THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/07-085

CESR Level 3 Recommendations on the List of minimum records in article 51(3) of the MiFID implementing Directive

Feedback Statement

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Background

On October 20 2006, CESR published for consultation a draft recommendation of a list of minimum records that competent authorities are required to develop in accordance with Article 51(3) of the Level 2 Implementing Directive (Ref. CESR/06-552).

During the consultation period, which closed on November 27 2006, CESR received 35 comments from various organizations. The list of respondents to this consultation, with an indication of their sector of activity is attached in appendix 1.

The purpose of this document is to provide a summary of the main comments received by CESR along with some explanations on CESR's final approach to some of the most significant issues raised in the consultation.

Some respondents have challenged the legal basis of those items on the list, which are not based on an express record keeping requirement under MiFID or the Level 2 implementing Directive. The general obligation on firms to keep records is based on Article 13(6) of MiFID. The article stipulates that firms must arrange for records to be kept in relation to all *"services and transactions"* sufficient to enable the competent authority to monitor compliance with the requirements under the Directive. If one chose to interpret the meaning of *"services"* under Article 13(6) narrowly, this would indeed preclude most of the record keeping requirements discussed below from being included in the list. MiFID however expects supervisory authorities to have the means to *"monitor compliance with the requirements under this Directive"* and expressly provides for a number of important record keeping requirements which are not, strictly speaking, a "service", but which are closely connected to, or a legal prerequisite to such a service (e.g. information requirements, know your customer rules, organisational requirements). Most of these requirements could not be monitored without a corresponding record keeping requirement. Thus if MiFID wants the supervisory authorities to monitor compliance with them, it is a prerequisite that supervisory authorities should have the legal and technical ability to do so. Therefore CESR believes that it is essential that a broad interpretation be given to Article 13(6) of MiFID.

The Level 2 Directive provides a number of record keeping requirements which go beyond a narrow interpretation of the term "services". The Directive derives its authority from MiFID and thus can only stipulate requirements which have a legal basis in the Level 1 framework directive. As a result, the record keeping requirements set out in the implementing Directive also ultimately derive their authority from Article 13(6) of MiFID. This can serve as an additional argument for a broad interpretation of Article 13(6) of MiFID.

Question 1: Do you agree that a common list of minimum records in all CESR members will benefit investors and industry?

The majority of respondents agree that a common list would benefit investors and industry. Some respondents disagree with the approach of a common list. Others believe that the list would only be useful if it was regarded as exhaustive and Member States were not allowed to add additional requirements under national law. In this context several respondents were concerned that Member States could "gold plate" the record keeping obligations. Yet other respondents were concerned about the interaction of the list of minimum records with record keeping obligations arising from other (also national) regulations. Only a few suggestions were made to introduce additional items to the list. Such suggestions related to Best Execution Policy, information given to clients,

monitoring compliance with the rules for MTFs, post-trade disclosure, the warnings required by Article 19(5) and Article 19(6) of MiFID, documents to which the client agreements refer and conditions accepted by the client for security financing transactions.

The list of minimum records in Level 2 should not be understood as a limitation of the scope of Level 1 and Level 2. CESR understands that compliance with the list does not provide investment firms with a safe-harbour from the record-keeping provisions in Level 1. National competent authorities may add to this list other record keeping obligations. It is also important to emphasise that CESR is not at this point trying to harmonise the content, timing or form of the different records in the list. In order to clarify this restriction, CESR has changed the headings of column two and three which now read as being "indicative" only. As stated in the consultation paper, CESR, at this stage, is striving to reach progressive convergence on the basis of the proposed list of minimum records. Finally CESR's list is without prejudice to other record keeping obligations arising from other legislation.

Question 2: Do you agree with the content of the list elaborated by CESR? If not, which records should be added or deleted and for which reasons?

Express record keeping requirements

The section of this feedback statement on question 2 of the consultation paper focuses on those items of the list, which are not based on an express record keeping requirement under MiFID or the Level 2 measures. The record keeping requirements, which are based on an express record keeping requirement, are mandatory and are not left to the Member States' or investment firms' discretion. Accordingly most of the respondents acknowledge that these items can be included in the list. In respect of these record keeping requirements, the list is merely declarative in character and therefore CESR believes that there is no need for a detailed discussion on these items in the feedback statement.

Some respondents expressed reservations with regard to the content or the timing of some of the express record keeping requirements. These comments refer in particular to possible issues identified in limited areas of business or specific circumstances in different Member States. As stated above, CESR is not trying at this point the content, timing and form of the records. Therefore member states may consider specific circumstances concerning the content or the timing of the records when they draw up their national lists of minimum records.

