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Understanding the definition of advice under MiFID / CESR/09-665

Dear Madam or Sir:

We appreciate the opportunity to comment on CESR's Consultation Paper regarding the definition of advice under MiFID.

Our comments and statements represent a consolidated view of our members who operate under various MiFID-relevant business models in Germany's financial centre, either as branches, subsidiaries or representatives of financial institutions acting on the German market.

Generally speaking, the definition of investment advice should be designed with care. If every statement on investment opportunities would cause potential liability to investment advisers, detrimental consequences for the market would follow. Liability should thus be linked to a personal connection between the parties that is created by a detailed client profiling of the investment adviser.

Corporate finance advice and investment advice are essentially different, which is why MiFID distinguishes between the two. We would like to highlight that corporate finance advice already has a liability regime which we consider sufficient.

We do hope that this paper is helpful to CESR and we will gladly answer any question that you may have.

Yours sincerely

Dr Oliver Wagner Dr Martin Schulte

Part 1: Does the service being offered constitute a recommendation?

Q.1. Do you have any comments on the distinction between the provision of personal recommendations and general information?

We believe that the description of the distinction lacks one important element:

A personal recommendation cumulatively requires that a) the selection of financial data is linked with the personal circumstances of the potential investor **and** b) that the provider of the financial data makes this link clear and plausible to the potential investor. This implies that the provider of the information shows that he or she is aware of the personal circumstances of the individual client. If the potential investor has reason to believe that his or her circumstances are not reflected in the specific provision of financial data, he or she has no reason to act upon the respective statements.

In the absence of these objective and subjective criteria, the potential investor cannot reasonably believe that an investment opportunity is personally designed or suitable for him or her. In a recommendation, the link to personal circumstances must be highlighted by the person making that recommendation. Otherwise, the inevitable psychological element that makes a recommendation personal and thus convincing – the assumed link between the recommender and the addressee – is missing.

Q.2. Do you agree that the limitation that filtered information is "likely to be perceived by the investor as, assisting the person to make his own choice of product which has particular features which the person regards as important." is a critical criterion for determining whether filtering questions constitutes „investment advice" ?

Generally speaking, filtering is a necessary pre-step that takes place **before** personal advice can be provided. Investment advice is a form of communication that necessarily comes after the information has been filtered, since it inevitably builds on filtered information. Consequently, only if it is suggested that a thorough filtering process was completed and a specific model portfolio is explicitly described as suitable, investment advice has been provided. This, however, requires that the filtering process meets certain criteria **that go beyond general classifications like "conservative" or "dynamic"**. For example, it is essential that it has been communicated to the potential investor that his or her **personal financial circumstances and reasonably bearable risk exposure** have been taken into account. The crucial question with regard to the example in Recital 27 of the Consultation Paper is thus, which elements must the collection of investor data contain to give the investor reason to believe that a personal recommendation has been made?

Part 2: Is the recommendation in relation to one or more transactions in financial instruments?

Q.3. Do you believe the distinction between general recommendations/generic advice and investment advice is sufficiently clear? Do you have examples of types of advice where the designation is unclear?

We believe that the distinction is sufficiently clear and needs no further comments.

Part 3a: Is the recommendation presented as suitable?

Q.4. Is there sufficient clarity as to when an implicit recommendation could be considered as investment advice? If not, what further clarification do you think is necessary?

In line with our answers to Q. 1 and 2, also an implicit recommendation should only be considered as investment advice if the potential investor has reason to believe that the recommendation is based on a thorough analysis of his or her personal financial circumstances. If someone recommends a certain share or bond just because “it appeals to conservative investors” no investment advice is given. On the contrary, when it is said that the product is suitable for investors with a stable income of € 50,000, € 500,000, or € 5m p.a., investment advice might be assumed. As a consequence, using a phrase like “people like you tend to buy this product” alone does not constitute investment advice unless the adviser communicates that he or she knows the personal circumstances of the potential investor and that this knowledge correctly represents the facts.

Part 4: Is the recommendation issued otherwise than exclusively through distribution channels or to the public?

Q.6. Are there other criteria you believe should be considered when determining whether messages to multiple clients constitute investment advice?

Generally speaking, a message to multiple clients may constitute investment advice, depending on the content and the language. However, if the message does not clearly show that it involves an analysis of the client’s personal circumstances, no personal recommendation should be assumed.

Part 5a: Is the recommendation made to a person in his capacity as an investor or potential investor?

Q.7. What information would be helpful to assist in determining whether or not what firms provide constitutes investment advice or corporate finance advice?

In our opinion, corporate finance advice does not fall within the definition of investment advice, nor is investment advice provided in the course of corporate finance advice.

Basically, investment advice and corporate finance advice are provided in different situations and under different motives, where different liability schemes apply. Typical corporate finance advisers are investment banks, specialised law firms and specialised consultancy firms. Corporate finance advice contains an analysis of the corporate entity that is subject of a potential merger or acquisition and may be provided either to the potential seller or buyer. In practice, both sides have their own corporate adviser. The advisers help to determine potential risks and – build on that risk assessment – a plausible purchase or selling price by carrying out a due diligence process. On the contrary, an investment adviser does not help determining a price for a financial instrument. Despite the use of certain – individually negotiated – disclaimers, which have limited scope, the corporate finance adviser is liable under civil law for the content of the respective due diligence report and the adequacy of the information provided. In the case of law firms, this service is remunerated regardless of whether the deal is sealed or not. In any case, there is basically no need for regulatory protection of clients of corporate finance advisers, since they can rely on civil law liability schemes outside MiFID, which we thus believe to be a crucial criterion for the distinction between investment and corporate finance advice.

The core service of corporate finance advisers is to provide an estimate on whether or under which circumstances the potential deal is economically beneficial or not. Different from firms which are making profits from selling financial instruments by providing investment advice, corporate finance advisers are remunerated for providing information on how to design a deal. Advice on the purchase or selling decision is not remunerated separately from the economic and legal analysis of the corporate entity. The emphasis of the business connection lies therefore on corporate analysis and not on investment advice as such. As opposed to an investment adviser, it is not the corporate adviser who chooses the potential investment opportunity but the managing board of the potential buyer or seller of the corporate entity, which is another distinctive feature.

In short, investments in financial instruments – being the subject of investment advice – shall enable the investor to participate in the performance of the financial instrument, whereas corporate finance advice is related to strategy and shall enable the client to value risks of a corporate entity and to sell or buy it at a good price and under good conditions. Corporate finance advice has a liability scheme of its own. Clients of corporate finance advisers rely on these schemes and chose their advisers also because they offer contractual and tort liability, which reduces risks for the managing board.

Q.8. Are there specific examples of situations you would like considered, where it is difficult to determine the nature of the advice?

In the light of the criteria mentioned above, the distinction between investment and corporate finance advice seems clear. Even in the case of an investment bank, which provides investment and corporate finance advice, these activities are strictly separated inside the firm and show very different structures which we have described above.