ASSORETI

Il Segretario Generale

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Via CESR's website

Subject: CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments – Second Set of Mandates – Investment Advice and Tied Agent.

The Assoreti – National association of companies (banks, investment firms and management companies) that provide outside the premises of the investment firm financial instruments and investment services through "financial promoters" – wishes to express its utter appreciation for the hard work executed by the CESR and also wishes to address a number of aspects pertaining to investment advice, especially as regards the role of the tied agent.

In this respect, we are aware that this Committee has received a mandate by the European Commission to express its opinion on the definition of advice and not on that of tied agent. However, it is undeniable that the afore mentioned definitions are strictly connected one with the other insofar as Directive 2004/39/EC has expressly granted the tied agent the power to provide advice on the financial instruments and investment services offered by the intermediary on whose behalf the same agent acts. Indeed, the same European Commission has acknowledged this connection, requesting the CESR to advise on criteria differentiating personal recommendations and the activities of the tied agents. It is this very aspect that we wish to address in detail in this note.

Anticipating the conclusions that we wish to back through this document, it is Assoreti's belief, based also on the sizeable experience in Italy, that

a) the tied agent can provide in its broadest sense investment advice *with respect to* the financial instruments and investment services offered by the intermediary on behalf of whom the former acts, including the execution of financial planning and asset allocation services;

b) the tied agent cannot provide investment advice on his own account;

c) the intermediary can provide advice through the tied agent enrolled in the pertinent national public register.

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1. Protection of the Italian distribution model and recognition, in directive 2004/39/EC, of the capacity of the tied agent to provide "functional" investment advice, distinct from investment advice in its 'pure' sense and as such, inclusive of financial planning and asset allocation activities

Italy has had a widely tested and effective regime in place for twenty years which governs the provision of financial instruments and investment services offered outside the premises of the investment firm. Unlike the approach adopted by directive 2004/39/EC, the legislation in Italy addresses the activity pertaining to the offer outside the premises of the investment firm, and as protection of public savings, intermediaries are required to use - in the performance of their activity – "financial promoters" enrolled in the apposite register kept by the Consob, regardless of the nature of their work relationship (agency appointment, subordinate employment relationship or mandate). This model applied in Italy is still deemed more evolved than that adopted by the directive, insomuch that the same has yet to address the subject beyond the issues related to the intermediary who is required, solely in the case where the same should intend to use a tied agent, to choose from among those enrolled in a national public register.

Apart from this difference in approach, one can safely state that the core of the subject and the regime laid down as regards the tied agent in directive 2004/39/EC is in every way faithful to that of the Italian "financial promoter". Hence the undoubted interest in going deeper into the knowledge of the Italian legal system, as source wherefrom the Community lawmaker has so far drawn, a source the interpretive elements of which must continue to inform the subject-matter for defining detailed aspects of law such as pertain to the activities that tied agents can carry out (or *rather*: those of the intermediary through the tied agent).

In this respect, it should be noted that according to the model of Italian law – the adoption of which did entail some considerable effort on the part of Italian intermediaries in the early stages, requiring also constant investment in terms of training and setting up of internal audit measures – the "financial promoter" (i.e.: the tied agent), far from being simply a vendor, is indeed someone who enters into a continuative relationship with customers built on trust, providing (and indeed is fully qualified and skilled to do so) direct and personalized advice.

This advice given by the "financial promoter" is not considered in Italy an expression of an investment advice service proper (intended as a 'pure' advice, a threehundredandsixty degrees type of service), rather, it is considered as a due phase of the allocation service and offer outside the premises of

the investment firm, instrumental if one is to perform the service in the best interests of investors, identifying the investment that will best suit customers' risk/yield profile.

With respect to this form of advising, provided as part of the allocation service, the term 'functional' or 'explanatory' advice has been referred to (this has also been the case with Consob, with communication no. BOR/RM/94005134 of 23 May 1994) to stress the fact that the same is strictly connected with the allocation service, of which it is a legally required phase if one is to ensure that the intermediary comply with the conduct requirements set forth in the regime specifically governing the provision of this service (similarly to the provision of any investment service).

More specifically, the said "functional" type of advice is viewed as distinct from the investment advice consulting service in a twofold respect: one is related to a quantitative aspect insomuch that 'functional' advice is limited to the financial instruments and investment services offered by the proposing intermediary (unlike an investment advice service which as a rule, is omni-comprehensive); and the other of a strictly quality/teleological kind insomuch that the advice provided insofar as it is 'functional' to the service rendered may also go beyond simply satisfying present needs, i.e. it may be fully finalized at a subsequent point and lead to a possible placement of financial instruments and/or investment services offered by the proposing intermediary (unlike an investment advice service, which necessarily exhausts its function upon providing such advice).

