



**CESR's Draft Technical Advice on Possible Implementing Measures
of the Directive 2004/39/EC on Markets in Financial Instruments**

Professional Client Agreements

Call for Opinions

December 2004



INTRODUCTION

Background

1. The Directive on Markets in Financial Instruments (Directive 2004/39/EC - "MiFiD") was adopted by the European Parliament and Council on 21 April 2004 (OJ L145/1 of 30 April 2004). The Directive will replace the Investment Services Directive 93/22/EEC.
2. In accordance with the Lamfalussy Process, the Commission may adopt implementing measures, so-called "Level 2 measures", with respect to a large number of provisions of the Directive. Before the Commission presents a proposal for implementing measures to the European Securities Committee, it seeks the technical advice on these measures from the Committee of European Securities Regulators ("CESR").
3. On 20 January 2004, the Commission published "*The Provisional Mandate to CESR for Technical Advice on Possible Implementing Measures concerning the Future Directive on Financial Instruments Markets*". The Commission asked CESR to deliver its technical advice in form of an "articulated" text by 31 January 2005. On 25 June 2004, the Commission published "*The formal request for Technical Advice on Possible Implementing Measures on the Directive on Markets in Financial Instruments*". In addition to confirming the provisional mandate, the Commission asked CESR to deliver its technical advice on additional mandates concerning some new areas of the Directive by 30 April 2005.
4. On 17 June 2004 CESR published its first consultation paper on the first set of mandates under the MiFiD (ref. CESR/04-261b). The public consultation closed on 17 September, except for mandates on best execution and market transparency. The deadline for these mandates has been postponed to end of April 2005.
5. On 17 November CESR published a second consultation paper on the first set of mandates. This consultation, which closes on 17 December, focuses on key issues of policy identified in the responses to the first consultation and the practical aspects of implementation.
6. Another issue raised during the first consultation paper relates to the professional client agreement. The first consultation paper contained CESR's draft advice regarding possible implementing measures of article 19.7 of the MiFiD regarding the client agreement, but only with regard to the agreement between an investment firm and its retail clients. It did not cover explicitly the issue of agreements between investment firms and their professional clients. CESR undertook however in the first consultation paper to go back to this issue, which is the subject of this call for opinions in order to check the overall consistency of CESR advice on client agreement. This issue has been discussed with the ISD Consultative Working Group in the last meeting on 2nd of December.

Area Covered

7. The call for opinions covers a single subject: advice to the Commission under article 19.7 in relation to agreements between the investment firms and their professional clients.

Call for opinions

8. CESR invites comments on its views regarding the issue raised. Market participants are invited to accompany their opinions with detailed reasoning and practical examples of the impact of the proposals.



9. A number of market participants at the open hearing on 18 November 2004 called for CESR's advice on the definition of investment advice to recognise that a professional client is better placed than a retail client to recognise that in certain circumstances, market views and other communications given by an investment firm should not be seen as a personal recommendation, even if they involve some consideration of the client's circumstances. The experts group will need to consider these comments (together with any written submissions on this point) when finalising its advice in this area. The practical implications of requiring an agreement for the provision of investment advice will depend on the outcome of these deliberations on the scope of definition of investment advice. CESR therefore considers it appropriate to harmonise the timing of its advice in these two areas.

10. Call for opinions closes on **20 February 2005**. Responses should be sent via CESR's website (www.cesr-eu.org) in the section "Consultations". CESR will publish a feedback statement justifying its final choices vis-à-vis the main arguments expressed.



CESR's draft advice on professional client agreements

Extract from the level 1 text

Article 19.7: The investment firm shall establish a record that includes the document or documents agreed between the firm and the client that set out the rights and obligations of the parties, and the other terms on which the firm will provide services to the client. The rights and duties of the parties to the contract may be incorporated by reference to other documents or legal texts.

Extract from the Commission mandate

DG Internal Market requests CESR to provide technical advice on possible implementing measures by 31 January 2005 on the minimum content of the client records, in particular the customer agreement and time at which such records must be established by the investment firm. This request should be combined with the request formulated with respect to Article 13.7.

Explanatory text

Areas covered in the first consultation paper (Ref. CESR/04-261b)

In its draft advice published on 17 June 2004, CESR proposed implementing measures under article 19.7 of the MiFID on the client agreement only with regard to retail clients.

CESR's draft advice on article 19.7 in this regard proposed:

- i) that the investment firm must provide to the retail client the terms of the agreement in writing¹ in good time prior to providing any investment service to the retail client;
- ii) that the investment firm must obtain the consent of the retail client to the terms of the agreement as evidenced by signature or an equivalent alternative mechanism.

CESR proposed a derogation from these requirements only where the means of communication employed do not allow provision of the agreement in writing and/or evidence of client consent by signature or an equivalent alternative mechanism. In such a case, the firm may provide the agreement in writing and obtain evidence of the consent of the retail client immediately after starting to provide the relevant service². This derogation should not apply, it was suggested, for the services of portfolio management and trading in derivatives and warrants for retail clients.

