EAPB Position on the CESR Consultation Paper CESR/04-562 of October 2004 on the Possible Implementation Measures for the Directive on Markets for Financial Instruments – Second Set of Mandates

The European Association of Public Banks (EAPB) represents the interests of 17 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions with a combined balance sheet total of EUR 3,000 billion and over 170,000 employees. The EAPB would like to thank CESR for the opportunity to state its opinion on consultation paper CESR/04-562 which deals with the second set of mandates on the possible implementation measures for the Directive on Markets for Financial Instruments (MiFID).

In contrast to the earlier proposed technical implementation measures for the MiFID, the present consultation paper is of less detail and therefore more appropriate. The EAPB welcomes the fact that, in this way, over-regulation has been avoided to a large extent. As a result, investment firms will be able to maintain the scope of action they need to provide their services, and red tape without any practical benefit is avoided. We would like to support CESR in continuing with this lean and pragmatic approach to the advice on the implementation for the MiFID.

Again, we would also like to point to the fact that the set deadline of 30 April 2006 for the implementation of all level 1 and 2 measures of the MiFID is a more than ambitious target. We therefore support the Commission in its recent thoughts on establishing a transitional period until 2007.

In more detail, our comments on the present consultation paper read as follows:

1. Definition of „Investment Advice“ (art. 4, para. 1, no. 4, MiFID)

The EAPB welcomes CESR's proposals on the definition of "investment advice". They are based on the clear definition of the term given by the Directive itself and are confined to provide a distinction between "investment advice" and "personal recommendation". This is clearly in line with the Commission's mandate.

However, the European public banks consider it useful to start from the assumption of a rational or judicious observer, just as proposed in the explanatory text (see p. 10). We therefore would like to propose an amendment to number 1 in box 1, which would then read as follows:

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> *"Personal recommendation"* means any information given to a person … that is held out, either explicitly or implicitly, to the *judicious* recipient as being suited to, or based on a consideration of, his personal circumstances."

Question 1.1.: Advice on services

Advice on services, such as a recommendation to use a particular broker, fund manager or custodian, should indeed not be covered by the term "investment advice". Obviously, it has not been necessary to rule advice of this kind to the moment, as at present no comparable provisions exist in any Member State. As CESR rightly points out, such regulation would, moreover, not be covered by the provisions of level 1. Art. 4, para 1, no. 4, MiFID only addresses advice on financial instruments, Art. 19, para 4, MiFID only deals with security services as defined by the MiFID.

Question 1.2.: Personal recommendation as being suited to the client's personal situation

It is right that a personal recommendation should take account of the individual situation of the client. This is in line with art. 19, para. 4, MiFID, according to which advice should be delivered on the basis of a certain knowledge of the client's situation. Additionally, a legal certainty can only be established with this definition of "investment advice". A definition without this characteristic would render the term "investment advice" boundless and practically unmanageable.

Question 1.3.: Restricting „investment advice" to recommendations of specific financial instruments

"Investment advice" should indeed be restricted to recommendations of specific financial instruments. Only after a specific recommendation, based on the service provider's assessment, does the client make a decision with direct economic consequences. It is this direct economic effect of a recommendation that makes specific regulation necessary. Recommendations of a general nature, as they are made in the context of a financial planning, in contrast lack the direct effect that would justify specific rules. Finally, only a restrictive interpretation of the term "investment advice" of this kind is covered by art. 4, para. 4, no. 4 and art. 19, para. 4, MiFID.

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2. General obligation to act fairly, honestly and professionally and in accordance with the best interest of the client (art. 19, para. 1, MiFID)

Question 3.1.: Proposals on portfolio management
We support CESR in its proposals on the general conduct of business rules on portfolio management. Apart from these proposals, we do not see any need of further advice on art. 19, para. 1, MiFID.

3. Suitability test (art. 19, para. 4, MiFID)

The EAPB considers the majority of the recommendations on the suitability test as viable. We do, however, see a certain danger of unnecessary red tape in the proposals in numbers 5 and 8 in box 8 ("criteria for assessing the minimum level of information from the client").

To our mind, there is no legal basis for the *review of the client portfolio* suggested in number 5. According to art. 19, para. 4, MiFID already, the client has to provide the investment firm with the information necessary for the "suitability test". Such a review moreover contradicts number 4, which allows the investment firm in principle to rely on the client's information. Furthermore, it is in conflict with number 5, according to which it is the client's responsibility to inform the investment firm about any substantial changes in the client profile.

Furthermore, the *differentiation between advice on a continuing and on an occasional basis*, as suggested in number 5, exceeds the framework laid down by the Directive. It would, moreover, lead to considerable problems in the day to day business. As the investment consultant will have to make sure that his or her recommendation suits the client's individual situation in any case, there is, finally, no practical need for this distinction.

For these reasons, we propose to delete the first paragraph of number 5 ("Where an investment firm provides investment advice, or acts as a portfolio manager, … it must undertake a review of the client profile whenever the retail client seeks advice").

