Banca Intesa

International and European Affairs

BANCA INTESA'S RESPONSE TO

CESR'S SECOND CONSULTATION

ON ITS DRAFT ADVICE TO THE EUROPEAN COMMISSION

FOR IMPLEMENTING LEGISLATION UNDER DIRECTIVE 39/2004

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A. INTRODUCTION

Banca Intesa is the holding company of the Intesa Group, which is the largest Italian banking group and one of the main players at European level. The Intesa Group is also active in new Member States like Hungary, where Central-European International Bank-CIB is the fourth largest bank, and Slovakia, where Všeobecná úverová Banka-VUB is the second largest bank.

Banca Intesa is grateful to CESR for the second consultation it has published on the revised version of its draft advice concerning possible technical implementing measures (hereinafter the "Level 2 Measures") of the Directive on Markets in Financial Instruments (CE 39/2004, hereinafter the "DMFI"), which it is rendering to the European Commission in accordance with the mandate granted to it on 25 June 2004.

This response addresses the questions raised in the version of the Level 2 Measures of November 2004. Banca Intesa's position on the FIMD and its implementing measures is set forth in the 17 September 2004 response to CESR. Our comments below are based on our previous position, which is here fully confirmed in further details.

B. ANSWERS AND COMMENTS TO CESR'S SECOND CONSULTATION

1. General questions from the first consultation

A. Split between Level 2 / Level 3, the degree and the calibration of rules

Banca Intesa suggests that the main criteria that CESR should follow in order to solve the trade-off it faces between an excessive level of detail of Level 2 Measures and the necessity to avoid national super-domestic rules, is the **overall goal of the Financial Services Action Plan**-FSAP[1] **and** its main measure, **the FIMD**. Such goal consists in the effective establishment of a single financial market in the European Union.

It is within the scope of the FSAP and the Lamfalussy approach to facilitate the harmonisation of rules at EU level. In the first case, new areas are now covered by EU legislation[2] in order to set a common legislative framework which is the precondition for the principle of mutual recognition to work effectively. In the latter case the express provision of the introduction of technical implementing measures at European level implies that Community legislation is meant to be detailed, at least to some extent, and not only to set general framework principles. Further evidence of this argument are the level 3 and level 4 measures provided for by the Lamfalussy procedure, which can work only on the basis of a comprehensive legislation introduced at European

[1] Communication COM (1999) 232 of the European Commission

[2] E.g. the Directive on Financial Collateral Arrangements (2002/47/EC) and the so called Market Abuse Directive (2003/6/EC)

level. In fact, given that supervisors are inherently technical bodies in charge of the implementation, interpretation and enforcement of the relevant legislation, it is hard to imagine an enhanced cooperation between EU supervisors for the "consistent and equivalent transposition" of European directives and regulations, unless these are already detailed enough. Any sensible convergence of interpretation and enforcement is indeed possible only if all supervisors operate on the same legislative text. Enhanced harmonisation is hence at the basis both of the FSAP and of the Lamfalussy procedure.

We believe that technical implementing measures should reinforce and foster primary legislation, rather than water it down. Accordingly, Level 2 Measures should be detailed enough to allow for the **consistent implementation and transposition** of the primary legislation comprised in the FIMD throughout all Member States. By so doing, the European Commission would reach the following two goals:

(i) reinforce the **effective establishment of a single financial market** and

(ii) enhance the **harmonisation process**, which is the aim of the FSAP and the Lamfalussy procedure.

Should CESR and the European Commission choose to adopt a ***de minimis* approach**, thus refraining from imposing a comprehensive European legislation and allowing a high degree of national discretion in the transposition of the EU directives, this could be **contrary to the case law of the European Court of Justice**, which could intervene on a case by case basis, in order to make sure that the express goals set forth by the FIMD are reached.[3]

We are here referring to the case law on the **doctrine of "*effet utile*"** (the principle of effectiveness), according to which Community law has to be implemented in the most effective way. In the recent opinion of advocate general Geelhoed in the case C-304/02, Commission of the European Communities v French Republic it is clearly said that: "In a general sense the Community legal order, although it is autonomous, is a dependent legal order to the extent that, in most fields, it depends on the efforts of the Member States to ensure full compliance with the obligations it imposes on economic operators. Member States are under a general obligation under Article 10 EC to take all measures necessary to ensure that Community law is applied and enforced effectively and that its 'effet utile' is achieved. More particularly, Member States must ensure that an adequate regulatory framework is in place for the application and enforcement of Community measures, that competent authorities have been appointed, that sufficient resources are made available