CESR also proposed requiring specifying at level 2 the content of the retail client agreement, including the items to be mentioned in standard agreement as well as in agreements for portfolio management and trading in derivatives and warrants.

CESR is now reviewing its initial proposals on the retail client agreement in the light of the responses to consultation. It is nevertheless helpful to bear in mind the general structure of the published draft advice on the retail client agreement in assessing the appropriateness of any future advice on the professional client agreement.

¹ In CESR's first consultation paper on the first set of MiFID mandates, the term "in writing" was defined as "on paper or another durable medium" this last term being defined as "any instrument which enables the client to store information in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored".

² See paragraph 2 of the draft advice under Article 19(7) in the first consultation paper.



Paragraph 12 of CESR's June draft advice (Ref. CESR/04-261b) under Articles 13(7) and (8) included certain proposals for a client agreement in relation to the holding of client assets that would apply to both retail and professional clients.

Approach to the professional client agreement

Several issues and possibilities arise in this respect as CESR considers the appropriateness of advising the European Commission on possible implementing measures relating to the professional client agreement in areas outside of the holding of client assets.

CESR could advise the Commission that no implementing measures are necessary under article 19.7 beyond those regarding the retail client agreement, bearing in mind the reduced need for intervention in this area on investor protection grounds for professional clients. Silence at level 2 could potentially lead to inconsistent implementation of article 19.7, as some Member States may read the level 1 text as requiring a written agreement with all clients (because of the reference to "document or documents agreed between the firm and the client") while others may draw the opposite conclusion (because of the reference to "a record that includes the document or documents agreed"). However, such different approaches may be justified by the lack of harmonisation of the obligations that will be implied in the absence of an express agreement between the parties under the different systems of private law in the Member States.

CESR considers that if it is to advise the Commission on these matters at this stage, its advice should be limited to the provision of portfolio management services and possibly investment advice.

Certain questions arise as to the scope of the requirement in terms of the types of services provided by the firm, and as to any further requirements with respect to timing, client consent and content of the contract.

CESR considers that any requirement relating to the mode of acceptance of the agreement (signature or equivalent as opposed to tacit acceptance by behaviour for example) or to the content of the agreement (items to be mentioned in the contract) would be over-prescriptive and unjustified in a professional client relationship.

CESR considers on the other hand that it may be appropriate to provide in a level 2 measure that investment firms must enter into a written agreement with their professional clients. It may also be appropriate to require that this be done prior to the provision of investment services to a new client. If a requirement for a client agreement is to be imposed in relation to investment advice, the derogation proposed for the retail client agreement with respect to this timing requirement where the service has been provided at the client's request using a using a means of communication which does not enable the provision of the agreement in writing would of course be extended to professional client agreements. CESR would appreciate views on whether the same derogation should apply in relation to the agreement for portfolio management services. Another possibility would be to require an agreement in writing within a reasonable time of the first provision of the service, regardless of the means of communication used.

It should be emphasized in this regard that CESR's advice on the retail client agreement is intended to apply to the framework agreement, not to each subsequent individual provision of a service or sale of an instrument that falls within the scope of the framework agreement, and that any advice on the professional client agreement would be intended to apply to the same type of agreement.

There are differing opinions as to whether the case for a mandatory written agreement for the provision of investment advice is as strong as for portfolio management services. On one hand, it would help to ensure that the parties understand the nature and scope of the service to be provided. It would also be very useful for regulators in supervising compliance with article 19(4) of the Directive. On the other hand, such a requirement may result in a greater delay in the commencement of services (especially for professional clients, who are more likely to negotiate the agreement than retail clients). Portfolio management services also involve a transfer of control from the client to the firm as a result of their discretionary nature and generally require the firm to obtain control over its client's assets before being able to provide a service. These factors are generally not relevant to the provision of pure advisory services. CESR would particularly welcome comments on



how such a requirement would apply in practice and on any practical difficulties that such a requirement would create.

The options under consideration by CESR may be summarised as follows:

1. *Not to provide any advice on the client agreement, recognising that this should entirely be a matter for Member State discretion or for commercial practice.*

OR

2. *An investment firm that provides portfolio management services to a professional client must enter into an agreement in writing setting out the rights and obligations of the parties in good time prior to providing any such services **OR** within a reasonable time after the first provision of the service].*

OR

3. *An investment firm that provides a portfolio management service or an investment advisory service to a professional client must enter into an agreement in writing setting out the rights and obligations of the parties [in good time prior to providing any such services **OR** with a reasonable time after the first provision of the service].*

By derogation from the previous paragraph, the investment firm may provide the terms of the agreement [for an investment advisory service] in writing immediately after starting to provide the relevant service to the client if that service has been provided at the client's request using a means of communication which does not enable the provision of the agreement in writing.

Questions:

Q.1: Should a written client agreement be necessary for professional clients of an investment firm?

Q2. If so, should the agreement be limited to certain investment services (portfolio management and investment advice) or should it be requested for other investment and ancillary services?

Q.3: If such a requirement is introduced, do you think that this would create additional costs? Please provide details of the nature and likely amount of these costs.

Q.4: If you consider that no such requirements should be introduced, please specify the reasons why.