Categorisation and identity of each client

CESR has suggested a record for the categorisation and identity of each client. With respect to categorisation it is suggested that sufficient information should be retained to support categorisation either as a retail client, professional client and/or eligible counterparty.

Some respondents question the legal basis for this record on the basis that there is no explicit provision in the Level 1 or Level 2 measures concerning the recording of client categorisation. On timing, some respondents have highlighted that the time to re-categorise clients needs to be taken into account.

In CESR's view this record keeping obligation regarding client categorisation can be based on Article 13(6) MiFID and article 28 of the Level 2 Directive. CESR is of the opinion that the categorisation of clients is important because the category determines which provisions of MiFID are applicable. The supervisory authorities need this record to verify that the firms (i) have categorised the clients correctly and (ii) if they have applied the rules for the respective category. In most cases the categorisation will have to be recorded in practice at the beginning of the client relationship. Therefore this requirement is not overly burdensome for investment firms.

Client details (Article 19(4))

CESR has proposed a record on client details, consisting of information about the client's or potential client's knowledge and experience, financial situation and investment objectives obtained by the investment firm in complying with its obligation under Article 19(4) of the Directive.

Some respondents have claimed that there was no express record keeping requirement in Article 19(4) of MiFID and therefore no legal basis for this record. However, in CESR's view the requirement can be based on Article 13(6) MiFID. The "know your customer" principle is one of the most important and fundamental conduct of business rules. It is impossible to provide sound portfolio management or investment advice without obtaining this information from clients. The supervisory authorities need these records to verify that firms have met their obligations under Article 19 (4) MiFID and Articles 35, 36 and 37 of the Level 2 Directive. In addition the records are useful for the supervisor as well as the firm and the client in case of client complaints.

In addition, some respondents have commented on the timing of the record. They have suggested, in particular, to make it clear that it would be sufficient to create the record on first giving advice and that no further record would be needed in the case of ongoing advice thereafter. However, this record keeping obligation is not intended to require repeated records when no relevant changes occur. In addition, as stated above, CESR has amended the heading of the third column of the list to make clear that the recommendation concerning the time at which the record must be created is indicative only.

Respondents have also highlighted that the record keeping obligation should have regard to the portfolio management services provided to institutional clients. In CESR's view, this concerns the question of what information has to be obtained in accordance with Article 19(4) and 19(5) of MiFID, and not the record keeping obligations based on information obtained according to these provisions.

Client details (Article 19(5))

CESR has suggested a record on client details, consisting of information about the client's or potential client's knowledge and experience obtained by the firm in complying with its obligation under Article 19(5) of the Directive.

Mirroring the comments outlined above in relation to Article 19(4) of MiFID, respondents have claimed that there is no express record keeping requirement under Article 19(5) of MiFID. However, CESR is of the opinion that the record keeping obligation can be based on Article 13(6) of MiFID. The "appropriateness" test is one of the most important and fundamental conduct of business rules. MiFID requires firms to obtain this information from their clients in order to enable them to assess whether the investment service or product envisaged is appropriate for the client. The supervisory authorities need these records to verify that the firms have met their obligations under Article 19 (5) of MiFID and Articles 36 and 37 of the Level 2 Directive.

In addition, some respondents commented on the timing and suggested in particular that it should be made clear that it is sufficient to record the information on entering into the service. However, this record keeping obligation is not intended to require repeated records where no relevant changes occur. In addition, as stated above, CESR has amended the heading of the third column of the list to make clear that the recommendation concerning the time at which the record must be created is indicative only.

Aggregated transaction that includes a client order

CESR has suggested a record on aggregated transactions that include a client order. CESR has merged this item with the following item in order to make it more concise.

Some respondents have objected to the inclusion of this record because there is no express record keeping requirement in Article 22(1) of MiFID. Other respondents were of the opinion that this record keeping requirement is not necessary as it is already covered by Art 7 and Article 8 of the Level 2 Regulation. In addition, respondents are of the opinion that the record keeping requirement is duplicative and without practical benefit.

In CESR's opinion the requirement can be based on Article 13(6) MiFID. Article 7 and Article 8 of the Level 2 Regulation do not contain an express record keeping with regard to aggregated transactions. Aggregated transactions can be crucial since they can be a cause of conflicts of interest between the investment firm and its clients and between clients The supervisory authorities need these records to verify if the firms have met their obligations with regard to client order handling rules under Article 22(1) of MiFID and Articles 47, 48 and 49 of the Level 2 Directive as well as with regard the firm's obligations under Article 19(1) of MiFID.

