of information in a standardised format virtually impossible. This is inconsistent with the respective Level 1 provision: Pursuant to item 7 and 9, for every product offered ("relevant financial instrument") a description is requested on whether or not the instruments involved are illiquid and/or traded on a regulated market or MTF. This obligation cannot be met in a standardised format. Instead, it will have to be met individually for every single product. We therefore propose to respectively employ the term "type of financial instrument". (For more information cf. page 32 f.)

2. Requirements under civil law with regard to *client agreements* (Box 9)

The proposals on client agreements would fail to deliver a higher degree of investor protection; instead, they would only result in excessive additional costs. This is notably the case whenever these provisions shall also apply to existing clients. In Germany alone, an amendment of client agreements for 35 million existing securities deposits would presumably cause a triple digit million Euro costs. Furthermore, the recommendations go far beyond the MiFID's regulatory scope and considerably interfere with Member States' (not harmonised) civil law. (For more information cf. page 34 ff.)

3. Obligation to keep records of telephone orders (BOX 4 item 2 (b))

The recommendation of a mandatory obligation to keep records of each telephone order on a voice recording system is equally a clear digression from the MiFID's regulatory scope. The MiFID does not differentiate between the various communication forms. Hence, this also means that subjecting any individual form of communication to a specific regime is not covered by the MiFID. Furthermore, such a policy could hardly be justified when measured against a cost-benefit analysis;

the net benefit which results for the client from a taping of his telephone order with regard to potentially easier fact findings in those rare cases where a client's order may have been recorded incorrectly, would be disproportionate when compared to the financial and organisational logistics which would be required for a complete change of the technical infrastructure of thousands of banks' and savings bank branches. (For more information cf. page 14 f.)

4. Recommendations on inducements (BOX 6, item 9 to 11)

The provisions contained under item 9 to 11 in box 6 on handling of inducements cannot be based on the MiFID. Although Level 2 regulation in this area is not *a priori* excluded, since inducements might lead to conflicts of interest for some investment firms, recommendations for a Level 2 regulation need to be based on existing Level 1 policies on the handling of conflicts of interest. Pursuant to this policy, an investment firm which receives inducements - and the same applies to any other conflicts - has to ensure that this does not violate the client's interests (Art. 18 (1)). Should this prove insufficient, then the "general nature" of the conflict of interestconflict of interest shall be disclosed pursuant to Art. 18 (2). Since item 9 provides for a ban on inducements, this provison is incompatible with Art. 18 (1). As far as item 11 does not refer to the disclosure of the "general nature" but to the disclosure of the "details" of the inducements, this equally contradicts Art. 18 (2). There are also additional issues where the recommendations on inducements are not in line with level 1 regulation under the MiFID (obligation to provide information on the "policy on inducements“; frequency of the information obligation). (For more information cf. page 23 f.)

5. Requirements with regard to compliance (BOX 1)

The recommendations on compliance strongly interfere with the organisational structure of investment firms. CESR should carefully reconsider whether the proposed regulations take sufficient account of the different structures and sizes of investment firms. Particularly the call for independence of compliance should not relate to organisational independence but should rather ensure independence of the fulfilment of the compliance task. (For more information cf. page 7 ff.)

6. Reporting obligations (BOX 15 and 17)

As far as the issue of transaction reporting is concerned, we strongly support CESR's goal of preventing any unnecessary new requirements that may create excessive additional costs. Whenever possible, we therefore propose to keep existing reporting procedures as they are. Unfortunately, after careful consideration of the proposals that are being made in the Consultation Paper, there are strong concerns that CESR is not going to achieve its self-formulated goal. Particularly the fields and field descriptions set out under Annex A are designed in a way that - at least in Germany - will lead to a considerable adjustment of existing reporting systems. The main reason for this is that CESR wants to achieve standardisation of many data sets in the reports in order to facilitate data exchange between the competent authorities. We feel this is a move into the wrong direction. The Directive explicitly does not call for a maximum harmonisation in the field of transaction reporting. This means that it is simply not the task of market participants to adapt their systems so as to ensure interoperability of data exchange between the competent authorities. This is rather a task which has to be performed by competent authorities themselves in line with the provisions set out under Annex B. (For more information cf. page 45 f.)

III. Definitions

We shall comment on the definitions in the context of their specific meaning under individual recommendations.

IV. Assessment of individual recommendations

SECTION II - Intermediaries

1. Compliance and personal transactions (Art. 13 (2)): BOX 1

a) Introduction

The recommendations on compliance requirements should take great care in order to prevent a "one size fits all approach". In our view, it will thus be indispensable to take account of the different business models of investment firms. We therefore explicitly welcome the statement in the explanatory text that "*smaller firms will not be able, nor will they be required, to devote the same amount of resources to compliance infrastructure as a large investment bank*"(page 12). Unfortunately, the text of the recommendations does not always reflect this understanding. We therefore feel the need for a clarification of the terms "*procedure*", "*policy*" and "*compliance function*". With regard to the term "compliance function" we are not clear about whether this term relates to a functional task in line with the definition of the Basel Committee's Consultation Paper "*The compliance function of banks"* or whether it refers to an organisational unit. It should thus be ensured that a functional approach is taken.

b) Individual recommendations

Policies and procedures to ensure compliance

- Item 2 (a) and (d) (Requirements with regard to independence of the compliance function, page 14/15)

The language under item 2 (a) and (d) is too broad. The obligation laid down under item 2 (a) and 2 (d) can be interpreted as a requirement to provide for a stand-alone compliance unit. Yet, in small and medium sized investment firms, an organisational compliance unit that would exclusively deal with compliance issues, is not a prerequisite for the effective implementation of the compliance function. For a large investment bank, the operation of a compliance department that is independent from the trading department, trading desk as well as clearing and settlement unit is the *conditio sine qua non* for this compliance function; notwithstanding the foregoing, the same does not apply with regard to small investment firms or smaller credit institutions. For these companies, the establishment of a compliance unit would be rather - also and especially given the scale of resulting compliance relevant issues - disproportionate. This is being explicitly recognised in the explanatory text. We therefore propose the following clarifying text for item 2 (a) and (d):

> "*An investment firm must establish and maintain an effective compliance function. Persons who exercise the compliance function must not be involved in the performance of services or activities they monitor. The budget and remuneration of the compliance function shall be linked to its own objectives and not to the financial performance of the business lines of the investment firm."*

One additional benefit of this language is that it would also clarify one further aspect, i.e. that the existing compliance unit does not have to perform each individual compliance function itself. Also major investment firms feature a need for not delegating all controls to the compliance unit proper. Efficient monitoring through a central compliance department is only workable where the compliance department has sufficient insight into the day-to-day operations and into the information flow within the organisational units of the company. For this reason, along with the establishment of a central compliance unit, it may be useful and appropriate to also entrust members of staff who directly work for a specific business division (and who are also being paid out of the budget of this business division) with compliance tasks. Naturally, these tasks will be limited to their own working area. Due to their close integration in the respective business division, such 'compliance delegates' will gain a much faster and more comprehensive insight into the compliance relevant issues of the respective business division. They may solve these either locally, or they may invoke the central compliance unit. Here, obviously it will have to be ensured that such compliance delegates may exercise their compliance function with the due level of independence. In order to ensure such independence, they must be regularly and carefully monitored by the central compliance unit.

If - contrary to our understanding - CESR understood "compliance" as an organisational unit, then we at least see the need for a clarifying qualification under item 2, i.e. adding "*where appropriate and proportionate in view of the nature, scale and complexity of is business"*. Without this addition, this recommendation may even be interpreted to mean that organisational requirements are identical for all securities firms.

- Item 2 (b) (Compliance-Policy, page 14/15)

Item 2 (b) calls for the establishment of a compliance policy. In the absence of a definition, this term is left completely unclear. We therefore strongly recommend to develop a comprehensive definition, distinguishing the term "compliance policy" from the "code of conduct" which is also incorporated by reference. In our understanding, the term "compliance policy" may only relate to a business Charta which enjoys a high degree of abstraction. Such a "Constitution" on compliance activity would have to contain a list of priority compliance principles. Yet, we would strongly oppose a "compliance manual" along with the already existing provisions on "compliance procedures“. The basic advantage of such a bullet point list of priorities is that it illustrates at one glance by which compliance principles an investment firm abides. We explicitly welcome the fact that CESR makes the exact nature of the principles subject to the principle of proportionality. In our view, there also needs to be a clarification that the compliance policy is not intended to be handed out to the client. *In lieu* of this, it will be sufficient if the existence and compliance of the policy is subject to supervision checks.

- Item 4 (a) (Monitoring, page 15/16))

The envisaged unlimited commitment of the compliance unit to constantly monitor all "policies and procedures" of the investment firm must not lead to a duplication of control functions within one and the same investment firm. Hence, for instance, logistically speaking, control and monitoring functions tend to be located at different units. Notwithstanding the foregoing, we feel the urgent need for a precise definition of compliance; such a definition would allow a clear allocation of compliance relevant control functions to the compliance unit and thus help prevent an excessive workload for this unit resulting from 'extraneous' control tasks which are already being performed by other organisational units.

In our understanding, this operationalisation of the term compliance should be defined as narrow as possible; under such a narrow approach, compliance with the securities trading legislation shall only concern part of the applicable rules and regulations ("securities compliance"). Contrary to this, a range of tasks should not be aggregated under the term compliance which are being performed by other departments that have the requisite expertise and resources (for instance risk management, legal department, controlling, auditing, data protection). Hence, if and when material requirements are being made, it should be made clear that this will not prejudice the organisational freedom of each investment firm.

- Item 4 (c) (Reporting obligation, page 16))

A reporting obligation of the compliance unit to the internal auditors would undermine the indispensable independence of the compliance unit and is therefore unacceptable. Rather, a permanent cooperation between two business divisions that is based on mutuality is called for. Under such an approach, the internal auditors would also be allowed access to the reports produced by the compliance department. Beyond this, we oppose a separate reporting obligation to the internal and external audit at least in those cases where compliance is being verified at least once a year by an internal and an external audit.

Complaints handling

- Item 5 (Handling client complaints, page 16)

We see no legal basis in the text of the MiFID for the recommendation of far-reaching obligations concerning complaints handling. Art. 13 (2) merely stipulates the need for the investment firm to ensure compliance with legal provisions. Whilst it is comprehensible that compliance with legal provisions will require the establishment of policies and procedures for recording client complaints since these complaints may point to shortcomings, this is no longer as easily understood when it comes to the stipulation of the duty to maintain "effective systems" for handling complaints (item 5 (a)). Yet, something that is completely divorced from the regulatory objective of ensuring compliance with legal provisions is an obligation to provide information on out-of court complaint and redress mechanisms (item 5 (a) (i)) and a duty for payment of compensation (item 5 (a) (ii)). Instead of fleshing out existing obligations created under the MiFID, these provisions give rise to entirely new obligations. In order to remain within the regulatory scope laid down by the MiFID, the language of item 5 should therefore be made clearly more restrictive. CESR should limit its request to a mandatory documentation of complaints and complaints handling.

Code of conduct

- Item 6 (Establishing a Code of Conduct, page 16)

It is absolutely essential to prevent duplication and overlapping regulation of compliance policy issues on the one hand and the Code of Conduct on the other hand. This is why pivotal importance attaches to a clear specification of what is meant by the respective term/nomenclature.

Personal transactions

- Item 7 (Personal transactions, page 16/17e)

Since the ban should apply to each and any personal transaction *"that conflicts … with the investment firm's duties under the Directive"*, the provision presented under 7 (a) is too far-reaching. Furthermore, the language *"is likely to have …"* is too vague and will hardly be feasible in practice. We therefore propose the following text:

> "… entering into a personal transaction in circumstances, where that **relevant person has information about a conflict of interest** or **a** price sensitive information that is relevant to **the** financial instrument to which that transaction relates."

The wording of 7 (e) should be transposed and reframed in the following way: *"take reasonable steps to ensure …"*. This takes account of the fact that an investment firm cannot do more than what it can be reasonably expected to do. We feel that an unlimited obligation as is currently provided for under item 7 (d), would be unrealistic.

(c) Answers to the questions

> ***Question 1.1***: *Must the compliance function in an investment firm comply with the above requirements for independence, or should this degree of independence only be required where this is appropriate and proportionate in view of the complexity of its business and other relevant factors, including the nature and scale of its business?*

Answer: The performance of the compliance function needs to take place in an independent manner. Yet, this does not automatically mean that, during the performance of other tasks, such person may not be integrated into the organisational structure of an investment firm. As far as human resources are concerned, additional personnel that is experienced and skilled in the field of securities transactions is only an option for larger investment firms.

> ***Question 1. 2***: *May deferred implementation of requirements for independence be based on the nature and scale of the business of the investment firm?*

Answer: If and when "compliance function" refers to a separate organisational unit, a mere delay for implementation of the provisions under item (d) will probably not be sufficient. In this case a lasting qualification *"where appropriate and proportionate in view of the nature, scale an complexity of its business"* would be indispensable.

2. Obligations related to internal systems, resources and procedures (Art. 13 (4) and (5) second subparagraph): BOX 2

a) Introduction

From the point of view of universal banks, particularly when stipulating organisational requirements, it is of special importance that these are in line with regulatory requirements. The recommendations presented by CESR in the Consultation Paper may appear largely unproblematic. Yet, major importance will probably attach to their interpretation at Level 3 and, based on this interpretation, their application by competent authorities.

