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**A EUROPEAN REGIME OF INVESTOR PROTECTION  
THE HARMONIZATION OF  
CONDUCT OF BUSINESS RULES**



## **CESR PROPOSAL FOR THE EU REGIME OF INVESTOR PROTECTION**

### **THE HARMONIZATION OF CONDUCT OF BUSINESS RULES UNDER ARTICLE 11 OF THE ISD**

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## **I. INTRODUCTION**

### **The need to develop Standards and Rules for investor protection by harmonisation of core conduct of business rules.**

1. The development of the single market in financial services warrants a common approach from the members of the Committee of European Securities Regulators (CESR) to those standards and practices governing the provision of investment services, which the Investment Services Directive (ISD) frames at a high level of generality under the heading "rules of conduct". According to article 11 of the ISD, rules of conduct must implement at least the standards set out in this article and must be applied in such a way as to take into account the professional nature of the person to whom the service is provided.
2. The ISD establishes some basic conduct of business requirements for EU investment firms. CESR members believe, however, that the present diversity of conduct of business regimes may hinder not only the freedom which investment firms have to provide services throughout Europe, but also the provision of an adequate level of protection to European investors. It is therefore necessary to undertake a process of convergence in this field, both to ensure a level playing field for investment firms and to foster public confidence in the operation of the single market in financial services. CESR members are aware in this respect of the consultative document that has been presented by the European Commission on the revision of the ISD.
3. The benefit of this work is to provide investors, investment services providers and EEA regulators, with a clear and concise statement of the Standards and Rules on conduct of business that CESR members expect investment firms to meet <sup>1</sup>.

### **The Standards and Rules**

4. The main body of the paper is composed of several chapters. Each chapter contains Standards followed by more or less detailed Rules. The Standards are intended to be the key parameters for a harmonised conduct of business regime. The Rules implement the Standards, clarifying their scope and practical meaning. Both Standards and Rules are intended to be mandatory.
5. Within their sphere of application the Standards and Rules have three main aims:
  - a) ensure that investors throughout the EEA enjoy an equivalent degree of protection, irrespective of the means used by investment firms to provide investment services;
  - b) improve the flow of financial services within the EEA by reducing impediments to competition and competitive distortions between investment firms;
  - c) foster mutual understanding and co-operation between the competent authorities as regards the interpretation and implementation of conduct of business rules.
6. This paper contains standards and rules that apply to retail customers. The professional and the counterparty regimes, including the categorisation of professional investors, requires further work by CESR.

### **Scope and structure of the paper**

7. With regard to the scope of the paper it is emphasised that the paper is without prejudice to the provisions of any of the Directives of the European Union or national laws and regulations implementing such Directives, in particular as regards the directives 01/34/EC, 89/298/EEC (public offer), 85/611/EEC (UCITS), 93/13/EC (on unfair terms in consumer contracts) and 84/450/EEC (on misleading advertising).<sup>2</sup> Furthermore, this paper is without prejudice to

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<sup>1</sup> These standards and rules apply to "ISD investment firms", as well as to "non-ISD firms" (including commodity derivatives dealers) and ISD investment services, as well as non-core services.

<sup>2</sup> CESR members are aware that in the European Council a political agreement was reached on the 27<sup>th</sup> November 2001 on a directive on distance marketing on the consumer financial services, which will be applicable also to services regulated under the ISD (93/22/EEC).

national laws and regulations concerning public offering of financial products, in particular of non-harmonized financial products.

8. This paper sets out definitions in chapter II. The Standards and Rules that the members of CESR consider to be necessary (as far as subjects dealt with in this paper are concerned) to ensure appropriate investor protection for retail customers are set out in chapter III. This Chapter develops the following sections that apply to an investment firm's relationships with retail customers:
- Standards and Rules of general application;
  - Information to be provided to customers;
  - the "Know your customer standard" and the duty to care;
  - Customer agreements;
  - Dealing requirements (including the "best execution" standard);
  - Individual discretionary portfolio management.

### **Implementation**

9. CESR members will seek to implement the Standards and Rules set out in this paper in their regulatory objectives and, when possible, in their respective rules. If a CESR member does not have the authority to implement a certain Standard or Rule, it will commend the Standard or Rule to its government and to the responsible regulatory authority. CESR is committed to undertake reviews of regulatory practices within the single market, on the basis of Article 4.3. of its Charter.

### **Objectives of the paper**

10. The broad objectives which CESR has focused on when constituting the Standards and Rules are the following:
- a) Ensuring that information provided to customers enables them to take their investment decisions on an informed basis, promptly react against actual or potential losses, and reflect on the consistency between their investment objectives and strategies and their actual portfolios.
  - b) Ensuring that information from a customer:
    - determines the scope of the information to be provided to such a customer so that he may properly take his investment decisions;
    - includes the customer's trading restrictions or other comparable circumstances which may affect the provision of services;
    - ensure that the customer's dealings and any advice given to him are suitable.
  - c) Ensuring that a written contract setting out the rights and obligations of the parties has been concluded between the investment firm and its customers prior to the provision of investment services.
  - d) Ensuring that investment firms:
    - operate efficiently, impartially and in the best interest of investors when handling customer orders;

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The policy of the Commission is to achieve agreement on a list of generic information that should be given to the consumer prior to the conclusion of the contract. Therefore it can result in an amendment/derogation to what is provided for in the CESR paper. The list of generic information and the interaction with specific information requirement provided for by community sectoral directives is currently under discussion.

CESR members are also aware that the proposal on distance marketing deals with issues such as cold calling, use of voice telephony communications, right of withdrawal, redress and burden of proof.

CESR members are finally also aware of the fact that directive 2000/31/EC (e-commerce) provides for certain rules on information to be provided by the service provider and on unsolicited communication. The European Commission adopted a communication on "e-commerce and financial services".

- obtain the best possible result with reference to the time, size and nature of customer orders, taking into account the state of the relevant market.
- e) Ensuring that with regard to portfolio management:
  - the customer understands the nature and particularities of this service;
  - the customer agreement contains all relevant provisions necessary to define this service and includes specific instructions of the customer;
  - the customer is regularly informed of the performance of the service;
  - the portfolio is managed independently and in accordance with the objectives of the customer.
- f) Ensuring that investment firms manage conflicts of interest fairly and provide appropriate disclosure to their customers in this respect.
- g) Ensuring that investment firms establish a code a conduct for management and staff, and policies and procedures designed to ensure compliance with such a code and conduct of business rules generally.

The overriding principle finally is that an investment firm must at all times act honestly, fairly and professionally in accordance with the best interests of its customers and the integrity of the market.

