

HBOS/GR/RCT/JNH/cdf
Your Ref CESR/06-0413

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Mr Fabrice Demarigny
Secretary General
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Dear Mr Demarigny,

CESR'S PROPOSED WORK PROGRAMME AT LEVEL 3 OF MiFID

Thank you for providing HBOS with the opportunity to comment on CESR's proposed work programme at Level 3. We appreciate the effort that EU level bodies, such as CESR, make to engage with stakeholders in advance of developing regulatory policy; we believe this leads to better solutions, and advances the EU more efficiently towards the achievement of a single market.

HBOS

HBOS, the fourth largest UK bank based on current market capitalisation, is a key industry stakeholder in the development of a level playing field for financial services. HBOS was formed in 2001 from the merger of two UK banks with long and successful histories – Bank of Scotland and Halifax. HBOS operates across five divisions: Retail; Corporate; Insurance and Investment; Treasury and Asset Management; and International. While well-known in the UK market as a major mortgage, bank account, and insurance provider, HBOS is also a significant player in the field of investment services in the UK and the rest of the EU.

In the Retail Division, Halifax Share Dealing offers the UK's second largest¹ online stockbroking facility to customers wishing to trade both on the UK markets and internationally. Within the same Division, HBOS' Advisory Sales business offering products such as pensions, life assurance, and other tax-efficient savings products has in excess of one million customers.

HBOS' Insurance and Investment Division includes the well-known brands Clerical Medical and Halifax Financial Services. Under these two brand names, almost £50 billion is invested for nearly two million customers. Products are marketed in the UK through the Bank of Scotland and the Halifax branch networks, as well as through investment intermediaries.

In the Treasury and Asset Management Division, Insight Investment, HBOS' asset management business, is one of the UK's largest operations, with funds of £88.7 billion under management.

¹ by transaction volume

HBOS' retail European Financial Services business is comprised of Clerical Medial International, Heidelberger Leben and CMH Vetriebs Services. It is one of the foremost cross-border insurance and investment businesses in Europe, spanning many countries, operating multiple brands, and using a diversity of distribution methods. We also have a considerable corporate banking business in Europe, with teams transacting business in equity, mezzanine, subordinated debt, senior debt and deposit product offerings from offices in Amsterdam, Edinburgh, Frankfurt, London, Madrid, Paris and Stockholm.

HBOS has:

- over 2.3m small shareholders – the largest private shareholder register in the UK;
- 72,000 employees worldwide – 66,000 in the UK with the balance spread across the EU, North America, and Australia; and
- 22 million customers – 40% of UK households have a relationship with HBOS.

Proposed timescales for the work programme

We are concerned to note that the proposed work programme seems to indicate that CESR will be preparing guidance around some areas of MiFID in advance of the implementation date for the Directive. Given the short timescales in which competent authorities must prepare final text, and the short timescales accorded to investment firms to implement the Directive, we believe that CESR should refrain from developing guidance around outsourcing, internal governance, best execution, record keeping, and inducements until after November 2007.

The UK Financial Services Authority (FSA) is currently consulting with the industry and other stakeholders on proposals for implementing MiFID. The industry, aware of the UK regulator's draft proposals through the open consultation process, is already preparing to implement along the lines suggested by those proposals.

The introduction of CESR-prepared guidance at a late stage in the lead up to implementation, e.g. a list of minimum record keeping requirements at Q1 2007 after the transposition deadline, has the potential to cause firms to incur significant costs where the CESR-prepared guidance differs from the UK implementation proposals and changes to systems and procedures must be made at short notice. Indeed, significant divergence in the CESR-prepared guidance could create a barrier to firms implementing MiFID requirements on time.

From a practical perspective, we are concerned that CESR will not have sufficient time to undertake full consultation with the industry and other stakeholders under the proposed timetable. Given that many firms are likely to be heavily engaged with their national regulators' consultations and their own implementation preparations, diverting resource to respond to CESR consultations presents a difficult choice. CESR should allow sufficient time to ensure a high quality of response, and we do not consider that the proposed timescales when taken in connection with national programmes would allow for this.

Additionally, we are not clear whether national implementing measures take primacy over CESR-prepared guidance.