Aggregation of one or more client orders and an own account order

CESR has proposed a record on the aggregation of one or more client orders and an own account order containing the intended basis of allocation which should be created before the transaction is executed. CESR has merged this item with the preceding item in order to make it more concise.

Some respondents were of the opinion that the content of this record refers to the order allocation policy provided by Article 48(1) (c) of the Level 2 Directive. Indeed it can be questioned if "*The intended basis of allocation*" means anything else than the policy required under Article 48(1) (c) of the Level 2 Directive. However, this item does not intend to establish a duplication of obligations. It is essential that there exists a basis of allocation at a time before the allocation is actually effected, otherwise the procedure can be vulnerable to manipulation.

In addition, some respondents have claimed that there was no express record keeping requirement with regard to the obligation under Article 48(1) (c) of the Level 2 Directive. However the requirement can be seen as covered by Article 13(6) MiFID.

Aggregated transactions and allocation can be crucial since they can be a cause of conflicts of interest between the investment firm and its clients and clients *inter se*. The supervisory authorities need these records to verify if the firms have met their obligations with regard to client order handling rules under Article 22(1) of MiFID and Articles 47, 48 and 49 of the Level 2 Directive as well as with regard to the firm's obligations under Article 19(1) MiFID.

Allocation of an aggregated transaction that includes the execution of a client order

With regard to this proposal, some respondents have claimed that there was no express record keeping requirement in Article 22(1) of MiFID. However the requirement can be seen as covered by Article 13(6) of MiFID. In addition some respondents were of the opinion that this record keeping requirement is already covered by Article 7 and Article 8 of the Level 2 Regulation. However, Article 7 and Article 8 of the Level 2 Regulation do not contain an express record keeping with regard to the allocation of aggregated transactions.

Aggregated transactions and allocation can be crucial since they can be a cause of conflicts of interest between the investment firm and its clients and between clients The supervisory authorities need these records to verify if firms have met their obligations with regard to client order handling rules under Article 22(1) MiFID and Articles 47, 48 and 49 of the Level 2 Directive as well as with regard to the firm's obligations under Article 19(1) MiFID.

Re-allocation

Some respondents have claimed that there was no express record keeping requirement with regard to allocation or re-allocation of aggregated transactions. However the requirement can be seen as covered by Article 13(6) MiFID.

Aggregated transactions and allocation can be crucial since they can be a cause of conflicts of interest between the investment firm and its clients and between clients. The supervisory authorities need these records to verify if the firms have met their obligations with regard to client order handling rules under Article 22(1) MiFID and Articles 47, 48 and 49 of the Level 2 Directive as well as with regard to the firm's obligations under Article 19(1) of MiFID.

Some respondents were of the opinion that the content of this record refers to the order allocation policy provided by Article 49(3) of the Level 2 Directive. It can be questioned if "The basis and reason for any re-allocation" means anything else than the policy required under Article 49(3) of the Level 2 Directive. This item does not intend to establish a duplication of obligations. However Article 49(3) refers only to re-allocation with regard to the aggregation of transactions for own account and transactions for clients. It does not deal with the aggregation of client transactions with other client's transactions.

Periodic statements to clients

Article 41(1) and Article 43(1) of the Level 2 Directive require firms to provide their clients with periodic statements. The supervisory authorities need these data to verify if the firms (i) have provided their clients with periodic statements and (ii) if the statements comprise the required content. Both Article 41(1) and Article 43(1) of the Level 2 Directive require the periodic statements to be provided in a durable medium and thereby expresses the long term relevance of those statements.

Most respondents were of the opinion that a record keeping requirement with regard to periodic statements would be too burdensome for firms. According to Article 51(1) of the Level 2 Directive the statements would have to be retained for a period of at least five years. It can be acknowledged that such a record keeping requirement may be burdensome in some situations, in particular where periodic statements must be provided at short intervals (once a month or every three months).

In order to make a more flexible proposal, CESR has amended the proposed content as follows: Information to evidence the content and the sending of the periodic statement sent to the client in respect of services provided, either as a copy, or in a manner that would enable reconstruction.

Marketing communications

CESR has suggested a record on each marketing communications by the investment firm addressed to clients or potential clients.

