

**EFAMA COMMENTS ON
CESR'S DRAFT TECHNICAL ADVICE ON POSSIBLE IMPLEMENTING
MEASURES OF THE DIRECTIVE 2004/39/EC ON MARKETS**

2nd Consultation paper

The European investment management industry, represented by FEFSI/EFAMA¹ welcomes the opportunity to respond to CESR's draft technical advice on possible implementing measures of the Directive 2004/39/EC on Markets in Financial Instruments². We have focused our comments on Chapter 2 of the CESR consultation paper covering the debated issue of the definition of investment advice. In particular, FEFSI/EFAMA recognises the importance that CESR attributes to the definition of investment advice as it has become apparent how much the investment management industry depends on the quality of advice provided at the point of sale.

FEFSI/EFAMA has been very active in this area since the beginning of the discussion with the aim to define quality of advice and suitability and to clarify the fund manager's role with respect to quality distribution. The large field of financial products and services of all kind makes a general definition of quality of advice a difficult task. We believe quality of advice can be achieved through a process that encompasses several stages starting from the collection of information about the customer and the product in order to enable the financial advisor to come - via a matching process - to the conclusion as to whether the proposed financial products are in general suitable for the customer to whom the advice was provided.

GENERAL COMMENTS

Fair competition between the various investment products

In view of the increasing number of financial products FEFSI/EFAMA believes that it is important for CESR to recognise that there are a number of financial products, which from the investor's point of view serve a similar purpose (e.g. investment funds, certain

¹ EFAMA (previously FEFSI), the European Fund and Asset Management Association, represents the interests of the European investment management industry (collective and individual portfolio management). Through its member associations from 19 EU Member States, Liechtenstein, Norway, Switzerland and Turkey, EFAMA represents the European asset and fund management industry, which counts some 41,100 investment funds with EUR 4.7 trillion in net assets under management. For more information, please visit www.efama.org

² CESR/05-164 of 3 March 2005

types of life insurance, certificates, structured bonds, etc.) but where, at present the regulatory requirements are significantly different. We would, therefore, like to underline the concern that financial intermediaries may avoid excessively cumbersome conditions and switch to other less regulated financial products, which are not covered by this directive (e.g. insurance products). It is significant that products not covered by the MiFID have the same regulatory environment (e.g. the duty to provide information regarding the clients knowledge and experience for appropriate advice, information regarding the effective rate of the insurance policy etc) and thus provide for an equal treatment of all financial products at the point of sale.

SPECIFIC COMMENTS

Chapter 2: The definition of investment advice –generic and specific advice

FEFSI/EFAMA has focused on the definition of investment advice and on the question whether the definition should be limited to specific financial instruments or should be extended to also cover more generic recommendations. In view of the consequences that derive from the characterisation of certain behaviour as the provision of investment advice it is important that investment advice is defined in a proportionate manner while ensuring an appropriate level of investor protection. In order to achieve quality of advice it is important to have a clear view regarding the scope of the definition of investment advice provided by the article 4 (1) (4) of the MiFID.

Question 1.3. *Do you believe that investor protection considerations require the application of the above conduct of business requirements from the point at which generic advice is provided or do you believe that sufficient protection is provided in any event to allow the definition of investment advice to be limited to specific recommendations?*

FEFSI/EFAMA’s opinion with respect to the aforementioned question is the following:

- ***The definition in the Level 1 text is concrete and rules out itself generic information.***
- ***However, as FEFSI/EFAMA considers that the provision of specific advice is usually based on a generic discussion on asset classes it is important that generic information provided from the part of the advisor fulfils the suitability requirements.***

The definition provided in the article 4(1) (4) of the MiFID where the provision of personal recommendations to a client is expressed in respect of one or more transactions relating to financial instruments does not leave room for a wide interpretation. Therefore, the wording provided in the Level 1 text restricts “investment advice” to recommendations of specific financial instruments and it cannot be read to cover advice that is generic.

According to the aforementioned interpretation, should the definition of investment advice be limited to specific personal recommendations, an investment firm will not provide an investment service until it provides a recommendation in relation to a specific financial instrument. The question that could be raised in this case where advice is provided is whether this approach could be realistic and whether it is appropriate for ensuring investor's protection.

When generic advice is provided, it is likely that such advice will be followed or combined with specific recommendations, which will lead to the client taking a specific investment decision. The generic advice - for instance - to invest in European shares opens usually more than 100 possibilities to invest. This type of advice does not empower the customer to select a specific share but it appears necessary to go into more details leading at the recommendation of a specific financial instrument. In such case specific advice is readily identifiable, as it will lead to the client taking a specific investment action. At this stage it is important to ensure that customer protection is provided and that the Conduct of Business obligations prescribed in Article 19 par. (3), (4) and (7) of the MiFID applies.

Notwithstanding this, CESR's attention should be drawn to the fact that sometimes it is likely to be difficult to set clear boundaries between specific and generic advice and, in our view, a personal recommendation might need to be qualified as either specific or generic on a case-by-case basis. On the other hand, recommendations that appear to be generic but do include implicit specific advice should be treated as specific advice. The moment specific weightings are attached to a particular portfolio we think it should be considered advice.

FEFSI/EFAMA would also like to underline that it is important that the specific advice must be in line with the pre-defined asset allocation of the client, which means that asset allocation should be part of the suitability test.

A financial advisor has to collect the necessary relevant information regarding the overall financial situation of the client he is advising and take into account his individual requirements. "Relevant" refers to the scope of this process, which should reflect both the nature of the fund product and its materiality to the overall financial situation of the client. For example, offering a long-term plan requires a more in depth knowledge about the overall financial situation of the customer than a relative small investment in a particular fund, obviously not representing a material part of the client's disposable assets.

Defining investment advice does not itself lead to a regime in which quality advice is available to investors. One important constituent of quality advice is product suitability. It should therefore be necessary for an advisor to place the investment advice on a specific product in the context of the broader awareness of the client's circumstances. This of course may not extend to a full financial plan for the client every time products are discussed.

It is the adviser's duty to bring all the information collected relating the customer and product together and draw the necessary conclusion that would enable him to recommend to the customer the product in question or not. Thus, the features of the product –in particular its risk and return potential –have to be matched with the relevant investor

characteristics such as risk attitude and investment horizon. A derivative instrument, e.g., will have a totally different impact if it is a hedge for a long instrument than if it is a standalone investment.

This matching process is based on the conviction that a financial product is “per se” suitable or not suitable. The financial advisor should among others:

- o Compare the financial situation with the amount to be invested;
- o Compare the objective risk-taking ability with the risk-parameter of the proposed fund;
- o Check whether the coherence of the proposed financial instrument complements the overall asset allocation of the clients’ disposable wealth.

We therefore agree with CESR approach that the exclusion of generic advice from the definition of investment advice should not circumvent the suitability requirement. Asset allocation is clearly part of the suitability test. We would like to repeat that the suitability cannot be referred to an instrument in an isolated view but the portfolio context has to be regarded.

Finally, we would like to underline that the nature of the product that is recommended by the investment adviser; in particular, the level of protection that needs to be built into the advice /suitability process should depend upon whether the product being discussed is itself regulated and supervised or not.

We hope that you find these comments helpful and we would welcome an opportunity to explain them in more detail should you desire such.

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