(b) Individual recommendations

Risk management policy

- Item 5 (a) (Risk management policy, page 20)

In our view, the language of the recommendation under item 5 (a) on management and the control of *all risks* is too broad. It could be construed as meaning that each and any potential risk will have to be recognised and managed. This requirement would be clearly too far-reaching. This would basically imply that any investment advice that is encumbered by shortcomings would have to be identified. Even if greatest resources were dedicated to this undertaking: this would remain virtually impossible; furthermore, there is no objective reason for this, either. The key factor of risk management is that it shall allow investment firms to recognise extraordinary risks, i.e. risks which exceed the norm. As an element to complete this concept we therefore suggest amendment of "all risks" under item 5 (a) to "*all **material** risks*“.

Information processing system

- Item 6 (a) (Data access, page 20)

Furthermore, we would like to point out that the option envisaged under item 6 (a) for the use of search applications leaves a lot of room for interpretation. Obviously, data will have to be stored in a way and manner which allows user-friendly access on the part of the auditor. Yet, we feel that the language chosen by CESR exceeds this requirement and appears to call for the deployment of specific technical search routines which shall be defined by the competent authority. We would therefore like to point out that -whilst this would not make use of the data during the audit any easier- implementation of such routines would be associated with considerable costs. We therefore see the need for a clarification. Instead of calling for *"adequate search applications"* we recommend adopting e.g. the following language:

"a) information technology resources to retain, store, and access data, which allows **the competent authority to readily access and search them.**"

3. Obligations to avoid undue operational risk in case of outsourcing (Art. 13 (5) first subparagraph): BOX 3

a) Introduction

CESR's proposals on the implementation of the MiFID partly involve detailed regulatory requirements with regard to outsourcing. Along with CESR, currently also the Committee of European Banking Supervisors (CEBS) as well as the Joint Forum (Basel Committee on Banking Supervision, IOSCO, IAIS) are involved in the preparation of principles on outsourcing. For the banking industry, it is of decisive importance that the regulatory standards which are being prepared in various fields and/or at various levels shall harmonise with each other. Hence, in order to prevent parallelisms and duplication of different or even contradictory provisions, it is urgently required that a consultation with the various institutions takes place that are involved in the preparation of outsourcing rules. Please find **enclosed** a copy of a comment letter by the Zentraler Kreditausschuss (ZKA) sent to CEBS on CEBS' Consultation Paper on High Level Principles on Outsourcing; we would greatly appreciate consideration of these comments in the forthcoming consultations.

(b) Individual recommendations

- Item 1 (Definition of outsourcing, page 23)

The definition of outsourcing is too far-reaching. This could particularly also cover the involvement of a broker. Yet, since this would encumber with additional requirements one of the investor's established and cost-efficient order execution routes, this can hardly be the envisaged goal. In order to prevent that different institutions will set different standards as regards outsourcing, we propose adopting the definition of outsourcing chosen by CEBS including the comments made by the Zentraler Kreditausschuss (ZKA).

- Item 3 (Defining material areas, page 23))

Under item 3 of the proposals, material areas are defined as mission critical for the due and proper order execution by the investment firm. In our view, this list is not differentiated enough and its scope is too far-reaching. Not all functions of the human resources department, IT department, and the marketing department can be regarded as mission critical for the due and proper business operations of an investment firm. Contrary to this, those areas which can be viewed as uncritical pursuant to item 5 are not listed sufficiently. With a view to the area Research which is mentioned as *material* under item 3, there would need to be a differentiation whether, e.g., this merely relates to the purchase of information that is available in the market - in which case this would already fail to qualify as outsourcing - or whether this involves an own assessment of the gathered information.

In any case, we propose developing a shared methodology on what should or should not be regarded as material; this development should take place jointly with other institutions which are involved in the preparation of outsourcing principles. During this exercise, the respectively competent national authorities should be given enough leeway in order to take adequate account of the markets' idiosyncrasies and of market participants' different business models.

4. Record keeping obligations (Art. 13 (6): BOX 4

a) Introduction

With regard to the record keeping obligations of investment firms, the actual rationale and purpose behind these obligations should always be kept in mind. The goal is the facilitation of audits that allow verification of legal compliance. Record keeping obligations may only be established if and when they serve such purpose.

(b) Individual recommendations

- Item 2 (a) (Minimum period for keeping records, page 28)

The proposed record keeping obligation of 5 years is too long. The underlying reason of this provision consists in the facilitation of audits by the competent authorities. After this audit has been completed, there is no longer any objective justification for such a record keeping obligation. Given the different audit periods of the various Member States, the proposal should be limited to a recommendation to keep the record until the end of the audit following the recording.

- Item 2 (b) (Keeping records of telephone orders, page 28))

We strictly oppose the obligation to keep voice records of telephone orders envisaged under item 2 (b). Such a practice may be a meaningful policy and a standard market practice with regard to dealings with institutional investors. Yet, in the field of retail clients, we feel it would be utterly inappropriate. The effective value added which may result from such a measure for the client in that it allows a potentially easier investigation in those rare exceptions where there has not been correct recording and/or forwarding of a client order bears no relation to the financial and organisational logistics which would be triggered through a technical change to the infrastructure of thousands of banks and savings banks branches. Furthermore, such an obligation lacks a legal basis under the MiFID, Art. 13 (6), which calls for:

> *"An investment firm shall arrange for records to be kept of all its services and transactions undertaken by it which shall be sufficient to enable the competent authority to monitor compliance with the requirements under this Directive, and in particular to ascertain that the investment firm has complied with all obligations with respect to clients or potential clients."*

This provision does not differentiate between the various forms of communication. Hence, this also means that subjecting any individual form of communication to a specific regime is not warranted by the MiFID.

Such a kind of record keeping obligation also infringes upon the evaluations of the European data protection provisions. The latter are marked by the endeavour to ensure a consistently high level of data protection and is thus geared towards the principle of data prevention and data economy (Recital 10 of Directive 95/46/EC dated 24 October 1995 as well as Art. 8 (4) c) of Directive 2002/21/EC dated 07 March 2002, which explicitly also makes it mandatory for the competent authorities to ensure a high level of data protection). Hence, ordering of a legal commitment as contemplated by Art. 7 c) of the Directive 95/46/EC for recording purposes must therefore, in turn, be necessary *per se*. Otherwise, the foregoing principles would be eroded. Yet, on the grounds mentioned above, this will not be warranted.

Finally, there would be stringent requirements with regard to the technical infrastructure of the recording processes (cf. Recital 46 of the Directive 95/46/EC), so that the record keeping obligation ought to be opposed also with a view to cost-benefit considerations.

- Item 2 (c) (Replicability of data, page 28)

This provision stipulates that records have to be kept in a way so that the data can be reproduced easily on paper whilst the format should be protected. The record keeping obligation hence does not only relate to the data content proper but also to the visual layout of the documents. For investment firms, this results in considerable additional costs which are due to the fact that not only the needed storage space would have to be considerably larger but also due to compatibility issues which may result, for instance, by using the services of an external service provider or during updates. This additional input of resources is not offset by any obvious interest that competent authorities might - conceivably - have in replicability of the original format. Replicability of the content should be deemed sufficient. Replicability not only of the content but also of desktop publishing elements, on the other hand, would only appear reasonable, if it is about embedded objects which do not contain client sensitive data (marketing communications, investment research, compliance policies and procedures, compliance reports und internal audit reports). This is due to the fact that this requires storage of one document only.

- Item 2 (d) (Protecting records from manipulation, page 28))

This provision stipulates that the records shall be prepared in a way so that any corrections or changes to the content of the documents will be highlighted and that the records must not be open to manipulations or modifications.

In order to prevent difficulties in interpreting this provision, we propose the following language:

> *"keep records in a manner designed to ensure that any corrections or other amendments as well as the contents of the records prior to any such amendments can be easily ascertained, and establish processes in order to ensure that the records can not otherwise be manipulated or altered."*

- Item 4 (Proof of having complied with the legal provisions, page 28)

The recommendation of a duty incumbent on the investment firm to prove that it has acted in line with legal provisions contradicts legal structures both under public law and under civil law; it also creates conflict with the Constitution or at the least the legal tradition of most Member States. Furthermore it constitutes a contradiction with regard to the provisions under Art. 13 (6), which stipulate that the record keeping obligations should allow competent authorities to monitor compliance with applicable legal rules and regulations. Under the recommendation, exactly the opposite should be the case: The investment firm is obliged to prove that it complies with the law. In the final analysis this is inadmissable reversal of the burden of proof.

- Documentation called for in the annex (Page 28/29)

In our view the **client** categorisation refers to the facilitation provided for under Art. 24 and Annex II of the MiFID concerning the code of conduct requirements in terms of transactions with eligible counterparties and professional clients. Hence, what is needed, is an assessment whether the client qualifies for status as an eligible counterparty or professional client. This should be made sufficiently clear in the language.

With regard to the provisions concerning the record keeping obligations in regard of the **retail client agreements**, we see a compelling need for a clarification: If other documents and/or legal texts are being incorporated by reference then this must not give rise to an obligation to store these documents separately for every single client. It must be sufficient if these documents that are incorporated by reference are being documented for the entirety of clients. Art. 19 (7) specifically regulates that the rights and obligations of the parties to the agreement may be incorporated by reference to other documents and legal texts. The goal of this provision - leaner individual agreements - would not be met if subsequently comprehensive client specific recording obligations would arise for all documents which were referenced in the retail client agreement. It should be sufficient if the competent authority can perceive which contractual agreements were in effect for the client at which point in time.

The record keeping obligations with regard to the **client details** appear to be based on a misunderstanding. The recommendation seems to be based on the belief that *a priori* and *ad infinitum* it will be possible to distinguish between those clients who use investment advice as contemplated by Art. 19 (a) and those clients who do not draw upon such services. This is not in line with standard market practice. It is rather the case that the client will use investment advice for certain transactions whilst on other occasions he will refrain from using such a service. Hence, not the abstract categorisation of the client but rather the correct handling of the specific transaction will be the task to be fulfilled by the investment firm.

With regard to the record keeping obligations in the case of **marketing communication,** there should be a clarification that such data should not be stored in a client specific manner. The rationale behind this obligation to keep records is that this should allow the competent authority to monitor an investment firm's compliance with Art. 19 (2). Hence, it will not be necessary to predicate this provision on the individual client.

Indent 13 provides that the record keeping obligation shall also cover **custody account statements**. Literally, it says: *"which include the copy of any periodic statement issued to clients by the firm in respect of services provided …“*. The expression "copy“ may point to the fact that this record keeping obligation does not only relate to the data contained in the custody account statement but also to the format/visual layout of custody account statements. Due to reasons which are mentioned in our comment on item 2 letter c (Box 4), the call for a graphical display would be both redundant and out of proportion. An unambiguous language for the provision contained under indent 13 therefore reads as follows:

"The data included in periodic statements to clients (on date on which it is provided).“

(c) Answers to the questions

Question 4.1: *Should there be a separate obligation for the investment firm to be able to demonstrate that it has not acted in breach of its obligations under the Directive?*

Answer: No. Such an obligation would lack any objective justification. The fundamental reason and the logical basis of the record keeping obligations is to allow a review as to the investment firm's compliance with legal provisions. The recommendation of a duty incumbent on the investment firm to prove that it has acted in line with legal provisions contradicts legal structures both under public law and under civil law. It is also a contradiction with regard to the provisions under Art. 13 (6), which stipulate that the record keeping obligations should allow competent authorities to monitor compliance with applicable legal rules and regulations. Under the recommendation, exactly the opposite should be the case: The investment firm is obliged to prove that it complies with the law. In the final analysis this is an inadmissable reversal of the burden of proof.

Question 4.2: *What should the nature of the record keeping obligation be in relation to i) capital markets business such as equity IPO's, bond issues, secondary offerings of securities; ii) investment banking business such as mergers and acquisitions; and iii) general financial advice to corporate clients in relation to gearing, financing, dividend policy etc?*

Answer: We are not entirely clear as to the gist of this question.

5. Safeguarding of clients' assets (Art. 13 (7) and (8)): BOX 5

a) Introduction

We feel that, as far as content is concerned, the requirements stipulated with regard to the safekeeping of securities are largely adequate. However, the fact that requirements in the individual Member States are already subject to statutory provisions as well as the market conditions in transactions with institutional investors and sub-depositories, is not taken into adequate account.

(b) Individual recommendations

- Item 5 (a) und (c) (Using financial instruments held on behalf of a client, page 34)

For institutional clients, we propose a waiver with regard to the form requirement of written communication (item 5 (a)) as well as a waiver with regard to the information obligation contemplated under item 5 (c). This is due to the fact that institutional clients are much more familiar with investment firms' business practices than retail clients. Only the latter require the protection that is the rationale behind item 5 (a) and (c), meaning that the costs associated with the information obligation pursuant to item 5 (c) are only justified in the latter case, i.e. in the case of retail clients.[2]

Sub deposit of client assets

- Item 8 (b) (Segregation of own account holdings and client holdings held by the sub depository, page 36)

Internationally, it is a common market practice to use so-called omnibus accounts for the aggregate amount of all securities of one class which a bank holds on own-account as well as those holdings for and on behalf of the client. This option should remain open also in future. Contrary to two separate custody accounts, holding only one securities portfolio facilitates clearing and settlement of securities transactions in practical terms; it also reduces the risk of amounts posted to the wrong accounts and ensures low depository charges. In the final analysis, investor protection would not warrant a segregation of portfolios. After all, the client's securities holdings are posted to a portfolio that is held at his bank and it is being documented by corresponding depository bank statements. A segregation of own account holdings of the bank and client holdings also takes place within the framework of the bank's accounting. Furthermore, in the longstanding experience in the field of depository services, no damage has occurred to date which would make it necessary to change the existing system.

