

By - email

CESR
Mr. Fabrice Demarigny
Secretary General

23 December 2004
H 551 – lbj,msp

Dear Mr. Demarigny,

CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments – 1st Set of Mandates (Second Consultation Paper – November 2004)

Realkreditrådet (The Association of Danish Mortgage Banks) has taken a closer look at the CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments – 1st Set of Mandates (Second Consultation Paper – November 2004) and would like to put forward its comments seen from the point of view of the Danish mortgage banks.

In order to understand the below stated points of view, a short description of Danish mortgage credit activity is given including an outline of the pursuit of investment services attached hereto.

Danish mortgage banking

The activity of the Danish mortgage banks – the granting of loans against a registered mortgage on real property based on the issuance of mortgage bonds – is subject to very detailed legislation. The close connection between the lending by the mortgage banks and the funding through the issuance of mortgage bonds means that the Danish mortgage bond market is the second largest in Europe. The outstanding volume of Danish mortgage bonds amounted to approximately 200bn EUR at the end of 2003, corresponding to the Danish GDP.

The legislative regulation of the mortgage credit activity is relatively restrictive and serves to reduce the risk of the mortgage banks and thereby also that of the investors in various ways. One major objective is to ensure a high quality of the bonds, which fund all the mortgage loans.

In Danish mortgage banks, clients demand investment services when they obtain, prepay, refinance or redeem mortgage loans (due to the fact that these requests translate into the selling and/or buying of bonds to/from the mortgage bank), whereas clients of investment firms are investors looking for a profit on assets. In other words, the primary goal for a client of a Danish mortgage bank is to enter into an agreement concerning a loan secured on his/her real property.

Therefore, a client of a Danish mortgage bank (a borrower) is a "non-typical" investment service client since the primary goal of the transaction is to obtain a loan and not to make an investment. This is a very important distinction, which should be taken into account when fixing the implementing measures.

Thus, a mortgage loan is in the point of view of a Danish mortgage bank client to be compared to a bank loan where it is the principal sum and the monthly repayment amounts that are relevant to the client, ie the interest on the loan and not the price of the underlying bonds. We at Realkreditrådet have the same intentions as the borrowers; to sell or buy at the best possible prices to obtain the best possible interest rates to the advantage of our clients.

General remarks

The CESR has asked for information about the costs and time spent including what is practically possible with the new regulations attached to the pursuit of investment services. A full estimation would require knowledge of all implementing measures and the final formulation hereof.

At present Realkreditrådet does not have the possibility to come up with such information but has noted that in view of the extent of the implementing measures, it is very important that the necessary time is given to implement these. At the same time it is important that when the final implementing measures are fixed, the necessary consideration is taken to the various types of investment services being carried out in order to make sure that firms such as the Danish mortgage banks are not imposed with requirements, which do not correspond to the activity carried out.

Specific remarks

Conflict of interest

Realkreditrådet understands that focus should be on possible conflicts of interest and the necessary internal measures to manage these. It is, however, in Realkreditrådet's opinion important that the necessary flexibility is given to the organization when setting up the measures etc., as these should to the widest possible extent reflect the characteristics of the organization in question.

Independence of compliance

As for the demands made on a compliance function, which appears from the presented advice, the main rule is still that such a function should be independence, which suggests that the persons responsible for the compliance function perform their monitoring duties independently of other persons and activities subject to their monitoring. However, a certain flexibility for minor firms is given.

Realkreditrådet finds it important that when functions of this nature are set up, there is the possibility to adjust it to the size of the organization and the complexity of its activities within investment services. The necessary flexibility in the set-up of the compliance function has to be present irrespective of the firm size, which could be the possibility of having a compliance function handle various tasks and not solely compliance tasks. The latter of course under the provision that the other activities of the compliance function are not placed within the area in which the compliance function is carried out.

Realkreditrådet considers it important that a compliance function is independent that that functions are separated.

Complaints

According to the CESR, the procedures of the mortgage banks for handling complaints shall be published, cf page 16, 5a in consultation paper CESR/04-261b (June 2004). This is a significant change compared with today when clients are informed at the end of a complaint procedure that they may complain to the Danish Mortgage Credit Appeal Board (Realkreditankenævnet).

It is the opinion of Realkreditrådet that as far as mortgage banks are concerned, the handling of complaints is already sufficiently regulated. In Denmark there are e.g. specially approved appeal boards within different business areas. The Realkreditankenævnet has been approved by the Danish Minister for Economic and Business Affairs and its activities are governed by the Danish consumer complaints legislation. The approval ensures that the Board complies with principles of independence, openness, contradiction, effectiveness, legality, freedom and representation. The Board is chaired by a Supreme Court judge. The Board may hear complaints regarding any legal issue in the relationship between the client and the mortgage bank.

In the opinion of Realkreditrådet, this regulation is sufficient to protect the clients' interest since mortgage credit loans are standardised products that are offered to all clients.

As regards the handling of any complaints, it should only be in such cases where general mistakes have been made that could trigger compensation to several clients that the clients in question need to be informed of the complaint/mistake, cf p. 16, 5ai.

Record keeping and burden of proof

It is very important that the presented requirements to record keeping do not imply a reverse burden of proof.

Realkreditrådet thinks that the presented requirements to record keeping are more extensive than necessary as for the material to be kept. Realkreditrådet is therefore of the opinion that no minimum requirement in regard to record keeping should be stipulated but that guidelines ought to be sufficient to meet the demands specified in article 13 (6).

It should be ensured that there are no requirements to the set-up of record keeping, which exceed the priority of the clients, which the regulations aim to protect. The attached costs will at the end reflect the prices towards the clients. A cost-benefit consideration should be included in the fixing of requirements to record keeping.

Tape recording

It is contemplated to impose requirements that investment firms shall tape clients' orders originating from phone conversations.

In the Danish mortgage banks it is, as stated, not until an agreement has been made to take out or (p)repay a mortgage loan that a securities transaction takes place. Until that time, all communication does not entail securities transactions.

To obtain a mortgage loan requires much communication between the Danish mortgage bank and its clients or potential clients. According to the legislation, the Danish mortgage banks must inform/explain the clients or potential clients of the factors behind a loan secured on real property, and therefore the order itself is normally just a small part of the overall communication. If it were made mandatory to tape record all communication with clients or potential clients, the amount of communication recorded about general matters would be disproportionately large compared to recordings regarding the conclusion of agreements.

If all phone conversations with clients or potential clients in Danish mortgage banks were to be tape recorded it would therefore 1) require a huge database and 2) require a tremendous investigation to find exactly those conversations in which the client actually accepts the order. And still, plenty of orders with clients of Danish mortgage banks would not be tape recorded for that simple reason that orders may as well be made in a face-to-face situation or over the internet.

This means that first of all not all client acceptances of agreements with Danish mortgage banks would be tape recorded, and secondly that it would require enormous resources for the Danish mortgage banks to keep and maintain a database containing all the tape recordings.

The main issue is that the clients of the Danish mortgage banks are not placed in any position inferior to that of other clients in connection with loans. This is indeed not the case, as all securities transactions are confirmed in writing to the client, and the client then has the possibility to complain about the securities transaction in case of disagreement.

We therefore believe that the tape recording of client orders should not be made mandatory.

Best regards,

Lars Blume Jensen