European Association of Public Banks
– European Association of Public Banks and Funding Agencies AISBL –

Draft EAPB Position on the CESR Consultation Paper on Implementation Measures for the Directive on Markets for Financial Instruments

The European Association of Public Banks (EAPB) represents the interests of 17 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions with a combined balance sheet total of EUR 3,000 billion and over 170,000 employees. The EAPB would like to thank CESR for the opportunity to take a position on Consultation Paper CESR/04-261b.

In its Consultation Paper, CESR presents initial proposals for technical measures to implement the Directive on Markets in Financial Instruments. These implementation measures are of great importance to the entire European banking industry. Two basic concerns stand in the foreground, to which public providers of securities services attach fundamental importance.

First, of particular moment is the fact that CESR's recommendations should not go beyond the framework laid down by the Directive. Equally significant is the fact that each regulation proposed should be subjected to a critical cost-benefit-analysis. Measures that merely result in increased expense without offering the investor any better protection or raising the efficiency of the market should be dispensed with under all circumstances. Hence, this should be taken account of where the "Standards and Rules for Harmonizing Core Conduct of Business Rules for Investor Protection", already developed by CESR, are drawn on for CESR proposals on MiFID.

Furthermore, it should be borne in mind that the quality of securities services is primarily able to improve by means of functioning competition. Hence, any regulations should be oriented towards encouraging – and not eliminating – competition between securities firms of differing sizes, orientation or structure. Hand in hand with this comes a call to distance oneself from over-detailed recommendations in the Consultation Paper and to carry out an assessment between the intended goal of regulation and the flexibility that securities firms need.

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In the following, we should like to take a brief position on the most important points.

1. **Compliance, internal systems, resources and procedures (Art. 13, para. 2, para. 4, para. 5, MiFID)**

   The CESR recommendations imply far-reaching interventions in the organisational structure of securities firms. These should particularly be tested against the background of securities firms being differently set up in terms of size and structure, as CESR's advice states expressly. In order to ensure and further promote functioning mutual competition between service providers, account should be taken of the differences in all the rules, including those dealing with the compliance function.

   Here, it is especially important to draw a clear distinction between compliance as a function or task and as an organisational unit. The implementation rules should gear to the task but not to a (central) organisational unit. The tasks of the compliance function can also be undertaken differently by people in other departments. The requisite independence is then guaranteed if the corresponding individual is not integrated within the business operations he or she monitors. For smaller firms, the effort of establishing an independent compliance unit would not match the benefits – especially with respect to the extent of issues relevant for compliance dealt by smaller firms.

   The proposals for a handling of complaints (Box 1, clause 5) tend to exceed the framework given by MiFID. Art. 13 para. 2 MiFID asks to ensure the observance of legislative rules. This may justify the obligation to keep record of complaints of their proceeding. However, demanding client information on "any out-of-court complaint and redress mechanism" and the payment of compensation (clauses 5 a) ii) and iii)) does not specify MiFID-obligations but creates new ones.

   Moreover, it has to be borne in mind that adherence to the legal requirements and verification of the numerous risks are monitored by various offices within a securities firm. Therefore, the term "compliance" must be defined in a manner that is closely bound to the securities business so as to avoid duplicating existing control functions. This also applies to the proposals in connection with the "obligations related to internal systems, resources and procedures."

2. **Obligations to avoid undue operational risks in case of outsourcing (Art. 13, para. 5, MiFID)**

   Currently, there are proposals for regulating outsourcing being made by various organisations (for instance CEBS, Basel Committee on Banking Supervision, IOSCO). It is

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a matter of urgency that these initiatives should be coordinated with one another and that CESR does not recommend rules that deviate from the other ones.

3. Record-keeping obligations (Art. 13, para. 6, MiFID)

As to an issue of general meaning, there should be no separate obligation for the investment firm to be able to demonstrate that it has complied with the obligations under the Directive. Art. 13 para. 6 of the MiFID demands that record keeping should enable the supervisory authorities to examine the observance of the respective obligations. CESR's advice stands in contrast to this requirement, as it intends to oblige investment firms to prove that their actions are legal. Ultimately, this would lead to the obligation for firms to produce proof of their own innocence which would be an inadmissible shift of the burden of proof.

The obligation provided for in the context of record-keeping duties, to document the issuance of orders on a voice recording system, in any event goes beyond the regulatory framework of the MiFID. A rule of this kind would entail great expense for a multitude of banking institutions and could have a negative impact on relations with clients. Data protection aspects also constitute an objection to such recording measures.

We are at present unaware of problems with the issuance of orders by telephone that could be resolved by means of telephone recordings. There are therefore no grounds for voice recordings. The required expenditure that the recording of telephone conversations would entail is therefore disproportionate to the – currently unclear – usefulness of such a rule. For this reason, we ask that this proposal be abandoned.

4. Conflicts of interests (Art. 13, para. 3, MiFID)

The proposals regarding settlement of conflicts of interests encompass measures for "inducements" that far exceed the regulatory framework of the MiFID. A prohibition against "inducements", as appears to be dealt with under section 9, is not permissible according to the Directive. First, the MiFID provides that conflicts of interests should be identified, then dealt with and finally disclosed. Moreover, CESR's proposals provide that the client should be informed of the details of "inducements". This is in contradiction with Art. 18, para. 2, of the Directive, which requires information to be given about the "general nature and/or sources of conflicts of interests."