Clarity of responsibilities

- Item 12 (a) (Requirements as to written form and contractual content, page 37)

CESR sets out the requirement that the investment firm has to enter into an agreement with the client covering all issues listed under item 12 (a). We strongly call upon CESR to make this provision subject to the proviso that, by default, only those issues shall be covered in the client agreement where there is an absence of statutory provisions, i.e. where there is an absence of rules

[2] Section 16 of the German Depositary Act dates back to Germany's 1896 Depositary Act; in order to promote business transactions, the latter provided for a simplified approach with regard to merchants.

and regulations which will, by default, anyway apply to the contractual relations. The reason for this is that this is the case under German law. As an alternative, we thus propose the following solution: "Unless provided by law, this contract must include: …“. Having said this, we feel no need to incorporate references to existing law in client agreements. Concerning the requirement as to the written form, please cf. our comments regarding no. 5.

- Item 12 (c) (Risk warning, page 37)

We are not very clear about the risks that should be covered by the warning. At least from the German point of view, no risks can be perceived.

- Item 12 (d) (Description of the legal situation in the depository country, page 37/38)

Under cost-benefit aspects, the envisaged obligation to supply clients with a description of the legal situation in the respective depository Member State would be unrealistic. There are serious doubts as to whether clients with an average level of education will be interested in detailed legal presentations, not to mention the doubts as to whether this will constitute meaningful information for these clients. On the contrary, this would even give rise to concerns with regard to an information overkill for the investor that would not be offset by any tangible value added. Furthermore, previous experience has shown that there has been no demand for such information. In the final analysis, this provision boils down to an excessive legal advice obligation that would be incumbent upon investment firms; these firms could only meet this requirement at a very high cost - costs which subsequently would have to be paid by the clients.

- Item 12 (e) (Collateral, page 38)

The type of eligible collateral is already specified under existing law. There is no need for any additional description. The fact that securities are eligible collateral goes without saying and does not need to be mentioned separately.

(c) Answers to the questions

Question 5.1*: Where the jurisdiction in which financial instruments have to be held regulates the holding and safekeeping of financial instruments, should investment firms be required to sub deposit their clients’ financial instruments with such institutions in all cases or are there cases in which overriding considerations to the contrary mean that it would be permissible to use an unregulated depository?*

Answer: Here, we advocate in favour of the second alternative. This is due to exceptional cases where shares, for instance may exclusively be held by the issuer himself; such circumstances would *de facto* rule out any possibility to sub deposit their clients' financial instruments with such institutions as contemplated by the first alternative.

Question 5.2.: *Which appropriate systems and controls an investment firm has to put in place to ensure that only financial instruments belonging to clients who have given their consent are used in those arrangements?*

Answer: This passage refers to the generally accepted accounting principles which already exist and which are being practiced by investment firms under their own responsibility. We see no additional regulatory need under supervisory law beyond this existing legal regime.

Question 5.3.: *Should a requirement be imposed that the records of the investment firm must indicate for each client the depository with which the relevant client assets are held, or is it sufficient that the investment firm should maintain records of the amount of each type of asset held for each client and of the amount of each type of asset held with each depository and ensure the aggregate figures correspond with each other in accordance with paragraphs 11(c) and 13(b)?*

Answer: We advocate in favour of the second alternative. Practical realities on the ground are marked by a general absence of loro/nostro allocation of the individual client assets to their depositories. Furthermore, we feel that there should be no formal obligation to do so, either. This is due to the fact that, in the final analysis, the decision as to if and which depositories it wants to involve, will be incumbent upon the bank; contrary to this, the client has no influence on such a decision and he does not know the depositories, either. From the client's point of view, the main point is that a bank chooses the depository/depositories carefully and monitors the latter on an ongoing basis and that the clients' bank shall, on aggregate, always be in possession of enough holdings to maintain the cover. If and when the case should occur where securities are suddenly no longer to be found in the holdings maintained as cover within an individual depository, and if the respective depository should not be able to accept responsibility for this (notably due to an insolvency) and if the client's bank should furthermore not be culpable with a view to careful selection and ongoing monitoring of the depository, then it will be appropriate that all clients who have holdings in the securities class concerned shall share the loss in equal proportions.

Question 5.4.: *If the client's assets may be held by a depository on behalf of the investment firm, should:*

(a) the investment firm be (i) prohibited from purporting to exclude or limit its responsibility for losses directly arising from its failure to exercise all due skill, care and diligence in the selection and periodic review of the depository; and (ii) required to accept the same responsibility for a depository that is a member of its group as it accepts for itself; or

(b) must the contract between the investment firm and the client state that the investment firm will: (i) in any event be wholly liable for any losses the client suffers where the investment firm is directly or indirectly linked to the depository, and (ii) be liable in whole or in part, according to the circumstances, for any such losses unless the investment firm shows that it has exercised all due skill, care and diligence in the selection and periodic review of the depository?

Answer: We advocate in favour of option (a) since we feel that, as far as content is concerned, option (a) is less ambiguous.

6. Conflicts of interest (Art. 13 (3) and 18): BOX 6

a) Introduction

The requirements with regard to conflicts of interest remain excessively detailed and are in starch contrast to the specific statement contained in the explanatory text, that certain structures should not be made mandatory (page 40). This particularly applies to item 8 in the version of the first alternative. Furthermore, the proposed provisions on handling inducements lack any legal basis. It also appears doubtful whether, along with the Market Abuse Directive and the corresponding implementing provision adopted by this on the part of the Commission there is still room for additional requirements for the field of investment research under the MiFID. We feel that the term "conflicts policy" is a misnomer in the context of provisions on conflicts of interest. At least the usage of this term appears to be incongruent with its use under the recommendations on Art. 13 (2). It may be one option, *in lieu* of a conflicts policy to refer to *organisational and administrative arrangements*.

(b) Individual recommendations

II. Conflicts Policy

- Item 8 (Organisational provisions, page 44/45)

The provision in the first alternative under item 8 contravenes CESR's declared objective that CESR does not intend to impose any specific organisational structure. Such a provision would not only limit the operational freedom of investment firms without any objective reason, but it would also take away any possibility for consideration of idiosyncrasies within a company. We therefore strictly oppose this proposal.

III. Inducements

- Item 9 to 11(Inducements, page 45/46)

Under the MiFID, we see no legal foundation for the rules envisaged under item 9 to 11 on handling inducements. At level 2, there are only legal grounds for a regulation of inducements if and when they may give rise to a conflict of interest.

But then, too, when spelling out the obligations, attention needs to be given to the regulatory scope established by the MiFID. Art. 13 and Art. 18 do not provide any legal grounds for a mandatory prevention of conflicts of interest. As a safeguard against a violation of the clients' best interests through an investment firm's conflict of interest, Article 13 and 18 rather set out three steps:

- First of all, an **identification** of the conflicts of interest is necessary (Art. 18 (1)),
- furthermore there is a general obligation to **manage** any occurring conflicts of interest in a way which prevents that the conflict will have a negative impact on the interest of clients (Art. 18 (2))
- and last but not least, should this not be enough, a **disclosure** of the "general nature" of the conflict is called for (Art. 18 (2)).

Even a partial ban on inducements imposed under item 9 would be incompatible with the regulatory framework thus established. But also the disclosure obligation stipulated under item 11 exceeds the scope laid down by the MiFID. Whilst Art. 18 (2) calls for the disclosure of the "*general nature*" of a conflict of interest, item 11 (b) calls for a disclosure of the "*details*" of inducements. Furthermore, there is a proposal to repeat this on information an annual basis. This, too, is not anchored in Art. 18 (2). What is called for is the information before undertaking business. Last but not least, Article 18 (3) does not provide any legal grounds for deriving a policy on inducements, i.e. as is envisaged under item 11 (a).

We therefore propose deleting item 9 and 10 without any replacement. Item 11 therefore requires a fundamental review und due consideration of Art. 18 (2).

IV. Disclosure

- Item 12 to 13 (Disclosure of the conflicts policy, page 46)

With the call for a mandatory disclosure of the conflicts policy, CESR once more digresses from the regulatory scope laid down by the MiFID. Such an obligation is not envisaged under Art. 13 and 18. The disclosure obligation under Art. 18 (2) only refers to individual conflicts of interest, not a conflicts policy. For a disclosure of the conflicts policy there is also an objective need. Information on the internal organisation would hardly constitute meaningful data for the investor; yet, the provision of this information would be associated with high costs.

- Item 14 (Agreement of the client, page 46))

We see no legal grounds for the obligation set out under item 14 (b) to obtain the approval of the client. We have difficulties in comprehending the rationale behind this proposal. Such information must be given to the client before offering a specific service. Upon ordering the service the client then indicates that he opts for this service on the basis of the information provided.

V. Investment Research - Contents of Conflicts Policy

- Item 15 to 17 (IOSCO standards, page 46/47)

We have certain concerns over CESR's approach to implement under the MiFID's implementing provisions- largely without any modifications - the "*Principles for Addressing Sell-Side Securities Analyst Conflicts of Interest*" laid down by IOSCO. The EU Market Abuse Directive as well as the Commission's corresponding Directive 2003/125/EC for implementation of the Market Abuse Directive as regards the fair presentation of investment recommendations and the disclosure of conflicts of interest for investment recommendations have submitted the area of research to comprehensive regulation which needs to be implemented across Member States by mid-October 2004. The key regulatory scope of these provisions relates to the disclosure of potential conflicts of interest. For investment firms, credit institutions and any other relevant persons whose main activity consists in the preparation of recommendations this hence imposes particularly stringent requirements with regard to the due and diligent presentation of recommendations. These requirements take particular account of any potential conflicts of interest which may exist within investment firms in the context of the preparation and the distribution of research. With regard to the management of such conflicts of interest, European legislatory bodies have thus decided in favour of a concept of disclosure pursuant to which all material conflicts of interest have to be disclosed *vis à vis* the recipient of such research. This explicitly applies not only to conflicts of interest of the respective legal person but also to all natural persons working for the respective company who are involved in the preparation of the recommendation. The company responsible for the research can thus decide freely whether it wishes to disclose the corresponding own conflicts of interest as well as the conflicts of interest of its employees or whether it prevents such conflicts *a priori* through internal precautions. This approach of the European legislator would be nullified if the MiFID implementing measures were to issue detailed requirements which - by way of mandatory organisational provisions - would *a priori* rule out many of the potential conflicts of interest that would have to be disclosed pursuant to the Market Abuse Directive.

Regardless of the more general concerns against a *de facto* duplicate regulation of research, in certain areas the proposals on potential prohibitive provisions for the general prevention of conflicts of interest are excessively far-reaching: For instance a differentiation would especially be in place with a view to the proposed ban on participation of analysts in sales pitches and road shows (item 16 (f) (ii): In the case of sales pitches, in practice, the participation of analysts is indispensable. After all, investment banks which apply for a mandate to accompany capital measures are regularly expected to also present expertise in the research area. The possibility for participation in a sales pitch through analysts should therefore be maintained. A general ban would appear excessive concerning the ban for analysts to participate in road shows. So, for instance particularly during the presentation of smaller companies, it may appear useful for the investors if an analyst participates in such an event. After all, in such a case a specialised analyst may be the best source of information.

(c) Answers to the questions

Question 6.1.: *Should other examples of methods for managing conflicts of interest be referred to in the advice?*

Answer: We do not see any need to provide further examples of methods for managing conflicts of interest. Such examples may potentially prejudice adequate consideration of the individual structures of an investment firm.

Question 6.2.: *(a) Should paragraphs 8 (a) to (f) (or the final list of measures for managing conflicts of interest adopted in response to question 1) be stated as examples of arrangements that may, depending on the circumstances referred to in* *paragraph 5, be effective methods of providing an appropriate degree of independence in respect of persons engaged in different business activities?*

(b) Alternatively, should there be a requirement for an investment firm to include these measures in its conflicts policy to the fullest extent possible unless it is able to demonstrate that it has implemented alternative arrangements for effectively preventing conflicts of interest from adversely affecting the interests of clients?

(c) If the answer to question (b) is yes, which of these measures should be subject to the requirement referred to in that question?

Answer: We absolutely warn against adopting legally binding provisions. This would make due consideration of the individual situation in different investment firms virtually impossible. Hence, we strongly advocate in favour of alternative (a).

***Question 6.3.**:* *(a) Is it appropriate for an investment firm that publishes or issues investment research to maintain information barriers between analysts and its other divisions?*

(b) If so, which divisions should be separated by information barriers in order to prevent analysts´ research from being prejudiced?

Answer: "Information barriers" could be one suitable means in order to prevent conflicts of interest. Yet, the nature and method of an efficient prevention of a conflict of interest should be left to the proper discretion of each individual investment firm. The only issue that is decisive is that, in the final analysis, every appropriate and proportionate measure shall have been adopted in order to curtail conflicts of interest wherever possible.

***Question 6.4.**:* *Should the derogation from the requirements in paragraph 16 (f) (i) to (v) be available if:*

(a) the investment firm complies with the requirements in paragraph 17, 18, 19 of the first option set out below; or

(b) the investment firm complies with the requirements in paragraph 17 of the second option

Answer: We explicitly oppose any provision along the lines of the second option. This notwithstanding, there are also overarching concerns against a provision that is in line with the first option: There will be no reason for additional organisational provisions whenever the corresponding investment firm - in line with the provisions under the Market Abuse Directive - decides to disclose potential conflicts of interest regarding its investment research; the same applies to the additional note that such research is not in line with such additional organisational provisions.