## II. DEFINITIONS

- **Board:** the term “board” is meant to embrace the different national models of board structures found in CESR Members; it normally refers to the “management board” and, where appropriate, it may refer to the “supervisory board” or the “internal auditors’ board”.
- **Cold calling:** any unsolicited interactive communication with a potential customer<sup>3</sup>, for example, a personal visit or a telephone call initiated by a person acting on behalf of an investment firm, and which has not been requested or expressly permitted by the customer.
- **Competent authority:** a regulatory authority within the European Economic Area, responsible for conduct of business rules. Where appropriate in the context, the term may refer to the authority that authorises or registers an investment firm, or to third-country regulatory bodies.
- **Compound product:** a financial product, which consists of a combination of financial instruments, e.g. a stock-lease product combining a loan, a cash financial instrument and an option.
- **Customer:** any current or potential customer of an investment firm.
- **Delegation:** entrusting another investment firm to perform part of the provision of an investment service.
- **Derivatives:** a financial instrument whose value changes with the movements in the value or the level of an underlying asset, index, interest or currency rate or other parameter (e.g. futures, options, swaps, warrants, contracts for differences).
- **Financial instruments:** any of the instruments mentioned in section B of the annex to the ISD. Where appropriate in the context, the term may cover other types of instruments, in particular commodity derivatives.
- **Inducements:** any monies, goods or services (other than the normal commissions and fees for the service) received by an investment firm or any of its members of the board, directors, partners, employees and tied-agents in relation to business for a customer with or through another person, whether on a prepaid, continuous or retrospective basis.
- **Interactive communication :** any oral communication either with the physical presence or at distance (example by telephone). It also includes any future form of interactive communication which becomes possible as a result of advances in technology.
- **Investment advice:** the provision of a personal recommendation to a specific customer related to one or more financial instruments or investment services, either incidentally or under a contract for investment advice.
- **Investment firm:** firms as defined in point 2 of Article 1 of the ISD. Where appropriate in the context, the term covers non-ISD firms providing investment services, in particular commodity derivatives dealers.
- **Investment service:** any of the services mentioned in section A of the annex to the ISD. Where appropriate in the context, the term covers non-core services mentioned in section C of the annex to the ISD, in particular safekeeping and administration of securities and investment advice.

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<sup>3</sup> Potential customer should include existing customers who are cold called for investment services different from those agreed upon in the customer agreement.

- **ISD:** Directive 93/22 on investment services in the securities field.
- **Legal entity:** a person in particular a customer of an investment firm, other than a natural person. The term is meant to cover partnerships and trusts.
- **Leverage:** the ratio of the market exposure of a portfolio to the exposure it would have if the portfolio were fully invested in the underlying cash financial instruments.
- **Leveraged portfolio:** a portfolio with a leverage greater than one.
- **Leveraged transactions:** transactions in derivatives, short sales of securities and purchases of any instruments using borrowed funds.
- **Marketing communication:** any form of information issued by or on behalf of an investment firm to the public, i.e. that is designed for and addressed to a number of people and not to one specific customer, that advertises, makes a recommendation or acts as a solicitation regarding investment services and/or financial instruments. So-called “image” advertisements, however, which are not used to recommend any particular service or instrument, but which are designed simply to make the public aware of a investment firm’s existence are not deemed to be marketing communications <sup>4</sup>.
- **Outsourcing:** any administrative function (different from the provision of an investment service) which might materially affect the provision of investment services to customers that an investment firm decides to contract out to another entity (e.g. back-office, accounting, Information Technology).
- **Regulated markets:** markets which comply with the requirements of article 1.13 of the ISD or equivalent non-EEA markets.
- **Tied-agent:** any legal or natural person<sup>5</sup> providing business solely for the account of and under the full and unconditional responsibility of an investment firm on the basis of a contract.
- **Trading restrictions:** general prohibitions on trading in financial instruments and particular restrictions applicable to specific types of financial instruments. These restrictions may derive, *inter alia*, from the law, from public regulation or self-regulatory arrangements, from articles of associations or other internal rules, and may result from the relevant person’s legal capacity or status, type of employment or position within an entity.
- **Written agreement:** a contract in writing or in a similar unalterable electronic form having equivalent evidentiary status <sup>6</sup>. Information to be given “in writing” is to be understood in the same way.

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<sup>4</sup> There is no restriction on the means of communication, which is used for the marketing. The definition therefore applies to marketing information communicated by way of printed advertising, radio, television, telephone, e-mails, the Internet and electronic media such as digital and other forms of interactive television or any combination of these means of communication. Activities and communications potentially covered by the definition of marketing communication include, for example: (a) the distribution of written product brochures; (b) general advertising; (c) the distribution of mailshots (whether by post, facsimile, e-mail or other media); (d) telemarketing activities, including oral communications such as from call centres; (e) presentations to groups of private customers; (f) securities research reports, and tip-sheets; and (g) other publications, which may contain non personal recommendations as to the acquisition, retention or disposal of financial instruments of any description or to the purchase of any investment services relating to such instruments.

<sup>5</sup> The document does not intend to interfere with professional requirements on tied-agents, imposed by national regulations.

<sup>6</sup> Community legislation provides a legal framework for the use of electronic contractual documents, including Directive 2000/31/EC on electronic commerce and Directive 1999/93/EC on electronic signatures.

### III. CORE CONDUCT OF BUSINESS RULES FOR THE « RETAIL REGIME »

#### 1. STANDARDS AND RULES OF GENERAL APPLICATION

##### 1.1 GENERAL

- **STANDARDS**

1. *An investment firm must at all times act honestly, fairly and professionally in accordance with the best interests of its customers and the integrity of the market.*
2. *An investment firm must have and must employ effectively the resources and procedures that are necessary for the proper performance of its business activities, including back-up procedures and systems so as to reasonably ensure that investment services can be provided without interruption.*
3. *An investment firm must ensure that any persons or entities with which it is undertaking authorisable investment business are authorised to conduct that business by the relevant regulator.*
4. *An investment firm that outsources functions retains full responsibility for the outsourced activity and must ensure that the providers of such outsourcing are able to perform these functions reliably, professionally and in the best interests of its customers.<sup>7</sup>*

##### 1.2. CONFLICTS OF INTEREST AND INDUCEMENTS

- **STANDARD**

5. *An investment firm must take all reasonable steps to ensure that conflicts of interest between itself and its customers and between one customer and another are identified and then prevented or managed in such a way that the interests of customers are not adversely affected. For these purposes the investment firm must establish an internal independence policy, including Chinese walls as appropriate.*
6. *An investment firm, its members of the board, directors, partners, employees and tied-agents may offer or receive inducements only if they can reasonably assist the firm in the provision of services to its customers. Where inducements are received disclosure of such inducements must be made to the customer.*

- **RULES**

7. Where conflicts of interest cannot be reasonably avoided or managed with the internal independence policy, an investment firm must not undertake business with or on behalf of a customer where it has directly or indirectly a conflicting interest, including any such interest arising from intra-group dealings, joint provision of more than one service or other business dealings of the investment firm or any affiliated entity, unless it has previously disclosed to the customer the nature and extent of its interest, either in writing or by telephone and recorded by the firm and the customer has expressly agreed to engage in such business with the investment firm. Where possible, this disclosure must be given at the beginning of the customer relationship; otherwise it must be given prior to the customer entering into any relevant transaction.

