14 December 2009

SPANISH BANKING ASSOCIATION RESPONSE TO "CERS´S CONSULTATION ON UNDERSTANDIG THE DEFINITION OF ADVICE UNDER MIFID" (the "CP")

Executive summary

- The Spanish Banking Association acknowledges CESR´s efforts to clarify the definition of investment advice and the opportunity to transmit our remarks.

- On the understanding of MiFID, the legal tools available since its enactment must play a fundamental role, rather than bringing into existence new rules of interpretation, applicable retroactively, over two years later.

- MiFID defines "investment advice" in a similar way to "portfolio management", in terms of investor protection and suitability requirements. With this in mind, our interpretation is that the defining factor for both (investment advice and portfolio management) is that the service provided to each client be tailor made, taking into consideration each client's in-depth profile and specific goals.

- We believe that, just like any other investment service, it would not be reasonable to presume as a matter of course the existence of investment advice. Indeed, for any investment service to exist, including investment advice, both parties must expressly agree that their relationship will consist on the provision of this service. The existence or not of an investment service should not depend on the perception of one of the parties only, but on what both of them have agreed upon. Understandable disclaimers should be useful to make clear to both parties the nature of the service provided.

- All the elements of investment advice must be present to conclude that there is investment advice: There must be a recommendation to take (or refrain from taking) a certain course of given action in relation to a given financial instrument, that is <u>both</u>: (i) based on the client's personal circumstances; <u>and</u> (ii) presented as suitable for the client. The presence of one of these elements alone should not amount to investment advice when giving a recommendation.

- For this purpose, the entity should have all the information about client's circumstances required in article 35 Directive 73/2006/EC. If that is not the case, advice may not be given pursuant to article 35.5 (as the objective requisites for it are not present) so, logically, in the same circumstances there could be no presumption of investment advice either.

- The fact that the advice should take into account all the information needed about the personal circumstances of the client, must concur case by case and it cannot be presumed by the fact that a complex organization (like credit entities or certain Investment firms) have previous information about the client.

- General recommendations, as opposed to personal recommendations, do not amount to investment advice and, therefore, marketing activities (comercialización in Spanish terminology) should be clearly apart from the scope of investment advice activities.

- Because of the lack of focus on the personal circumstances of each client, it would be hard to justify that recommendations issued through en masse distribution channels, or to the public in general may be classed as "personal recommendations".

- Expanding the concept of investment advice to other activities will have adverse consequences for investors: (i) reduce the expected quality of the service as it was defined in MiFID, (ii) less freedom of choice, (iii) fewer investment opportunities, (iv) higher costs of service and (v) disincentivizing the client´s financial education.

- The CP presents an apparently objective instrument, the "five key test" but, as one reads the document, it becomes obvious that it is the subjective elements which are the key elements to determining what is and what is not investment advice and, as a result, most of the activities carried out by entities might be considered investment advice.

- The timing of the CP is such that, if its provisions are adopted, it would open the floodgates of legal uncertainty, confusion and claims in those countries and for those entities that have, over the past two years, construed the concept of investment advice earlier than, and in a way very much different from, the one stipulated in the CESR's CP. If CESR disagrees with the current scope of MiFID as applied by most of the countries and entities all around the EU, the Spanish Banking Association believes that CESR should propose an amendment to said Directive.

- Finally, the Spanish Banking Association will very much appreciate if CESR made the proposal to the competent authority that the responsibility of the entities be clearly outlined and covered matters relating to the suitability test, and advising on products suitable to the client in view of its circumstances at the time the advice is given. However, if these matters have been complied with, the entities must not be made responsible for the result of the investment.

SPANISH BANKING ASSOCIATION RESPONSE TO "CERS´S CONSULTATION ON UNDERSTANDIG THE DEFINITION OF ADVICE UNDER MIFID" (the "CP")

The Spanish Banking Association acknowledges CESR´s efforts to clarify the definition of advice and the opportunity to transmit our remarks, as it is a core concept for the financial markets participants.

1.- GENERAL REMARKS

The Spanish Banking Association agrees with CESR´s view, about the importance of qualifying a service given by an investment firm or credit entity as investment advice due to the important legal effects of this qualification, in particular, to better protect clients and to provide greater legal clarity for the entities.

This clarification should start from some considerations in the norm, mainly, Directives 39/2004/EC and 73/2006/EC, that do not need an interpretative exercise.

The first clarification should be that not every activity or service performed by the entities is considered investment advice. There are other activities subject to compliance with rules of conduct under MiFID. In this context, special importance should be given to the marketing or "comercialización" as it is known in Spain, of financial products and services. On the other hand, we do not deny the existence of investment advice where the requirements for it under MiFID, as well as other relevant rules, apply.

With regard to such requirements, we underline the importance of article 52 of Directive 73/2006/EC, pursuant to which a "recommendation to be considered as investment advice should be a recommendation that is made to a person in his capacity as an investor or potential investor, must be presented as suitable or based on a consideration of circumstances of that person and must refer to a concrete operation on a financial instrument".

It is also important to remember that the Commission explained in the document titled "Your questions on MiFID" that "in order to consider a recommendation as investment advice it is to be presented expressly as suitable for that person and tailored to that person".

In this sense article 35 of Directive 2006/73/EC demands that every personal recommendation must be done with the client information about his personal circumstances, with the detail explained in the mentioned article.

The general assessment of the CP is that, in spite of the effort made in order to clarify the investment advice concept, still persists a great uncertainty about where investment advice really takes place. In fact, despite the use of an instrument apparently objective like the "five key test", the description of what constitutes investment advice, suggests an assessment on a case by case basis, placing great importance on the client's own subjective perception about the nature of the service received. That is clearly showed in paras. 5 and 47, where more importance is placed on the client's perception (which is impossible to measure objectively), than a reliable statement between the parties. This leads to a considerable degree of legal uncertainty.

