

**International Swaps and Derivatives Association
International Securities Market Association
Futures and Options Association
Association of Norwegian Stockbroking Companies
Bankers and Securities Dealers Association of Iceland
Danish Securities Dealers Association
Finnish Association of Securities Dealers
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Comments on CESR's call for evidence on the European Commission's draft mandates for implementing legislation under the Financial Instruments Markets Directive (FIMD)

These comments on the Commission's draft mandates for implementing legislation under FIMD have been prepared by the International Swaps and Derivatives Association, International Securities Market Association, Futures and Options Association, Association of Norwegian Stockbroking Companies, and Bankers and Securities Dealers Association of Iceland, Danish Securities Dealers Association, Finnish Association of Securities Dealers, London Investment Banking Association, and Swedish Securities Dealers Association.

General comments

Level of detail and regulatory intervention

1. CESR should take particular account of the Commission's request for CESR to pay 'particular attention to the level of detail to be included in Level 2', and its statement that CESR should 'pay particular attention to striking the right balance between the objective of establishing a set of harmonised conditions for the licensing and operation of investment firms and regulated markets and the need to avoid excessive intervention in respect of the management and organisation of the investment firms. The amount of detail included in the advice should be very carefully calibrated case by case; the advice should ensure clarity and legal certainty but avoid formulations which would lead to overprescriptive, excessively detailed legislation, adding undue burdens and unnecessary costs to the firms and hampering innovation in the field of financial services' (page 7). Some of the Commission's requests do not appear to be consistent with this aspiration (see comments on particular mandates below).
2. It is particularly important to take into account the environment in which the Directive will operate: 28 already existing regulatory systems; investors and markets with different relative maturities, different products, and different balances between professional and retail investors.

3. It is also important to avoid detail and prescriptiveness where a regulation is setting standards for an action which will vary depending purely on the facts of the case: e.g. suitability of product to client; fair, clear and not misleading communications. In these cases there is little more that can be said over and above the Level 1 legislation, given the variety of products being marketed in 28 different jurisdictions, without running into wasteful and damaging prescriptive detail. Implementing measures must at all costs avoid restrictive micromanagement by regulators of customer relationships and market structures.
4. It is also vital to ensure that implementing measures will not require a comprehensive re-write of national regulators' existing detailed rules, unless there is good cause. It is particularly important to bear in mind that changes to the detail of rules may require firms to make very extensive changes to their systems. The time needed to make these changes – and the costs – should not be underestimated. In some cases this will determine whether a Level 2 measure should be deferred at this stage.
5. CESR should be prepared to advise the Commission that in particular areas further detailed implementing legislation, except perhaps a statement of minimal high-level principles, is not appropriate, even where the 'shall' formulation is used in the Directive, because the Level 1 text provides sufficient detail.
6. CESR should bear in mind the non-binding nature of the indicative guidance: in very many cases, the advice that the Commission requests or envisages is far too detailed to be practical.
7. CESR should also bear in mind the Commission's admonition to address to the Commission any questions CESR has concerning the clarification of the text of the Directive. CESR appeared not to be given this option in its work on the Market Abuse Directive, which probably suffered as a result of not clarifying certain aspects of the Directive.
8. We attach as an Annex a schedule (updated to reflect the draft mandates actually published) which some of us provided to the Commission in December 2003 on the appropriate level of detail for each measure.

Determination of priorities

9. Given the potential size of the task of developing implementing measures, CESR should be prepared to advise the Commission to give priority to certain implementing measures, with the consequence that lower priority measures should be dealt with later. It is the essence of the Lamfalussy approach that there is more than one opportunity to develop and update implementing measures, and that European legislation can be developed in an iterative way.
10. For example, there appears to be no pressing reason for CESR to devote scarce resources to the development of detailed implementing legislation where comitology provisions in the Directive are permissive ('...the Commission may...') rather than mandatory ('...the Commission shall...').

11. Careful attention to avoiding inappropriately detailed and prescriptive measures (see paragraphs 1 to 8 above) is also relevant to the process of determining priorities.