Most of the respondents did not support a record keeping requirement with regard to marketing communications. Some respondents were of the view that there is no legal basis for such a requirement because Article 13(6) MiFID refers to "services and transactions" and a marketing communication is neither a service nor a transaction. CESR has considered this argument, but is of the opinion that a record keeping requirement on marketing communications can be legally based on Article 13(6) MiFID. A narrow interpretation of the term "services" would not allow a record keeping requirement with regard to marketing communications to be based on Article 13(6) of MiFID. On the other hand, MiFID expects the supervisory authorities to be able to "monitor compliance with the requirements under this Directive". The MIFID provides a number of

important requirements which are not a "service" on a strict interpretation of the term, but which are closely connected to a service or are a legal prerequisite for a service. Since the MiFID wants the supervisory authorities to be able to monitor compliance with those important requirements, there must be legal and technical ability to do so. Therefore, in CESR's view the term "services" in Article 13(6) MiFID must be understood broadly to include all requirements authorities will have to monitor.

Many respondents were concerned that the record keeping obligation for marketing communications was too burdensome for investment firms. In particular, respondents were concerned about recording each marketing communication sent to each client, recording marketing communications to the wholesale market and recording oral marketing communications. CESR has taken into account these comments and has narrowed down the record keeping requirement to essentials in order to avoid too burdensome a requirement. However, Article 19 (2) and Articles 27 and 29 (7) and (8) of the Level 2 Directive establish detailed rules for marketing communications. The supervisory authorities need at least a sample of the marketing communication (e.g. flyer, press advertisement, TV footage etc.) and a record showing the (group of) clients to whom the marketing communication was issued (e.g. existing clients, the public) in order to monitor compliance with these requirements. CESR therefore clarifies that the record keeping requirement applies only to a sample of the marketing communication and only to those marketing communications issued to retail clients. Furthermore CESR does not include oral marketing communications in this list of record requirement.

Investment research

CESR has suggested a record on each item of investment research, in accordance with Article 24(1) of Directive 2006/73/EC issued by the investment firm in writing.

Some respondents were of the view that there is no legal basis for such a record keeping requirement. CESR considers that the record keeping requirement can be based on Article 13(6) of MiFID, which refers to "services". According to Annex I.b.5 of the MIFID, investment research is an (ancillary) service and therefore covered by Article 13(6).

Article 25 of the Level 2 Directive provides organisational requirements where a firm produces and disseminates investment research. Although MiFID and the Level 2 measures do not provide rules for the content of investment research (The Market Abuse Directive provides for disclosures on this area), investment research is a source of conflicts of interest. Therefore there is a need for supervisory authorities to know not only the fact that a firm produces and disseminates investment research but also that it should know the content of such research.

Compliance procedures

CESR proposed a record keeping requirement with regard to Compliance policies and procedures. Some respondents have challenged the legal basis of this requirement or were of the opinion that a record keeping requirement in this area is not necessary. Article 13(2) of MiFID and Article 6 of the Implementing Directive require firms to establish adequate policies and procedures sufficient to ensure compliance of the firm with its obligations under the MiFID. In addition, one could consider that that a record keeping requirement with regard to compliance policies and procedures is covered by Article 5 (1) (f) of the Implementing Directive because compliance can be seen as part of "internal organisation". The supervisory authorities need at least basic records about the firm's compliance procedures. In order to avoid too burdensome requirements, CESR has narrowed the required records to essential procedures which will not necessarily comprise all details of internal procedures. Also the record keeping requirement concerning policies has been deleted, on the understanding that all the policies that MiFID establishes need to be kept in written form.

Compliance reports, risk management reports and internal audit reports

Article 9(2) of the Implementing Directive requires investment firms to ensure that their senior management receive on a frequent basis and at least annually, written reports on the matters covered by Articles 6, 7 and 8 of the Directive. Therefore CESR has proposed a record keeping requirement with regard to these reports. Such reports can be an important and valuable source for supervisory authorities to assess the functioning of the firm's compliance organisation and the measures taken in the event of any deficiencies. One could be of the opinion that a record keeping requirement is not necessary because the reports have to be produced in writing and therefore are at the authority's disposal anyway. But without being subject to a record keeping requirement, there would be no obligation to retain the reports under Article 51(1) of the Level 2 Directive. The reports could be presented to the senior management without being retained for a reasonable period of time afterwards. Some respondents were of the view that there was no legal basis for such a record keeping requirement. CESR believes that this requirement can be based on Article 13(6) of MiFID. In addition, one could consider that that a record keeping requirement with regard to these reports is covered by Article 5 (1) (f) of the Level 2 Directive because the reports can be seen as part of "business and internal organisation" ("business" is more comprehensive than just providing a service to the client).