7. Fair, clear and not misleading information (Art. 19 (2): BOX 7

a) Introduction

In our eyes, the requirements with regard to the communication of an investment firm with its clients or potential clients also appear to feature an excessive level of detail and appear to be fraught with excessively overperscriptive bureaucratic requirements. Especially in this area, we kindly request CESR to hold a critical review as to whether the host of information which clients receive really constitutes meaningful benefits for clients. Furthermore, the recommendations - at least if and when such recommendations relate to the field of marketing communication - clearly exceed the regulatory scope defined under Art. 19 (2) of the MiFID. Here, too, the provisions under the Directive and the Commission's mandate are being ignored.

Pursuant to Art. 19 (2) MiFID, the only provisions that may be adopted, are provisions on the type and nature for presenting information (including marketing communication). Consequently, under (1), the Commission's mandate calls upon CESR to merely specify in greater detail "*the criteria for assessing the fairness, clearness and not misleading character*“ of marketing communication and other communications to (potential) clients. This is incompatible with recommendations on the content of marketing communication and other communications.

Furthermore, CESR’s recommendations fail to take account of the fact that marketing communication is already regulated through European and national competition law. In its mandate, the Commission explicitly calls upon CESR to take into account the *acquis communautaire* of Community legislation that already exists in this area. Yet, the recommendations, including the corresponding explanatory text, give no indication whether CESR has heeded the Commission's call in this regard. Quite to the contrary, the recommendations clearly exceed the general requirements under competition law. The demarcation line between requirements with regard to marketing communication and information obligations as contemplated by Art. 19 (3) of the MiFID becomes entirely blurred. Hence, in the field of marketing communication, a specific law for services is being proposed in relation to financial instruments, without any evidence that this is really needed. Universal banks will have difficulties in comprehending that, depending on their respective business divisions, they will henceforth have to comply with two different regulatory regimes when it comes to marketing communication.

(b) Individual recommendations

- Item 2 and 3 (Information provided in the context of marketing communication, page 50))

The obligations set out under item 2 and 3 are appropriate for meeting the information requirements contemplated by Art. 19 (3). This does not apply to marketing communication since the role of marketing communication is a different one. During marketing communication, the main goal is to draw the client's attention to a product and/or a service. Information about the risks falls under the heading of information obligations. If and when marketing communication should make presentations and/or promises, there are already unfaircompetition provisions which state that such claims need to be true and/or that the marketing communication party must keep its promise. Hence, we strongly call upon CESR to exclusively limit the requirements set out by item 2 and 3 to information obligations under Art. 19 (3).

- Item 5 (c) (Content of the marketing communication, page 51)

Under Art. 19 (2), we do not see any grounds for provisions on the content of marketing communication. Especially in the field of marketing communication, we furthermore see a danger that investors will misinterpret the information supplied by the competent competent authority as a quality label.

- Item 8 (Information in the event of product based marketing communication, page 51)

Item 8 calls for an information in the event of product based promotion/publicity communication. We are not immediately clear as to the rationale behind this information. This means that an investment firm's information obligation will be shifted to a much earlier point in time. Yet, anticipation of this obligation does not improve investor protection, whilst, on the other hand, it incurs considerable costs.

Given that timely client information prior to order placement is mandatory even in the absence of the obligation set forth under item 8, said provision does not improve the protection of investors. On the contrary, it is an added cost since any promotional material that is being sent would have to be equipped with comprehensive background material. This is likely to make client's information concerning specific products more expensive to a point where such information may no longer take place at all. This is not in the best interest of the investor.

The information which should be provided pursuant to item 8 (a) (i) and (ii) can be given neither in advance nor in a standardised format. Financial instruments can suddenly and unexpectedly become illiquid. Furthermore, no general and conclusive statement can be made concerning whether or not financial products are being traded on a regulated market in the European Union or on an MTF. The same applies to a statement concerning whether there is a right of withdrawal. This question, too, can only be answered on a case-by-case basis and thus, by default, cannot be answered by an advertisement that is addressed at a host of (potential) clients.

- Item 9 (The term advertisement, page 51/52)

Pursuant to item 9, the information proposed under item 8 is not mandatory for certain promotional measures. Here, the term 'advertisement' is being used. This is inconsistent with the nomenclature used up to this point which merely referred to 'marketing communication', 'retail marketing communication' and 'direct offer retail marketing communication'. For the purposes of an unambiguous language, this nomenclature should be used consistently throughout the entire text. Based on the heading, item 9 would read as follows: "Paragraph 8 does not apply *to a retail marketing communication.*"

- Item 10 (Information pursuant to Art. 19 (3), page 52)

We strongly oppose the requirement provided for under item 10 pursuant to which the information owed under Art. 19 (3) shall be contained in the advertisement proper. In the case of advertisement, this is an inadmissible intermeshing of the requirements under Art. 19 (3) and Art. 19 (2). Apart from the fact that - as has been pointed out earlier - it must and may not be the role of marketing communication to pre-empt information obligations under Art. 19 (3), such requirement already leads to redundant issues in those cases where clients already have received the necessary information pursuant to item 1 of the recommendations on Art. 19 (3). Yet, it must remain an option for investment firms to meet their information obligations pursuant to Art. 19 (3) also outside of marketing communication. Please cf. also our comments on item 8.

- Item 13 (simulated historic returns, page 52)

The complete ban on using *simulated historic returns* appears too far-reaching. During the launch of new products, such calculations may give the client a clearer picture of the underlying mechanisms of these products. Instead of a strict ban, we propose issuing a recommendation to the effect that a clear message shall be given to the client explaining that this is merely a simulated computation which does not allow any reliable forecast with regard to future performance.

<u>- Item 14 (b) (past performances, page 52)</u>

In our view, the minimum reference period proposed under item 14 b (ii) for a historical presentation of no less than one year appears too static. Here, it should be particularly left to the investment firm's discretion to fix a period on the basis of verifiable criteria which presents the performance of the financial instrument in a meaningful way. The provision to the effect that such information must not be misleading is sufficient in order to prevent abuse.

With regard to the reference to past performance - contrary to the provisions under item 14 b (iv), in the case of a foreign currency it may be appropriate not to carry out a conversion into national currency. Only then will a correct statement concerning the actual performance regardless of potential currency fluctuations be possible. The client mandatory information on a potential foreign currency risk already results form Art. 19 (3).

<u>- Item 15 (Forecasts, page 53)</u>

If and when forecasts are being made concerning financial instruments, pursuant to item 15 letter b such forecast should also state the assumptions on which the respective estimate, forecast or promise is based. Since in this regard, a host of assumptions would appear eligible, there should be a qualification by adding the words *reasonable* assumptions.

8. Information to clients (Art. 19 (3): BOX 8

a) Introduction

Under cost-benefit considerations, we feel that key importance attaches to the question as to the type and way in which this information is given to the client. Requirements are needed which meet the client's demand for information on the risk inherent in securities transactions in a way that will not lead to a dramatic increase in service costs. This need has been taken into account by the European Parliament and the Council through the possibility of providing information in the form of standardised brochures. Forthcoming Level 2 provisions shall and may not abrogate this decision precedent at Level 1.

(b) Individual recommendations

- Item 1 (Requirement as to written form, page 55)

Under the MiFID, we do not see any legal grounds for a stipulation of a general obligation as to written information. Yet, we do feel that a detailed written information of the client concerning the way in which financial instruments are structured and concerning the risks that are associated with such instruments would be perfectly sensible. The same applies to the services which are being offered to the client. This is basically in line with the practice in some Member States. Pursuant to this, basic information is being provided by way of standardised information brochures. Yet, a general requirement as to the written form would be far too rigid. If and when new types of financial instruments enter the market, there must be a flexible regime until the brochures are being updated. In these cases it must be possible to also provide the necessary information to the client in a different form (orally, particularly during telephone ordering, i.e. a method that has become a common market practice nowadays). Such an *ex ante* information on the type of a financial instrument in a timely manner before purchasing should also be preferable to the information *ex post* set out under item 5. We therefore strongly call upon CESR to renounce to a (general) requirement as to the written form.

- Item 3 (Updates of the information, page 56)

We feel that the obligation to give the client an information update whenever **material** changes occur prior to new client transactions is essentially appropriate. Yet, here, too, an obligation for *written* information would not only incur additional costs but would also make timely information more difficult. Consequently, here, too, oral information should be sufficient.

- Item 4 and 5 (information during telephone communication, page 56)

The duty for information during a telephone communication is utterly exaggerated. It by far exceeds the level required by the Directive concerning the distance marketing of consumer financial services. Contrary to this Directive, detailed information is required for each individual call. This lacks any objective justification. If and when the client has received the corresponding information already during the phase when the business relation was being established, there is no longer any need to keep reiterating this during every discussion. This kind of red tape would not provide any value added. In other words: it is not mitigated by the fact that there is a waiver for cases where the client was the one who made the call on his own initiative. Such a kind of information obligation would impose an additional cost burden on one of Germany's most widely used communication channels for order placement thus making its use unattractive for the client. In order to prevent that there will be divergent provisions with regard to the Directive concerning the distance marketing of consumer financial services, no further, additional provisions should be adopted under MiFID.

- Item 6 (Ensuring consistency with the Directive concerning the distance marketing of consumer financial services, page 56/57)

Item 6, specifies a host of individual information. We therefore kindly ask CESR to hold a very careful review in order to ascertain beyond any reasonable doubt whether such information is really in the best interest of the investor. At least MiFID does not provide any basis for fixing information on out-of-court dispute settlement procedures as is being stipulated under item 6 (g) to (k). Given the detailed provisions contained under Art. 3 of Directive 2002/65/EC (*Directive concerning the distance marketing of consumer financial services*), which will be adopted simultaneously with the coming into force of Directive 2004/39/EC on the basis of national implementations in Member States, CESR should furthermore absolutely avoid divergent provisions and should provide for an adoption only if and when Art. 19 (3) provides a sufficient legal basis for this. This also applies to the information called for under item 6 (a), (b) and (e), which already have to be given to the client pursuant to Art. 3 Directive concerning the distance marketing of consumer financial services.

- Item 7 (Product related information, page 57/58)

Given the explicit authorisation under Art. 19 (3) of the MiFID concerning admissibility of a standardised format for the provision of client information, we feel that the recommendation provided under item 7 is unacceptable. First, item 1 - which in our view equally lacks a sufficient authorisation basis at Level 1 - sets out the need for written information, then item 7 (a) takes this even further by requesting that such information be product related. Yet, this is virtually impossible in a standard format; hence this would be incompatible with Art. 19 (3) which provides that standardisation shall apply to each and any information that will be provided. This would presuppose the existence of written information material for each single product which a client may possibly want to acquire. In practice, this will be completely unrealistic. It would, at the same time, rule out the possibility of direct banking as we know it today. In order to protect the possibility of standardised information that is granted by the MiFID, we propose the following language for item 7:

"*a)* *a general description of the main characteristics of the relevant type of financial instruments and/or investment services, including*

i) *the nature of the financial commitment*

ii) *(1)* *a description of the implications when a financial instrument is illiquid; and/or*

(2) a description of the implication when a financial instrument is not traded on a regulated market or a MTF

iii) the risk involved"

Neither could the information which is proposed under item 7 (c) to (g) be provided in a standard format; hence, this recommendation is similarly in breach of the provisions under Art. 19 (3). The requested information forms part of the bilateral contractual agreement between clients and the investment firm, i.e. it is virtually impossible to define such information in an abstract manner.

Furthermore, even in the framework of an individual information, part of the information proposed under item 7 (c) on the overall will be virtually impossible. For instance during securities transactions that are being conducted abroad, it will not always be possible to ascertain the fee of the broker who is executing the order abroad in advance, since this, e.g. would be based on the order volume which may include several client orders. Here, a waiver would be absolutely indispensable for those cases where a statement on the overall price is not possible; in such cases, a note by the investment firm shall and must be sufficient that further fees may result by drawing upon third party services, the exact amount of which cannot be foreseen at the present point in time. This option is also indicated under item 7 (c) (ii) where, however, it is left unclear whether this shall only relate to payable tax amounts.

- Item 8 (Information on charges and fees, page 58)

The detailed information obligation called for under item 8 equally digresses from the scope laid down by the MiFID. The exact amount of charges and fees, of costs as well as of the relevant currency is subject to the individual contractual agreement. With regard to the costs, the issue is further compounded by the fact that the investment firm partly has no influence on such costs.

- Item 9 (Product specifications, page 58)

Also with regard to the recommendations under item 9, it is striking that the provisions of the MiFID are being ignored. So, for instance, the requirement to provide information on the duration of the product, indicates a description of the individual product which, contrary to the provisions under Art. 19 (3) would rule out the provision in a standard format. In line with the MiFID's provisions, this case too, should contain a reference to the "type of financial instrument" and not to the individual product.

- Item 10 (Details about the guarantee and the guarantor, page 58)

The call for presentation of "sufficient detail about the guarantor and the guarantee" again digresses from the MiFID's framework. The only possible obligation that can be imposed on an investment firm is the obligation to provide information on the insolvency risk. Anything else would not be feasible in a standardised format.

- Item 13 (Type of risk assessment and type of depository, page 59)

Item 13 remains equally silent on whether product related or standardised information is required. Since the MiFID allows standardised information, the only legitimate request can be a description of general risks and the conditions of providing depository services.