2. PRELIMINARY CONSIDERATIONS

Before embarking on an assessment of the contents of this CP, we feel that it is necessary to first make some specific points:

2.1. Interpretative Background

We believe that MiFID, the Markets in Financial Instruments Directive, presents a number of unclear legal requirements that would benefit from clarification. Such requirements, in their current form, have hitherto created significant uncertainty among the parties expected to put them into practice: financial institutions and investment firms.

To a great degree, the various follow-up documents issued as clarificatory guidelines relating to the application of the Directive bear witness to the lack of clarity referred to above. One such document is the CP commented on here.[1]

As a preliminary of our reading of the CP, we should like to make the following remarks:

The content of the CP seems inconsistent with what ought to be the norm in a Level 3 step of the Lamfalussy Process for MiFID. It is not a document aimed at the convergence of supervisory practices through the work of the relevant committee -- in this case, the Committee of European Securities Regulators. Rather, the CP sets out to interpret a specific concept in MiFID; what is more, the interpretation it comes up with is both wide in scope, and, as argued in this paper, highly debatable.

Recital (12) of Directive 2006/73/EC clearly prescribes that the body competent to interpret MiFID is the Commission. The role of other bodies is circumscribed to the giving of mere guidance intended to ensure that MiFID is applied consistently:

> "To ensure a uniform application of [the Directive], the Commission may issue guidance by way of interpretative communications or other means. Furthermore, the Committee of European Securities Regulators may issue guidance in order to secure convergent application of this Directive and Directive 2004/39/EC by competent authorities."

Interpretative precedents

Financial institutions have had to make a very considerable effort to adapt to their procedures, systems and practices to MiFID. First, as a direct consequence of the many new duties imposed on them by the Directive; secondly, owing to Spain's long delay in implementing the Directive in national law -- this created a legal vacuum and meant that the timeframe for adaptation was far from adequate. For the purposes of adapting to the new rules, financial institutions have had little more to go on than their own ability to construe an enactment which, as the Commission itself has impliedly acknowledged, is riddled with vague terms. One of the most controversial points continues to be how to draw the boundaries around the concept of "investment advice". Financial institutions have had to make their own reading of this concept almost entirely unaided, with no support from regulatory bodies, and no clear guidelines, pointers or interpretations, despite the fact that the interpretative difficulties and doubts in issue have been raised time and again.

Over the two years that MiFID has been in force, the industry's interpretation of the concept of "investment advice" has rested solely on the following documents, listed in chronological order:

(i) Directive 2004/39/EC, specifically Articles 4.1(4) and 19.4.

[1] See http://www.cesr-eu.org/index.php?page=contenu_groups&id=53&docmore=1#doc for further examples.

(ii) *CESR's Technical Advice on Possible Implementing Measures of Directive 2004/39/EC*, released in April 2005 (i.e., before the Level 2 Directive 2006/73/EC).

The CESR paper attempts to construe Article 4.1(4) of MiFID, but this construction must be viewed with caution, given the considerations pointed out in paragraph 1.1 above and CESR's own acknowledgement of its limited role in paragraph 2 of the paper: "Before the European Commission presents a proposal for implementing measures to the European Securities Committee, it seeks technical advice on these measures from the Committee of European Securities Regulators ("CESR")." So the paper merely relays the technical advice that was laid before the Commission as part of the preparatory work for the adoption of Directive 2006/73/EC.

It is nonetheless worth considering the CESR's guidance as to the definition of "personal recommendation":

- A recommendation was defined as "any communication that, taking into consideration all of the relevant circumstances, it is **reasonable to understand as being** [...] **suited to, or based on a consideration of the personal circumstances of the recipient.**" It was acknowledged that communications "in which there is no explicit recommendation will still be recommendations for this purpose where, taking into consideration all the relevant circumstances, an implicit recommendation is being made."

- Which, then, were those "relevant circumstances that may be taken into consideration when determining whether investment advice is being provided"? The *Technical Advice* paper did not spell them out (they were, in the event, specified in Article 35 of Directive 2006/73/EC), but it did say that one of them ought to be "**the relationship between the parties,** including the nature of the recipient".

- Finally, the CESR proposed a number of significant distinctions. Hence, "in comparison with a personal recommendation in most cases, **'information given to the client' is factual information that would not be understood to be suited to, or based on a consideration of, the recipient's personal circumstances**, nor would it include a recommendation in respect of one or more financial instruments or specific transactions or be intended to influence the client in this respect." The Committee then went on to say that "in comparison with a personal recommendation, in most cases, **an 'offer' would generally lack a recommendation** in respect of one or more transactions in financial instruments **and would not be understood as being suited to the recipient's personal circumstances.**"

So at this stage there were at least two tests by which to determine whether or not a service qualified as "investment advice". First, the recommendation had to take account of the personal circumstances of the client; secondly, the instrument had to be held out as "suited" within the context of the "relationship between the parties".

(iii) Directive 2006/73/EC, in Articles 24, 35 and 52, and Recitals 56 to 60, 79, 81 and 83.

(iv) The Commission's document *Your Questions on MiFID*, interpreting the Directive. We highlight the following Commission guidance on how to interpret the concept "investment advice":

- In response to question 158, the Commission says that the requirement that the "recommendation must be presented as a suitable..." is an intrinsic part of the definition of "personal recommendation". In its answer to that question, the Commission admits that it cannot be sure that "a recommendation that is not distributed through distribution channels, or to the public, and which is given to a client without any regard to its suitability or to the circumstances of the client, will not amount to 'investment advice' under MiFID," given the "fiduciary obligations[2] that firms are subject to". The Commission therefore acknowledges that it has its own doubts on the matter, and enters upon the realm of the interpretative difficulty and ambit of application of this concept.

