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Milan, 17th September 2004
Prot. n. 136/04/MCO/ta

CESR
The Committee of European
Securities Regulators
11-13 avenue de Friedland
75008 Paris - France

RE: CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments.

Introduction

ASSOSIM is the Italian Association of Financial Intermediaries, which represents the majority of Italian financial intermediaries, banks and branches of foreign institutions, active in the Investment Services Industry.

Before addressing the merits of the comment to the consultation, we wish to take this opportunity to thank CESR for having given market practitioners the chance to express their viewpoint on highly delicate issues, through open and transparent consultation.

Nevertheless, we also wish to convey to our interlocutor the difficulties experienced in working properly on document, in view of the detail and wide scope of the regulations proposed, but most of all, in view of the consultation occurring in the summer period.
We are aware that the non-extension of deadlines for market practitioners depends on the time available to CESR and the European Commission to perform their respective tasks, the whole with a view to the implementation of the directive and respective implementing measures, processes that need to be completed within two years of the entry into force of the MIFID (30 April 2006).
Nevertheless, it should be noted – as a principle by now widely recognized by institutions and the industry at large – that the required swiftness in adopting legislation (or perhaps it would be more appropriate to call it efficiency and rigour in the execution of the procedure) should not be made to impair the quality of the same.

We wish to suggest that perhaps **provisional measures** might be adopted, both in the light of the foregoing and of the fact that the changes to be implemented by the addressees of the legislation will be considerable indeed, and they will involve all aspects of a business set-up, from the setting out of commercial policies down to technological systems.
During the open hearing held on 8/9 July, in Paris, the European Commission - represented at the hearing - excluded that the said measures might defer deadlines, but suggested that "particular arrangements" could be provided for.
This point, we believe, should be dwelt on and we wish to point out that any provision designed to meet the needs of intermediaries, as they adjust to new regulations, is by all means welcome.

However, if the expression 'particular arrangements' refers to adjustments of the procedures over various stages, there is concern that provisions introduced to facilitate intermediaries may involve additional costs to be borne.
And indeed, implementing procedures by fulfilling requisites provided for at intermediate stages may turn out to be more costly than simply proceeding with direct implementation of final procedures for which, we wish to stress once more, the appropriate time will need to be granted.

A further issue that needs to be addressed before moving to the merits of the regulation proposal is that of **harmonization of legislations** and the choice between maximum or minimum harmonization.
ASSOSIM has had occasion to express its stance on this delicate theme (see reply to the CESR consultation paper **"The role of CESR at "Level 3" under the Lamfalussy Process")** and has said to feel confident of the possibility of pursuing a **profound harmonization of legislations** and at the same time **limiting the discretion** of member countries in laying down further requisites for the regulated entities, with a view to bringing about true integration of European financial markets. The said approach would truly answer the objectives of the FSAP. It is also seen as necessary especially in relation to the clear choice made by the European law-maker with the directive 2004/39/EC to extend the home country control principle to favour and facilitate activities of cross-border operators, thereby protecting investors.
The foregoing does not necessarily mean having an extremely detailed legislation set out at European level, with the risk of ending up with over-regulation. In our opinion, insofar as among the objectives of the law-maker there is that of achieving quality and balance in regulations, the same should constantly seek to arrive at a **fair** degree of detail in making rules, account being taken of the extreme variety of business organizations that such rules are to address, while guaranteeing compliance with the principles of the directives.

Section II – Intermediaries

Compliance and personal transactions (article 13, par. 2)

Independence is deemed by the Association as an unavoidable feature of the compliance function, in small businesses too. We do not believe that this characteristic can be sacrificed in the business activity, with respect to the type and size of the investment firm, though we recognize, as a rule, the need for the law-maker to take into due account the specificity of the different entities it sets out to govern (Q. 1.1 and 1.2)

Surely, the costs of setting up a facility that will fulfil the compliance function can be met through outsourcing (see under p. 3; for ease of presentation, we chose to deal with outsourcing of investment services, box 1, and other operational functions, box 3, together), or the law-maker might consider the opportunity of loosening obligations (for example, provide for a different frequency) for a simpler structure in a smaller-sized business.