The distribution of financial products and services through "financial promoters" has therefore arisen as a result of a legal obligation and has translated into an organizational model that has gained wide approval (suffice it to mention that at 31 December 2004, the "financial promoters" enrolled in the register kept by the Consob were 64.898, over two-thirds of whom in employment, and that as many as 33.000 of these are "financial promoters" operating for intermediaries who are members of Assoreti and who look after the interests of over 4.000.000 customers for overall assets of some 175 billion Eur); this is a situation that we deem can be effectively replicated in other member countries and, it is important to stress this, in the light of the most enhanced protection afforded by the Italian regime covering the outside-of-premises offer.

The success of this model, as can be easily inferred, is mainly based on the "financial promoters"' recognized capacity to establish a quality and trusting relationship with customers whom they can advise - in accordance with the expectations of the same – on the best products and services out of those offered by the proposing intermediary. More specifically, compared to the provision of the 'pure' investment advice service, the above-mentioned model satisfies the needs for advice of investors (especially retail ones) without requiring any additional expense insofar as the fee for providing 'functional' advice is not considered, as a rule, as arising independently to the placement service acceded and is therefore included in the placement commissions received by the offering intermediary.

In view of the foregoing, we feel that the capacity of the Italian distribution model - centred on the professional function of the "financial promoter" - of satisfying investors' needs of information and consulting has been the very basis for the full recognition given by directive 2004/39/EC. Indeed the same in defining the tied agent along the lines of the statutory rules governing the Italian "financial promoter" has expressly provided for the power of the same to provide customers with advice in respect of the instruments and services offered by the proposing intermediary [see articles 4 (1) (25) and 23 (1)], in other words, to provide the kind of advice that in Italy is referred to as "functional". There are other grounds that lead to this same safe conclusion, specifically, the fact that the above-mentioned laws

expressly refer to the tied agent's power of "providing advice in respect of such financial instruments and service offered by that investment firm".

Therefore, we feel it is crucial that, with a view to enhancing investors' protection, future regulations of the European Commission for the implementation of the provisions of the above-mentioned directive 2004/39/EC duly emphasize, where possible, the implicit potential of the above-mentioned model, confirming the capacity of the tied agent to provide, on account and under the instructions of a single intermediary (as provided for in the above-mentioned directives), with the best and broadest advice with respect to the products and services provided by the same.

2. ***Inclusion of financial planning and asset allocation services, in any case, in investment advice tout court (also recognized with respect to the tied agent).***

Should this Committee, however, not view the tied agent's functional investment advice activity as distinct from the activity of providing investment advice proper, we feel that the intermediary may still perform financial planning and asset allocation services through the tied agent insofar as the concept of advice used – in this case indistinctly – in the definitions of investment advice and tied agent *naturally* includes the execution of such services.

We now come to address the question raised by this Committee: whether the advice should solely amount to specific recommendations or whether it may include, as it is felt it should, the provision of generic advice, and specifically, the provision of financial planning and asset allocation services[1].

By analyzing the consultation paper covered herein it emerges that a possible restrictive interpretation of the investment advice service, limited to the provision of only specific advice, is based

[1] This question, viewed in terms of the consultation paper covered herein, pertains to the investment advice activity proper, that in the foregoing was referred to as being distinct from the advice intended as ancillary service, as set forth in Community definition of the tied agent. And the latter type of advice, where viewed as ontologically distinct from an investment advice service, ought not to suffer limitations other than those deriving from its 'ancillary' quality. Therefore, the tied agent should also be allowed to perform financial planning and asset allocation activities (of course, on behalf of the investment firm), where the same are not separate activities but performed with a view to a subsequent placement and also with a view to offering the best possible performance with respect to the same placement service.