9. Client agreement (Art. 19 (7): BOX 9

a) Introduction

The proposals on the client agreement are a manifest digression from the regulatory scope established by the MiFID. Without providing even the slightest benefit for investors, these proposals would create unfathomable costs.

Art. 19 (7) stipulates a record keeping obligation for the agreements finalised between the investment firm and its client. The provision remains silent on the content of such agreements. Also the Commission's mandate unambiguously clarifies that the scope of the forthcoming provisions shall exclusively relate to a further record keeping obligation in addition to the record keeping obligation already contained under Art. 13 (6) of the MiFID (cf. heading of the mandate on this provision "client records", further the mandate itself which refers to the fact that it aims at a specification of merely "minimum content of the client records, in particular the customer agreement" and the Commission's call that this request shall be combined with the request to Article 13 (6)). The mandate on Art. 13 (6) contains a clarification saying that the records need to be sufficient so as to "enable the authorities to verify the investment firm’s compliance with the applicable rules“.

Hence, neither Art. 19 (7) nor the Commission's mandate warrant a provision to the effect that agreements shall only be valid if they are prepared in writing nor do they authorise regulating the content of such agreements. This restraint is owed to the fact that to date harmonisation under civil law - notably contract law - is still pending.

But even if one were not to share this view the recommended requirements are clearly beyond proportions if they would become applicable to each and any contractual relations that is already in existence on 30 April 2006. According to the statistics of the Deutsche Bundesbank there are 35 million custody accounts in Germany, i.e. 35 million contractual relations between investment firms and clients. According to the recommendations, all these contractual relations would have to be put on a new legal basis. In terms of the associated costs, even the most conservative estimates arrive at least EUR15 per client (redrafting of the agreements, advice and support services, postage charges, feedback control, IT input). This would involve overall costs of at least EUR525,000,000 in Germany alone. For the investors, this would mean added costs and not added value.

(b) Individual recommendations

Basic retail client agreement

- Item 1 (Requirement as to written form, page 61)

The provision that any service provided shall require a written agreement is incompatible with the Europeanwide principle as to free choice of the contractual form and constitutes a severe interference with national civil law structures. Such an approach would be unprecedented. Even the Directive on the distance marketing of consumer financial services does not stipulate any mandatory form requirements for agreements. Let there be no misunderstanding: Naturally, when establishing business relations in practice, framework agreements, such as custodian agreements, are being finalised with clients in a written form. Concerning the ensuing individual purchase or sales agreements of financial instruments, however, mostly no corresponding written agreement takes place but a recording of client orders[3]. In the case of advice, there is not even a need for an explicit conclusion of an agreement. Instead the advice agreement may also be concluded through an implied agreement (e.g. in the case of an investment firm which complies with its client wish for a recommendation[4])..

And - contrary to the regime envisaged under item 1 (a) - in the event of advice there is a conspicuous absence of detailed provisions on the potential rights and obligations. Any other approach would even be a pointless undertaking. When entering into an investment advice agreement, both supervisory law and civil law stipulate the obligation for the provision of an advice that is suitable for the investment and the investor alike. The specific duties which may

[3] In such cases the order will, however, be stored on the system, thus ensuring transparency for a potential later audit but also in the event of potential civil law suits

[4] Here, too, internal records are being kept in order to verify whether an investment advice agreement has been finalised or not; the rationale behind this approach is that, in the event of an audit or litigation under civil law, this allows to verify whether there has bee compliance with the applicable rules and regulations

arise from this general obligation will be based on the individual case, i.e. on the investment goals, on the experience and prior knowledge as well as on the financial situation of the respective client (cf. Art. 19 (4), MiFID) and also on the product that is being recommended to the client by the investment firm. Consequently, in the case of investment advice, it is virtually impossible to lay down in a standardised format the contractual rights and obligations.

- Item 4 (Provisions on the content of agreements, page 61/62)

The provisions on the content of agreements similarly lack any legal authorisation. *De facto,* without any need for this, they subject the provision of services in financial instruments to a law *sui generis*. The requirements under item 4 (f) ("description of any withdrawal right or cooling-off period") may not at all be transposed into an agreement in a standardised format, since such rights usually result from other legal provisions, which, however, only apply in individual investor cases. Whether or not a withdrawal right or a cooling-off period exists and to which extent this applies, can only be determined on a case-by-case basis.

Here, CESR's reasoning appears to be mispremised if it regards information obligations as less binding than contractual agreements and if, based on this hypothesis, it then arrives at a need for a contractual regulation of information obligations (cf. explanations on page 60). Concerning the possibility of potential non-compliance, it should make no difference whether there has been a breach of contractual or of statutory information obligations; both breaches shall be equally sanctionable under either civil law or supervisory law. Yet, for practical reality on the ground of securities transactions it does, however, make a considerable difference whether the forthcoming provisions relate to agreements or, moreover, to information obligations that are divorced from agreements. Only the latter shall allow investment firms to carry out an update at reasonable expenses without having to go through onerous contractual changes. Last but not least the contractual information obligations should not lead to duplication of pre-contractual information obligations.

- Item 5 (Incorporation by reference to other documents, page 62)

The recommendation under item 5 is similarly beyond the scope of the MiFID: Pursuant to Art. 19 (3), incorporation by reference to other documents shall only be possible *in toto* and not merely for individual items. Furthermore, the possibility of incorporating other documents by reference does not mean that the documents which are thus incorporated will have to meet the same form requirements as the original document. Any other approach would, *a priori,* rule out the possibility of incorporation by reference.

- Item 8 (Record keeping obligations, page 62)

The record keeping obligations envisaged under item 8 are clearly too long. First of all, the begin of the record keeping period should be predicated on expiry of the individual agreement and not on the period of the business relation. Furthermore, a record keeping period shall be sufficient which ensures access to the documents during an audit. This means that a record keeping period should be sufficient that lasts only until the end of the audit following the recording.

Furthermore, it should be clarified that the record keeping of documents which are incorporated by reference does not have to take place for each single client in a separate manner. General Terms and Conditions, for instance, are being applied to each and any client alike, so that a documentation for every single client would constitute an unnecessary amount of bureaucracy. It must be sufficient if these documents that are incorporated by reference are being documented for the entirety of clients. Art. 19 (7) explicitly stipulates that the laws and obligations of counterparties may be incorporated by reference to other documents and legal texts. The goal of this provision - leaner individual agreements - would not be met if subsequently comprehensive client specific recording obligations would arise for all documents which were referenced in the retail client agreement. It should be sufficient if the competent authority can perceive which contractual agreements were in effect for the client at which point in time.

Last but not least, if he has already been in receipt of such agreement immediately after the conclusion of such agreement, there is no objective need for the requirement that the client shall be entitled to request another copy of the agreement at any subsequent point in time. The same applies if and when the client places orders via telephone; the reason is that in such cases, pursuant to Art. 19 (8) of the MiFID, he will already have received corresponding information within a short period after the order placement.

Retail client agreement involving trading in warrants and derivatives

- Item 9 (a) (Warrants and derivatives, page 62)

It is not possible to already lay down in an agreement "whether the relevant instruments are admitted to trading on a regulated market or not“ (No. 9 a)). There can only be a general regulation as to whether also OTC forward deals are admissible, along with on-exchange trading. A contractual reference to information that, in any case, shall have to be provided pursuant to Art. 19 (3) of the MiFID, is equally redundant.

- Item 9 (b) to (d), page 62/63

An agreement can make no statement with regard to the "envisaged transactions" (item 9 (b)). Furthermore, the requirements under item 9 (b) are likely to involve overlapping items which are covered by Art. 19 (8) of the MiFID.

Also an "appropriate warning" - such as is envisaged under item 9 (d) - can only be given in individual cases; it does not lend itself to prior contractual regulation thereof. An information in the agreement proper concerning the experience and prior knowledge etc. always mingles the obligations pursuant to Art. 19 (7) with those under Art. 19 (4) or, respectively, (5) of the MiFID. Furthermore, such a policy would be completely unfeasible since - if the information was to be included in the agreement - any update thereto would only be possible upon signature by the client, even if there is evidence for the fact that the client's performance has resulted in changes (e.g. worsening of the financial situation). Furthermore, the disclosure of the financial situation is mandatory only in cases of investment advice and asset management (cf. Art. 19 (4) of the MiFID). This is compounded by the fact that numerous clients do not exclusively provide investment advice and/or are not exclusively engaged in execution-only transactions, but that they freely choose between both services. Hence, enshrining the obligations under Art. 19 (4) and/or (5) of the MiFID under the framework agreement would thus be, objectively speaking, inappropriate.

Retail client agreement for portfolio management

- Item 10 (c) (Designation of a benchmark, page 63)

Contrary to the other recommendations for the client agreement, we largely welcome the recommendations on the retail client agreement for portfolio management. Yet, the same does not apply to the obligation to designate an appropriate benchmark set out under item 10 (c). Mostly, finding such a benchmark will just be impossible; this is also stated by CESR itself, which, however, then calls a negative statement for those cases where no benchmark can be found; such statement must point out the impossibility of finding a benchmark and also has to mention all other points based on which performance can be assessed. Since portfolio management is always active management of the entrusted funds, it will hardly be possible to put together a benchmark group. What should a benchmark look like, for instance, if portfolio management has a policy of shifting its focus between shares and debentures in Europe, the US and the newly industrialised countries (NICs)? Here, CESR should hold a very careful review as to whether investment firms are not being faced with an obligation which they cannot meet under realistic terms. The alternative pointed out by CESR should thus only be helpful to a limited extent.

10. Reporting to clients (Art. 19 (8): BOX 10

a) Introduction

With regard to the recommendations on reporting obligations under Art. 19 (8), one aspect is of paramount importance for us: Obligations should be avoided under which the client has to be given duplicate information which is already in his possession. This would create a cost burden that would be utterly unjustifiable.

(b) Individual recommendations

- Item 2 (Information during order execution, page 66/67)

The requirements under item 1 and 2 are basically already in line with present requirements. Yet, at present the client is not being informed on the time of execution as is requested by item 2 c). Hence, it is neither clear why investment firms should be duty-bound to provide such information. The time of execution is not within their sphere of influence. They are only held to forward the order to the stock exchange in good time. We assume that timely order execution is being supervised by the stock exchange supervisory authority. Hence, there should be no need for such a provision. Instead, it is likely to create a huge migration process for the technical infrastructure of investment firms.

Item 2 (i) sets out that the information given to the client after order execution also has to contain information as to whether the retail client's counterparty was the investment firm itself or any person within the investment firm's group. This appears a meaningful approach if it is based on the rationale of preventing that an investment firm carries out the order on its premises as the execution venue without the client being aware of this. Yet, in such a case, two scenarios would have to be exempt from this provision:

On the one hand, the case of an explicitly agreed fixed price deal or purchase agreement with a right to fix the price. Here, the client will know in advance with whom he is concluding the agreement, because he will agree the price with such person when he awards the contract.

Secondly, in the case where orders that have been given independently are being aggregated through the trade on a regulated market or MTF. Here, for the client it is irrelevant whether he closes the deal with the investment firm, a person which belongs to the investment firm's group or with a third party. This is due to the fact that the price was generated on the basis of market rules and, at the point of conclusion of the agreement, neither party was aware of the counterparty's identity.

These two scenarios should be exempt from the regulatory scope; such derogation is justified because the investment firm would otherwise have to go to great lengths in order to ascertain the identity of the counterparty and it would have to do so for every single transaction.

In the final analysis, item 2 k) will not be feasible during a single transaction, especially not under a contract note or confirmation. The delivery dates and the procedure vary strongly between individual stock exchange locations; this difference is especially pronounced when comparing domestic banks and banks abroad. They tend to look to the respective stock exchange standard market practices at a local level, i.e. the *mores*. There is also an agreement with the client on this. This fact is further enhanced because in Germany, credit institutions are under a contractual obligation *vis à vis* their client that they shall guarantee proper order execution for the purposes of the respective client transaction. Hence, at least under this scenario, there is no need for a detailed client information concerning the point in time and the procedure during delivery.

- Item 3 (Information in the event of non-execution, page 67)

With a view to the time information, the content of the information obligation during non-execution should remain limited to the date of order reception. Any further information may be given to the customer upon explicit request. If and when in individual cases the exact time of order reception and/or the exact time and date of the order transmission will be important, then such information may be given to the customer upon explicit request. This has the advantage that on the one hand, the client's information need is being met, whilst, on the other hand, investment firms will not have to change their entire system infrastructure in order to display the time of order reception and the date and time of order transmission. Sentence 2 under item 3 should therefore read as follows:

> *"The order confirmation notice must include client order details and the date of reception; upon request the investment firm must also name the time of reception and the date and time of transmission."*

- Item 6 (Information in the case of investment saving schemes, page 67)

We basically welcome the provision pursuant to which investment savings schemes do not require individual confirmations for the various transactions being sent to the client; instead, said provision stipulates that a collective confirmation every 6 months shall be deemed as sufficient. Notwithstanding the foregoing, a six month deadline appears inappropriate. We feel that an annual collective confirmation would be more appropriate from the point of view of costs. At least this will apply if the rates for the investment saving scheme remains within a certain limit (e.g. 300

Euro per month). This would create congruence with regard to annual statements and the costs would remain within an appropriate framework.

- Item 8 and 9 (Statements of clients' assets, page 67)

Item 8 (a) and (b) are not covered by MiFID, since they do not directly relate to the safekeeping and management of securities or other types of services or activities as contemplated by MiFID.