[3] The main goal of the FIMD is set forth under Recital 2, it being "it is necessary to provide for the degree of harmonisation needed to offer investors a high level of protection and to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision".

and that appropriate action is taken against offenders. Where enforcement effort in the Member States is inadequate, it will be impossible to attain the objectives of the relevant Community provisions in a more or less uniform fashion throughout the Community".[4]

The application of the *effect utile* doctrine by the ECJ on a case by case basis would introduce a material element of **unpredictability** would be introduced in the legal framework of the market in financial instruments, hence impairing a crucial advantage of the rule-making process such as the certainty of investment firms that they can rely on a given legal order.

On the same line, in the recent case **Caixa – Bank France against Ministère de l'Economie, des Finances et de l'Industrie**[5], the ECJ ruled that a French provision on interest on sight-accounts did not apply to a subsidiary of a Spanish bank incorporated under French law, because the rule constituted "a serious obstacle to the pursuit of their activities via a subsidiary in the latter Member State [i.e. France], affecting their access to the market", hence depriving the subsidiary of the possibility to compete more effectively. It is to note that this decision was taken on the basis of articles 43 and 48 of the EC Treaty, dealing with the freedom of establishment, being the case at issue out of the scope of any given directive or regulation.

The above decision restates and emphasises the predominance of the interests protected by Community law over national laws, **even** in cases of conflicts between a general Community law provision and a very specific domestic one. That is the reason why we believe that it is highly possible that the national rules transposing the FIMD will not be applied even to subsidiaries incorporated in that Member State on the ground of articles 43 and 48 EC Treaty. This implies that each Member State faces the alternative either to put - at least potentially - its investment firms at a competitive disadvantage; or to abandon any tailoring of the FIMD to its market.

As far as Level 2 Measures are concerned we summarise our conclusions as follows:

1. *Systematic approach*: Level 2 Measures need to be considered in the context of the FIMD and of the FSAP, so that the whole legislation is consistent and coherent, not only formally but also substantially;
2. *Ratio legis:* the *ratio legis* of the FIMD and the FSAP should be the driver for Level 2 Measures. The aim is, in fact, to ensure the effective

[4]Opinion of advocate general Geelhoed, delivered on 29 April 2004, in the Case C-304/02, Commission of the European Communities v French Republic, paragraph 29. The same principle has also been at the basis of a number of decisions: e.g. ECJ C-314/01 of 18 March 2004, Siemens AG Österreich, ARGE Telekom & Partner and Hauptverband der österreichischen Sozialversicherungsträger, joined party: Bietergemeinschaft EDS/ORGA.

[5] ECJ C-442/02 of 5 October 2004

establishment of a single financial market in the European Union. Whereas Level 2 Measures of minimum harmonisation would not ensure a consistent fulfilment of this goal, a Community legislative body of maximum harmonisation would surely reach this goal;

3. *Harmonisation vs. subsidiarity and proportionality*: the ECJ is of the consolidated view that the principles of subsidiarity and proportionality can be pursued inasmuch as they do not jeopardise the aim of a Community provision in place. While subsidiarity and proportionality play an important role in the law making process, on the other hand, these cannot be a way to water down or even jeopardise the scope and the aim of the law as established by a directive. This is the outcome of the doctrine of *effet utile* and of the recent important decision of Caixa – Bank France, based on a consolidated case law;
4. *Predictability and certainty of the law*: in a situation where the FIMD and its techical measures were to be implemented and transposed in such a way to jeopardise the purpose of the FIMD and the FSAP, the ECJ may well intervene on a case by case basis to ensure the achievement of the main goals of EC law. This element of uncertainty of the law can be avoided by introducing Level 2 Measures which fulfil the general goals of FIMD and are applied consistently in all Member States, i.e. Level 2 Measures of maximum harmonisation.