However, should the Committee feel that this distinction between investment advice proper and investment advice "functional" cannot be made, we wish to note that the tied agent may in any case execute financial planning and asset allocation services both when the same are considered an integral part of the investment advice service and when considered, instead, extraneous to this service. Should this not be case, we wish to stress once more that an essential part of the service rendered outside the investment firm through the tied agent would be amputated and this would cause the following negative effects:

a) it would deprive the retail client of a fundamental investment advice service which is provided free of charge, as a rule;

b) penalize the vital sector of outside-the-premises distribution as a whole, unduly affecting the organizational autonomy of the intermediary;

c) demeaning the professional role of the "financial promoter" outlined first by the Italian law-maker and then by the Community law-maker who have provided for very strict requisites of honesty and professionalism that make this same role highly qualified to give expert advice to investors (naturally, with the means provided by the proposing intermediary and under the full and unconditional responsibility, supervision, auditing of the same);

d) last but by no means least, it deprives the investor of the guarantees offered by a continuative relationship, established through the tied agent, exposing investors to merely contacts that would translate in a mere selling of a product.

on an interpolated clause contained in the definition of investment advice [art. 4 (1) (4): "*in respect of one or more transactions relating to financial instruments*"], extrapolated from the rest of the directive.

However, this interpolated clause - it is important to stress this - may lend itself to this restrictive interpretation (but not only to this one) but there are of course many other elements, literal and non-literal, which, if we apply a more systematic interpretative criterion work in the opposite direction.

Firstly, it should be stressed that the regime of investment services as a whole revolves around the priority of protecting the market and investors, a priority that the same European Commission has referred to as being one of the two objectives that the CESR should bear in mind in giving its opinion in this matter [see point 2.3 of the "*formal mandate*" of the European Commission to the CESR, of 25 June 2004, which indeed refers to recitals (17) and (71) of the directive 2004/39/EC].

Consequently, rules on this subject should be interpreted, as a rule, in such a way as favours the objective sought, i.e., being careful to give due emphasis to the substance of the interests to be protected.

As to the investment advice service, should we wish to apply an interpretative criterion that considers first and foremost the tenor of the rule, it is absolutely plain that the term "*transactions*" cannot be interpreted in the sense that such a case arises only when a transaction is actually executed 'concomitantly' to providing such advice; otherwise this would mean that no investment advice service can be said to arise whenever such advice is not followed by a transaction and clearly this cannot be; which safely leads us to conclude that investment advice should be intended as "leading to a transaction" and, therefore, regardless of whether the investment advice is generic (portfolio planning) or specific (selection of the single product).

And this is corroborated by the fact that there is no trace of such "specificity" in the definition of investment advice, nor is it found in any other rule of the directive. Conversely, there are clear textual references on the fact that the investment advice service may be extended beyond simply providing specific advice. The said references are mostly contained in article 19 (4) (concerning the suitability rule) and articles 4 (1) (25) and 23 (1) (carrying the definition of tied agent), where it is clearly specified that investment advice consists in recommending not only financial instruments, but also other investment services suitable for the client or potential client. So, it is plain that advice on an investment service cannot but be, by its very definition, generic advice; and the fact that it is indicated as the object of a rule of conduct or of a definition amounts to the expression of the Community law-maker's intention, both implicit and unambiguous, of considering generic advice (i.e.: asset allocation) as being the subject of investment advice.

After all, this conclusion would appear to conform to the interpretative criterion set forth in recital (3) of directive 2004/39/EC, according to which it is appropriate to include the provision of investment advice service as part of core investment services due to the: "increasing dependence of investors on personal recommendations". This justification given above clearly suggests an interpretation centring on the purpose sought, one which will carefully assess the *ratio* of the new regulations in matter of investment advice, indicating as guiding criterion to distinguish investment advice from other activities that of the personalization of the advice (and not its specificity, which, as mentioned hereinabove appears in no part of the directive). It should also be noted that the European Commission, in formulating the mandates here discussed, has expressly placed an emphasis on the

distinction between 'personalized' recommendation and a series of other cases (including the advice that the tied agent may give), which is evidence that it has already given due consideration to the centrality of the personalization element with respect to the definition of investment advice.

In view of the foregoing, the definition of investment advice that the European Commission is called upon to specify with the CESR's technical aid should be expressed, in Assoreti's opinion, according to such criteria as can provide guarantees, designed to broaden as much as possible the area of reserved activities; it should also be expressed so as to include all such activities as are instrumental to supporting the client (*who is given, moreover, neutral advice*) in making certain investment choices and subsequent and consequent transactions in financial instruments and, therefore, regardless of the generic or specific quality of the advice provided.

More specifically, as to the above-mentioned finalistic criterion, the reference to "one or more transactions" in financial instruments contained in the definition of investment advice, far from suggesting that the said service should be limited to only advice on specific financial instruments, takes on the exact opposite meaning: in other words, it suggests that such advising activity should *also* include advice on a single financial instrument, without prejudice to the fact that any advice, be it generic or specific, falls within the afore mentioned definition, when it is rendered *in view* of the client effecting transactions in financial instruments.