Finally, any guidance developed in advance of the implementation deadline cannot:

- benefit from the experience of implementation, and therefore may not be fit to address the practical problems that may be identified by market participants and competent authorities during implementation;

- derive significant, valuable lessons from comparative analysis of the different approaches employed by Member State competent authorities to implement MiFID;
- be said to be in response to significant market failure; or
- be informed by rigorous cost-benefit analysis or regulatory impact assessment as the baseline against which costs and benefits are to be judged would only exist post-implementation.

Passporting

Notwithstanding our reservations about the development of guidance in advance of implementation, we agree with CESR's assessment that passporting issues must be resolved in advance of the implementation deadline. The effective operation of the passporting regime is central to MiFID and to creating a level playing field across the EU, therefore, we urge CESR to focus on this task over all others.

Given that not all Member States will be "MiFID compliant" by November 2007, we are keen to ensure that firms operating from compliant Member States are able to exercise passporting rights into non-compliant Member States without restriction.

Conversely, we are concerned that firms operating from a non-compliant Member State seeking to passport into another Member State are restricted from doing so, or are only allowed to do so subject to meeting full MiFID requirements. That such a firm meets MiFID requirements must be fully verified by the Host Member State competent authority (if the Host is MiFID-compliant) or by CESR (if the Host is non-compliant). Failure to adequately address this issue could see instances of regulatory arbitrage, as firms seek to establish branches in non-compliant Member States to benefit from what are perceived as less onerous regulatory regimes.

Further, as MiFID has investor protection as a central driver, it is important to ensure that all customers across the EU are afforded the full protection of the Directive or equivalent from 1 November 2007.

Approach to examination

CESR's work plan identifies specific areas where there will be collaboration with CEIOPS and CEBS, and we welcome this intention. HBOS' activities span the remits of all these committees and we would welcome a harmonisation of approach between them to the extent this is practicable. In jointly examining issues and taking a pragmatic approach, the three committees can further the development of a single market in financial services.

We recommend that all committees also take in the wider landscape. Firms are not subject only to financial services legislation, for example data protection legislation, corporate governance and company law, consumer protection legislation, competition law, etc are also applicable. The committees must be mindful in their development of guidance and practice of any mis-alignment with existing non-MiFID requirements. To illustrate, while current data protection legislation is driving towards a paper-less approach, MiFID places greater emphasis on provision of customer information in paper form. Such anomalies and mis-alignments in EU legislation, if addressed, would greatly decrease the burden on all companies operating in the EU. While CESR and its partner committees cannot rectify this issue alone, we believe that a sensitivity and awareness to the issue would result in better solutions.

CESR should also pay regard to guidance produced and work already completed by related supra-national organisations such as the Basel Committee and the International Organisation of Securities Commissions. For example, the Basel Committee has already prepared

guidance on the compliance function. Where such guidance exists, CESR should align their own guidance to it to the greatest extent possible. This is particularly relevant where EU banks are operating on an international as well as a European basis.

We would also recommend that CESR engage specialist expertise when developing guidance which would have, or may have, implications for IT systems. With current technology, some MiFID requirements are considered to defy a sensible IT solution. To illustrate, recent discussions in the UK around best execution under MiFID have highlighted that some of the more sophisticated solutions that were envisaged cannot be built and tested in the time for implementation.

CESR's original advice to the Commission

CESR's original advice to the Commission, in H1 2005, was the result of considerable discussion. While reference to earlier discussions will be of value to CESR when considering how to further harmonise the approach across the EU, we would not wish to see CESR attempt to re-introduce its original advice without rigorous cost-benefit analysis and regulatory impact assessment. We note particularly that CESR intends to re-visit telephone recording; the text of the original advice on this issue represented a compromise driven by the deadline to respond to the Commission and did not represent a practical solution. HBOS would not want to see the text of the original advice to the Commission reappear in CESR's own guidance.

Further explanation

There are some areas of the work programme which are ambiguous, and we request that CESR provide further clarity as to what issues it perceives work around these areas will be addressing. In particular, CESR expresses an intention to work on "Substitute Products" (pp 7), but we have been unable to find any reference to this term elsewhere on CESR's website. Our working assumption is that CESR intends to examine the extent to which non-scope products are subject to similar requirements as MiFID, e.g. information gathering at point of sale. We would appreciate further explanation from CESR as to what is meant here.

HBOS contacts

Please do not hesitate to contact either myself, or my colleagues, David Gordon and Cat Fereday, if you would like to discuss any of the matters we have raised in our response or if you would find it helpful to meet with a member of the HBOS Group.

Yours sincerely,

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