Fact-finding about existing level of detail in CESR members' requirements

12. In a number of key areas, CESR should, as a first step, gather information about how each CESR Member regulates at present, and differences between key Member States' existing regulatory regimes. This information about the detail of national requirements should not be used as the basis for proposing a detailed Europe-wide rulebook, but rather to provide a basis of evidence to enable CESR to ensure that the implementing measures it advises are proportionate, appropriate, relevant to markets and their users, and grounded in specific knowledge about variations between existing requirements, and the impact that change at various levels of detail would have. To save time later, CESR should gather such information now also in respect of those measures where mandates are expected but have not yet been received.

13. Areas that would benefit from such fact-finding include:

- Determination of whether transactions are carried out on- or off-exchange.
- Requirements for post-trade reporting of executed trades.
- Differentiation, or lack of it, of regulatory obligations depending on whether a firm is dealing with a counterparty, a professional or a retail client (and definition of those categories).
- Requirements for firms to obtain best execution for their clients.
- Requirements for firms providing non-advice services to clients, where they exist.

Duplication of matters dealt with under other directives

14. The Commission and CESR must avoid duplicating provisions that are dealt with elsewhere in Community law. For example, some of the mandates deal with the treatment of operational risk, market risk, and credit risk, which should be properly dealt with under CAD.

Format of advice

15. CESR should provide its advice, as recommended by the Commission, in an 'articulated text' which can if appropriate be easily adopted by the Commission in its drafting. This approach will ease the process of identifying where and why the Commission departs from CESR's advice, if it decides to do so.

Regulations v Directives

16. The draft mandates show a clear preference for Regulations over Directives. On the choice of the legal instrument for implementing measures, the draft mandates

focus on the rapidity of implementation which it is asserted that the Regulation route would offer, and, apparently, whether the Commission has experience in the field concerned (page 4). On the first issue, we consider that the rapidity of implementation should not be the driving consideration for CESR's advice. There is sufficient time in the timetable to allow implementation via Directives where appropriate. In any event quality of drafting should be the ultimate goal, and it will be important to avoid poor requirements put in place merely to meet a deadline. Regulations also do not necessarily mean faster implementation. Even though Regulations are directly applicable without the need for transposition by Member States, the need for existing national law and national enforcement arrangements and procedures to be integrated with them to make them operational may diminish their speed advantage. On the second reference criterion, we do not think that the level of the Commission's experience should be a determining factor when deciding the format of implementing legislation.

17. We consider that it is much more important to consider the legal form of implementing measures from the point of view of the degree of technical precision that is achievable, and how far there is a need to provide flexibility for Member States to adapt their specific requirements to different local market structures or legal environments. Regulations are likely to be appropriate where consistency across Europe is vital on a self-contained technical matter which is objectively definable. Directives are likely to be more appropriate where:

- flexibility is necessary on less objectively definable matters to take account of national regulatory or legal structures, or
- the type of market, market practices, or developments in the market differ markedly so that a Regulation would not be able to encompass them, or alternatively by promoting a single model a Regulation would cause unnecessary and harmful change, or
- there are many different ways to achieve a policy objective, or
- the matter is not self-contained, and interacts with other provisions that are governed by directives, either at Level 1 or Level 2.

The decision between the two types of instrument should be an objective one in each particular case.

18. CESR must have a clear understanding of whether it considers a Regulation or Directive is more appropriate in each case, before it drafts its consultation proposals, since the legal form of the measures may give rise to significant differences in the advice that CESR provides. CESR should consult on the factors it thinks are relevant in deciding between directives and regulations.

19. Areas where CESR and the Commission should, or should not, rule out Regulations include:

- Prudential requirements: Regulations clearly inappropriate.

- Conflicts of interest management: Directive more appropriate
- Conduct of business rules: Directive more appropriate
- Best execution: Directive more appropriate
- Order-handling: Directive more appropriate
- Post-trade transparency: Could be achieved by regulations?
- Transaction reporting: Could be achieved by regulations (but as a 'may' provision, should not be a priority?)

Transitional arrangements

20. There is a need to provide adequate transitional and grandfathering arrangements to prevent unnecessary and costly repapering of client classification, client agreements and other documentation.

Consultative Working Group

21. We welcome the establishment of the Consultative Working Group, which CESR should use as a source of advice on priorities and the level of detail which is appropriate and feasible.

Planning for CESR consultation

22. We understand that the CESR Expert Group on Cooperation and Enforcement Issues plans to publish a concept release in the spring, in advance of the formal consultation. We welcome this intention and consider that the consultative process would benefit from such an iterative approach by all the expert groups.