Item 8 (b) provides for information obligations of investment firms which these can only meet if the transactions they are dealing with are not client transactions with third parties.

Item 8 (c) requests that any movement of clients' assets be shown clearly and consistently based on either trade date or settlement date. Here, CESR digresses from the regulatory framework established by Art 19 (8). The client will have received the owed information with the statement pursuant to item 2. More cannot be reasonably expected of investment firms. Art. 19 (8) regulates which information shall be passed on to the client. There is no objective justification for regulating the type and nature of the information and, during this process, even calls for multiple transmission of one and the same piece of information. The mere reiteration of his assets movements on the client's securities account statement does not provide the client with any added insight. This only creates additional costs for the client.

Item 8, second sentence should therefore be deleted completely.

At least the derogation provided for under item 9 should become a real option by broadening the scope of its application. This conditional waiver for provision of the necessary information also in the form of other periodic statements or by other separate documents to the client is not really an option of practical relevance if it only applies when all of this information is prepared (a) relating to the same date and period and (b) is delivered to the client within a reasonable period of one another. This is due to the fact that under the existing qualifications, settlement statements are not seen as eligible separate documents which would make the renewed delivery of the information contained therein redundant in the securities account statement. Particularly the renewed information on any movement of the clients' assets criticised with regard to 8 (c) even applies if the asset movements can be tracked and traced without any gaps due to the settlement statements that have been sent out to the client. The last half sentence under item 9 (beginning from: "as long as …“) should be deleted.

- Item 16 d) (Requirement as to written form, page 68)

In combination with item 18, the information obligation set out under item 16 d) for payments which the investment firm has received from a third party in the course of portfolio management is not under the regulatory scope of Art. 19 (8) MiFID, but falls under the scope of Art. 18 (2) MiFID (conflict of interest). Concerning the limiting preconditions under Art. 18 (2) MiFID cf. our detailed comments on item 9 to 11 of the recommendation on Art. 13 (3) and Art. 18 MiFID (Box 6). Resulting from this, in particular, there is an absence of provisions on an information obligation concerning details as well as an absence of provisions on periodic information. Hence, there should be a renunciation to a separate regulation under item 16 d) and item 18, or, in order to ensure regulatory convergence, it would at least have to be adjusted to the provisions set out by Art. 18 (2) MiFID.

(c) Answers to the questions

Question: *What type of reporting requirements relating to the provisions of investment advice should be included in the advice to the Commission? When should such requirements apply and what concrete requirements should be imposed?*

Answer: It would be inappropriate that in the case of advice, “reporting requirements" shall be provided. The advice always relates to the given moment in time, i.e. the advice is finished once the recommendation has been made. Hence, it is under the client's responsibility to keep monitoring the performance of the financial instrument and, if necessary, to call for renewed advice.

11. Client order handling (Art. 22 (1): BOX 11

a) Introduction

Concerning the requirements with regard to client order handling, a detailed list of questions has been submitted and we shall largely limit our comment letter to answering this list.

(b) On the individual recommendations

- Item 3 (Information on the position as principal, page 81)

Under item 3, there should be a limitation of the regulatory scope to retail clients since such a note would be dispensable with regard to professional clients.

- Item 12 (Priority of client orders, page 82)

The general priority of allocations to clients where orders for own and client accounts have been aggregated and where such aggregated orders are only partially executed appears inappropriate. At least in those cases where, without an aggregation of own account orders of the investment firm an allocation to the respective clients would have been impossible or would only have been possible under poorer conditions, a pro rated allocation also of the own account orders should be possible. We therefore propose the following addition to item 12:

> "… By way of exception, this shall not apply if the overall situation suggests that without an aggregation of the investment firm's own account orders, an allocation to the respective clients would have been impossible or would only have been possible under less favourable conditions."

- Item 20 (b) (Information on order transmission, page 83)

Item 20 (b) ("*record the person to whom the orders was transmitted*") is at least incompatible with regard to network structures were the local bank transmits orders to its central bank for the purposes of execution at the stock exchange. In these cases, order transmission to the central bank is not recorded for every individual order; quite on the contrary, once the order has been approved by the local bank and due to the existing system architecture, the order is automatically transmitted to the central bank. We therefore propose the following addition to item 20 b):

> "...the person to whom the order was transmitted**, unless the order is transmitted automatically.**

(c) Answers to the questions

Question 1: *Do you agree with the definition of prompt fair and expeditious execution of an order from a client? Do you think that it is exhaustive? If not, can you suggest any elements to complete this concept?*

Answer: We agree with the definitions and feel they are sufficient.

Question 2 : *Do you think that the details of the orders included under paragraph 2 of the draft technical advice should apply also to professional clients?*

Answer: Item 2 should not be applicable to professional clients since the situation is not comparable. This is due to the fact that, for instance in transactions with professional clients, the name of the agent is not being recorded; instead, there is only proof of his authorisation which is evidenced by a previously agreed access feature.

Question 3: *Which arrangements should be in place to ensure the sequential execution of clients' orders?*

Answer: There is no need for any additional arrangements. The date and time of order acceptance has to be recorded; on the basis of the order acceptance, it is possible to verify whether there has been sequential execution of clients' orders.

Question 4: *Do you agree with the reference in paragraph 7 of the draft technical advice to prevailing market conditions that make it impossible to carry out orders promptly and sequentially?*

Answer: Yes; it may make sense to wait with order execution for instance in the case of illiquid markets.

Question 5: *Do you think that the possibility that the aggregation of client orders could work to the disadvantage of the client is in accordance with the obligation for the investment firm to act in the best interest of its clients?*

Answer: Yes, because despite sufficient prior precautions to act in the best interest of the client, it may afterwards turn out that the aggregation has worked to the client's detriment.

Question 6: *Do you think that the advice should include the conditions with which the intended basis of allocation of executed client orders in case of aggregation should comply or should this be left to the decision of each investment firm?*

Answer: This decision should remain at the investment firm's discretion. Transparency for the client is guaranteed by the fact that he will receive prior information on the allocation principles of the investment firm. These principles shall be recorded by the investment firm pursuant to item 9.

Question 7: *Do you consider that CESR should allow the aggregation of client and own account orders? Do you think that other elements (i.e. in respect of the arrangements in order to avoid a detrimental allocation of trades to clients) should be included?*

Answer: The aggregation of client and own-account orders should be allowed because it may also be in the best interest of the client (e.g. more economic rates). There is no need for any additional arrangements. As far as the provision under item 12 is concerned, we feel a derogation clause is appropriate (cf. proposed amendment of item 12).

Question 8: *Do you think that paragraphs 15 and 16 of the draft technical advice should only apply to retail clients?*

Answer: Yes, since for professional clients there will be no need for corresponding provisions because they are capable of an adequate assessment of the risks and hurdles.

SECTION IV: COOPERATION AND ENFORCEMENT

12. Transaction Reporting (Art. 25): BOX 15 und 17

a) Introduction

We strongly endorse CESR's commitment set out on page 101, third paragraph, that during the implementation of MiFID unnecessary new obligations for the regulated parties should be avoided if and when they give rise to excessive additional costs. We therefore propose using the option of maintaining existing reporting procedures as widely as possible. Unfortunately, after having carefully studied the provisions made in the Consultation Paper, we are very much concerned that CESR is not going to meet this goal. Particularly the fields and field descriptions laid down under Annex A are designed in a way that - at least in Germany - will lead to a considerable adjustment of the existing reporting systems. The main reasons for this is that CESR attempts a standardisation of a great amount of reporting data sets. This should allow competent authorities an easier exchange of data. We feel this is a move into the wrong direction. The Directive explicitly does not call for a maximum harmonisation in the field of transaction reporting. This means that it is simply not the task of market participants to adapt their systems so as to ensure interoperability of data exchange between the competent authorities. This is rather a task which has to be performed by the authorities themselves in line with the provisions under Annex B. For more detailed information, please cf. our comments on Annex A (cf. enclosure).

We would furthermore like to point out that, for the time being, implementation of the considerable changes with which investment firms are faced at Level 2 of the MiFID will not be possible within the implementation deadline set forth under the Directive. A calculation of the actually needed transitional period will only be possible once the details of the technical implementing provisions will have been finalised. In any case, after finalising the details, at least **one year** will be necessary for the implementation. If and when completely new reporting systems would have to be set up, like, for instance in the case of branches, this would lead to a corresponding longer implementation period. We therefore explicitly ask CESR to take this circumstance into account when drafting its final advice to the European Commission.

Concerning Level 3, we notably support the recommendation of preventing unnecessary overlapping duplicate reporting obligations. This implies that competent authorities make use of waiver rules to the greatest possible extent. Wherever possible, such waiver rules should already set in at the level of the individual reporting investment firm exempting such firm from its reporting obligation.

b) Individual recommendations

- *Financial instruments to which the reporting obligation is applicable*

On page 101, paragraph 1, together with the reference to recital 45 of the MiFID the request is being made that within Member States there should also be the option of reporting financial instruments that are not admitted to trading on a regulated market to the competent authority. We oppose such an extension of the reporting scope with a view to a missing adequate cost-benefit ratio. In our view, financial instruments that are not listed at the stock exchange are not relevant with regard to the prosecution of insider dealings or market manipulation so that the costs incurred for the coverage of such instruments would be disproportionate and unjustified. We similarly oppose a general extension of the reporting obligations to include any further products.

We furthermore kindly request a clarification that the exercise of options and subscription rights is not regarded as a transaction that is contemplated by Art. 25 paragraph 3 MiFID and that they shall thus be exempt from the reporting obligation.

- *Branches abroad*

In our understanding, Article 25 paragraph 6 MiFID stipulates that legally dependent branches abroad will have to report their on-exchange and off-exchange transactions to the competent authority in the Host Member State. The latter, in turn, should send this information to the Home Member State authority unless the Home Member State waives its right to receive such information. For on-exchange transactions this is e.g. already in line with the current provisions set out under § 9 German Securities Trading Act, where, however, the BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) usually waives its right to receive a transaction report in its capacity as competent authority of the Home Member State. Under this regime, on-exchange transactions are being reported by a London branch via the London Stock Exchange (LSE) without the branch having implemented an own technical reporting system. Off-exchange transactions are, however, usually directly reported to the Home Member State's competent authority (BaFin) by using the bank's existing reporting system. This will change in future. Hence, the MiFID will require banks to implement for every branch an interface that is based on the Host Member State's local common reporting practices; due to the highly heterogeneous reporting infrastructure across Europe, this will lead to prohibitive additional costs and a huge logistical burden. Until there is any further harmonisation of the reporting systems in the EU, a transitional regime modelled on present practices should therefore be seriously considered.

- *Level 3 measures*

Page 103, second paragraph contains a reference to potential Level 3 measures. We would like to clarify that the scope of Level 3 under the Lamfalussy procedure merely extends to interpretation issues and does not allow CESR's stipulation of any new provisions beyond those of Level 1 and Level 2. Further, we would welcome a public consultation on possible Level 3 provisions.

- *Forwarding of the report to the competent authority of the "most relevant market"*

We feel the CESR recommendations on defining the "most relevant market“ (Box 16) are an appropriate proposal. Hence, we lend our unqualified support to this. As a consequence, we shall refrain from answering the questions 16.1 to 16.5.

- *Annex A*

Annex A shall be regarded as a minimum harmonisation. Unless the information is regarded as vital due to a combination of other fields or for national supervision purposes, we therefore feel that it will be necessary to exclusively recognise some of the envisaged fields as an option only and not as a mandatory field - at least at the level of those persons that have to make the reports. This applies particularly with regard to field 4, field 8, field 9, field 12 und field 13 (as per enclosure).

Furthermore, we feel it is absolutely necessary to clarify that the fields envisaged pursuant to Annex A do not necessarily have to be mirrored on a one to one basis in national reporting obligations; i.e. in other words: it is both possible that one field will be translated into several national fields (e.g. field 19) and also that various fields may be translated into one national field.

We furthermore propose that the minimum fields will still have to be complemented to include a field for a potential cancellation of the report.

(c) Answers to the questions

Question 15.1: *Should competent authorities be able to waive the requirement for investment firms to report transactions in electronic format? Should such an exemption be limited to exceptional cases, and what cases would those be in your view*?

Answer: We support the general option for competent authorities to waive the requirement for reporting transactions in the specified electronic format in exceptional cases, i.e. a waiver for small banks which only carry out but few transactions per year that fall under the reporting obligation. We see no need to specify this case in greater detail. Instead, we think that this general option which is not specified in greater detail provides the competent authorities with enough leeway for action.

Question 15.2: *In respect of bond markets and commodity derivatives markets, new systems for reporting financial transactions will probably have to be put in place in many Member States, in order for investment firms to be able to meet the requirements of the Directive and Level 2 advice. (Note that Article 20(1) (b) of ISD1 already requires investment firms to report all the transactions covering bonds and other forms of securitised debt to competent authorities, though Member States have the right to provide that this obligation only applies to aggregated transactions in these instruments. To what extent should the implementing measures allow market participants more time to implement these proposals ("transitional regime")? What could be legitimate reasons for such a possibility*?

