ASSORETI

*Il Segretario Generale*

Rome, 4 April 2005
Prot. no. 131/05

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Via CESR's website

**Subject: Implementing Measures of the Directive 2004/39/EC – Second Consultation Paper – Definition of Investment Advice.**

The Assoreti – National association of Companies (mainly, banks and investment firms) that provide outside the premises of the investment firm financial instruments and investment services through financial promoters – has already expressed its opinion *in favour of an extended definition of investment advice, to also include asset allocation and financial planning services,* in the framework of a broader memo designed to support full acknowledgement of the tied agent's advisory faculties (refer to memo dated 20th January 2005, via CESR's website, relative to the first consultation paper on this issue).

The second consultation paper published by the Committee now asks for further considerations confirming the opinion already expressed in the above-mentioned memo (in particular, refer to paragraph 2 of the memo in question).

## 1. *The given regulation is expressed as an interpretation of the definition of investment advice as including the provision of generic advice*

First of all, in the writer's opinion, directive 2004/39/EC leaves no margin for doubt with regard to the need to include asset allocation and financial planning services in the definition of investment advice.

This conclusion is based on converging and certain regulatory indices. The provisions set out in directive 2004/39/EC, which govern investment advice, explicitly refer to the fact that the service provided consists in advice that relates to both financial instruments and to investment services [as set out in Article 19 (4), relating to the suitability of investment advice; and again in Articles 4 (1) (25) and Article 23 (1), with regard to investment advice exercisable by the tied agent]; and advice relating to investment services, by definition, is *generic* advice.

In this certain regulatory context, also the reference to "one or more transactions relating to financial instruments", included in the investment advice definition [Article 4 (1) (4)], can only be read in the sense that, by virtue of its customised nature, investment advice is the service that is potentially able to persuade the retail client to engage in one or more investment transactions relating to financial instruments (and not of course only the service that is provided when advising on specific financial instruments). This purposeful interpretation is confirmed in recital (3) of the directive in question, where inclusion of investment advice among investment services is motivated by way of “the increasing dependence of investors on personal recommendations” (with no distinction being made, either here or elsewhere, between generic advice and specific advice). And even generic advice has a particular inductive effectiveness, enhanced by the impression of greater neutrality induced in the client precisely by the generic nature of the advice provided.

## 2. *The analysis of the practical implications confirms the validity of the foregoing broad interpretation, in view of the interests involved*

The foregoing, clear indications which originate from the regulatory provisions are already sufficient in their own right for a jurist of continental origin, tied to an exegetic analysis of the text, to be convinced of the fact that even generic advice is included in the regulated investment advice.

However, to appreciate the importance assigned by the Committee to the practical effects of accepting one solution or the other solution, it should be noted how the same conclusion could also be reached, and for all the more reason, if due consideration is given to the tangible implications, as reached through a pure analysis of the regulatory provisions in an EC context characterised by the need to mediate between the interpretative rules of the civil law system and the rules of the common law system.

In this regard, it is worthwhile remembering that the mandate conferred by the European Commission expressly invites the Committee to pursue the objective of protecting the market and the investors (refer to the point 2.3 of the “formal mandate” conferred by the European commission on CESR dated 25th June 2004).

This should mean that in the interpretation and in the implementation of the execution measures of the regulations of Directive 2004/39/EC due consideration must be taken of the protected interests; and in this regard there is no doubt that, in the case in point, protection of the market and of the investors is better ensured by including the asset allocation and financial planning activities in the sphere of regulated services.

### 2.1 *The negative effects of a hypothetical interpretation of the investment advice definition limited to providing specific advice*

More in detail, it is believed that there are at least two orders of practical effects that advise against limiting the notion of the regulated investment advice to only specific advice. Our attention will now focus on these issues, in strict compliance with the invitation made by the Committee with the second consultation paper cited in the subject.

a) *The first serious undesirable effect originates from the danger that the client’s investments may be influenced by an inappropriate asset allocation*, executed by parties not subject to forms of prudential supervision or precise rules of conduct the relative breach of which is strictly



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sanctioned. A danger indeed made worse by the presumed and uncontrollable “neutrality” of the advice provided by the advisor.