- The answer to question 159 appears to evince a clearer position: "in order to consider a recommendation as 'investment advice', it is to be presented expressly as suitable for that person and tailored to that person." These requirements -- that the recommendation be "tailored" and presented as "suitable" for the recipient -- are, as will be shown presently, essential to a definition of the kind of recommendation that falls within the meaning of "investment advice". Another key point is that the Commission requires that that presentation of the recommendation as "suitable" be explicit. So the claim advanced in the CP at paragraph 45, namely that "it is certainly not necessary for a firm to tell a client that a recommendation it is making is suitable for them in order for its recommendation to be viewed as being presented as suitable," is unfounded.

- Finally, at question 1.2, the Commission says that "the suitability test is required by MiFID for the services where the client places a greater reliance on the recommendation given by the firm – investment advice and portfolio management." The key idea here is that the client, when provided with the investment advice service, places greater trust in the recommendation because of the fiduciary relationship intrinsic to the concept of investment advice. It is here that the difference emerges with respect to other activities, such as marketing, non-personal recommendations, or recommendations not presented as specifically suitable. The obvious inference is that the special relationship brought about by this enhanced trust is also one of the key elements by which an "investment advice" service is to be identified.

Against that background, financial institutions have sought to comply with the prevailing legal framework by applying the above criteria and on the basis that, for the purposes of the "suitability test" requirement, investment advice is a service which MiFID places on the same footing only with discretionary portfolio management. This, and this alone, is the status that the law seeks to give to the concept of "investment advice". For other types of service, MiFID makes provision for investor protection by different means, as discussed later in this paper. Specifically:

(i) Financial institutions are under an express duty to provide the client with pre-trade information about the characteristics and risks of the given product.

(ii) The "suitability assessment" requirement coexists with an "appropriateness assessment" requirement. If the concept of "investment advice" were construed broadly, as now urged by the CP, "appropriateness" would be emptied of meaning. There would be virtually no imaginable situation in which the appropriateness test would apply, since the suitability assessment test would almost invariably displace it.

(iii) Clients are classified into various levels -- retail, professional, eligible counterparties -- and application may even be made to switch a client's category in order to strengthen the standard of investor protection and the information requirements to be satisfied by financial institutions.

(iv) If a product is inappropriate, the entity is under a duty to let the client know. However, product inappropriateness does not bar a client from signing up to it anyway. This is sensible; otherwise, investors would be deprived of the ability to use certain products which, though riskier, are more attractive and profitable. This statutory provision makes clear that a given client is just as entitled as any other client to access a range of different financial

[2] The concept of "fiduciary obligations" is left unexplained and is hence open to dispute. In MiFID, the relevant obligations are not fiduciary but obligations of conduct, except -- it is fair to say -- in the specific case of investment advice.

instruments -- whether high-, medium- or low-risk. Anything different would constitute discrimination among investors on grounds that are not always objectively justifiable. The real point is to protect investors before they enter into a transaction by ensuring that they are adequately informed about the risks and consequences; the statute does not, however, deprive them of the freedom to access the products they want.

In the light of the above, and taking an overall view of MiFID, we think that the interpretation advanced in the CP alters the present statute and goes beyond its provisions. MiFID has already put in place the necessary and sufficient conditions to protect investors. Where an entity properly applies the existing mechanisms, the principle of the protection owed to the investor can be combined with the investor's freedom to enter into contract for the financial instruments of his or her choice. The same cannot be said of a disproportionate use of the suitability assessment and the consequences that such use would entail.

The above considerations are examined in greater depth below.

Untimely issuance of the CP and resulting risks

By this stage -- two years after the entry into force of MiFID -- it would appear to be too late to issue an interpretative document like the CP, which goes beyond the plain meaning of MiFID and the interpretative criteria of the European Commission known so far. Those financial institutions that over the past two years have not construed the concept of "investment advice" as bearing the disproportionately wide meaning now advanced in the CESR's CP -- that is to say, most of the industry -- will find that their efforts have been left "off-side".

Many of the terms of MiFID are ambiguous and vague; leaving this aside, however, the fact remains that the industry brought its practices into line with MiFID two years ago. If it was the CESR's view that a further clarification, indication or criterion was required over and above the plain meaning of MiFID, that interpretative addendum should have been communicated before MiFID entered into force so as to avoid the legal uncertainty that may come about as a result of an ex-post interpretation like the one contained in the CP.

Given that at the time of enactment neither the Commission -- the body competent to do so -- nor CESR -- despite it not being competent -- chose to issue the interpretative guidance advanced in the CP, the principle of legal certainty requires that, if CESR disagrees with the scope of MiFID, it should either propose an amendment that brings about the effects not expressly and clearly prescribed at the outset, or leave the interpretation of MiFID to the courts.

It is a matter of extreme seriousness that a document should be issued containing the line of argument set forth in the CP, because of the legal uncertainty that would ensue if such an approach were entertained. This interpretation would create severe confusion among market participants -- including, of course, users -- and could set off a spate of claims, especially now, when the market has undergone far-reaching and unpredictable change and any pretext is enlisted in an attempt to escape past commitments. Investors who, within the new meaning proposed by the CP, were given “advice” without a prior suitability test would be able to rely on mere presumptions. In addition, users would feel the adverse effects of institutions' reaction to the situation thus created, as discussed in further detail in section 4 of this paper.

The financial services industry has at times faced the uncomfortable situation of being obliged to comply with a legal framework the exact application of which has been, at times, uncertain. Financial institutions are, of course, entitled to some measure of legal certainty, and should not have to suffer -- two years after the event -- ex post facto interpretations like the one proposed in the CP, which does not even succeed in making its purported “clarification” comprehensible: paragraph 77 of the CP, for example, is a model of obscurity.

3.-THE CONCEPT OF "INVESTMENT ADVICE"

In our view, MiFID creates a concept of "investment advice" quite unlike the broad notion advanced by the CP. We shall attempt below a definition of the concept of "investment advice" that avoids the implications of the CP construction while delimiting -- with a measure of legal certainty for both parties, investor and financial institutions -- a form of financial service that calls for special investor protection.