Comments on particular draft mandates

Article 13

NB: 'CESR's advice should be proportionate'; 'the advice should avoid excessive detail'.

Should be implemented by Directive: a Regulation is inappropriate in view of need to accommodate local variation, and the limited range of objectively measurable elements.

Article 13.2

Only high-level principles are appropriate in relation to (1), (3), (4). The indicative elements too detailed, particularly as regards operation of the compliance function and conditions for personal account dealing. It is not appropriate or necessary to define managers and employees under (2). In the light of the range of differences between investment firms as regards size, products, client base, and services, it would be inappropriate to attempt to prescribe detailed minimum content requirements, which run the real threat of being over-prescriptive (or under-prescriptive). The appropriate minimum content for a code of conduct will differ greatly between, for example, a global investment bank and a small brokerage firm. One size cannot fit both. These decisions are best left to national regulators who can tailor their policy proportionately to the policy goals that the Directive seeks to achieve.

Article 13.4 and 13.5

Only high-level principles are appropriate. The indicative elements envisage far too high a level of detail, in particular as regards risk management, proprietary trading, and management of outsourcing. There is a need to avoid duplicative treatment of risk management in FIMD and CAD3. The concept of a 'critical operational function' cannot possibly be defined on an EU-wide basis. It is a judgement which will always be determined by the (highly variable) facts of each case.

Article 13.6

Implementing measures are unnecessary, except perhaps as regards (3). Level 1 provides sufficient detail, and CESR should advise that this is the case.

Article 13.7 and 13.8

CESR should consider carefully whether implementing measures are appropriate at all, since national requirements will be heavily influenced by local insolvency rules and settlement/registration systems. CESR should consider carefully whether any further detail is needed than is already in the Level 1 Directive (including Recital 26). Since the safeguarding of client assets and money is usually regulated by specific prescriptions of the regulator, any requirement concerning information to be given to the client will invariably mean providing the client with, in essence, the requirements that the firm is required to follow.

Article 18 and 13.3

Should be implemented by Directive? Only high-level principles are appropriate, and certainly not more detailed than existing CESR standards. The indicative elements envisage far too high a level of prescription, and one which would harm investors by introducing too mechanical a process. Firms need to be able to exercise judgement in particular cases in accordance with general principles. The definition of 'under which conditions' the organisational arrangements taken by a firm could be considered effective to limit conflicts of interest is another factual matter which has no place in a Level 2 measure. The admonition to pay particular attention to the 'frequency of conflicts' indicates a lack of knowledge of how the industry operates. In multi-service investment firms, some conflicts need to be controlled continuously – for example, the need not to use client information to the detriment of the client.

Article 19

It will be important to set out principles for differential application of conduct of business rules depending on the nature of the service offered, the nature of the financial instrument, and the nature of client. But any 'general typology' should be based on general principles of relative risk, and not be too detailed, prescriptive or complex. The level of detail should at most not go beyond CESR's conduct of business standards.

Article 19.2

'Fair, clear and not misleading' can be subjective terms which do not fit easily with the level of detail envisaged by some of the indicative elements. Only in respect of the more objective elements (what is a marketing communication, minimum essential information or explanation) are implementing measures appropriate; they should not seek to define the boundary of unfairness or misleadingness.

Article 19.3

The Commission envisages specifying the content of information provided in a very great level of detail: the level of detail should not exceed existing CESR standards. Is it important to avoid excessive obligations towards 'potential clients' - Firms owe no duties to 'potential customers' except in relation to marketing communications and the general obligation to ensure all information given is true and accurate. Firms cannot be expected to give full warnings to potential clients as this may lead to the situation where potential clients must be given and acknowledge all documentation provided, even though the majority of potential clients are likely to decide not to become clients of the firm.

Article 19.7

The Commission envisages specifying the content of client agreements in a very great level of detail: the level of detail should at most not exceed existing CESR Standards.

Article 19.8

The Commission envisages specifying the minimum content and methods of delivery of client reports in great detail: the level of detail should at most not exceed existing CESR Standards. Regulators should be concerned to ensure that reports are provided, but not with the means of delivery that the client and the firm may agree is most suitable for them.