In contrast, the obligation to take prior transactions into consideration, as foreseen in number 8, is a justifiable and reasonable approach to the provision of investment advice. However, it must me made sure that this provision will neither bring along the obligation to continuously and actively monitor the client's portfolio nor excessive documentation requirements. We do not approve of CESR's proposal that the investment firm "should therefore take reasonable steps to review the suitability of the client's portfolio in addition to conducting the suitability-test in relation to each recommendation or decision to trade" and

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that "this sort of arrangement is not confined to portfolio managers" (CESR/04-562, p. 42). The continuous analysis of a portfolio is a central characteristic of portfolio management in the narrower sense. To establish an equivalent requirement for any transaction related advice would mean to obliterate the borderline to portfolio management. In this point, CESR's recommendations should therefore clearly avoid obscuring the definitions.

4. Appropriateness test (art. 19, para. 5, MiFID)

The EAPB welcomes the proposed recommendations on the appropriateness test as being feasible. It should be in the investment firm's responsibility to choose the adequate parameters for the test of the appropriateness of products or services for a client. Giving a limited number of examples of adequate parameters rather than presenting a closed list of them especially is a feasible approach. It is essential that investment firms have the necessary options open to assess the appropriateness of a product or service.

At the same time, the client should be able to take a decision on a product or a service on his or her own responsibility, on the basis of their knowledge and experiences. Clients should, moreover, be able to develop their abilities further, and to make new experiences, as long as the conditions of art. 19, para. 3 MiFID are fulfilled. In our view, art. 19, para. 5, MiFID would cover such a proceeding. The term "appropriate" leaves the necessary scope and, at the same time, provides for an effective protection against misuse.

Apart from that, we consider it right and reasonable that CESR deems recommendations on the content of warnings as not necessary. We agree with CESR that the provisions laid down by the Directive are sufficiently concrete.

5. Execution only (art. 19, para. 6, MiFID)

As regards determining non-complex instruments, art. 19, para. 6, MiFID contains very detailed provisions for the execution only business. To exclude bonds with derivative elements completely from the execution only business would deprive art. 19, para. 6, MiFID from its practical relevance. Online brokers would be completely made subject to the requirements of art. 19, para. 5, MiFID. In terms of the economic effect of certain instruments, this would be contradictory. On behalf of their clients, online brokers would then be able to buy all shares dealt at a regulated market, for example, but not to buy index certificates on a European or international standard index. To extend the understanding of "other non-complex instruments" to instruments comparably comprehensible for clients would, in contrast, be a sensible solution. This could be the case for index or discount

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certificates that track shares. These would allow clients a wider spread of investments than directly investing in shares.

Question 5.1: Legal categorisation or the economic effect of the financial instrument

The legal categorisation and the economic effect of a financial instrument are, in our opinion, of equal importance for determining the characteristics of non-complex securities. Indeed, both criteria are named in art. 19, para. 6, MiFID, and the examples of non-complex instruments which this article mentions relate to both the legal categorisation and the economic effect. We consider the economic effect, however, to be the decisive criterion in the end.

Question 5.2.: Service provided "at the initiative of the client"

For a comprehensive characterisation of when a service is provided "at the initiative of the client", we would like to refer to recital 30 of the MiFID. We do not see any allowance for further regulation on level 2 in this point.

6. Transactions executed with eligible counterparties (Art. 24, MiFID)

To the EAPB, there is no legal basis for an obligation to inform eligible counterparties about their status (see box 11). Neither the Directive nor the Commission's mandate include such information requirements. The costs arising from such a reciprocal information of the countless institutions that could be counted as eligible counterparties would not be justifiable. Moreover, market participants as professional as eligible counterparties can be expected to know the MiFID's rules and, consequently, their status.

Question 6.1: Quantitative thresholds for undertakings to request treatment as eligible counterparties

The EAPB agrees that the quantitative thresholds for undertakings to request treatment as eligible counterparties should be the same as the thresholds for professional clients. This would be a consistent solution that would guarantee clarity and manageability.

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7. Pre-trade transparency - Systematic Internalisers (art. 4 and 27, MiFID). Definition of Systematic Internaliser

When it comes to the pre-trade transparency requirements for internalisers, the EAPB explicitly welcomes that CESR refers to recital 53 of the MiFID and states that the obligations of Article 27 will not apply to firms which deal on own account solely on an OTC basis, as the characteristics of those transactions include that they are ad-hoc and irregular, carried out with wholesale counterparties, are part of a business relationship which is itself characterised by dealings above standard market size and are carried out outside the systems usually used by the firm concerned for its business as a systematic internaliser. Recital 53 of the MiFID clearly states that it is not the intention of the Directive to extend the time- and cost-consuming pre-trade transparency requirements of Article 27 to this highly specialised market. We therefore suggest that this distinction is also included in the definition in box 14.

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