3.1. Configuration of the concept of "investment advice"

The elements defining an investment advice service under MiFID (specifically, Articles 4.1 (4) and 19.4 of Directive 2004/39/EC, and Recitals 56 to 60, 79, 81 and 83 and Articles 24, 35 and 52 of Directive 2006/73/EC), which are reflected in Spanish statute law under article 63.1.g and 79.bis.6 of the *Ley del Mercado de Valores* [Securities Market Act], articles 5.1.g and 72 of Royal Decree 217/2008 and the clarifications set out in the CNMV [Spanish securities market regulator] letter of 7 May 2009 are: the subject-matter of the service (i.e., the personal recommendation presented as suitable for the client) and its classification:

(i) Subject-matter of the service

MiFID (and the modest quantum of interpretative guidance issued by the Commission in its document *Your Questions on MiFID*, discussed above) prescribes that the subject-matter of the service is a personal recommendation presented as suitable to the client. So a recommendation (this term on its own is left undefined in MiFID) must carry highly specific characteristics for it to qualify as the subject-matter of an investment advice service:

- The recommendation must be personal. The financial institution must therefore collect certain details from the client which would not have to be collected for the purpose of conventional marketing. And,

- The recommendation must be presented as suitable to the client. The financial institution must therefore discharge a quasi-fiduciary duty of acting in the client's interests by making "tailored" recommendations having regard to the client's particular circumstances.

With regard to the first of these elements -- knowledge of the client's personal circumstances -- MiFID requires that an entity intending to provide the service first procure the necessary tools, namely:

- Knowledge of the client's investment objectives, including "information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment" (Article 35.4 of Directive 2006/73/EC and article 72.a Royal Decree 217/2008).

- Knowledge of the client's financial situation, including "information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments" (Article 35.3 of Directive 2006/73/EC and article 72.b Royal Decree 217/2008).

The scope of the information required to provide an investment advice service clearly goes beyond the information that an entity would have in its typical relationship of marketing to clients. In conventional marketing, the financial institution is not apprised of the client's particular circumstances to the degree of detail required by the provision of an investment advice service.

As set out in article 35.5 of Directive 2006/73/EC, "Where, when providing the investment service of investment advice ..., an investment firm does not obtain the information required ..., the firm shall not recommend investment services or financial instruments to the client or potential client." To the same effect, article 72 of Royal Decree 217/2008 prescribes that "when the entity does not obtain the information specified in the foregoing paragraphs, it may not recommend...". In other words, it may not provide an investment advice service.

(ii) Classification of the specific service to be provided

In the service to be provided, the recommendation must be expressly presented as suitable to the client (see Q 159 of the document *Your Questions on MiFID*, discussed above). This calls for a measure of additional diligence, embodied in the requirement to administer a suitability test and the duty not to recommend any product not suited to the client. Further proof that investment advice carries a requirement of enhanced diligence is that the other investment service for which a suitability test must be administered and which is subject to similar investor protection strictures as investment advice is discretionary portfolio management -- here, the client delegates his or her decision-making to the entity after disclosing his or her personal circumstances.

When rendered an investment advice service, the client relies on the trust that the very nature of the service implies; the financial entity is undertaking a standard of diligence above that which would apply to conventional marketing. Every client is aware that when an entity carries on a marketing activity it is offering products in the interests of both the client and itself: such would be the nature of the mere recommendation, for instance. However, where the entity provides investment advice, the client's interests must prevail.

As set out in paragraph 1.1 of the CNMV letter of 7 May 2009, "both parties must be aware and accept that their relationship consists precisely in the provision of this service rather than some other service." This point is vital. The existence of the service cannot be "presumed", as it would if the approach advanced in the CP were followed. For the sake of legal certainty for both parties, and, in particular, for the financial institution, the service must be expressly consented to by both parties. The investment advice relationship is especially consequential, because the entity assumes a quasi-fiduciary duty to act primarily in the client's interests by making "tailored" recommendations having regard to his or her particular circumstances.

3.2. Investment advice and marketing

As shown above, then, MiFID configures an investment advice service as a relationship expressly consented to by the parties. It carries high value-added, based on knowledge of the client and his or her circumstances, as demonstrated by the fact that provision of the service is subject to tighter requirements -- on a footing equivalent to a portfolio management service -- and, furthermore, by the fact that Spanish statute law recognises a special form of corporation designed to provide investment advice exclusively: the EAFI (*empresa de asesoramiento financiero* – investment advice firm).

However, as a preliminary to the provision of an investment advice service, it is typical first to carry on a "marketing" activity (*comercialización* in the Spanish terminology). This consists of giving recommendations of the kind subject to Article 1.3 of Directive 2003/125/EC,[3] which do not satisfy the conditions of Article 24.1 of Directive 2006/73/EC[4] and which MiFID terms "marketing communications".

[3] "'[R]ecommendation' means research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public."

This activity of "marketing", which is subject to express statutory provisions in articles 63.4 and 64.7 Spanish Securities Market Act and article 5.g[5] of Royal Decree 217/2008, embraces both the information released by a commercial network about its products, and the making of generic or other recommendations which fall short of satisfying the conditions to qualify as investment advice, i.e., recommendations that do not have regard to the personal circumstances of the recipient nor are presented to him or her as being suitable on the basis of such circumstances. Such recommendations are, by their very nature, the primary activity of a large commercial network that addresses the general public, such as the branch network of a credit institution, the prime purpose of which is the marketing of the bank's products.

Such marketing, after MiFID, will in any event lead to the assumption of a heavy burden of duties to the client if it ever crystallises into an investment service (which for such purposes would include the "proprietary trading" service, however odd it may be to apply the term "service" to an activity not rendered to a third party). Such duties are not limited to the test of appropriateness and its attached requirement to evaluate the client's knowledge and experience of the product; they further extend to the furnishing to the client of a considerable volume of product information. Clients must be provided with the mandatory prior disclosures, and, in some cases, financial institutions volunteer further details, such as product catalogues, etc.