Nor would it be possible to remedy the lack of rules in the generic advisory stage with the rules applicable at the date the client acts on the advice in a tangible form. In fact, the client would remain definitively deprived, inter alia, of the protection provided by the rule of suitability, if the client were persuaded to engage in transactions included in the execution only service [not subject to the foregoing rule, pursuant to Article 19 (6) of Directive 2004/39/EC] on the basis of the generic advice received. Therefore, the potential deregulation of generic advice will result in endorsing a seamless avoidance mechanism of the above-mentioned rule of suitability in a scenario in which the client, far from having chosen alone the transactions to be executed, has instead been persuaded by receiving some generic advice. And one has to consider that this circumstance would be by far the most frequent circumstance, it being difficult to imagine that the retail investor – intended to be protected by the rule of suitability – after having sustained the cost of the generic advice, then also incurs an additional cost for specific investment advice and/or individual portfolio management, preferring instead to choose the more economic solution of transmitting the orders, based on the advice received.

And from here the distance is very short to doubting that behind the role of the generic advice can be hidden a party that unlawfully engages in the specific investment advice, if not also that of individual portfolio management or the reception and transmission of orders.

Then, in the rare scenarios in which the client decides to engage in operations in the framework of investment services subjected to the rule of suitability (more probably, this scenario could entail application of the rule of appropriateness in the framework of the placement service, a rule however that is less incisive compared to the rule of suitability), the client, on the one hand, could remain firm in the decision induced by the generic advisor (also considering the presumed neutrality of the latter party, as well as the unpunished use that the latter could make of more attractive statements), while on the other hand, if the authorised firm objects to the suitability of the transaction, the client would inevitably be left confused, since he would not understand – and rightly so – why there are competitors on the market subject to rules and competitors on the market not subject to rules, although referring to the same protected interests (the client's savings).

To conclude, the personal asset allocation and financial planning services, if they were to be considered outside the sphere of the regulated investment advice, they would be provided in a regime totally without rules. Which is absurd, if only one considers that another service, undoubtedly less hazardous, since by definition it is not personal, namely the investment research and financial analysis service, when provided by an authorised firm is considered to be included among ancillary services and therefore, in principle, subject to the same rules of conduct established for the principle investment services. Nor would the assumption expressed on this point in the second consultation paper issued by the Committee appear to be beyond contention, according to which the authorised firm would always be subject to such rules of conduct when engaging in the asset allocation and financial planning activities, since Directive 2004/39/EC limits the extension of these rules to providing (only) the ancillary services, which do not included the above-mentioned activities.



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Therefore, in conclusion, generic investment advice would be the only unregulated customised investment service, and unaccountably the generic advisor would be the only unregulated competitor on the financial market.

b) *The second serious order of undesirable effects then originates from the practical difficulty – if not the practical impossibility – of establishing the borderline between generic advice and specific advice*.

In fact, it is necessary to consider beforehand that the asset allocation and financial planning services, even if they can be equated to activities in their own right, in general, fail to satisfy the client's interests, but represent a phase that is specified in the precise investment advice in one or several specific products or services. Therefore, to extrapolate asset allocation from investment advice would be equivalent to curtailing artificially the scope of the service in question, with serious consequences both in terms of the market's integrity and protection of the investor.

In fact, if such a curtailment were to be implemented, it would become difficult, even in abstract terms, to distinguish the exact demarcation line of regulated investment advice from free asset allocation: in practical terms, what would be the limit beyond which advice should no longer be considered as being generic advice but on becoming specific advice, could only be given by an authorised firm? And how many times would litigation occur with regard to the interpretation of this limit and with regard to whether, in tangible terms, the foregoing has been exceeded or otherwise? And how would it be possible to claim that the authorised firm would not be subject to rules when engaging in asset allocation, whereas the firm would be subject to very severe rules were subsequently providing investment advice based on the initial asset allocation? And even if the opinion expressed by the Committee with regard to subjecting the authorised firm to the rules of the sector which discipline the provision of financial planning and asset allocation services is beyond contention, how would it be possible to justify the fact that the same service is subject to severe rules to protect the market and the investor when the service is rendered by a qualified and supervised firm and instead the service is not subject to any rule when provided by any given party?

In fact, the circumstance in which the interpretation disputed here raises such queries represents further proof of the fact that any separation between generic advice and specific advice can only be artificial and the forerunner of so many doubts that it induces a different interpretation to be preferred.

However, if in the past it was clearly acceptable to include asset allocation and financial planning services in the notion of ancillary investment advice (in this sense reference can be made to the communication by Consob (Companies and Stock Exchange Commission) No. 1083623 dated 7th November 2001, in the Italian legal system, retrievable from the Internet Web Site: www.consob.it), it cannot now be the case that the EU legislator has eliminated the notion, thereby achieving the opposite effect to the declared effect, in order to show that it wants to strengthen the safeguards of the market and of the investors elevating this service to the category of principle regulated services; and however it cannot lack a regulatory expectation in this sense.