QUESTIONS AT PAGE 5

Banca Intesa believes that Level 2 Measures should **apply uniformly** to all competitors in the EU, not only to create a true level playing field and enhance fair competition but also to achieve the general goals set forth by the FSAP and the FIMD and to establish a certain and predictable legal order in this field. For this reason we believe that CESR should solve its trade off **in favour of maximum harmonisation**, thus establishing comprehensive Level 2 Measures and at the same time limiting to the maximum extent the discretion of Member States in the transposition of the FIMD.

In our view, having detailed Level 2 Measures is a regulatory asset rather than a problem. We welcome the idea of a **European rule book** – whenever it is possible – which provides for a common regulatory platform for all investment firms. Furthermore, thanks to the Lamfalussy procedure, such rule book can be updated and amended by way of an easy and timely procedure, so that flexibility is not an issue any more.

B. Lack of responses from consumers and retail investors

Banca Intesa agrees with CESR on the opinion that **all stakeholders** should be taken into account in the drafting of Level 2 Measures. However we notice that the **fragmentation of the consumers' views and positions** makes it difficult to represent them properly. In fact, differences of sophistication, protection

needs and practices in the retail investors sector vary greatly among the various Member States.

Since **commercial banks** have to deal mostly with consumers and retail investors, by definition they need to take into account the specific features and needs of this segment of investors. Therefore the response of commercial or universal banks, such as Banca Intesa, are significant also from the prospective of market participants.

QUESTIONS AT PAGE 5
In order to overcome the practical difficulty to represent the interests of all consumers and retail investors across the European Union, CESR should weight in the first place the responses of commercial banks. Since retail clients are the main customers of commercial banks, the view of retail clients are taken in primary concern in our answers to the CESR consultations.

C. Transitional issues

Banca Intesa joins the recommendation of the financial services industry for a deferral of the full application and transposition of FIMD and of its related Level 2 Measures, in order to be able to adapt its internal procedures and upgrade and test its IT systems.

2. Independence of compliance

Banca Intesa agrees with CESR's opinion that the "principle of compliance is key to ensure effective performance of its role". We believe, as we already brought forward in our previous response on this issue, that what matters in this respect is the status of "investment firm" and the confidence attached to it by investors, rather than its dimension or scale.

Since the independence of compliance lies at the core of investor protection, we believe that it should be treated as an absolute concept, hence refraining from introducing any carve-out.

QUESTION AT PAGE 6
Banca Intesa would like CESR to provide for a compulsory outsourcing of compliance in the case of very small investment firms, as an alternative to in-house independent compliance.

3. Record keeping and the burden of proof

Banca Intesa welcomes the clarification of CESR on the fact that its Level 2 Measures on art. 13.6 FIMD do "not intend to reverse the burden of proof". The

reversal of the burden of proof would be disproportionate where compared with the necessity to that competent authority "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".

QUESTION AT PAGE 7
Banca Intesa suggests that CESR should be as in line with the textual provision of article 13.6 DMFI as possible, given that - provided that it is read in conjunction with all the DMFI provisions on the relationship between investment firms and supervisors – this article 13.6 already provides a satisfactory degree of disclosure and transparency of investment firms *vis-à-vis* supervisors. We believe that the *ratio* of this provision lies in the necessity of investment firms to keep records in order to enable supervisors to monitor their compliance. Therefore we invite CESR to refrain from imposing on investment firms a positive obligation to demonstrate that they have not acted in breach.

4. Tape recording requirement

As a matter of fact the whole Level 2 Measures on tape recording requirements will not require major implementation changes by Italian investment firms, given that the legislation currently in force in Italy already sets forth for very similar obligations. Article 69 of Consob Regulation No. 11522/98 already provides for that:

1. As a general rule all records made in accordance with Regulation No. 11522/98 have to be kept for at least 8 years;
2. A specific provision refers to certificates and magnetic recordings of orders and of telephone authorisations, which have to be kept for at least 2 years; and
3. Any contracts, correspondence or document under Regulation No. 11522/98 has to be kept for at least 5 years following the termination of the relationship with the client.

QUESTION AT PAGE 7
For the above mentioned reasons Banca Intesa believes that the Level 2 Measure in question will not have a major impact on its internal organizational requirements.