In evaluating the proposal of CESR, one cannot but refer to the domestic situation and the make-up of businesses in this country where the 'compliance' function is not always distinct from the 'internal audit' function. The roles assigned under the document at hand to the compliance function are executed in part by internal audit and for the other part, by other departments (e.g. the legal one
Naturally, there are also situations where the compliance facility is already operating and others where such a function is in the process of being set up.
In view of the foregoing, it is our opinion that functions of compliance and internal audit need to be clarified and we suggest introducing these two concepts in the list of definitions.
The need for the roles of the two functions to be better spelt out also arises with respect to the very proposal of CESR.
Indeed, in the paragraph "Additional Requirements" of box 2, there is a provision to the effect that the intermediary may decide to set up a specific function independent of internal audit should the nature, scope and complexity of the activity be such as to require it.

As to the tasks of an internal audit structure, we would require greater details as to the evaluation on the adequacy and effectiveness of the compliance function as carried out by the same structure. A mention of this relationship of control between the internal audit function and that of compliance is provided under letter c) of box 2, and in our opinion it needs to be clarified and expounded on.

As to the advisability of providing for two distinct functions, on the basis of the above-mentioned criteria (nature, scope and complexity of the activity), intermediaries wish to have objective factors whose evaluation be univocal so as to have no doubts whatsoever as to if and when there are to be two distinct and independent structures.

Obligation to avoid undue additional operational risk in case of outsourcing (article 13.5 first sub-paragraph)

The Members of the Association have expressed themselves in favour of outsourcing with respect to all investment activities and services (Q. 1.3, outsourcing allowed not just for portfolio management) and other operational functions, viewing this as a further opportunity to organize their own activity.

Though granting that in both situations (outsourcing of investment activities and services and outsourcing of other operational functions) it is the outsourcer that is to retain responsibility, it was highlighted that in practice, in the latter case, it is difficult to perform audits on the work of the service provider undertaking the outsourced activity.
We therefore ask that the law-maker consider the special nature of this situation and lay down (without prejudice to the principle of responsibility resting on the outsourcer) a distinction between the outsourcer's obligations in case of outsourcing of investment activities and services as opposed to outsourcing of other operational functions.

Conflicts of interest (article 13 par. 3 and 18)

Before addressing the merits of the proposals on the regulations in matter of conflicts, we wish to draw the attention of CESR to the fact that it is not easy to circumscribe the notion of conflicts of interest and the relevant scope of application, especially in the case of a conflict of interest between two clients. We wish to note that neither the framework directive nor the implementing measures proposed by CESR contain a definition of conflict of interest.
We sincerely hope CESR might mark the boundary of the conflicts of interest territory in such a way as to ensure that such a definition does not become a catch-all for any circumstance where there is a mere difference in interests between intermediary and client or where potential damage to the client might be caused.
We therefore suggest that the initial part of paragraph I.1 be modified as follows:
The conflicts of interest that must be identified pursuant to Article 18(1) of the Directive and to which this advice applies are actual conflicts of interest and circumstances involving a risk of a conflict arising, where *there is a heightened risk that:*
- the firm or interested person may pursue its own interest in a way that makes it impractical for the firm to properly and completely carry out , or results in a breach of, a duty owed to a client;
- the firm or interested person may pursue a duty owed to a client in a way that makes it impractical for the firm to properly and completely carry out , or results in a breach of, a duty owed to another client
Without limiting the generality of Article 18(1) of the Directive, an investment firm must ensure that its conflicts policy includes all reasonable steps to identify at least conflicts of interest *insofar as they arise* in the following situations and that these steps are effectively implemented: (...)"

As to the contents of the proposal, the subject of conflicts of interests was one of those referred to in the foreword, as we addressed the need for harmonization of legislations to exclude that single authorities exercise any further discretion, which does not necessarily mean overly enhancing the detail of level 2 legislation.
Naturally, in terms of setting out commercial policies (conflict policies or best execution policies) flexibility and universality must be unrenounceable characteristics of the scheme proposed by the law-maker insofar as such scheme needs to be applied to an extremely varied range of business set-ups.
In our opinion, therefore, of the 3 options given in question 6.2 we feel that letter a) offers the most balanced solution, in that it sets forth that letters a) through to f) of point 8 should serve as examples for each intermediary to set out a conflict policy and not as a list of elements absolutely required to be featured in all policies.