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<sup>7</sup> This standard is not intended to interfere with relevant provisions on civil liability, applicable at national level.

8. Where inducements are permitted an investment firm must act in the best interest of the customer and inform the customer at the beginning of the relationship, which may give rise to conflicts of interest between itself and its customers, about the investment firm's policy on inducements and at least once a year in writing of the relevant details of such inducements.

### **1.3 COMPLIANCE AND CODE OF CONDUCT**

- ***STANDARDS***

9. ***An investment firm must take all reasonable measures to ensure that the firm and its members of the board, directors, partners, employees and tied-agents at all time act in accordance with the best interests of its customers and the integrity of the market by establishing and implementing adequate compliance policies and procedures, including an independent compliance function and an internal code of conduct.***

10. ***An investment firm must be able to demonstrate that it has not acted in breach of the conduct of business rules and the internal code of conduct and that its organization, policies and procedures facilitate such compliance.***

- ***RULES***

11. The persons responsible for the compliance function must have the necessary expertise, resources, authority and must have full access to all relevant information enabling them to perform their duties. They must perform their monitoring duties independently of all persons and activities subject to their monitoring.
12. A summary of the results of the monitoring must be reported to the senior management of the investment firm and to the internal or external auditors. The investment firm must report these results, together with remedies adopted, to the competent authority at least once a year.
13. An investment firm must ensure that the competent authority is informed, without undue delay, of serious breaches of the conduct of business rules. In assessing whether the breaches are serious, an investment firm must take into account the impact on regulatory goals and on the capacity to provide services, their frequency, the damages suffered by customers.
14. The compliance function must:
  - regularly verify the adequacy of policies and procedures to ensure compliance with the regulations on investment services;
  - provide advisory assistance and support to the various business areas of the investment firm on problems concerning compliance with the regulations on investment services.
15. An investment firm must keep records relevant for the purpose of demonstrating compliance with the conduct of business rules, for a period of five years in order to enable the competent authority to verify compliance with these rules. Tape recording of orders must be kept for a period of one year.
16. An investment firm must keep a register of customer complaints related to the provision of the investment services and the measures taken for their resolution and must regularly verify whether complaints are adequately processed.
17. An investment firm must establish a code of conduct for members of the board, directors, partners, employees and tied-agents. The code of conduct must contain:
  - a) The rules and procedure to meet the obligation to protect data of a confidential nature;

- b) the rules and procedures for carrying out personal transactions involving financial instruments;
- c) the rules and procedures governing the business relationship with customers in order to ensure that the persons referred to above, in particular where a conflict of interest may arise, always act in the best interests of customers, and that such persons do not take advantage of any confidential information;
- d) the investment firm's policy on conflicts of interest and inducements.

#### **1.4. COLD CALLING**<sup>8</sup>

- **STANDARD**

***18. For the purpose of protecting customers from undue pressure to enter into a contract, cold calls can only be made to potential customers in accordance with the rules set out below.***

- **RULES**

- 19. Cold calls may only be made by persons employed by, or appointed as tied-agent<sup>9</sup> by an investment firm. Responsibility for the competence and activities of such persons rests with the firm.
- 20. An investment firm cold calling customers may do so only between the hours of 9.00 a.m. and 9.00 p.m. Monday to Saturday (local time for the customer) and excluding local national holidays.
- 21. The identity of the person making the cold call, the investment firm on whose behalf the person is acting, and the commercial purpose of the cold call must be explicitly identified at the beginning of any conversation with the consumer. The caller must also make reference to the frozen period (see par. 24) during which orders may not be executed.
- 22. The person making the cold call is also required to establish whether the potential customer wishes the cold call to proceed or not. An investment firm must abide by a request from the customer either to end the cold call and/or not to cold call again.
- 23. An investment firm must not exert undue pressure on a potential customer during the course of a cold call and must be able to demonstrate that this is not the case, for example, by recording any such telephone calls.
- 24. During the period for which the customer benefits from a right of withdrawal from the contract (as determined by Article 4.a of the Distance Marketing Directive), an investment firm shall not execute any customer orders in respect of financial instruments under the contract.

## **2. INFORMATION TO BE PROVIDED TO CUSTOMERS**

### **2.1) BASIC REQUIREMENTS**

- **STANDARDS**

***25. An investment firm must pay due regard to the information needs of its customers and communicate information to them that is fair, clear, and not misleading.***

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<sup>8</sup> These rules are without prejudice to any provisions of EU law governing the means whereby or conditions under which an investment firm or its tied-agent may initiate unsolicited contacts with a prospective customer.

<sup>9</sup> This is without prejudice to the applicability of professional requirements, imposed at national level.

***26. An investment firm must supply its customers on a timely basis with the information that enables them to make informed investment decisions.***

- **RULES**

27. The firm must ensure that information provided to customers is clear and comprehensible. The content and purpose of the information should be easily understood and key items should be given due prominence. The method of presentation of the information must not disguise, diminish or obscure important warnings or statements.

28. In supplying information on a timely basis the investment firm must take into consideration: a) the urgency of the situation and b) the time necessary for a customer to absorb and react to the information provided and c) the terms of business agreed with the customer.

## **2.2.) MARKETING COMMUNICATIONS** <sup>10</sup>

- **STANDARDS**

***29. If an investment firm provides information in a marketing communication it must be fair, clear and not misleading.***

***30. The promotional purpose of marketing communications issued by an investment firm must not be disguised.***

- **RULES**

31. The information provided by an investment firm in a marketing communication must be consistent with the information it provides to its customers in the course of the provision of the investment services.

32. Any marketing communication must contain at least the information about the investment firm defined in points a) and b) of paragraph 36. In case of a cross border marketing communication, the information provided must in addition state that information about the firm can also be obtained from or through the competent authority of the Member State where the customer resides.

33. An investment firm must not use the name of the competent authority in such a way that would indicate endorsement or approval of its services.

34. Where a marketing communication refers to a financial instrument or an investment service it must contain at least the information referred to in points a) and d) of paragraph 40.

## **2.3) INFORMATION ABOUT THE INVESTMENT FIRM**

- **STANDARD**

***35. Before providing investment services an investment firm must supply adequate information about itself and the services it provides.***

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<sup>10</sup> This is without prejudice of EU or national provision requiring authorisation and/or other requirements affecting the provision of marketing services.