But the supply of both mandatory and voluntary information and the making of a recommendation that does not satisfy the conditions of being personal and of being presented as suited to the client should not be confused with the provision of investment advice. For investment advice to be made out, the recommendation must carry the value-added of being personal and must be presented as suitable on the basis of the entity's enhanced knowledge of the client.

The information handled by a financial institution's commercial network about its products is designed to guide marketing officers' relationships with all present and prospective clients, regardless of any investment service they may finally request. It is accordingly descriptive, non-personal information that focuses on the characteristics of a given product, not on the characteristics of an individual client. It is therefore clear that the proprietary trading of a financial instrument that has been previously marketed by means of "campaign" conducted through the marketing network -- without regard to the personal circumstances of each client -- is not the same service as a personal recommendation of that instrument to, for instance, a private banking client about whom sufficient information is known to determine whether the instrument is suited to his or her personal circumstances.

No confusion must therefore be made between two activities that are undertaken in pursuit of clearly distinct objectives. Investment advice is not a prior duty attaching to the marketing activity; it is an investment service that entails a range of costs and benefits for both the entity and the client. A request for and the provision of investment advice should hence be neither imposed nor presumed. It must spring from a voluntary agreement between two parties in accordance with the rules of a free-market economy.

3.3. Warning as to the type of service provided

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[4] The following conditions: "(a) it is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation; (b) if the recommendation in question were made by an investment firm to a client, it would not constitute the provision of investment advice for the purposes of Directive 2004/39/EC."

[5] This provision directs that "it shall not be held that advice exists where... generic, non-personal recommendations are made in the sphere of the marketing of securities and financial instruments." It is further specified that "such recommendations shall be treated as marketing communications."

Given this background, investor protection requires that both parties be fully aware that no personal recommendation is being made or being presented as suitable -- the service being provided and received is not investment advice. Such awareness and acceptance, in fact, as prescribed in current statute law and the letter of CNMV of 7 May 2009, form the basis for the existence (or the absence, as the case may be) of the advice relationship between the parties.

The need for both parties to be aware of the nature of the service being provided and its implications could be met by a clause or an express warning that clearly and specifically indicates that the client is not being provided with investment advice. The use of this expedient would not prevent the status of "investment advice" from attaching to a personal recommendation presented as suitable which clearly does make out the elements of investment advice. So it is not a matter of exempting either party from liability; the point is to ensure that both the entity and the client are fully aware of the fact that investment advice is not being provided where such non-provision is in fact the case. The purpose of this is simply to secure transparency and legal certainty as between the parties regarding the "ground rules" that are to govern their relationship. In addition, the consequences could be specified of the absence of an investment advice service -- among others, the fact that no assessment of suitability is to be administered.

4. CRITICAL OVERVIEW OF THE CP

4.1. Personal recommendation and presented as suitable

As indicated above, in order to determine when investment advice is rendered, it is necessary to define the type of recommendations provided in such a service, namely a personal recommendation presented as suitable for the client. Consequently, three elements must be present:

(i) A recommendation, i.e., advice on some aspect (a financial instrument) for the benefit of a person (a client or potential client).

(ii) This recommendation must be personal, i.e., based on a consideration of the person's circumstances.

(iii) The recommendation must be presented as suitable[6], that is, adapted to the circumstances of the client.

One of the key defects of the CP is that, having separated these three key elements (numbered 1, 3.1. and 3.b), **the CP slips in the assumption that when a recommendation is given, the other two conditions are automatically present**. However, this is not always the case, given that it is quite possible to encounter a non-personal recommendation that is not presented as suitable: in fact, one can recommend something without taking into account the circumstances of the recipient and therefore without presenting the recommendation as suitable, to the extent that the recommendation is intrinsically beneficial for the purposes at hand. For example, one can recommend getting up early in order to accomplish all the things to be done during the day, but this recommendation is not necessarily suitable for someone who doesn't go to bed until dawn. A good example of the foregoing is that both MiFID (Articles 24 and 52 of Directive 2006/73/EC) and Spanish statute law (article 63.1.g of the Spanish Securities Market Act and article 5.g of Royal Decree 217/2008) foresee the possibility of making recommendations that do not fulfil these characteristics.

[6] The Spanish dictionary [*DRAE*] definition of "suitable" [*idóneo*] is "adequate and appropriate to something." "Adequate" [*adecuado*] is "appropriate to, or fit for, the conditions, circumstances or purpose of something" and "appropriate" [*apropiado*] is "adapted to or provided for the purpose to which it is put."

Likewise, a firm could tell clients that a given product is suitable for them, but if the individual client's circumstances were not taken into account, the recommendation would be rather risky. In addition, a recommendation can be given to clients whose circumstances are known, but expressly indicating that the recommendation does not take into account these circumstances.

Consequently, in the first case (recommendation only), no investment advice can be deemed to have been provided. In the second case (recommendation indicated to be suitable but without taking into account the client's particular circumstances), the firm would be responsible for having led the client to believe that it was providing investment advice when this was not actually the case. Lastly, in the third case (recommendation from a firm knowing the circumstances of the client but expressly indicating that these circumstances have not been taken into account, where the product is therefore not presented as suitable), a disclaimer stating that the recommendation does not take into account the client's circumstances is sufficient to clearly establish that no investment advice is being provided.

4.2. Investment advice: consideration as investment advice and the five key tests

4.2.1. Consideration as investment advice

The CP is based on an erroneous and legally unfounded premise, namely that advice can be "presumed" to exist. Moreover, the presumption is unilateral, i.e., seen only from the investor's point of view, as indicated in paragraph 5 of the CP (and, similarly in section 10)*:* "where the client reasonably relieves that a personal recommendation is being provided […], it should be considered that investment advice is being provided."