Answer: For all parties that fall under the reporting obligation, the harmonisation - even if it is limited to minimum standards - will lead to more or less major adjustments. Even those Member States which already have a highly sophisticated reporting system and which fully comply with the provisions of ISD 1993 (Investment Services Directive) will have to carry out some adjustments (e.g. due to the broadening of the scope of instruments that need to be reported to include all financial instruments; innovations concerning the foreign branches; introduction of a strict Home Member State principle through abolition of the waiver provision - Art. 20 (2) ISD 1993; Changes and/or amendments for fields and/or field descriptions, cf. Annex A). Currently it is not clear how much time will be required for this exercise. This depends on the final content of the specifications, with regard to which we propose various amendments/clarifications (cf. also comments under Annex A). In any case, an implementation for the regulated parties (also under cost aspects) will only be possible if and when all necessary information for IT adjustments will have been laid down in a legally binding way. With regard to transaction reporting, we therefore feel that meeting the deadline for implementation set out by MiFID is extremely ambitious.

Question 15.3: *To what extent should CESR investigate the possibility for future convergence between national reporting systems? What are the advantages and disadvantages of harmonising at EU level the conditions (including format and standards) with which all the reporting methods and arrangements have to comply in order to be approved, instead of, as proposed by CESR, harmonising the conditions at a national level? What impact might harmonisation have on existing national reporting channels, national monitoring systems and on the industry?*

Answer: **C**urrently we feel that a discussion on the Europeanwide harmonisation of the reporting obligations would definitely be premature if not unhelpful. Although through a comprehensive harmonisation identical supervisory law requirements could be guaranteed due to the different work that has been made to date for the establishment of national reporting systems, the overall implementation effort will, however, vary greatly between individual Member States. Furthermore, for every bank engaged in cross-border transactions which has to comply with the reporting obligations in different countries, a harmonisation would only require a one-off effort for adjustments and thus, through centralisation, result in significant reductions for maintenance costs. In order to achieve this, however, it would be necessary to produce a very long-term project plan which would anyway have to reflect any migration costs resulting from system adjustment cycles thus giving the regulated parties planning certainty with regard to the future. One indispensable prerequisite in this case would be that during this time the national competent authorities shall renounce any exclusively nationally oriented innovations or amendments of the reporting systems. Yet, what would clearly speak against a full harmonisation of reporting obligations is that this does not result in any significant value added but instead in significant added costs for the purely national reporting system which relates to domestic transactions in domestic securities. It should not be overlooked that the securities business - particularly in the field of retail - is largely not of a cross-border nature. Particularly under the aspect of an adequate cost-benefit ratio we therefore feel that a maximum harmonisation of reporting obligations would not be a constructive move. *In lieu* of this, we first of all recommend adopting a wait and see attitude in order to verify which impact the present harmonisation approach which is currently laid down in MiFID will have in practice. Above all, the costs for the implementation of Art. 25. paragraph 3 MiFID should be weighed against the *de facto* efficiency gains in combating inside dealings and market manipulation. In the absence of such a detailed cost-benefit-analysis, we oppose any project for further harmonisation of the reporting obligations in Europe.

Question 15.4: *Do you agree with the set of the general minimum conditions suggested? If you do not agree, what other general conditions would be more appropriate in your view? In particular, taking into consideration the responsibilities of investment firms on the one hand and third parties and other reporting channels, on the other, do you think that CESR and a reporting channel in the list of general minimum conditions, or would this be better addressed at Level 3? What is your view on the border line as to the responsibilities for reporting if done by a third party acting on behalf of an investment firm or be a reporting channel?*

Answer: We support the mentioned minimum conditions pursuant to Box 15, item 1, page 104. Generally we feel it is appropriate if a regulated party will have to bear the responsibility for the report regardless of the chosen reporting channel. Concerning the standard level agreement, we hence see no need for any further requirements with regard to the use of other reporting channels which go beyond the regular outsourcing agreements for credit institutions. Correspondingly, we neither see any need for further Level 3 work under the Lamfalussy procedure.

Question 15.5: *What other issues, if any, should CESR take into account when responding to the Mandate concerning the "methods and arrangements for reporting financial transactions"?*

Answer: Given CESR's mandate, we have nothing to add to the envisaged methods and arrangements.

Question 17.1: *Do you agree with the approach to standardise/harmonise the list in Annex A to this draft advice only at a national level in order to be able to keep reporting systems that are already in place? If you do not agree, what approach do you think would be more appropriate?*

Answer: We lend our explicit support to CESR's objective of keeping, wherever possible, the reporting systems that are already in place at a national level. This notwithstanding, we feel that CESR's proposals on Annex A unfortunately fail to meet this objective (for a more detailed discussion, please cf. […]).

Question 17.2.: *What are advantages/disadvantages of moving towards harmonisation at EU level as regards the standards or format of the list in Annex A to this draft advice? To what extent would harmonisation at EU level of the standards or format of the list in Annex A to this draft advice impact the existing national data collection mechanisms and national transactions databases? Do you see merits in having an EU harmonised regime for the content and format of transaction reports, taking into consideration whether future and immediate long-term benefits could compensate the initial costs of harmonising the transaction reports?*

Answer: The Annex A recommendations constitute an excessive interference with national reporting systems because - also at the level of the market participants - they stipulate which information has to be contained in which field. Furthermore, we would like to point to our answer concerning question 15.3..

Question 17.3.: *Do you agree with the proposed fields in Annex A and B to this draft advice? If you do not agree, what other fields would be more appropriate in your view?*

Answer: Cf. our comments on Annex A.

Question 17.4.: *How would you define the field "agent/propriety"?*

No comment.

Question 17.5.: *What are the advantages/disadvantages of requiring the field "client identification code" in transaction reports, bearing in mind the objectives of transaction reporting? What are your views on making the client/customer identification field mandatory in transaction reports? What are your views on the idea to promote a pan-European code for client/customer identification? Do you see any legal impediment to the introduction of such a code in your Member State?*

Answer: We have doubts whether a client identification code is really necessary for the purposes of a minimum harmonisation. Furthermore, *de facto* within Europe - as far as can be seen - there is no legally admissible, uniform and common basis for this. Establishing a Europeanwide standard client identification code would be, last but not least, also objectionable under cost-benefit considerations.

Question 17.6.: *What other issues, if any, should CESR take into account when responding to the Mandate concerning the "minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities"? Will this approach serve the objectives pursued?*

Answer: We see no need for action beyond the recommendations made by CESR. We rather feel the need for abandoning plans for a harmonisation of the standard and format at the market participants level.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
1)	**Reporting Firm Identification**	A code to identify the reporting firm. The code should be unique for the reporting firm and could be a regulatory code, an exchange code or a BIC code. Reports made by agents on behalf of an investment firm should identify the investment firm using the appropriate code.	No comments.
2)	**Trading Day**	The business day on which the transaction took place.	No comments.
3)	**Trading Time**	The time, including hours, minutes and seconds (where available) at which the trade took place. This should be the local time ~~in the jurisdiction in which the transaction took place~~ <u>of the competent authority</u>.	In the case of cross-border transactions, it would be very difficult to determine where and when the trade took place. Using the local time of the competent authority would make the reporting process much easier.
~~**4)**~~	~~**Time Identifier**~~	~~This field describes the relevant time zone of the transaction and this should be expressed as GMT +/- hours.~~	This new field is unnecessary in light of our comments on field 3. Given that this information is irrelevant in countries with only one time zone, we consider it superfluous in the context of “minimum content”.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
5)	**Buy/Sell indicator**	The field defines whether the transactions was a buy or sell ~~and should be expressed from the perspective of the reporting firm~~.	This is a complete reversal of the system practised up to now in Germany, at any rate, where the information is always reported from the perspective of the customer. This field requires it to be expressed from the perspective of the reporting firm, which would mean completely revising existing reporting practices. It would no longer be possible to report transactions on an agency basis as a buy or sell from the perspective of the agent. For cost-benefit considerations, we therefore advocate deleting the second part of the field (“and ….”) and ensuring harmonisation of the definition by means of an exchange of information between the competent authorities.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
6)	**Trading Capacity**	This field should identify whether the reporting firm was acting on an own account basis or acting as an agent on behalf of a customer/client. ~~Competent authorities may require further details of the trading capacity of the investment firm.~~	The purpose of the second paragraph is unclear to us. We therefore suggest it be deleted.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
7)	**Instrument Security Code**	A unique code applicable to the instrument in question. Applicable codes could ~~include~~ be ISIN~~numbers~~, exchange codes or other suitable product code. Firms may also need to specify which code they are using but this will be subject to national discretion All financial instruments that are subject to the transaction reporting rules should have a unique product code ~~(or a series code in the case of derivative contracts)~~. However, in the event that they do not have one then investment firms will need to report the ~~name of the instrument.~~product code of the underlying.	In the light of the envisaged European harmonisation, this field should already focus on ISIN as an international standard that has already been introduced in many EU member states. The second sentence should then contain a clause to accommodate instruments that do not (yet) have an ISIN and transitional arrangements for countries that, unlike Germany, have not yet made ISINs mandatory. The phrase in brackets in paragraph 3 referring to a "series code" for reporting derivatives is problematic, in our view. A derivatives series is identified by "put" or "call", its basis and maturity, so that there are between 47,000 and 48,000 series on Eurex alone. If these had to be reported, the continuous updating of the codes would create an enormous administrative burden. Moreover, this information is superfluous because derivatives are dealt with in detail by fields 19 to 22. We suggest amending the final sentence to reflect our proposed modifications.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
~~8)~~	~~Underlying Instrument Security Code~~	~~A unique code applicable to the security that is the reference asset in a derivative contract. Applicable codes could include ISIN numbers, exchange codes or other suitable product code.~~ ~~Firms may also need to specify which code they are using but this will be subject to national discretion.~~	Our amendments to field 7 would make this field superfluous.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
~~9)~~	~~Instrument Type~~	~~The classification of the instrument that has been traded. Competent authorities can define the granularity of the descriptions but they must include whether the instrument could be one of the following~~ • ~~Equity~~ • ~~Bond~~ • ~~Equity derivative~~ • ~~Bond derivative~~ • ~~Commodity derivative~~ • ~~Interest rate derivative~~ • ~~Index derivative~~	Article 25(3) does not provide a legal basis for this field, in our view. Since this information can already be inferred by competent authorities from other data, such as the ISIN, we advocate deleting it.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
10)	**Price**	This is the price per security or derivative contract. ~~excluding items like commission and accrued interest.~~ Subject to national discretion investment firms may also need to specify how the price is being expressed, i.e. the relevant currency or whether it is expressed as a percentage (for debt instruments).	Article 25(4) requires only the transaction price to be reported. The chosen definition is problematic because, as explained in our comments on field 5, information is always reported from the perspective of the customer and gross or net prices are expressed in accordance with the customer account settlement. We therefore suggest amending the wording as we propose.
11)	**Quantity**	The number of securities, the nominal value of bonds, or the number of derivative contracts in the transaction.	No comments.
~~**12)**~~	~~**Trade Value**~~	~~The value of the transaction, including accrued interest where applicable.~~	We consider this information superfluous in the context of minimum harmonisation.
~~**13)**~~	~~**Value Notation**~~	~~If the trade value is expressed in a different currency to the price then, subject to national discretion, investment firms may also to specify the currency in which the value is being expressed.~~	Field 13 would inevitably lead to breaches of reporting requirements since it would be impossible to report this information within the prescribed time.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
14)	**Price Multiplier**	The number of pieces of the financial instrument concerned in a trading lot, e.g. the number of derivatives ~~or securities~~ represented by one contract.	This information is superfluous for securities.
15)	**Counterparty**	This field identifies the counterparty to the transaction. It could either be the name of the counterparty or a code that identifies the counterparty. Appropriate codes would include regulatory, exchange or BIC codes where available, otherwise investment firms could use their own internal code for their counterparty.	A mandatory requirement to complete the “counterparty” field as currently envisaged would go far beyond current practice in Germany. We see as particularly problematic the fact that no standardised international codes exist for the range of possible domestic and foreign customers. In addition, the envisaged different possibilities of completing the field would make it impossible to analyse the information, in our view.
16)	**Customer/Client Identification**	This field contains the identification of the client or customer on whose behalf the reporting firm was acting. This is likely to be the reporting firm's own internal code for its client/customer. Investment firms need only report this information if it is required to do so by the national law of the competent authority to whom it is reporting.	It would make good sense to define fields 15 and 16 in the same way. Nevertheless, we believe it needs to be clarified whether this content is really necessary for a minimum standard and whether it will continue to be possible to use collective identification for certain securities transactions. It might be necessary to add wording in this regard to the field description.
17)	**Trading Venue**	An identification of the stock exchange or trading venue in which the transaction took place. Appropriate codes could include a Market Identifier Code for the exchange, a BIC code or regulatory code for the MTF or OTC/OFF for other transactions.	No comments.
18)	**Transaction Reference Number**	A unique identification number for the transaction provided by the investment firm or reporting party.	No comments.

Annex A to draft advice - Minimum content of a transaction report by or on behalf of an investment firm

	Field name	Field Description	Comments
19)	**Maturity Date**	Required for most bond and derivative transactions. It should be the maturity date of the bond or the exercise date/maturity date of the derivative contract.	No comments.
20)	**Derivative Type**	Whether the derivative is an option~~,~~ or a future~~, warrant or other~~.	Since warrants are securities they are already covered by other fields!
21)	**Put/Call**	Whether the option ~~or warrant~~ is a put or call	See field 20.
22)	**Strike Price**	The strike price of the option ~~or warrant~~ contract.	See field 20.

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Consultation Paper on High Level Principles on Outsourcing
KWG § 25 a

Dear Sir or Madam,

We welcome the opportunity to comment on your Consultation Paper concerning High Level Principles on Outsourcing which was published on 30 April 2004.