- **RULE**

36. An investment firm must provide customers with the following information prior to the commencement of provision of investment services:
- a) the identity of the investment firm, the (financial) group to which the investment firm belongs, its postal address and telephone number;
  - b) the fact that the investment firm is authorised and/or registered and the name of the competent authority that has authorised and/or registered it;
  - c) the functions that the investment firm performs so that the customer is able to assess the scope of the firm's responsibilities;
  - d) the relevant compensation scheme(s);
  - e) where such a procedure exists, a description of the mechanism(s) for settling disputes between the parties such as an out-of-court complaint and redress mechanism;
  - f) an outline of the firm's policies in relation to conflicts of interest and inducements;
  - g) the languages in which the customer can communicate with the investment firm.

#### **2.4) INFORMATION ON FINANCIAL INSTRUMENTS AND INVESTMENT SERVICES**

- **STANDARDS**

- 37. An investment firm must inform customers of the key features of investment services and financial instruments envisaged, according to the nature of such instruments and services.***
- 38. An investment firm must communicate clearly and precisely to the customer all the charges relating to the services or instruments envisaged and how the charges are calculated.***
- 39. If information provided by an investment firm refers either to the past performance or to a forecast of the future performance of a financial instrument or investment service, this information must be relevant to the instrument or service being promoted and the source of the information must be stated.***

- **RULES**

40. The information provided to customers can be delivered using standard documentation but must include the following as a minimum:
- a) a description of the main characteristics <sup>11</sup> of the instrument/service, including the nature of the financial commitment, whether the instruments involved are traded on a regulated market or not and the risks involved;
  - b) price, including commissions, fees and other charges, relating to the transaction, the instrument or service;
  - c) arrangements for payment and performance;
  - d) details on any cancellation rights or rights of reflection that may apply.
41. The information to be disclosed to customers on commissions, charges and fees must contain:
- a) the basis or amount of the charges for transactions, products or services, detailing, where appropriate, the percentage or rate applicable, the frequency with which it is applied, any maximum or fixed minimum fees and, where the commission or fee must be paid in foreign currency, the currency involved;
  - b) if various investment firms are to be involved in a transaction or service, an estimate of the other fees that will be payable.

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<sup>11</sup> If the customer envisages undertaking transactions in derivatives, the information provided must include an explanation of their characteristics (especially the leverage effect, the duration of the contract, the liquidity and volatility of the market), a description of their underlying parameters (e.g. equities/interest rates/currencies), and the method to be used to execute the customer's transactions (in particular, whether on a regulated market or not).

42. In order to give a fair and adequate description of the investment service or financial instrument, an investment firm must avoid accentuating the potential benefits of an investment service or financial instrument without also giving a fair indication of the risks.
43. The fair and adequate description of a compound product must contain all the relevant characteristics of the composite instruments including, for example, the different services involved, the duration of the product, whether the instrument involves credit, the interest due, etc.
44. The information on financial instruments and investment services must not state or imply that the performance of services or of the investment is guaranteed unless there is a legally enforceable arrangement to meet in full an investor's claim under the guarantee. Sufficient detail about the guarantor and the guarantee must be provided to enable the investor to make a fair assessment of the guarantee.
45. When information provided refers to a particular tax treatment the investment firm must advise the customer that the tax treatment depends on his personal situation and is subject to change and that he may wish to obtain independent tax advice.
46. If a reference to historical performance of investment services or financial instruments is made, it must be clearly expressed that the figures refer to the past, and that they may not constitute reliable guidance as to the performance of these services and instruments in the future.
47. The use of simulated returns is prohibited. If the information refers to actual returns based on past performance:
  - a) the reference period must be stated and must not be less than one year;
  - b) where returns relate to more than one year, they must either be reduced to a compound annual rate or stated separately as annual returns;
  - c) where a compound annual return is presented for more than one year, a reference period of five years must be used provided the relevant data are available. If the relevant data are not available over a reference period of five years (e.g. because the financial instrument or the investment portfolio has not existed for such a period), the returns may be measured from the issue date or the date on which the portfolio was established;
  - d) where a benchmark is used to compare returns, it must be identified and its reference period must be relevant, clear and sufficient to provide a fair and balanced indication of performance of the investment service or financial instrument being promoted;
  - e) if the return figures are not denominated in local currency, the currency used must be stated and reference shall be made to the currency risk for the return in local currency;
  - f) the information for the comparison should be based on net performances or if it is based on gross performances commissions, fees or other charges have to be disclosed.
48. The relevant provisions on actual returns shall apply to the method of calculating and presenting any future returns. Information on estimated future returns must state that these future returns are forecasts. Such forecasts must in turn be based on objective, realistic assumptions of investment returns.
49. Any estimate, forecast or promise contained in the information on financial instruments and investment services must be clearly expressed, must state the assumptions on which it is based, must be relevant and must not mislead the customer.
50. If information provided contains comparisons, the requirement of being fair, clear and not misleading means that the comparisons must:
  - a) be based either on data from attributed sources or disclosed assumptions;
  - b) be presented in a fair and balanced way;
  - c) take reasonable steps not to omit any fact that is material to the comparison.

## **2.5) RISK WARNINGS**

- ***STANDARDS***

***51. An investment firm must provide its customers with risk statements that warn of the risks associated with financial instruments and transactions having regard to the customer's knowledge, experience, investment objectives and risk profile.***

***52. Risk warnings must be given due prominence. They must not be concealed or masked in any way by the wording, design or format of the information provided.***

- ***RULES***

53. An investment firm must provide its customers with risk warnings as appropriate. Instances where the type of instrument or transaction envisaged makes specific risk warnings necessary include:

- financial instruments not traded on a regulated market;
- transactions in illiquid financial instruments;
- leveraged transactions;
- financial instruments subject to high volatility in normal market conditions;
- securities repurchase agreements or securities lending agreements;
- transactions which involve credit, margin payments or the deposit of collateral;
- transactions involving foreign exchange risk.

The investment firm must also, where necessary, inform the customer of risks associated with:

- a) clearing house protections (e.g. that although the performance of a transaction is sometimes 'guaranteed' by the exchange or clearing house this guarantee will not necessarily protect the customer in the event of default by the investment firm or another counterparty);
- b) suspension of trading or listing (e.g. that under certain trading conditions it may be impossible to liquidate a position);
- c) insolvency (e.g. that in the event of default of an investment firm involved with the customer's transaction, positions may be liquidated automatically and actual assets lodged as collateral may be irrecoverable).

54. Risk warnings about derivatives must disclose that the instrument can be subject to sudden and sharp falls in value. Where the investor may not only lose his entire investment but may also be required to pay more later, he must also be warned about this fact and the possible obligation to provide extra funding.