After all, if it were not so, as well as violating the tenor and *ratio* behind the decision to include investment advice as part of authorized investment services, one would also run the serious risk that the investments of clients might be influenced by inappropriate asset allocation performed by individuals not subjected to forms of precautionary supervision or not made to comply with specific obligations in matter of evaluation of the suitability of the advice given. And to avoid such a risk, it is of no assistance whatsoever to object that at a later stage there would be the intervention of an authorized intermediary whom the investor should in any case consult before implementing the generic advice received. Indeed the client might also enter into an agreement covering reception and/or execution only of orders, on the basis of which he would have the power to place orders in line with the generic advice received, without those crucial checks of suitability by an authorized intermediary [not provided for in the case of execution only, pursuant to art. 19 (6) of directive 2004/39/EC].

And even if the client were to enter into an investment advice agreement (in this case, covering financial instruments) or into a portfolio management agreement, the evaluation of suitability carried out by the consultant intermediary or by the portfolio manager may prove of no assistance in dissuading the client from proceeding in any case on the basis of the information he has been provided, at a more general level, but still governed by absolutely no rules and in view of its being immune from punishment it may easily be prone to hyperbole.

As to *asset allocation*, though the same may amount to an activity in its own right, as a rule, it cannot be said that the same exhausts the client's interest (especially that of the retail client). It represents instead a phase that is defined as the giving of accurate investment advice on one or more specific products or services. Eradicating *asset allocation* from investment advice would be tantamount to artificially amputating the scope and purport of the very service, with serious consequences and repercussions in terms of market integrity and investors' protection.

Indeed, if the said amputation were indeed performed, it would then be difficult to distinguish, even in abstract terms, the exact line separating reserved investment advice and not-reserved *asset allocation*: in practical terms, at what point does advice cease to be viewed as generic and therefore becoming specific at what point can it be said to require an authorized entity? And how many times would disputes arise on the interpretation of the said limit and whether the same has actually been exceeded or not? And how could one maintain that an authorized intermediary is not required to comply with rules in effecting asset allocation, but there are instead extremely strict obligations regarding subsequent investment advice based on the initial asset allocation, rules with which he is required to comply?

The fact that the interpretation contested does indeed give rise to all these questions is in itself proof that any splitting between generic advice and specific advice cannot but be viewed as artificial and redolent of uncertainty to such an extent as to suggest that a different interpretation might be preferable. Otherwise, one would have to say, sadly, that the Community law-maker has taken a step backwards compared to the situation in the past, where the inclusion of asset allocation in the ancillary investment advice was not at issue (the definition of which, in directive 1993/22/CEE, was already referred to "*investment advice concerning one or more of the instruments listed in Section B*"), with the effect that at least authorized intermediaries were required to provide the same by complying with the same rules applicable to core investment services.

But since directive 2004/39/EC, in transforming investment advice from ancillary to main service, has not doubt intended to enhance investors' protection, presumably the Community law-maker, had he intended to eliminate asset allocation from the definition of investment advice, he would certainly have included the same under ancillary services. The fact that no such mention is made of asset allocation among ancillary services is further proof of what amounts in our opinion to a clear intention of the Community law-maker to have this same activity (now viewed as a main service) as included in the investment service.

And it is this last interpretation given hereinabove that we hope this Committee will submit to the European Commission in implementation of the mandates here covered, in conformity with the above-mentioned provisions carried in the recital (3), article 4 (1) (4) and (25), article 19 (4) and article 23 (1) of directive 2004/39/EC. It plainly and neatly follows from this interpretation that the proposing intermediary may use the tied agent to provide investment advice to his clients, including the type of financial planning and asset allocation (insofar as in their own right such services fall within the concept of investment advice).

3. ***Power of the tied agent to carry out non-reserved financial activities (including financial planning and asset allocation activities where considered as being extraneous to the investment advice activity).***

The above-mentioned conclusion would not change even in the case – with which we do not agree – where the CESR considered the opposite supposition of excluding asset allocation from the notion of investment advice.

Indeed, recital (37) of directive 2004/39/EC sanctions the right of the tied agent to undertake, among others: "related activities in respect of financial services or products not covered by this Directive, including on behalf of parts of the same financial group".