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## 2.2 *The positive effects of the interpretation of the investment advice definition extended to generic advice*

Vice versa, the inclusion of the foregoing services in the definition of investment advice enables only positive effects to be identified. Moreover, the effect of this inclusion:

- prevents the asset allocation and financial planning services, which are however susceptible to undermining the market's integrity and being prejudicial to investors, from being provided without authorisation and therefore without public supervision;

- establishes correct competition on the financial markets, by excluding the presence of unregulated operators and therefore privileged operators, since not subject to rules or to supervisory costs;

- the confusion generated in the investor by the contemporary presence of regulated and unregulated operators on the same market is avoided, which furthermore could provide conflicting assessments as regards investment choices;

- the generic advisor has an obligation to comply with a number of basic rules of conduct, ranging from the obligation of providing information to the client with details of the service rendered and details of the firm rendering the service [Article 19 (3)], to the obligation of providing suitable advice [article 19 (4)], in line with the fact that the asset allocation and financial planning services provide the client with an initial guide in which the client can then probably operate to make the investments, based on a seamless logic that proceeds from the generic advice towards the specific advice;

- there is an obligation to provide minimum content in the generic advice agreement and a special mechanism to express contractual consent [Article 19 (7)], fully consistent with the suitability of the advice in question to give the client the initial guidance that conditions the client's subsequent investment choices;

- referring the application or otherwise of the investment services discipline to the very fine distinction between generic advice and specific advice is avoided. This distinction would be difficult to identify in the real world and would undoubtedly generate conflicting interpretations in the single national legal systems, as well as a multitude of disputes with the undesirable effects of a significant increase in the aggregate rate of litigation in the sector;

- avoidance among other consequences, of the adversarial approaches which render even more apparent the artificial nature of the distinction made between generic advisory and specific advisory, whereby a broker authorised to provide investment advice benefits from the community passport limited to the provision of specific advice and cannot benefit from the community passport to provide the financial planning service, which is also premonitory of the subsequent investment advice;



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- finally, supervision is truly extended to all parties that operate on the financial market, avoiding the situation where the independent financial advisor can be facilitated in the unlawful exercise of other investment services through theoretically “free” activities.

## 3 *The directive shifts the issue from the community law level to the level of the single national rights, free not to apply the directive to investment advice tout court*

Therefore, on the basis of all the foregoing considerations, both in terms of the law and from a practical aspect, it is believed that the definition of investment advice must include asset allocation and financial planning services.

At most, the question could be raised as to whether to graduate the applicable rules depending on the greater or lesser degree of specificity of the advice provided. Considering that there should be no grounds even to raise that question - since the question would have meaning only if one were really convinced of the greater degree of persuasion towards investment achieved by specific advice compared to generic advice (whereas, it cannot be excluded that the contrary may even be applicable in certain cases, since other factors would appear to be crucial in convincing the client), and however the practical difficulties would remain associated with the need to identify the borderline between generic advice and specific advice - the foregoing having been said, however, it is important to state here that the solution of graduating the rules in fact appears to be the solution adopted by Directive 2004/39/EC to resolve the issue under review.

In fact, this directive evidently already conditioned by the various points of view of the legal systems applicable in the various member states, establishes the possibility of a softer regulation in the case of firms that only provide investment advice [Articles 5 (5), 16 (3), 17 (2), 67], even going as far as to defer to the single national laws the choice of whether to apply or otherwise the directive in question to firms “not allowed to provide any investment service except the reception and transmission of orders in transferable securities and units in collective investment undertakings and the provision of investment advice in relation to such financial instruments” [Article 3 (1)].

Therefore, the directive already takes into account the point of view of the legal systems that would like to exclude asset allocation and financial planning services from its field of application, granting the foregoing autonomous regulatory powers in this regard. This solution, which is already a compromise solution, presupposes the broad definition of investment advice and is designed precisely to avoid that the different choice made by single Countries may influence the definition of the field of application of directive 2004/39/EC for those countries that instead, decide not to depart from the directive, with all the implications that derive from this, also in terms of the community passport.

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In conclusion, while noting that many of the considerations outlined above are expressed in the second consultation paper cited in the subject, we trust that the Committee will uphold the



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foregoing definition of investment advice, including the asset allocation and financial planning services.

We take this opportunity to thank you for the time dedicated to the foregoing considerations and remain at your disposal for any further cooperation as desired.

Yours sincerely.

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