Executive Summary

- In order to ensure convergence in lieu of divergence in terms of the various supervisory standards in the field of outsourcing, we kindly ask you to consider coordination between the forthcoming principles (hereinafter HLPs) and the concurrent work in this field which is being conducted by CESR and IOSCO (cf. item 1).

- In addition to the waiver for purchase agreements, the forthcoming regulatory definition of outsourcing should equally exclude agreements that are exclusively procurement based (e.g. rental agreements, leasehold agreements, etc.) as well as measures that are not geared towards the long-term (cf. also item 2).

- Since the corresponding risk situation is more favourable in cases where areas are outsourced to EU companies that are subject to supervision, such cases should become subject to less stringent requirements (cf. also item 3). Intra-group outsourcing should not be treated as an instance of outsourcing.

- Whilst complying with the requirements of a European level playing field and in order to take account of the host of different business models and of the idiosyncrasies of submarkets, waivers for the application of these HLPs should be made possible (cf. also item 4).

- When outsourcing areas to companies that work for a large number of institutions, waivers should be envisaged concerning the renunciation of individual instruction and control rights on the part of the outsourcing institution (cf. also item 8).

First of all, we should like to point out that, already today, when it comes to outsourcing, Germany has a very high level of supervision. This is owed to the 1997 introduction of section 25 a, subsection 2 German Banking Act [KWG] and it is also due to the corresponding more detailed implementing provisions adopted by the German regulator BaFin (Bundesanstalt für Finanzdienstleistung) in 2001. We welcome the fact that the formulation of European-wide HLPs will now create a level playing field for credit institutions within in the EU thus facilitating cross-border outsourcing solutions. At the same time, however, it is of special importance that the HLPs provide national supervisors with a framework for accommodating the wide variety of differences in the business models of institutions with their very own risk profile and which also take account of the idiosyncrasies of local submarkets.

Market needs are subject to increasingly rapid changes. Together with the general business climate, this leads to a situation where banks increasingly have to capitalise on their own core strengths. This means that they may have to outsource to specialised service companies those functions which do not form part of said core competency of their own business or functions which lack the critical mass necessary for delivering these functions in-house. Hence, for the banking community, it is of crucial importance that regulatory provisions shall confine themselves to setting out the broad terms thus granting banks that degree of autonomy which is essential for the flexible responses needed by the market. As a general principle, entrepreneurial freedom should not become curtailed due to regulatory provisions on outsourcing. In order to ensure an efficient implementation and handling both on the part of supervisory authorities as well as on the part of the institutions subject to supervision, mandatory legal provisions should be strictly geared towards the real and relevant risks and they should remain limited to an appropriate level.

After the foregoing preliminaries, we would like to submit the following more specific comments on the individual regulatory proposals:

1. Consultation with CESR

First of all, we should like to point out that the Committee of European Securities Regulators (CESR) currently holds a mandate by the EU Commission concerning the drafting of recommendations for the implementation of Directive 2004/39/EC on Markets for Financial Instruments which shall also contain special provisions on the outsourcing of functions by investment firms. For the companies concerned, it is indispensable that the regulations in the general field of prudential banking supervision as well as supervision in the field of securities shall be consistent with each other. This will avoid the creation of two different legal regimes that would have to be applied in parallel. We therefore strongly recommend close consultation between CESR and CEBS in matters concerning outsourcing of areas and functions to another company.

Furthermore, also the International Organization of Securities Commissions (IOSCO) is currently working on Standards regarding outsourcing. In this respect, too, we perceive a strong need for consultation in order to prevent a subsequent drifting apart/divergence of supervisory standards or, moreover, the need for a subsequent adjustment that would, once more, shift the goalposts for institutions.

2. Definition of outsourcing

The definition of outsourcing should only cover those functions that are transferred on a permanent basis or which, at least, take place over a sustained period of time. Otherwise, even the assignment of individual tasks (e.g. the preparation of a valuation report) would have to be regarded as outsourcing. Such an approach would make the implementation of the outsourcing rules unrealistic. Its benefits would bear no relation to the necessary expenses. What is more, it would create inappropriate obstacles for the assignment of such jobs.

Furthermore, we feel that an amendment of the language is necessary. There needs to be a clarification that an instance of outsourcing as contemplated by the HLPs shall only apply to those cases where the activity etc. in question is specifically connected to the execution of a banking or investment firm transaction.

For an easier distinction between cases of material outsourcing on the one hand and non-material outsourcing on the other hand, it would be extremely helpful if, by way of example, case groups were listed or if at least more detailed guidelines for their identification were provided.

We welcome the fact that the definition of outsourcing shall not cover purchasing contracts i.e. purchase and/or service agreements used by an institution to procure standardised products. In our view, however, the scope of this derogation is not wide enough. We would welcome an additional amendment clarifying that the same exclusion from the regulatory scope of the HLPs shall apply to any further procurement agreements, such as rental and lease agreements. Furthermore, the question whether the purchase in question concerns ready-made, i.e. standardised goods or custom-made goods and services is irrelevant. The field of software development is but one example where this becomes evident. Software development does not form part of a bank's core business areas. For efficiency reasons, such functions are regularly transferred to third parties. In our view, they should thus not fall under the outsourcing definition. Besides the purchase of standard software, institutions regularly commission customized applications geared to their individual business needs. Yet, this practice does not necessarily give rise to any higher risk. The question whether a software is standardised or whether it is custom-made is not mission critical for the security of a banking operation. What is, however, mission critical for the security of a banking operation is that before being deployed in day-to-day banking operations, such software will be carefully tested by management with a view to its orderly functioning and in terms of potential security issues.

Beyond this, there should also be a clarification that the definition of outsourcing as contemplated by the HLPs neither covers temping agency staff who -for the duration of their engagement- are fully integrated into an institution's operations and logistics. Said full integration into the organisation creates a situation where there is no longer any difference between an institution's regular staff and its temporary workers.

3. Outsourcing to institutions subject to supervision/intra-group outsourcing

We feel that, from the point of view of risks, less stringent formal requirements are warranted in those cases where functions and areas are outsourced to EU companies which themselves need to hold a banking license or similar permits for these functions and areas. After all, such EU companies are thus already fully covered by supervision through competent authorities. By way of example, this applies whenever a contractual clause grants individual inspection rights and it equally applies to the commitment to stipulate a contractually binding clause to the effect that the outsourced areas shall be subject to the same standards as the outsourcing institution.

Under risk aspects, in those cases where the outsourcing company is a company that is already subject to the supervisory authority, we feel that it would be appropriate to exclude intra-group outsourcing to subordinate companies and similar constellations (e.g. joint ventures) from the scope of the definition of outsourcing. Such a kind of interpretation would be appropriate since these outsourcing cases already comply with the HLPs. The outsourcing service provider companies will be regularly bound by the senior company's instruction right. Hence, there is no danger that the senior executive management's ability to manage and monitor the business will be impaired or that the latter will lose control over the orderliness of the outsourcing institution's business being conducted or the financial services being provided. Furthermore, in any case of these outsourcing companies, the supervisory authority's right to require an inspection of the business and its ability to supervise the business is guaranteed. Due to the growing importance of intra-group outsourcing, from the point of view of risk mitigation, coverage of intra-group outsourcing under the outsourcing rules would create little value added. Quite the contrary: Such an approach would frequently burden institutions with considerable and costly administrative logistics.

4. Regulation of waivers for certain areas of activity

Certain business types require cooperation between several companies. Such cooperation tends to be based on the division of labour. In certain cases, the formal application of outsourcing HLPs would lead to a significant complication, higher prices and red tape that might potentially also disrupt dovetailed processes without generating any material benefits to compensate for such disruptions. This would be the case where -owed to the specific nature of the workflow behind the respective business transaction– an involvement of third parties is inevitable for a complete and economically viable execution of the transaction or where this is needed due to the specific, structurally essential division of labour within a banking group. We thus propose that particularly the following business types shall be specifically excluded from the HLP's scope: Function of the clearing houses for the purposes of clearing and settlement during securities transactions, use of securities trading systems by institutions, the authorisation centres for electronic cash transactions as well as the central bank function within one banking group, the involvement of lead managers, arrangers or agents for syndicated loans and similar case groups.

Furthermore, in order to take adequate account of the wide variety of institutions' business models within the EU, there should be a specific provision stipulating that national supervisory authorities may issue further waivers for those areas that are under their jurisdiction. Flexible solutions that also provide scope for derogations are the only way for an adequate reflection of the respective risk situation at hand. One approach that, at least in Germany, has proven successful is that the German regulator BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht) and the banking industry agree derogations for specific, individual cases or case groups where the risks associated with outsourcing are not relevant in terms of the prudential supervision law.

5. Setting up a central interface

Pursuant to the presentations on HLP V, the institution shall set up an internal unit that is responsible for supervising and management of each outsourcing measure. One single central unit alone will, however, generally lack the expertise necessary for an efficient simultaneous supervision and management of all service companies at once. It would thus appear judicious to construe this provision along the lines that one central unit shall keep track of the overall picture in terms of each and any outsourcing activity whilst the ongoing coordination and monitoring shall be incumbent upon the respectively competent authorities that are in possession of the necessary expertise.

6. Trouble reports

Under HLP VI, there is the requirement that all serious problems in relation to the service provider shall be brought to the attention of the supervisory authority. This would, in practice, lead to redundant, additional red tape. One approach that has proven successful in this regard in Germany is that material shortcomings shall be reported in the annual audit report of the outsourced area and thus brought to the attention of the supervisory authority. Furthermore, in Germany an auditor is held to give immediate notice to the supervisor whenever circumstances occur which may have a materially adverse impact on the development of the institution (Section 29, subsection 3 - German Banking Act [KWG]).

7. Fixing of the Service Level

Concerning HLP VIII, there is a provision stipulating the need to prepare a Service Level Agreement (SLA). In the case of outsourcing of activities which require a comprehensive service specification, such an SLA is prepared separately, in addition to the agreement. However, for other activities which require a far less specific service description, a service description under the outsourcing agreement is sufficient. In our understanding, this provision means that the preparation of a separate SLA in addition to the outsourcing agreement is not mandatory. The issue of a separate SLA will, in the final analysis, depend on the individual circumstances and on the respective jurisdiction, as long as it is secured that the service will be rendered on the basis of a written agreement.

8. Provisions on service providers providing services to several outsourcing institutions

Under HLP X, the Consultation Paper stipulates that supervisory authorities should manage and monitor concentration risks. This appears to be based on the understanding that outsourcing to service providers providing services to several authorised outsourcing institutions will be associated with a higher risk. Yet, it also needs to be taken into account that service providers providing services to several outsourcing institutions generally have a higher degree of know-how concerning the outsourced area than service providers who provide services to just one outsourcing institution. What is more, whenever a service amendment occurs (i.e. due to changed regulatory or technical provisions), the resulting changeover costs as regards the individual outsourced activity are considerably lower meaning that such an adjustment will be encumbered by far less problems. Based on the foregoing remarks, we would welcome a more detailed specification of the nomenclature, i.e. a more concrete specification of what is involved by *managing* concentration risks (cf. HLP X).

For service providers that have assumed the same service for a number of institutions, any individual instruction right as well as any granting of independent inspection rights for an internal review in each outsourcing institution may lead to highly problematic consequences. Such individual rights would have an extremely negative impact on cost efficient transfer of functions to units that are capable of handling economies of scale. Therefore, in order to rule out any unlimited or excessive individual review and instruction rights for each individual institution, a derogation should be included for service providers providing outsourcing services to several outsourcing institutions.

9. Cancellation of the outsourcing measure by supervisory authorities

Concerning HLP IX, paragraph 7 requests that the supervisory authority shall be entitled to initiate cancellation of the outsourcing agreement. In our understanding, this provision stipulates that the supervisory authority shall, however, not hold any individual right of its own allowing it to proactively cancel the outsourcing agreement. After all, the supervisory authority, first and foremost, holds considerable rights of intervention *vis-à-vis* the outsourcing institution itself. Secondly, any right of termination on the part of the supervisory authority will very likely engender considerable problems under contractual law; from the point of view of civil law it will frequently prove unfeasible.

10. Outsourcing to service providers abroad

In the event of outsourcing of areas to service providers abroad, there need to be comprehensive contractual safeguards that fully ensure inspection and monitoring rights of the supervisory authority. Concerning the issue of the exercise of supervisory competencies beyond their own territorial jurisdiction, we propose the establishment of rules for a regime concerning cooperation of national supervisory authorities. This should guarantee that the authority which has the easiest access becomes involved and it should also prevent duplication of work as far as inspections by different authorities are concerned.

11. Expansion of intervention rights

Pursuant to item 7 of the Consultation Paper's Cover Note, there are plans to lay down specific criteria which would warrant intervention. We feel that the stipulation of such intervention criteria would be redundant. Already today, the legislator has granted competent supervisors comprehensive intervention rights *vis a vis* institutions; once the European Union sees implementation of Basel II's second pillar, this intervention list will be further expanded.

12. Editorial suggestion: Bullet point notes

In order to facilitate quotes and reference to individual provisions under the HLPs, we would furthermore suggest numbering the basic HLPs; we also propose numbered bullet point notes for the individual subsections of the text.

We would very much appreciate consideration of the foregoing arguments in the forthcoming proceedings.

Yours faithfully,
For
ZENTRALER KREDITAUSSCHUSS
Deutscher Sparkassen- und Giroverband
For and on behalf

Dr Thomas Schürmann