Consistently with the foregoing, we favour the second of the two versions proposed in point 8 which, by introducing the above-mentioned list, sets forth that these are examples of organizational choices that - account being taken of the characteristics of the activity and pursuant to letter 5 - may prove

effective in guaranteeing the 'independence' of such entities as are involved in the provision of the various services.

Naturally, the discretion of the single member countries in implementing level 2 legislation must not be made to such an extent as to render obligatory those measures that CESR views as examples. The discretion of member countries cannot be expressed with respect to elements that represent the very *ratio* of the choices made by CESR and the European Commission at second level legislation. Furthermore, the said more restrictive choices of national regulators in many cases would translate into a competitive disadvantage for some parties, an outcome that would be absolutely inconsistent with the objectives pursued: those of integration of financial markets.

As regards the first item of the list given by point 8, we wish to make a few remarks on the concept of independence.
As we set out to analyse the document at hand, we asked ourselves whether it was always feasible to set up effective information barriers among the sectors of investment firms listed under point 8 lett. a) and possibly some others too, where required. On account of the difficulty intrinsic to establishing such strict divisions, we emphasized the importance of speaking of and ensuring, instead, independence and separateness of functional areas to be completed by information barriers too, where possible or appropriate.

Inducements

The Association has had occasion to express its views on the subject of inducements, that is, expressing a rejection of hard commissions and also expressing the need for caution with soft commissions, insofar as they cause distorting effects on competition.
It is felt that it might be useful to provide examples of admissible soft commissions since, especially in the case of retrocession of goods or services, the difference between the two categories of what is permitted and what is not may not always be clear-cut.
We fully agree with CESR that, insofar as they will be permitted, inducements will need to be disclosed to customers, as provided for in point 11 a) and b) of box 6.

Disclosure

The law-maker's choice of treating conflicts of interest no longer in the context of rules of conduct entails consequences that can profoundly affect transactions executed by intermediaries. Firstly, on the subject of conflicts, the obligations on the intermediary no longer fall within the set which **expressly** requires that their extent be properly defined in relation to the client category wherewith the intermediary has the relation and also apply with respect to the new category of eligible counterparties.

That being the premise, pursuant to paragraph IV of box 6 on disclosure, point 12, the intermediary is required to disclose to the client the terms of its conflict policy in writing, before entering into the business.
On this point, we wish to stress that we do not feel it is appropriate that the intermediary disclose the terms of its conflict policy in writing at the start of the business relationship, therefore we ask that point 12 of box 6 be eliminated.
Firstly, we feel that this type of information is of no particular interest to the client who instead should be advised on the conflicts that the intermediary cannot manage and that may damage the same, pursuant to article 18 par. 2. We wish to question whether it is useful for the client to have information on the conflict policy as implemented by the intermediary. Moreover, apart from the issue of usefulness, that in terms of effectiveness of communication is not to be underestimated, it is feared that such a load of information may even be a hindrance to the client and ultimately be counterproductive.
This principle will be resumed and duly developed with respect to article 19 par. 2, according to which the quality and clarity of information should be encouraged rather than the quantity of such information in order to enhance the protection of clients.

Moreover, information relating to conflict policy pertains to the organizational side of the intermediary's business which ought not be disclosed in detail, for reasons of confidentiality.

Point 13 also specifies that the frequency and content of the disclosures that are required to be made should take into consideration the nature of its recipients.

We feel that this specification is extremely important and well-advised especially in light of point 14 hereafter which requires that the intermediary, where the same should be unable to manage conflicts (under art. 18 (2), **provide the disclosure of such conflicts in writing** and **obtain the client's consent before undertaking transactions.**
We fear that complying with the obligation of disclosure, **under** the terms set forth in point 14, in transactions with institutional clients and eligible counterparties, may give rise to problems in ordinary operations, since it is difficult to bring about.
The obligation of disclosure in writing and that of obtaining the client's consent prior to undertaking transactions should be appropriate and proportionate to the nature of the recipients of the disclosed information and the needs arising from the type of relations established with such parties, for example in terms of timeliness.