The presumption that advice is being provided would strip it of its meaning, as well as the activity of credit entities with a large commercial network targeting the general public. Parties would not have to agree on the understanding of the type of service to be rendered and the actions to be carried out: only the client's point of view is important. The objective existence of a personal recommendation presented as suitable would also have no bearing on the matter, given that only the client's perception would be considered in determining whether or not the recommendation meets the requirements in question. This subjective perception then becomes the criterion to identify the type of service rendered. In such a situation, the financial entity has only one way of avoiding the risk of a client perceiving that investment advice is being given when it is not actually being provided (bearing in mind that the CP also indicates that a disclaimer is not sufficient): by simply rendering it at all times.

However, this would be detrimental to investors, as explained in section 5 below.

4.2.2. The five key tests

The CP proposes a test for determining whether investment advice is being rendered. If we apply the criteria of this test, we naturally conclude that virtually all actions of a financial entity in connection with financial instruments would constitute investment advice, given that all of a bank's activities tend to recommend in the broadest sense of the term (first key test) its products (second test) to clients of which it has some knowledge, albeit only information deriving from other products contracted with the financial entity (third test) in in-bank relations (fourth test) and, of course, to encourage the client to purchase the product in question (fifth test).

What, then, can a bank do so that the commercial service is not considered investment advice? According to the CP, entities can do so by answering any of the five key test questions negatively. This would entail:

(i) Not issuing any recommendations at all. In general, this would mean not speaking with the client or communicating in any way. If clients visit the bank to ask about investment products, bank employees (as if they were nothing more than machines distributing documents) must only hand clients brochures on each product available and let the clients decide whether or not to purchase any product, and, if so, which product to purchase. If clients ask any questions, bank employees should not answer, given that otherwise the clients could "reasonably believe" that a recommendation is being provided (paragraph 5 of the CP), even if no one indicates that the product is suitable for them (paragraph 45 of the CP).

(ii) Issuing recommendations that do not relate to financial instruments. Doing so would be extremely difficult, given that any recommendations put forth by a for-profit financial entity interested in selling its products would have to refer to something in particular.

(iii) Not presenting the recommendations as suitable ***or*** not taking into consideration any circumstances of the client. The third key test establishes an "a ***or*** b" format when an "a ***and*** b" format would be more appropriate, given that the Commission has already indicated that the presentation of recommendations as suitable is an intrinsic part of the service and, therefore, that the recommendation should be personalised ***and*** (not ***or***) presented as suitable for the client.[7] By separating these two elements, it is more likely that a recommendation would be considered advice, because only one condition would be necessary as opposed to two.

As the perception of whether or not a recommendation has been presented to be suitable is something that the CP leaves entirely up to the client and beyond the control of the financial entity (despite the contradictory criteria of the Commission requiring suitability to be *expressly* indicated), it appears that the only way to be able to answer this part of the test in the negative is to have no knowledge whatsoever of the client (for example, clients would have to be told to go to another branch where the bank employees do not know them) and no knowledge of the client's circumstances (for example, bank employees could not look at details of clients' accounts or other documents, even though this could be quite irresponsible from the point of view of credit risk management).

(iv) Issuing the recommendation through distribution channels or to the public. That is, the only way of not answering affirmatively to the fourth test question is to avoid all contact between bank sales representatives and clients, which seems rather difficult to do.

(v) Making recommendations to someone other than a potential investor. It is impossible to not answer the fifth key test affirmatively, given that no recommendations are even possible without someone to make it to.

In summary, given that in any interaction between clients and bank sales representatives that deals with a financial instrument, the second, fourth and fifth key tests are inevitably answered in the affirmative, the bank's only way of avoiding giving investment advice would be to refrain from making any recommendations or to refrain from taking into account the client's circumstances; i.e., creating commercial processes similar to automatic document vending machines, without weighing any characteristics of the products outlined in the informational documents or any circumstances of the client. In other words, the way to avoid rendering investment advice in a personal interaction between a bank sales representative and a client is… to not have any contact at all.

At this point, the following should be considered:

[7] Article 5.1.(g) of Royal Decree 217/2008 establishes that recommendations must be presented as suitable for the person based on a consideration of his or her particular circumstances.

(i) What is the point of the appropriateness test bearing in mind the CP's interpretation of investment advisory services? In performing the test, certain information on the client (knowledge and experience) would be accessed, which would automatically answer the fifth key test question affirmatively. It would only be necessary for clients to believe that a product is being recommended to them (and how can this be avoided, considering that clients generally think as much?) for the interaction to be considered investment advice.

(ii) How can an obligation such as that set out in article 19 of *Ley 36/2003* [Spanish Financial Reform Act 2003], namely to offer a product to hedge the interest rate on mortgage loans, be compatible with the interpretation underlying the CP? Could this mean that, in this case, the law actually requires banks to provide investment advice? And if no available product is considered suitable, by not offering a product is the Spanish Financial Reform Act 2003 being breached? Or is the MiFID being breached by offering the product?

(iii) Such things as non-personal recommendations not presented as suitable and commercial efforts as an activity prior to the rendering of an investment service do actually exist…but when would they occur? What would they consist of so that they are not considered investment advice?

4.3. Particular aspects of the CP: questions posed by the CESR

III. Part 1. Does the service being offered constitute a recommendation?

Q1 of the CP asks whether we have any comments on the distinction between the provision of personal recommendations and general information. However, paragraphs 8 to 18 only address the difference between recommendations and information (when the most relevant thing would be to differentiate between a recommendation and a personal recommendation).

With respect to the difference between recommendations and information, the CP suggests that a recommendation is anything other than objective information (paragraph 15) devoid of comments or value judgements (paragraph 13) and with no emphasis on the characteristics of the product (paragraph 16). This appears rather extreme. Following this reasoning and in line with the concept set out in the CP, in order to avoid issuing recommendations, a financial entity's commercial network would have to act as vending machines of objective information.