## **2.6. CUSTOMER REPORTING**

- ***STANDARDS***

***55. An investment firm must ensure that a customer is provided promptly with the essential information concerning the execution of his order.***

***56. Where an investment firm has control of, or is holding assets belonging to a customer, it must arrange for proper identification and regular confirmation of such assets to the customer.***

***57. An investment firm that operates customer accounts, which include uncovered open positions, must provide regular statements of such positions.***

- ***RULES***

a) Customer order and transaction information

58. No later than the first business day following the execution of the transaction or receipt of confirmation of execution by a third party, an investment firm must send to the customer<sup>12</sup>, by fax, mail or electronic means (provided the firm reasonably believes that the customer can store it on a permanent medium), a contract note or confirmation notice which includes the following information:
- a) the name of the firm;
  - b) the name of the customer account;
  - c) the time of execution, if available, or a statement that the time of execution will be supplied on request;
  - d) date of execution;
  - e) the type of transaction; e.g. buy, sell, subscription etc.;
  - f) the market on which the transaction was carried out or the fact that it was carried out off-market;
  - g) the financial instrument and the quantities involved in the transaction;
  - h) the unit price applied and the total consideration;
  - i) whether the customer's counterparty was the investment firm itself or any related party;
  - j) the commissions and expenses charged;
  - k) the time limit and procedure for the settlement of the transaction, e.g. details (name and number) of the bank account and securities account.

If a transaction is not executed within one business day of receipt of the customer order, an investment firm must send a written confirmation of the order to the customer. The confirmation notice must include customer order details, date and time of reception and, where applicable, date and time of transmission.

59. The investment firm must notify the customer immediately if it refuses to accept or transmit an order. The firm must inform customers as soon as possible if it is unable to transmit their orders.

#### **b) Periodic information**

60. An investment firm must send to its customer at least once a year or as often as agreed with the customer a statement of all assets held in custody on behalf of each customer. The statement must also:
- a) identify assets which have been pledged to the firm or any third parties as collateral;
  - b) identify assets which have been lent;
  - c) clearly and consistently show movement of assets based on either trade date or settlement date.

#### **c) Derivatives and leveraged transactions**

61. Where an account includes uncovered open positions<sup>13</sup>, an investment firm must send to its customer a monthly statement, which includes the following:
- a) information about the options contract, e.g. market price, date of exercise, exercise price, as well as any incidental costs connected with the exercise;
  - b) each payment made by the customer as a result of the margin requirements in respect of the open positions and the amount of the unrealised profit or loss attributable to open positions;
  - c) the resulting profit or loss arising from positions closed during the period.

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<sup>12</sup> The reference to "send to the customer" includes to a tied-agent, other than the firm, nominated by the customer in writing.

<sup>13</sup> Examples of uncovered open positions include:

- (1) short positions on cash instruments;
- (2) selling a call option on an investment not held in the portfolio;
- (3) unsettled sales of call options on currency in amounts greater than the portfolio's holding of that currency in cash or in readily realisable securities denominated in that currency;
- (4) transactions having the effect of 'selling' an index to an amount greater than the portfolio's holdings of designated investments included in that index.

### **3. THE “KNOW-YOUR-CUSTOMER STANDARD” AND THE DUTY TO CARE**

#### **3.1 INFORMATION FROM THE CUSTOMER**

- ***STANDARD***

***62. Prior to providing any investment service to a customer for the first time and throughout the business relationship, an investment firm must be in possession of adequate documentation on the identity of the customer, as well as the identity and legal capacity of any representative of the customer.***

***In addition, prior to providing any investment service the investment firm must seek to obtain from the customer information enabling an investment firm***

***a. to determine whether the investment services envisaged are appropriate for the customer<sup>14</sup> and***

***b. to meet any duties owing to the customer in respect of the services to be provided.***

- ***RULES***

63. The “know-your-customer” standard applies to each investment firm having a direct business relationship with the customer with respect to investment services. However, where two or more investment firms are involved in providing an investment service and each has a direct relationship with the customer, an investment firm may rely on the information received from another of such investment firms.

64. An investment firm must obtain evidence of the identity of its customers in accordance with national laws and regulations implementing the provisions of Council Directive 91/308 on the prevention of the use of the financial system for the purpose of money laundering. Until such evidence is obtained, an investment firm must not provide any investment services to the customer concerned.

65. An investment firm must seek to obtain information on the customer’s knowledge and experience<sup>15</sup> in the investment field, his investment objectives and risk profile,<sup>16</sup> his financial situation/capacity and any trading restrictions applicable to the customer. The extent of the information required will vary according to the standards laid down in paragraph 62, second subparagraph.

66. An investment firm shall be entitled to rely on the information provided by the customer, unless it is manifestly inaccurate or incomplete or the firm is aware that the information is inaccurate or incomplete. In this case paragraph 69 applies.

67. An investment firm must take reasonable care to keep the customer profile under review, also taking into consideration the development of the relationship between the investment firm and the customer. The customer must be advised that he should inform the investment firm of any major changes affecting his investment objectives, risk profile, financial situation/capacity, trading restrictions, or the identity or capacity of his representative. Should the firm become aware of a major change in the situation previously described by the customer, it must request additional information.

68. An investment firm must draw up and implement appropriate written internal policies and procedures to keep and update all documents required for customer identification and profile, as well as records of customer addresses and telephone/fax numbers.

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<sup>14</sup> This is not considered to be investment advice according to the definition of the paper.

<sup>15</sup> Information on the customer’s investment knowledge and experience includes the types of services, transactions and products the customer is familiar with and his trading history, i.e. the nature, volume, frequency and timeframe of his transactions.

<sup>16</sup> Information on the customer’s investment objectives and risk profile includes the temporal horizon of the customer’s future investments, as well as his preferences regarding risk-taking and recurrent income.

69. An investment firm must warn the customer that any refusal to supply information may adversely affect the ability of the investment firm to act in the best interest of the customer. If a customer refuses to supply information the investment firm must warn him in writing that this may adversely affect the ability of the investment firm to act in his best interest.
70. The customer should not be invited not to provide information.

### **3.2 THE INVESTMENT FIRM'S DUTY TO CARE FOR THE CUSTOMER**

71. After having obtained the information from the customer according to chapter 3.1., the extent of an investment firm's duty to care for the customer depends on the nature of the investment service to be provided: where the service to be provided is a full hand-holding service of transmission or execution of order par. 72-76 apply; where the service to be provided is the pure transmission or execution of orders <sup>17</sup> par. 74, 76 and 77 apply.