Our suggestion to CESR, that would give more substance to the contents of point 13 (which provides for an evaluation of the entities it addresses), does not involve exemption from the obligation of disclosure (given that it arises from the first level legislation), but **provisions for alternative terms** to be complied with in case of professional clients and eligible counterparties. As to **the obligation to provide disclosure in writing**, an alternative might be the publishing of details

regarding conflicts of interests on the intermediary's web site whereto the client could be advised to refer.
Reading points 20 and 21 carrying the definitions of the wordings "in writing" and "durable medium", this possibility would appear at present to be excluded.
Indeed, point 20 specifies that the wording "in writing" should be taken as meaning written "on paper or other durable medium". The definition of "durable medium" set forth in point 21 does not include internet websites, "unless they fulfil the criteria contained in the definition of a durable medium".

Should CESR agree with our proposal, for purposes of consistency of the future law provisions, the definitions of 20 and 21 of CESR paper would require adjustments, specifically, they might be adjusted so as to include that in some cases (i.e. disclosure of conflict of interests) the durable medium might also be a web site, or, as suggested by ASSOSIM, to foresee as an alternative to the disclosure provided in writing that the details regarding conflicts be published on the intermediary's web site.

As to the provision to obtain **the client's consent before the transaction** it is felt that, once the disclosure has been made under the terms above-mentioned, the professional client or eligible counterparty are in a perfectly acceptable position to consciously evaluate whether to ask the intermediary to undertake the transaction that is in conflict, without having to provide for the consent-granting procedure in each separate case. Though the law-maker's intention is perfectly comprehensible, in this case ordinary operations prove that it would be absolutely unfeasible to comply with such an obligation, without creating serious impediments and delays in the activity.

On this point, we wish to refer to Directive 2003/125/EC, implementing the Directive 2003/6/EC (*Market Abuse Directive*), on fair presentation of investment recommendations and public disclosure of conflicts of interest.

In this case, the law-maker has taken into consideration the needs arising from special types of recommendations, foreseeing that obligations on fair presentation of recommendations and on public disclosure of conflicts be adapted in such a way as not be disproportionate in the case of non-written recommendations and brief recommendations (regardless of considerations on the category of parties that is to benefit from such information).
As regards the latter group, we wish to refer to the provision set forth in article 5 paragraph 3, which, on the subject of public disclosure of conflicts of interest reads as follows: 'where the requirements be disproportionate in relation to the length of the recommendation distributed, it shall suffice to make clear and prominent reference to the place where the information can be directly and easily accessed by the public, such as a direct internet link to that information on an appropriate Internet site of the relevant person.'

The consideration on the part of the European Commission of special needs regarding recommendations is very practical and well-targeted.
Indeed, it is our opinion that the two cases are comparable, in that it is required that conflicts of interests be disclosed in both cases and the need is set forth for loosening the said obligation in some special cases - something which is also granted by the law-maker in directive 2003/125/EC. Furthermore, in the case of article 18 par. 2, the required simplification would only be implemented with the categories of professional and eligible counterparties, which is even more justifiable in terms of investor protection.

Investment research – contents of conflicts policy

With regard to the paragraph on research, the rules introduced in paragraph 16 from a) to e) are extremely detailed; they pertain to the conduct of the analyst and the investment firm with respect to the issuer, largely based on the IOSCO paper of September 2003.
While we acknowledge the validity of the contents of the said obligations and that the majority thereof is already provided for by self-regulatory codes of practice as implemented by a good number of intermediaries, we do ask whether such regulations need to be detailed to this degree.

Leaving aside the foregoing consideration, the provisions of point 16 from a) to e), in terms of the overall aim of achieving balance with the regulations, do not appear to be consistent with letter f) following thereafter, combined with point 17, especially the second option, which instead show a very open approach on the part of CESR to the most varied needs of organization.