This recital, in granting the tied agent the right to undertake such other activities on behalf of third parties, whether or not they are part of the same financial group of the proposing intermediary, implicitly grants the tied agent the right o undertake the same activities on behalf of the same (if we agree that what is obvious does not require to be rendered explicit). Therefore, on the one hand, the definition makes it clear that the activities mentioned in the definition of the tied agent are those which the tied agent is required to carry out on behalf of only one proposing intermediary and not just the ones that the tied agent is entitled to perform and, on the other hand, the definition has been intended to secure the intermediaries' complete freedom to organize their sales structure, both on an individual and group basis, enabling them to use the network of tied agents also in connection with the performance of activities other than those set forth in the respective definition.

It therefore follows that, if the services of financial planning and asset allocation were viewed as being non-reserved pursuant to directive 2004/39/EC, no preclusion with respect to the tied agent could in any case be inferred. After all, the above-mentioned recital (37) specified, as mentioned in the foregoing, that the tied agent could also carry out the said services on behalf of other parties belonging to the same financial group of the intermediary. It would therefore be absurd to maintain that he cannot carry out the same services on behalf of the same.

After all, though it is logically possible to preclude an individual providing financial planning and asset allocation services from giving also specific recommendations, it is not logically possible to do the opposite, that is, limiting an activity to the provision of only specific advice insomuch that the same is the result of subsequent approximations from the general to the specific, in other words it necessarily forms via the generic advice route. In other words, it would go against logic to prohibit the execution of an activity that is necessarily included in another expressly permitted under the legal system.

At any rate, prohibiting the intermediary from using the tied agent to provide asset allocation services to his clients would also have the absurd effect of depriving the same from the assistance of a highly qualified individual, as is ensured by the special statutory rules (registration in an official register and therefore regulated by a public authority, requisites of honesty and professionalism, obligation of joint responsibility on the intermediary), one that, moreover, has already been expressly authorized to provide investment advice to clients; and also in this case, specific advice, which he is authorized to provide would be potentially more dangerous than the provision of generic advice with respect to which, again in this case, prohibition has been suggested!

4. *Discretion of the intermediary in deciding whether to use tied agents to provide investment advice to its customers.*

Without prejudice to the foregoing, it is felt lastly that directive 2004/39/EC does not impair the intermediary's right to use, if he so wishes, tied agents – as appointed individuals – for the provision of

pure investment advice, that is, going beyond the financial instruments and services provided by the proposing intermediary.

This is not a case of enabling the tied agent to provide an investment service. So long as the same acts on behalf of an intermediary, he cannot and shall not provide investment advice on his own account; and not because he does not possess the requisites but because the said activity would deeply clash with his contemporary execution of services as a tied agent.

The question is rather one of enabling the intermediary not to lose the *naturally* possessed experience and knowledge of the tied agent, - by reason of the statute governing his services - in explaining to clients, via the tied agent also – as person acting on behalf of the same intermediary, it is crucial to note – the characteristics of the investment advice and in explaining the reasons for the single pieces of advice (generic o specific) rendered to the same by the intermediary on the basis of analyses that only the latter can and must draw up, obviously.

Consequently, similarly to the provisions of the Italian legal system, it is felt that the above-mentioned directive grants the intermediary the right to carry out, also jointly, two distinct activities: a) the offer outside the premises of the investment firm of financial instruments and investment services, as part of which it provides 'functional' advice; b) investment advice 'proper', intended as investment service in its own right. To exercise the former, he is required to use a tied agent enrolled in a public register; to exercise the latter activity he may use an appointed party, who may be enrolled in the public register of tied agents, who, in this case will be required to make it explicit to the client that the advice given through him by the intermediary may lead to transactions whereon the same may make a profit in the form of commissions (this would be only when the advice covered instruments and/or services offered by the proposing intermediary, on whose behalf he should also be acting as tied agent).

After all, any prohibition to use the tied agent to carry out the investment service proper would translate into an undue restriction of the organizational freedom of the intermediary, which the above-mentioned recital (37) has intended to safeguard; in addition, it would obviously and unjustifiably penalize Italian intermediaries, who would see themselves deprived of an asset which they may easily have access to, having at their disposal a network of tied agents trained and experienced specifically in the provision of investment advice to clients.

Consistently with the principle which has always guided this Committee, according to which legislation should not be made to affect the organizational models of intermediaries, it is therefore felt that the same should be free to use an appointed party, including when enrolled in the register of tied agents, to provide its clients investment advice within the restricted terms referred to hereinabove.

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Thanking you in advance for your kind attention on the above-mentioned considerations, I hope you will not hesitate to contact us should you wish to establish collaboration,

Best regards

Marco Tofanelli