With respect to Q2, i.e., whether filtering mechanisms for providing information to the client can constitute a criterion for determining whether investment advice has been given, again, the terms "advice" and "recommendation" have been conflated. In any event, it does not appear that this filtering mechanism would easily "personalise" the recommendation with the degree of customisation required for investment advisory services. In this question, as in all aspects of customisation or personalisation of the recommendation, the CP proposes an excessively broad interpretation of what can be considered personalisation. Applying this interpretation, merely taking account of one personal element of a client is sufficient, as if a suit could be considered to be customised or tailor-made by only taking into account a certain characteristic of the customer, such as whether the customer is male or female or whether they prefer double-breasted jackets.

IV Part 2: Is the recommendation in relation to one or more transactions in financial instruments?

As indicated above, this question is pointless in the majority of cases in the actual workings of a commercial network. No matter how generic advice is, if clients ask about the difference between bonds and shares (as cited in paragraph 32), they would be doing so as potential investors in a specific bond or share, and, even if this were not the case, nothing could be done to prevent the clients from considering that the recommendation is not generic but rather specific to the product currently being sold by the financial entity or to the financial instrument in which they are interested.

In response to Q3, which asks whether the CP clearly distinguishes between general recommendations/generic advice and investment advice, our answer is that this is not the distinction that should be made. Rather, a distinction should be made between general recommendations, information, and particular recommendations for a specific instrument. In our opinion, the more general a recommendation, the less it takes into account the circumstances of a client, and the less it can be considered to present an option suitable for these circumstances. One issue not resolved in the CP is the possibility mentioned in paragraph 37 of considering generic advice to be the sum of various individual pieces of advice.

V. Part 3.a. Is the recommendation presented as suitable?

In this section, the CP confuses, on one hand, an implicit recommendation with the presumption of recommendation, and, on the other hand, a recommendation in which the product is not said to be suitable with a recommendation putting forth the suitability of the product:

(i) With respect to the first confusion, while it is true that a recommendation can be implicit, it does not necessarily follow that an implicit recommendation occurs whenever a client's decision regarding a financial instrument is influenced, given that, again, this depends on the subjective point of view of one of the parties. In that regard, paragraph 47 indicates that even if a "clear, prominent and understandable disclaimer" is provided stating that no recommendation is being given, the communication with the client can "still create a reasonable expectation by the client that he is being advised [and] the firm may be viewed as providing investment advice." It is clear that a recommendation need not be express. However, it is also true that the less express the recommendation, the less clear it will be that a recommendation has been made. In response to Q4, our response is that the CP not only fails to clarify "when an implicit recommendation could be considered as investment advice," but actually gives rise to new uncertainties.

(ii) With respect to the second confusion, paragraph 45 states that "it is certainly not necessary for a firm to tell a client that a recommendation it is making is suitable for them in order for its recommendation to be viewed as being presented as suitable." This statement is diametrically opposed to the second paragraph of Article 52 of Directive 2006/73/EC and the Commission's response in the document titled *Your Questions on MiFID* (question 159), which clearly state that in order for a recommendation to qualify as investment advice, it must be expressly presented as suitable for the client. Even if a recommendation has been made, if the product is not presented as suitable, it cannot be considered investment advice.

VI. Part 3.b. Is the recommendation based on a consideration of the person´s circumstances?

If the circumstances of a client are not taken into account when recommending a financial instrument, the recommendation would not fall under the umbrella of investment advice. Q5 asks whether the circumstances where "it is clear that the firm is making a personal recommendation" are sufficiently clear. However, paragraphs 48 to 54 do not actually clarify the degree of knowledge of these circumstances needed to give rise to this type of recommendation. Rather, the subject circumstances can be either factual or subjective and, if they are known, it is impossible to avoid them.

With respect to this question, if the client is clearly advised that their personal circumstances will not be taken into account in making recommendations (and they are truly not taken into account), it makes no sense to consider the recommendation to be a personal recommendation.

vii) Part 4. Is the recommendation issued otherwise than exclusively through distribution channels or to the public?

Part 4 states that advice can be rendered through general distribution channels, depending on the means, number of recipients, selection process, content and wording of the recommendation.

However, in response to Q6, it is important to note that no mention is made of the relevant feature of the recommendation, namely its personal nature. The greater the number of recipients of a single recommendation, the greater the likelihood that the personal circumstances of each client have not been taken into account enough to present the recommendation as suitable. Therefore, the wording used and the content of the message are not the relevant factors, unless either one presents the recommendation as suitable to the client's personal circumstances, without these circumstances having been taken into account.

vii) Part 5.a. Is the recommendation made to a person in his capacity as an investor or potential investor?

The fact that this question is asked illustrates the legal uncertainty surrounding MiFID, which is excessively general and ambiguous. A document such as the CP, which aims to interpret and clarify, cannot limit itself to acknowledging that companies will have to assume a certain degree of uncertainty when determining if they are providing investment advice or a corporate finance service (paragraph 77). This lack of precision and this uncertainty are unacceptable in a supposedly interpretive document.

Without prejudice to the above, the correct criterion is indeed set out in paragraph 75: services relating to mergers and acquisitions (corporate finance) are in no way identical to investment advisory services, especially considering that corporate finance services are contracted for a specific situation (such as a merger, an acquisition, or a complicated situation) for a limited time and with a predetermined objective regarding the capital structure, industrial strategy and similar issues, mergers or acquisitions *of a company*. In contrast, investment advice is in no way related to the organisation of a company or to its possible fluctuations, nor is it focused *on companies*. In answer to Q7, the most helpful information is already set out in paragraph 75.

5. ADVERSE CONSEQUENCES FOR INVESTORS

As explained above, in the uncertain legal framework that could arise if the CESR finally adopts the position set out in the CP, financial entities would have no choice but to limit their activities to personal recommendations presented as suitable. However, this would give rise to the following consequences:

(i) *Reduced freedom of choice for investors*. If financial entities were forced, for their own legal protection, to limit their activity in financial instruments to rendering investment advice, clients or investors wishing to invest in those instruments would be required to receive a service that today is merely optional.