Similarly, with regard to investment research, CESR's recommendations (which go into too great a detail also) go beyond the European regulatory framework. In this respect,

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the Market Abuse Directive already offers comprehensive rules on the disclosure of possible conflicts of interests.

5. Information to clients (Art. 19, para. 3, MiFID)

Art. 19, para. 3, MiFID states that securities firms should provide clients with a series of pre-contractual information. At the same time, the provision allows that this information may be given in standardised form. The wording in box 8, nos. 7 and 9, appears to contradict this. Thus, for instance, no. 7, letter (b) encourages information about "relevant financial instruments" and information on whether the "instrument" is illiquid. Such statements cannot be made in standardised form. In accordance with the provisions of the Directive, here only information regarding the "relevant type of financial instrument" should be provided for.

Furthermore, there should not be a requirement that all information has to be presented to the client in writing (cf. no. 1). It makes more sense if, alongside written information about "the type of financial instruments", verbal explanations should be given regarding further details with respect to specific individual cases. This is particularly relevant for the very common case of orders placed by telephone.

At this point, it might also be noted that the requirements of "fair, clear and not misleading information" according to Art. 19, para. 2, MiFID go far beyond the framework of the Directive. The CESR recommendations contain not only criteria for assessing information, as required in the Commission's mandate, but also a multitude of specific content-stipulations. Moreover, the relationship to the pre-contractual duties of information under Art. 19, para. 3, MiFID is blurred as a result of the recommendations.

As regards voice telephone communications, the requirements suggested in CESR's advice do not seem practicable. If a retail client has been provided with the information demanded at the outset of a (potential) business relationship, a need for repetition on the occasion of each telephone communication is not obvious. Additionally, these requirements would create inconsistencies to existing legislation, as they go far beyond the obligations of the Distance Selling Directive. Lastly, obligations such as these would, again, burden the phone order business.

6. Client agreement (Art. 19, para. 7, MiFID)

CESR's proposals contain a large number of stipulations as to detail and information. This partly contradicts Art. 19, para. 7, of the Directive, which also permits references to

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other documents or legal texts. Neither the Directive nor the Commission's mandate ask for provisions ruling the form and the content of contracts.

Furthermore, as a result of the technical transposition provisions of the MiFID, regulations would merely entail increased costs and could even lead to uncertainty if it requires a number of contractual clauses that are already applicable to the contractual relationship within the framework of the general legal provisions. Moreover, proposing individual contract clauses interferes deeply with the not yet harmonised civil law of the member states and departs from the MiFID's framework.

Finally, the question arises as to what should happen in respect of millions of contractual relationships that already exist throughout Europe. Recasting all contractual relations would cause lasting impairment to the European market in terms of its world competitiveness.

7. Reporting to clients (Art. 19 para. 8, MiFID)

When it comes to reporting requirements, unnecessary additional expenses could be avoided by ensuring that there be no obligation to provide information to clients that they have at their disposal already. Moreover, there should be no reporting requirements relating to the provision of investment advice. Investment advice applies to the situation at the present time of a consultation, and it must be up to the client to follow the developments after the consultation has ended.

8. Transaction Reporting (Art. 25 para. 3, MiFID)

The EAPB fully supports CESR's ambition to maintain existing reporting systems to the greatest extent possible. Reporting systems should not be unduly fraught with new and unnecessary requirements that would bring about considerable conversion costs.

Against this backdrop, the fields and information given in Annex A should be understood as conveying the required content of a reporting format and not to represent a binding format pattern. This means that there should be the possibility to provide the information demanded in one field of Annex A in combining several fields of already existing reporting systems.

Art. 25 para. 3 MiFID calls for an exchange of reported data amongst the competent national supervisory authorities. In this context, we would like to stress that market participants cannot and must not be charged with the task of rendering the reports they

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have to submit in a way that guarantees the smooth exchange of data amongst the supervisors. This is the authorities' responsibility.

We must object to the request to include financial instruments into a reporting system that are not listed in a regulated market, as this is not subject of the Directive. Financial instruments that are not listed in a regulated market are not of sufficient relevance for a follow up of insider dealings or market manipulations which could justify the resulting costs. Furthermore, it needs to be made clear that options and subscription rights must not be regarded as a "transaction" in the sense of Art. 25 MiFID. In this context, the fact that the "transaction" itself is only carried out with the execution of the stipulated right in question needs to be taken into consideration.

Market participants need sufficiently dimensioned transition periods to implement Art. 25 MiFID. The extent of this time span will depend on level 3 and cannot be measured at the moment. The time limit for the implementation of the Directive will in no way suffice.

Against the background of the most important examples that are summed up here, we should like to ask CESR again to verify the usefulness and complexity of the individual regulations, including under the aspect of enabling further competition of the institutions amongst one another. We shall accompany the consultation procedures' further progress with great interest.

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