If we proceed by following the same order, of the two versions of letter f) (i) we favour the former - that provides for the establishing of information barriers between the research function and all of the other investment firm's divisions - over the latter, that restricts the scope by having information barriers established between the analysts and only the corporate finance division.

Box 6 lists other prohibitions, from (ii) to (v), which together with the 16 f) (i) provision on information barriers, may be departed from if the conditions set forth in point 17 occur, this point also including two versions.

Going back to the observation at the outset on the approach of the regulations proposed, it would seem as poorly consistent to lay down legally binding prohibitions as regards the personal trading of analysts (e.g. point 16 lett. a) and b) and in the same context provide for the possibility to depart from the rules on information barriers and on the separateness itself of the research function (i.e. f) (ii).

Of the two options given for point 17, our preference is for the first option (Q. 6.4: (a).

Fair, clear and not misleading information (Article 19 par. 2)

The implementation measures of article 19 that refers to obligations of information do not pose overall critical aspects for intermediaries. The currently applicable regulations are in line with the proposal of CESR.
Nevertheless, we wish to take this opportunity to make an observation that takes into consideration the viewpoint of the investor as user of the information, with a view to balancing the contents in such a way as to ensure the information is well-targeted and therefore effective. In our opinion it is important to stress that too much information does not necessarily prove of help to the average investor in terms of the same making an informed investment; rather than focusing on quantity, the law-maker should instead look to guaranteeing the quality and comprehensibility of such information.

We now wish to address specifically the matter of marketing communications and, in detail, the derogation to the application of point 8 of box 7, where the conditions set forth in point 9 should occur.
The reason for the smaller amount and lesser specificity of information that CESR requests of the intermediary in the case set forth in point 9, would appear to reside in the fact that marketing communication, in this case, is aimed at advertising mainly the investment firm (the services and types or "classes" of financial instruments offered by the same) rather than the specific financial instrument.
If we have understood this correctly, we believe the information set forth under letters g) and h) of point 9 to be superfluous in terms of the purpose of advertising the investment firm. Furthermore, a brief and generic description of the financial instruments may mislead the inexperienced investor who would run the risk of deciding on an investment on the strength of very few elements, failing therefore to carefully consider matters at the subsequent stage of evaluation of the full information that is received before subscribing the contract (pursuant to article 19).
Besides, if the description of the financial instruments required by the rules is altogether generic, we fail to see how the client can get any added value therefrom; if instead, the information is overly detailed and refers to specific financial instrument there is the risk of spilling into the territory of soliciting investment thus leaving the sphere of marketing communications and entering into an altogether different field of activity with different rules. In any event, where concise information on costs and (potential) yields of a specific financial instrument are admitted, we feel that such information needs to be combined with information on the main risks of the same instrument so as not to violate the general principle sanctioned in article 19(2).

Therefore, we ask that letters g) and h) be erased or that a reference to 'classes of financial instruments' be provided for, where considered useful.

Reporting to clients (article 19 par. 8)

Our only consideration on this subject, which was submitted to CESR during the consultations for the paper carrying the standards on the rules of conduct, of 2002, concerns the **too little time** for notifying the client of the execution.
Point 2 of box 10 sets forth that the said communication is to be sent no later than the first business day following execution. Consider that an intermediary in Italy has currently 7 days.

As to the periodic information by the portfolio managers, point 19 of box 10 sets forth that in derogation to the prompt information on the execution of an order, the portfolio manager may give the client this type of information in a periodic statement, should the client so choose. On this subject, we ask that it may rest with the single intermediary to decide on which manner of reporting to use, and the same intermediary will therefore insert it in his contracts. This is without prejudice to the intermediary's choice to have the investor decide between the alternatives. By so doing, intermediaries whose procedure is already set up with the forwarding of three-monthly statements would not be required to change the procedures, unless they themselves should deem it appropriate to offer the client, against refund of the costs entailed in sending statements on a continuous basis, the alternative (or offer just that mode of reporting).

We remain at your disposal for any other clarifications you should require.

Yours sincerely