5. Outsourcing of investment services

Banca Intesa believes that investment firms should not be allowed to become "letter boxes". Therefore, outsourcing of investment services should be limited

in its scope to individual portfolio management. Such outsourcing should be regulated consistently with the provisions of the Ucits Directive 2001/107.

QUESTION AT PAGE 8
Banca Intesa supports CESR proposed approach and further believes that the outsourcing firm's liability should not only be limited to the "culpa in eligendo", but should encompass also the "culpa in vigilando", thus imposing on investment firms also an ongoing monitoring obligation on the outsourced service provider.

6. Methods and arrangements for reporting financial transactions

Banca Intesa acknowledges that CESR's approach with regard to reporting financial transactions should strike a balance between the goal to foster the creation of an efficient single market, where there is convergence of reporting channels and practices, and the necessity to avoid imposing excessive additional costs on investment firms, MTFs and regulated markets. In particular we believe that CESR should conduct a careful analysis of the marginal costs and benefits of any new reporting requirement it introduces, also taking into account that existing reporting channels have not shown major flaws or deficits or problems whatsoever.

In light of this reasoning, we support CESR's general approach to impose on reporting channels a set of general minimum conditions only.

BOXES AT PAGE 13
Level 2 Banca Intesa agrees with CESR's Level 2 advice on the methods and arrangements for reporting financial transactions save for the exception from the requirement of the electronic form provided for under 1) a). Given that financial reporting is aimed at monitoring markets and investment firms on a EU basis, the introduction of exceptions to the electronic format reporting would impair the ability of the competent authorities to exchange information, thus vanishing most of the utility of the transaction reporting.
Level 3 Banca Intesa shares CESR's proposal to recommend a service level agreement (SLA) between investment firms and reporting channels, as this is a tested and effective instrument to regulate the terms and conditions of the relationship in question. We appreciate that CESR aims at facilitating cross border operations by recommending the "same approach" in the approval and monitoring of reporting channels. Indeed this is the most viable option to reach the above goal.

7. Criteria for assessing liquidity in order to determine the most relevant market in terms of liquidity for financial instruments

Banca Intesa welcomes the use of proxies to determine the most relevant market in terms of liquidity as suggested by CESR. In particular it favours the explicit introduction of the proxy system for the most "standardised" products, such as shares and bonds issued by an EU entity, coupled with the computation of "volume" and/or "turnover" for the rest of the financial instruments.

Banca Intesa does not support CESR's recommendation not to publicly identify the most relevant market in terms of liquidity for a specific financial instrument and its competent authority (paragraph 21 at page 16), since transparency of transactions should be the prevailing driver also as far as transaction reporting is concerned.

BOXES AT PAGES 17-19
Level 2 N. 5) Even though the concept of domicile is quite spread across European civil law, we would suggest CESR to provide a definition of "Domicile" either in this section of Level 2 Measures or in the Definitions at the beginning of Level 2 Measures. Such a definition should make clear that the domicile has to be determined on the basis of the factual centre of business of a company, the place of the registered office not being relevant. N. 9) We agree that the most liquid market should be determined taking into account not only the regulated markets but also other trading venues, such as MTFs and internalisers.
Level 3 N. 2) We suggest that the CESR website could be used for the purpose of centralising the list of the competent authorities of the most relevant market for each financial instrument.

Banca Intesa is in agreements with CESR with its Level 2 Measures and its proposed level 3 measures on cooperation and exchange of information related to transaction reporting, pursuant to article 58 DMFI. As a matter of fact the idea to convey all reporting to a sole authority, who in turn is in charge to transmit the information received to the most relevant authority in terms of liquidity, is highly valuable in that it couples efficiency with simplicity and low cost impact.

Along these lines we notice that any exchange of information between authorities should take place electronically, to the benefit of speediness and effortlessness.

8. The minimum content and the common standard or format of the reports to facilitate its exchange between competent authorities

Banca Intesa agrees with the CESR's proposal to introduce – for the time being – only a set of minimum information to be communicated by investment firms. In our view it is indeed not possible to harmonise the common standard of the reports across all the European Union.

We welcome that CESR has opted for a national discretion on the issue of the "client/customer identification" field.

BOX AT PAGES 24 – 25
We suggest CESR to specify that the systems referred to under N. 1) are IT systems and that transactions should be transmitted in an electronic format.

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