#### **• STANDARDS**

- 72. When an investment firm provides investment advice to the customer, it must have reasonable grounds to believe, in light of the information disclosed to it by the customer and the information available to it, including the information arising from the customer relationship, that this investment advice is suitable for him. The investment firm must communicate the reasons why the advice is considered to be in the best interest of the customers at the time the advice is given.*
- 73. Before accepting an order an investment firm must take reasonable care to verify that the order is suitable for the customer in light of the information disclosed to it by the customer and the information available to it, including the information arising from the customer relationship.*
- 74. An investment firm must take reasonable care to verify that the customer has sufficient financial resources to settle the proposed transaction.*

#### **• RULES**

75. Where an investment firm receives an order regarding a transaction that it considers – in the light of the information disclosed to it by the customer and the information available to it, including the information arising from the customer relationship – not suitable<sup>18</sup> for the customer, it must advise the customer accordingly and provide appropriate information on the transaction, including any necessary risk warning. The investment firm may transmit or execute the order only if the customer nonetheless confirms his intention to proceed with the transaction in writing or by telephone and recorded, and provided that such confirmation contains an explicit reference to the warning received.
76. An investment firm may accept an order without having taken reasonable steps to verify the immediate availability of the funds (securities) necessary for carrying out the related purchase (sale) only if an adequate credit facility has been agreed on beforehand.
77. Where the service to be provided is the pure transmission or execution of orders (either through a special distribution channel, in individual cases or generally) the customer must be made aware of this fact prior to the transaction taking place for the first time. On the basis of the information obtained from the customer on opening the account, the investment firm will define an appropriate service including investment parameters, i.e. types of instruments, types

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<sup>17</sup> This implies that no investment advice is provided and that suitability will not be tested on a transaction-by-transaction-basis.

<sup>18</sup> A transaction may be considered unsuitable for a customer, *inter alia*, because of the instrument involved (e.g. derivatives), because of the type of transaction (e.g. sale of options), because of the characteristics of the order (e.g. size or price specifications) or because of the frequency of the customer's trading.

of transactions and types of orders, and inform the customer accordingly. Where the investment firm receives an order regarding a transaction, which is not in line with the defined investment parameters, it must warn the customer accordingly and provide appropriate information on the transaction, including any necessary risk warning(s). The investment firm may transmit or execute the order only if the customer nonetheless confirms his intention to proceed with the transaction in writing or by telephone and recorded, and provided that such confirmation contains an explicit reference to the warning received.

#### **4. CUSTOMER AGREEMENTS**

##### **4.1) BASIC CUSTOMER AGREEMENT**

- ***STANDARDS***

***78. Prior to providing any investment service, an investment firm must enter into a signed written agreement with the customer setting out the rights and obligations of the parties, a description of the services to be provided, and all other items of information necessary for the proper understanding and performance of the agreement.***

***79. The customer agreement must be clear and easily understandable by the customer.***

- ***RULES***

**80. The customer agreement must contain the following items as a minimum:**

- a) the identity, postal address and telephone number of each of the parties;
- b) the names of any persons authorised to represent the customer for the purposes of the agreement, in particular the names of the natural persons authorised to represent the customer who is a legal entity;
- c) the investment firm's general terms of business for investment services and any particular terms agreed between the parties concerning, e.g. margin requirements or potential obligations where securities may be purchased on credit
- d) a general description of the investment services, including custody, offered by the investment firm and the types of financial instruments to which such services relate;
- e) the types of orders and instructions that the customer may place with the investment firm, the medium/media for sending them (e.g. by telephone, E-mail or post) and the alternative medium to be used when normal media are unavailable;
- f) the information to be given by the investment firm to the customer regarding the performance of services including the medium/media for sending the information and the type, frequency and rapidity of the information to be given e.g. regarding order execution or portfolio evaluation;
- g) details of the investment firm's fees and prices for investment services, including information on how they are to be calculated, the frequency with which they are to be charged and the manner of payment;
- h) the name of the competent authority which has authorised the investment firm;
- i) the law applicable to the contract, as ascertained to the best of the knowledge of the firm or as agreed between the parties;
- j) the duration of the agreement and the procedures for amending, renewing, terminating or withdrawing from it;
- k) where such a procedure exists, a description of the mechanism for settling disputes between the parties such as an out-of-court complaint and redress mechanism;
- l) the actions that the investment firm shall or may take in the event the customer does not honour his obligations (e. g. payment of money due to the investment firm), in particular whether the investment firm is allowed to dispose of any of the customer's assets, the timeframe for doing so and the information to be given to the customer in such circumstances;
- m) the languages in which the customer can communicate with the investment firm.

81. Rather than containing all the above items itself, the contract may refer to other documents containing certain of them, e.g. the general terms of business, the types of investment services offered, the types of orders and information to be sent by the parties and the fee schedule, provided that all the contractual documents so referred to are provided to the customer prior to the signing of the contract.
82. Where a custody service related to the other services provided by the firm to the customer is provided, either directly by the investment firm party to the contract with the customer or indirectly by another investment firm, the contract must contain at least a brief indication of the rights and obligations of the parties, including the provisions relating to the exercise of voting rights attaching to the securities held.
83. The contract must state that any modification of the agreement by the investment firm, e.g. regarding fees, requires the prior notification of the customer, and the contract must provide a sufficient opportunity for the customer to terminate the agreement.
84. A copy of the agreement signed by the customer (and any related contractual documents) must be kept by the investment firm for the duration of the customer relationship and for at least five years after the end of the relationship; a copy must be provided to the customer immediately after signing, and at any time subsequently on request.

#### **4.2) CUSTOMER AGREEMENT INVOLVING TRADING IN DERIVATIVES**

- ***STANDARD***

85. ***Prior to providing the services of reception/transmission and/or execution of orders involving derivatives, a customer agreement containing the relevant provisions of the basic customer agreement as well as certain additional provisions specific to trading in derivatives must be signed between the parties.***

- ***RULES***

86. In addition to the relevant items of the basic customer agreement, where the firm provides services involving derivatives, the customer agreement must contain:
  - the type(s) of instruments and transactions envisaged,
  - the obligations of the investment firm with respect to the transactions envisaged, in particular its reporting and notice obligations to the customer,
  - the obligations of the customer with respect to the transactions envisaged, in particular his financial commitments toward the investment firm and the time allowed for honouring such commitments,
  - an appropriate warning calling to the customer's attention the risks involved in the transactions envisaged.
87. The contract must mention the types of transactions envisaged, in particular whether the customer intends to undertake transactions giving rise to contingent liabilities, the types of instruments envisaged, in particular whether they are traded on a regulated market or not, and it must refer to the documentation on such instruments provided by the investment firm to the customer for information purposes.
88. The contract must provide for the immediate confirmation of derivatives transactions and the immediate notice to the customer of his payment obligations as they arise, as well as the procedures to be used for such confirmation and notice.
89. The contract, or the documentation referred to in the contract, must provide adequate information on any margin requirements or similar obligations, regardless of the source of such

rules and requirements, e.g. an exchange or clearing house, or the investment firm itself. This document must indicate how margin will be calculated and charged, the assets (cash, securities, etc.) accepted as margin, the frequency of margin calls and the timetable for the delivery or payment of margin by the customer to the investment firm. The contract must require immediate notification to the customer of any change in margin rules.