Article 21

Should be implemented by Directive? Only high-level principles are appropriate, and certainly not more detailed than in the existing CESR standards. Both the Commission's requests and the indicative elements envisage too high a level of prescription, and one which would harm investors by introducing too mechanical a process. Firms need to be able to exercise judgement in particular cases in accordance with an execution policy that is fit to provide best execution, and whose material aspects are disclosed to inform investors of the means and quality of execution that will be provided.

Article 22

Should be implemented by Directive? Only high-level principles are appropriate, and certainly not more detailed than in the existing CESR standards. Both the Commission's requests and the indicative elements envisage too high a level of prescription, and one which would harm investors by introducing too mechanical a process. Firms need to be able to exercise judgement in particular cases. Establishment of criteria for determining 'prompt, fair and expeditious execution' is more appropriately a task for national regulators using knowledge of local markets, trading conditions, and investors to tailor their requirements to local needs, rather than for detailed requirements at Level 2.

Article 25

The Commission has discretion on whether or not to adopt implementing measures for Article 25. Given the need to prioritise CESR's work, we consider that CESR should advise that implementing measures should be considered at a later stage.

Transparency obligations (Articles 43, 29, 44, 30, 28, 39, 56, 58)

The draft mandates consider transparency mainly from the point of view of 'efficient price formation' and 'investor protection', regardless of other consequences for users of the market. They also tend to assume that all market users will be able to access and use perfect information about trading opportunities. It is important that CESR's advice to the Commission makes clear:

- When transparency is useful and when it is not, explaining where and why differentiation in transparency is essential.
- That it is commercially unrealistic to believe that individual members of the public will be as prepared as professionals to pay for access to continuous quotes. In practice, real-time quotes are important only to those who can quickly trade against them. This would typically include market counterparties and professional investors, but not members of the public who would contact their broker in order to trade.

CESR should thus, as the Commission requests:

- Differentiate between information provided to direct users of a trading system and to the general public
- Differentiate between quote and order driven systems

In all areas, CESR should undertake background analysis to obtain a thorough understanding of current arrangements in Member States (including the specific purposes that transparency serves and the way in which trade reporting interacts with transaction reporting under Article 25) and, as the Commission requests, consider thoroughly the implications of experience of transparency obligations in non-European jurisdictions. This analysis should draw on the expertise of those who have practical experience in dissemination and use of disclosed data. In paragraph 3.7 of section 2, the Commission states that 'CESR should take into account the necessity to facilitate the consolidation of trading information'. This 'necessity' goes beyond the provisions of the Directive. Consistent with its mandate, CESR should consider what areas should be left to the regulated market or MTF and its regulator, for example the range of information that should be made available. As the regulated market meets the needs of its users, this should be largely a matter to be determined by markets and users, subject to appropriate oversight by the Member State regulator.

20th February 2004

ANNEX: Comments on draft mandates provided informally to Commission,
December 2003 (reordered to reflect draft mandates actually published)

FIMD: Level 2 draft mandates published January 2004

Article	May/shall (R/D*)	Detailed comitology needed	Less detailed comitology needed	Low detail comitology needed	No comitology needed.	Notes
13.2	Shall (R)			X		No need to define "managers and employees"
13.4/5(2 nd)	Regulation not appropriate given divergences in national rules			X		
13.5(1 st)				X		
13.6					X?	
13.7/8					X	Heavily influenced by local insolvency etc. rules
18/13.3	Shall (not specified)			X		Level of detail should not exceed CESR standards Purported speed of implementation via Regulations may be illusory since sanctions need to be fixed at national level.
19.2	Shall (R)		X			
19.3					X?	
19.7					X?	
19.8			X			
21.1	Shall (R)			X		
21.2				X		
21.3				X		
22	Shall (R or D?)			X		
25	May (not specified)				X	Not needed for Directive to take effect
43/29	Shall (R)			X		
44/30	Shall (R)				X?	
28	Shall (R)			X		
39	Shall(R)			X		
56	May(not specified)				X	Not needed for Directive to take effect
58	May (R)				X	

*R/D = Commission preference to use a Regulation/Directive as implementing measure

Other comitology provisions

2(3)	May				X	Not needed for Directive to take effect
4.4 (investment advice)	May clarify (R)				X	
19.4/5/6	Shall		X			
24.2(3)	May (not specified)				X	
24(5)(b) and (c)	May				X	Not needed for Directive to take effect
27	Shall					
44	Shall					