# BRITISH BANKERS' ASSOCIATION

**BBA RESPONSE TO CESR ISD MANDATE CALL FOR EVIDENCE**

The British Bankers' Association represents more than 260 banks carrying on business in the United Kingdom. The majority of these banks come from outside the United Kingdom. Many are banks from other EU jurisdictions attracted to London as an international financial centre. We welcome the opportunity to respond to CESR's call for evidence with regard to the Commission's Provisional Mandate relating to the Investment Services Directive. Our response is as follows:

Overall the Mandate is very long and detailed. If comprehensive and detailed work on the Mandate is attempted there is considerable likelihood that there will not be pan-European comfort with the CESR output. The experience of working on the Mandates for the Market Abuse Directive was that it became obvious through working on the first mandate that it was necessary to avoid too much detail and too much prescription.

In view of this we would urge CESR to avoid setting out too much detail e.g. regarding organizational requirements relating to the compliance function, operational risk etc. We consider that this is particularly important as the Commission has clearly flagged its interest in making more use of Regulations at Level 2. We support the approach set out in page 7 of the Mandate: "The advice should ensure clarity and legal certainty but avoid formulations which would lead to over prescriptive excessively detailed legislation…"

Given the detail of the Mandate it would be possible to set out many points in relation to it. We pick out 4 in particular:

- Organisational requirements (Art 13)
- Conflicts of Interest (Art 18)
- Information and Advice to clients (Art 19 (3) to (6))
- Best execution (Art 21)

*Organisational Requirements*

The mandate asks for technical advice on minimum basic elements which should apply to a wide range of the functions of investment firms including in particular:

1. Compliance policies and compliance arrangements generally.

2. Administrative, accounting, risk, information processing and control procedures.

3. Operational functions and their outsourcing.

4. Record-keeping requirements and arrangements.

5. Protection of clients' funds and financial instruments.

In our experience investment firms are organized in widely different ways in different member states and within member states. The right balance has to be struck between improving the quality of internal arrangements and permitting a diversity of ways in which this can be achieved. Page 7 of the Mandate acknowledges there is a need to avoid excessive intervention in respect of the management and organization of the investment firms, but the section of the Mandate dealing with Art. 13 does not appear to be consistent with this important principle.

A simple example is the fact that smaller institutions often cannot have a Compliance Officer who only works on compliance. Often this person will be a senior officer of the firm working on other business also. It would be inappropriate to mandate that all firms should have a Compliance Officer who only worked on compliance. It is sufficient to say that a firm should have a Compliance Officer.

Another example might be that CESR could say that firms must have regard to potential operational risk and put in place policies, procedures and controls to limit the risk of operational failures when outsourcing key operational functions. Art 13(5) already goes a long way towards setting out the appropriate high level requirements for outsourcing. It is inappropriate to spell out in great detail which functions are, and which are not, key because this can vary substantially depending upon the nature of the organization.

In our view the focus of the work on organizational requirements should be kept high level in this way and should not contain very much detail about how arrangements should be made (although on the face of the mandate it sometimes appears as though the Commission is seeking more detail).

*Conflicts of Interest*

BBA have extensive experience of dealing with the issues raised in this area having worked on:

- The Market Abuse Directive and the first Mandate given to CESR in relation to disclosures on conflicts by issuers and firms and their analysts.

- The Forum Group report on Research Analysts and conflicts of interests

- FSA consultations on conflicts of interest.

We consider that Art 18 of the ISD contains adequate detail and that there was no need for comitology in relation to it. Consequently we would very much welcome CESR taking the view that no further detail is needed in this area.

However, when looking at the steps which a firm should take to manage conflicts we would ask CESR to adopt the following approach:

- Identify whether a conflict exists.
- If one is identified see whether it is already managed (e.g. by an information barrier) or can be managed.
- If it cannot be managed consider asking whether the customers involved, in knowledge of the conflict, will, nonetheless, agree to the firm continuing to act and seek that consent, or;
- If the customer will not consent or no request is made, and there is no other means of continuing to act, cease to act on the particular transaction.

We consider that this approach is implicit in Art 18 but that if CESR is going to have to provide technical advice it should set out this approach explicitly.

*Article 19 (Conduct of Business with Clients)*

BBA also have extensive experience of dealing with the issues raised in this area having worked on:

- The CESR Investor Protection Standards which contain provisions in relation to this.
- The Investment Services Directive at Level 1.
- FSA domestic consultations on conduct of business.

BBA work at Level 1 of the ISD has focused heavily on what is now Art. 19(6) – the provision permitting the continuance of execution only business. The only aspect of Art. 19(6) to which the mandate relates is the question of which "financial instruments" can be dealt on an execution only basis. Our preference is for the most generous definition of which instruments can be dealt with on an execution only basis. In particular we would be against the idea of CESR creating a specific list of instruments which it considers to be capable of being sold execution only. In our experience when such lists are created they become out of date quickly, and can prove very restrictive and limit the scope for innovation.

On Arts 19(4) and (5) we would consider that it is important to differentiate between these two provisions. From a UK perspective Art 19 (4) applies where a customer is receiving advice as we traditionally understand it. Art 19(5), by way of contrast, would, in our view, apply to assisted – but not fully advised - sales. These "assisted" sales are

not subject to full advice obligations and instead are likely to involve the customer making its own decision on the financial instrument or product but with the assistance of "decision trees" and other documentation. In view of this the criteria for Art 19(5) should be of a much lower order/less onerous than the criteria for Art 19(6).

*Best Execution*

BBA also have extensive experience of dealing with the issues raised in this area having worked on:

- The CESR Investor Protection Standards which contain provisions in relation to this.
- Investment Services Directive Level 1.
- FSA's Consultations on best execution.

We consider that Art 21 of the ISD contains adequate detail and that there was no need for comitology in relation to it. Consequently we would very much welcome CESR taking the view that no further detail is needed in this area.

However, insofar as CESR concludes that it must submit technical advice on the issues raised by the Commission we would ask CESR to ensure that the criteria to be taken into account by firms when executing clients' orders are broad and flexible. We would also ask CESR to highlight areas where best execution simply means following the customer's instructions to the letter and not deviating from them. For example if the customer asks the firm to sell at a particular price and the firm does so the fact that a better price could have been obtained does not mean that the firm has breached its best execution obligation.

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