90. The warning given to the customer should reflect the transactions envisaged, in particular where potential losses may exceed the amounts invested, as well as the experience, knowledge and financial situation/capacity of the customer or type of customer involved, and should be given due prominence in the contract.

## **5.- DEALING REQUIREMENTS**

### **5.1) RECEPTION AND TRANSMISSION OF CUSTOMER ORDERS**

- ***STANDARDS***

91. *An investment firm must record and process customer orders in accordance with the customer's instructions and in such a way as to facilitate best execution.*
92. *An investment firm must ensure that the firm and its members of the board, directors, partners, employees and tied-agents do not use the information they possess on customers orders to the disadvantage of customers' interest.*

- ***RULES***

#### **Reception**

93. An investment firm must ensure that, prior to their transmission for execution, orders given by customers are clear and precise and include the following:
- a) the name of the customer and of any person acting on his behalf,
  - b) the date and time of the order,
  - c) the financial instrument to be traded,
  - d) the size of the order,
  - e) the nature of the order, e.g., subscription, buy, sell, exercise etc.,
  - f) any other relevant details and particular instructions from the customer for the order to be properly transmitted and executed, e.g. limit orders, validity period and market of execution;
  - g) the account for which the order has to be executed.
94. An investment firm must record orders immediately, documenting and verifying all relevant items of proper execution.
95. An investment firm must keep a record of telephone orders on magnetic tape or an equivalent medium. Investment firms must duly inform the customer that the conversation will be recorded.
96. Before transmitting orders on behalf of several beneficiaries on an aggregated basis, an investment firm must pre-assign such orders in order to ensure that they can identify and match the orders with the relevant customer at any time.

#### **Transmission**

97. An investment firm must transmit orders promptly and sequentially and must take all reasonable care to transmit orders in a way to facilitate their best execution, taking into account all relevant details of the process of transmission, e.g. the size and characteristics of the order.
98. An investment firm must take all reasonable steps to refrain from transmitting orders for its own account or the account of its members of the board, directors, partners, employees and tied-agents before those of customers in identical or better conditions than the latter (“front running”).
99. An investment firm, which aggregates orders, must pre-assign such orders prior to transmitting them.
100. An investment firm may transmit orders for its own account and for its customers account on an aggregated basis when it is clearly in accordance with the best interest of the customer and provided that the best execution standard is respected.
101. In the case of orders in connection with public offers of securities, an investment firm may transmit such orders provided that they offer the relevant prospectus to the customer or informs the customer where it is available.

## 5.2) EXECUTION OF ORDERS

- **STANDARDS**

***102. An investment firm must take all care to obtain the best possible result for the customer with reference to price, costs born by the customer, size, nature of the transactions, time of reception of order, speed and likelihood of execution and trading venue taking into account the state of the relevant market(s). The relevant market(s) shall be deemed to be the market(s) offering the most favourable trading conditions also in terms of transparency, liquidity and clearing and settlement arrangements in connection with the envisaged transaction. If the investment firm executes in another trading venue, it must be able to demonstrate to the customer that this was done in accordance with his best interest.***

***103. An investment firm must ensure that orders are executed in accordance with the instructions from the customer.***

- **RULES**

104. An investment firm acting as principal in relation to a customer order must inform the customer accordingly beforehand and must be in a position to justify the price at which the transaction is executed, with reference to the prices and volumes in the relevant market(s), where appropriate, or the presumed value determined on the basis of objective elements, e.g. mark-to-market.

105. An investment firm must take all reasonable steps to refrain from executing orders for its own account or the account of its members of the board, directors, partners, employees and tied-agents before those of customers in identical or better conditions than the latter (“front running”).

106. An investment firm must execute orders promptly and sequentially, unless the characteristics of the order and/or prevailing market conditions make this impossible or require otherwise in the interest of the customer.

107. Customer orders may be matched internally only if such offsetting is clearly in accordance with the best interest of the customers involved and provided that the best execution standard is respected.
108. If an investment firm aggregates orders, it must pre-assign such orders prior to executing them.
109. The price received or paid by the customer shall be identified separately from the fees and costs to the customer.
110. An investment firm must inform customers of relevant risks or impediments for the proper execution of the orders. If, due to market conditions, or for any other reason, an order cannot be executed according to the instructions given by the customer, an investment firm must ensure that the customer is duly informed as soon as possible.

### 5.3) POST- EXECUTION OF ORDERS

- ***STANDARDS***

111. *An investment firm must ensure the proper and speedy recording, allocation and distribution of executed transactions.*
112. *Where orders for own and customer accounts have been aggregated, the investment firm must not allocate the related trades in any way that is detrimental to any customer. If such an aggregated order is only partially executed, allocation to customers must take priority over allocation to the investment firm.*

- ***RULES***

113. An investment firm must record the essential elements of transactions, including those carried out for its own account, immediately after their execution. An investment firm must record in an analogous manner the orders they give and the transactions they carry out for the purpose of remedying errors made in recording, transmitting or executing orders.
114. An investment firm must ensure that once a transaction is executed it is promptly allocated to the account of the relevant customer(s).
115. Where an order has been executed in several tranches, the investment firm must inform the customer about the price of execution of each tranche, unless the customer requests an average price. If customer orders have been aggregated and such an aggregated order has been partially executed, the investment firm must allocate the related trade on a proportional basis, unless the firm has a different allocation policy and the customers involved have been informed accordingly prior to the execution. An investment firm must have procedures in place to prevent that reallocation of principal transactions executed along with customers transactions on an aggregated basis give unfair preference to the investment firm or to any of its customers for whom it deals.

## 6. INDIVIDUAL DISCRETIONARY PORTFOLIO MANAGEMENT

In addition to the foregoing standards and rules, additional provisions apply to the service of individual portfolio management.