Record of the information to be disclosed to clients regarding inducements

CESR proposes a record keeping requirement with regard to information to be disclosed to clients regarding inducements. Article 19(1) of MiFID provides that when providing investment services and/or ancillary services to clients, an investment firm must act honestly, fairly and professionally in accordance with the best interests of its clients. Article 26 of the Implementing Directive sets further requirements in relation to the receipt or payment by an investment firm of a fee, commission or non-monetary benefit (inducements). Such inducements can give rise to detrimental conflicts of interest. Therefore Article 26 provides a disclosure requirement with regard to such inducements. The supervisory authorities need records concerning the information of the clients in order to verify the firm's compliance with this important disclosure requirement. Some respondents have challenged the legal basis of this record keeping requirement. CESR believes that this requirement can be based on Article 13(6) of MiFID.

Question 3: Do you consider that a specific requirement for keeping records of the provision of investment advice should be introduced?

With regard to question 3 of the consultation paper there was not a uniform result. Some respondents were not in favour of a record keeping requirement regarding investment advice. Others challenged the legal basis of such an obligation or were of the opinion that it would be too burdensome for the firms. In addition, the argument was brought forward that investment advice is a complex and comprehensive process and that it would be very difficult to reflect such a process in a record. Representatives of consumers were strongly of the opinion that there should be a requirement to keep records of investment advice.

The legal basis for a record keeping requirement with regard to investment advice is Article 13(6) of MiFID. Investment advice is a service according to Annex I.A.5 of MiFID. Therefore it cannot be questioned if there has to be a record keeping requirement at all regarding investment advice. But it can be acknowledged that investment advice can be very complex, individual and comprehensive and that it would not be appropriate to introduce a record keeping requirement that covers all details of the entire process of investment advice. As a minimum record, CESR believes that (i) the fact that investment advice was given to retail clients and (ii) the financial instrument that was recommended, have to be recorded. Without element (i) it would be impossible for the supervisory authorities to ascertain if investment advice was rendered at all. There are intermediaries who offer transaction services with or without investment advice. The duties of the firms and the rights of clients differ materially in respect of the service rendered. In addition, investment advice can be

important to detect or assess potential conflicts of interest. So it cannot be left open what service was rendered. The financial instrument that was recommended should be recorded because this is the essential element of investment advice. This is where the money of clients is invested and which is decisive for the success or failure of the investment. Recording the recommended financial instrument is comparable to recording the financial instrument with regard to transaction services. Both situations are based on a service in terms of MiFID and the financial instrument is the subject of this service.

Annex

Respondents to the consultative paper (Ref.: CESR/06-552)

Activity	Name of the respondent
Banking	ABN-AMRO
Investment services	APCIMS
Insurance, pension & asset management	Association Française de la Gestion financière (AFG)
Banking	Association of Danish Mortgage Banks
Insurance, pension & asset management	Assogestioni
Issuers	ASSOCIAZIONE ITALIANA INTERMEDIARI MOBILIARI (ASSOSIM)
Banking	Austrian Federal Economic Chamber
Banking	Banca Intesa
Banking	Association of German Banks (BDB)
Banking	British Bankers' Association (BBA)
Insurance, pension & asset management	Bundesverband Investment und Asset Management (BVI)
Banking	Bundesverband der Deutschen Volksbanken und Raiffeisenbanken, Bundesverband Öffentlicher Banken Deutschlands and Deutscher Sparkassen- und Giroverband
Government, regulatory & enforcement	CNMV ADVISORY COMMITTEE
Legal & Accountancy	Compllex
Others	Danish Shareholders Association (DAF)
Issuers	Deutsches Aktieninstitut (DAI)
Others	European Federation of Financial Analysts Societies (EFFAS)
Banking	European Association of Co-operative Banks (EACB)
Banking	European Association of Public Banks (EAPB)
Banking	European Banking Federation (EBF)

Insurance, pension & asset management	European Fund and Asset Management Association (EFAMA)
Banking	European Savings Banks Group (ESBG)
Investment services	French Association of Investment Firms (AFEI)
Investment services	French Banking Federation (FBF)
Investor relations	German Investor Protection Association (DASB)
Investment services	HSBC International Financial Advisers (Malta) Ltd
Legal & Accountancy	Institut der Wirtschaftsprüfer (IDW)
Insurance, pension & asset management	Investment Management Association (IMA)
Insurance, pension & asset management	Irish Association of Investment Managers (IAIM)
Banking	Italian Banking Association (ABI)
Investment services	Joint response by ISDA, ICMA, AMF, BSDAI, BWF, DSDA, Euribor ACI European Commission Working Group, FASD, FOA, NSDA, LIBA, SSDA
Others	Spanish Compensation Scheme for Investment Firms (FOGAIN)
Consumers	Federation of German Consumer Organisations
Consumers	Test-achats
Consumers	Fin-Use