This would curtail the freedom of choice of investors, unjustifiably, considering that an appropriateness test already exists to adequately protect them in the event that they wish to invest without using an investment advisory service. Clients should be aware of the options put forth by MiFID and should select the service they deem most appropriate. The authorities and the financial services industry must inform clients of the consequences derived from provision of a particular service, but not limit, in an exaggerated attempt to protect investors, their freedom to choose the service they desire.

Certain clients will be loath to reveal their personal circumstances in order to acquire a financial instrument for which they already have sufficient knowledge and experience. Other clients, after having been told that the entity does not believe they have sufficient investment knowledge and experience, will want to contract the financial instrument anyway (either because they do not want to reveal their information and are sure of their own capacity to value instruments, or because they have already been advised by a trusted friend or family member). Furthermore, other clients will prefer to not receive personalised advice (due to the cost this entails, as indicated below) because they consider themselves to be sufficiently responsible to assume the risk of investing in a financial instrument without having received a personal recommendation.

The capacity of all these clients to freely act and decide will be negatively affected, because they will only be able to invest in financial instruments after having received investment advice, and only when the instrument in question is, in the view of the entity providing the service, suitable for them based on their particular circumstances. This clearly limits their freedom of choice and freedom to make their own decisions, without legal grounds, given that MiFID neither creates nor aims to create such a situation.

(ii) *Reduced investment opportunities for clients.* As indicated, the only alternative for financial entities would be to limit their activities in financial instruments to rendering investment advice, given that it would be the only way to avoid a situation in which, while not actually providing advice, the client could assume that it is indeed being provided. This would mean that a given type of instruments that up until now have been available to a wide-reaching public, after an appropriateness analysis by the entity, would no longer be within their reach.

It is clear that financial entities cannot offer investment advice to all their clients, first, because they lack the resources and means to do so, given that the sales networks of financial entities are not large enough to render a service that requires both a significant amount of time and special relationships with clients. Secondly, and more importantly, it is not necessary, given that this is not what the majority of investors are looking for.

A position such as that laid out in the CP would result in a drastic reduction in investment possibilities, jeopardising the interests of clients, given that:

- there will be occasions on which clients will not be able to invest in any type of financial instruments because entities will choose to not provide investment advice; and

- there will be cases in which clients will not be able to access certain financial instruments because, even if they may be considered appropriate for the client (after the appropriateness test) it might not be possible to determine whether they are suitable for the investor.

In short, if entities only provide investment advice, clients would not always be able to invest in the financial instrument of their choice: rather, they would first need their financial entity to conclude that the subject instrument is suitable for them. If the entity does not deem the particular instrument to be suitable, the investor would not be able to invest (given that the entity could not “recommend” it, as per Article 35.5 of Directive 2006/73/EC, and therefore would not be able to sell it, lest it be accused of providing the service improperly).

(iii) *Higher costs of the service or of the financial instruments*. The natural consequence of all the above points is that the end cost of the products would increase. This would be passed on to the investor, either through service commissions or through higher prices or costs of the financial instruments in question.

It appears clear that for a financial entity, the only available way to widen – or even to generalise – the provision of investment advice would be to assume all the means necessary to do so. However, these resources are only currently made available to those clients that request this specific service, and not to the general public.

This build-up of resources and the resulting cost would only be justified if it were properly compensated or passed on in such as way as to not diminish the entity's profits. It is clear that this could only be achieved by charging for the service (a service that not all clients desire) or by passing these higher costs on in the prices or conditions of financial instruments; that is, transferring the cost to a client base that, moreover, would not have the option of avoiding this cost given that no entity would be willing (except by assuming major risks) to sell a financial instrument without having first provided investment advice concluding that the investment in question is suitable for the client.

(iv) *Clients discouraged from becoming more knowledgeable about finance.* As mentioned above, an interpretation such as that put forth in the CP encourages a situation in which the failure of clients to assume any responsibility or diligence (deliberately or otherwise) when contracting financial instruments (and when understanding the legal relationship with these financial entities) is compensated by the possibility that clients can presume that a personal recommendation presented as suitable has been issued. Yet this would render financial entities defenceless and unable to assess how each client will understand the particular exchanges that took place. In these circumstances, in order to act with the necessary legal certainty, this can only be done under the umbrella of investment advice.

The generalisation of the service (with the aforementioned limitations) would mean that clients would be discouraged from learning more about the financial world, other than to know the characteristics and risks of products,[8] given that they would have virtually no ability to make their own decisions because the final decisions on the financial instruments in which clients could invest would lie with the financial entities (i.e., those instruments which the entity considers to be suitable).

In short, the CP's interpretation can be likened to wanting all passengers on an aircraft to travel in business class so as to avoid any tourist class travellers from erroneously thinking that they will be able to rest during a long trip or that they are not going to suffer from "economy class syndrome." The result of such a measure is clear: fewer people would travel, because the capacity of the airplane must be adjusted accordingly, and the cost would be higher. In other words, all travellers would undoubtedly be more comfortable and safe, but the trip would be more expensive and fewer people would be able to afford travelling by plane.

MiFID wisely does not prescribe that the only option available to entities is to provide investment advisory services. However, initiatives such as the CP, should it prevail, would cause the industry and investors to enter a situation not foreseen by MiFID itself, in which the enhanced (and imposed) protection of certain investors would only be achieved at the expense of other investors, who would not be able to access the majority of the financial instruments they can access today and, to the extent that they were able to access, would have to bear a significantly higher cost.

[8] We understand that it is in the interest of European authorities to improve the financial knowledge of retail clients, as indicated in the Communication from the Commission to the European Parliament and the Council regarding Packaged Retail Investment Products (30 April 2009): "an essential complement to these rules is the ongoing drive to improve the level of **financial education** among retail investors in the European Union, as a means of equipping the least sophisticated investors for financial decision-making."