## 6.1. CUSTOMER AGREEMENTS FOR DISCRETIONARY PORTFOLIO MANAGEMENT

### • **STANDARDS**

116. *Prior to the provision of any discretionary portfolio management service, a customer agreement containing the relevant provisions of the basic customer agreement mentioned above, as well as certain additional provisions specific to portfolio management must be signed between the parties.*
117. *Where the conditions for delegating management of the portfolio are met and the contract allows the investment firm to delegate this function, the contract must state that the delegator retains full responsibility for the protection of the customer's interests.*

### • **RULES**

118. Instead of the items referred to in paragraph 80.e) , the customer agreement must contain:
- a) the management objective(s) and any specific constraints on discretionary management,
  - b) the types of financial instruments that may be included within the portfolio and the types of transactions that may be carried out in such instruments, including any related limits.
- In addition to the above, the customer agreement must contain:
- c) without prejudice of paragraph 121, the benchmark against which performance will be compared,
  - d) the basis on which the instruments are to be assessed at the date of valuation,
  - e) details regarding the delegation of the management function where this is permitted.
119. The contract must indicate the objectives and the level of risk agreed upon, and any particular constraints on discretionary management resulting from the customer's personal circumstances as referred to in paragraph 62 or his request to exclude certain types of investments (certain business sectors for example).
120. If an investment firm is mandated to invest in any of the following types of instruments or to undertake any of the following types of transactions, the contract must state so explicitly and provide adequate information on the scope of the investment firm's discretionary authority regarding these instruments and transactions:
- financial instruments not traded on a regulated market,
  - illiquid or highly volatile financial instruments,
  - leveraged transactions,
  - securities repurchase agreements or securities lending agreements,
  - transactions involving credit, margin payments or deposit of collateral,
  - transactions involving foreign exchange risk.
121. For information purposes with respect to the customer, the contract must indicate an appropriate benchmark, based on financial indicators produced by third parties and in common use, that is consistent with management objectives and against which the future results are to be compared. Where it is not feasible to establish such a benchmark in view of specific customer objectives, this must be stated clearly in the contract and an alternative measure of performance must be indicated.
122. The contract must state whether the financial instruments are to be valued at bid/ask or offer or mid-market price, including any relevant currency exchange rates, and, where relevant, by reference to indicators such as yield curves or other pricing models or the methodology to be used to value unlisted equities.
123. The contract must define a specific reporting requirement in the event of losses, defined as a marked-to-market decrease in the value of the portfolio as compared to the value of the portfolio as stated in the most recent periodic report (after neutralisation of any contributions or

withdrawals). The contract must set a percentage threshold and a time period to warn the customer accordingly.

124. If the contract provides for a variable management fee based on the performance of the management service, the method of calculation must be clearly defined in the contract.

125. The contract must provide:

- that the customer may terminate the agreement with immediate effect, subject only to the completion of all transactions already commenced and the time necessary to liquidate the portfolio where this is required by the customer;
- that the investment firm may terminate the agreement subject to a two-week notice, provided however that where the portfolio cannot be liquidated (where required by the customer) within this timeframe, the agreement may be extended for the necessary additional period, and provided that where the customer so agrees after being informed of the firm's intention to terminate, the agreement may be terminated in the timeframe agreed between the parties.

In both cases, the termination must take place on terms that are fair and reasonable for both parties.

### **Delegation of portfolio management**

126. If an investment firm is mandated to delegate management of any or all of the customer's assets, this must be stated in the contract and adequate information must be supplied in this regard, both to the customer and to the competent authority. The contract must also provide that the customer will be informed prior to any significant change regarding delegation of portfolio management.

127. An investment firm may delegate the portfolio management function to another investment firm only if such delegatee firm is authorised in its home country to provide portfolio management services on an individual basis and is qualified and capable of undertaking the function in question. The mandate shall not prevent the effectiveness of supervision over the delegator, and in particular, it must not prevent the delegator from acting in the best interests of its customers. In no case the investment firm may delegate its functions to the extent that it becomes a letter box entity. Furthermore, it may so delegate to a non-EEA investment firm so authorised in its home country only if an appropriate formal arrangement between regulators enables them to exchange material information concerning both cross-border delegations and the delegatee.

128. The delegation agreement, in writing:

- a) must be revocable with immediate effect by the delegator;
- b) must provide for sufficient notice to be given to the delegator by the delegatee of termination of the agreement;
- c) must be in conformity with the indications contained in the customer agreement with the delegator;
- d) must require, where the execution of transactions is not subject to the prior consent of the delegator, the delegatee to observe the investment guidelines, including investment allocation criteria, laid down from time to time by the delegator;
- e) must be formulated so as to avoid conflicts of interest between the delegator and the delegatee;
- f) must provide for the delegator to receive a continuous flow of information on the transactions carried out by the delegatee permitting it to monitor effectively at any time the activity of the delegatee and to reconstruct the assets under management belonging to each customer of the delegator.

## **6.2 PERIODIC INFORMATION**

- **STANDARD**

**129. *An investment firm must send periodic statements to its portfolio management customers so as to enable them to assess the performance of the service.***

- **RULES**

130. Periodic statements for portfolio management customers must contain:

- a) a statement of the contents and valuation of the portfolio, including details of each investment held, its market value and the performance of the portfolio and the cash balance, at the beginning and at the end of the reporting period;
- b) a management report on the strategy implemented (to be provided at least yearly);
- c) the total amount of fees and charges incurred during the period and an indication of their nature;
- d) information on any remuneration received from a third party and details of its calculation basis;
- e) the total amount of dividends, interest and other payments received during the period.

131. If the basis for valuing any of the assets in the portfolio has changed with respect to the methods described in the portfolio management agreement, these changes must be indicated in the statement along with their impact on profits and/or losses.

132. Periodic statements must include full information on any remuneration received by the investment firm or the manager from a third party that is attributable to services performed for the customer by the manager of the portfolio.

133. In case the customer has elected – in derogation to rule 58 - not to receive information on each transaction in due course carried out by the portfolio manager, the periodic statement containing details of each transaction must be provided at least every three months. Where the details of each transaction are notified after each transaction to the customer, the periodic statement may be provided only every six months.

134. Where the contract authorises a leveraged portfolio, the customer must receive a periodic statement at least once a month, including an assessment of the risks.

### **6.3. MANAGEMENT REQUIREMENTS**

- **PRINCIPES**

**135. *An investment firm must take all reasonable steps necessary to ensure the independence of the portfolio management function and mitigate the risk of customers' interests being harmed by any conflict of interest, in particular by providing for the strict separation of functions within the investment firm and its group.***

**136. *An investment firm must define investment strategies for its portfolio management services and carry out transactions in accordance with such strategies, taking into account the terms of the customer agreement.***

**137. *The transactions carried out by the portfolio manager, both individually and as a whole, must be exclusively motivated by the interests of the customer and in accordance with agreed management objectives.***

- ***RULES***

138. The structure of the investment firm, its policies and procedures must seek to ensure the independence of the portfolio management function.
139. The investment firm must maintain records of its investment strategies, as well as the analyses and forecasts underlying them.
140. The investment firm must ensure that its orders are executed as efficiently as possible and in particular that:
  - a) orders issued are immediately recorded by the firm;
  - b) transactions executed are recorded and the portfolios affected are adjusted as quickly as possible;
  - c) the portfolios affected and the relevant amounts are determined, or objectively determinable, no later than the time at which the order is issued and cannot be changed, except for the purposes of rectifying an error, after the execution of the order, regardless of whether the order relates to one or more accounts.