EACB position paper on the technical advice of the Committee of European Securities Regulators (CESR) to the European Commission on investor protection and intermediaries in the context of the review of the Markets in Financial Instruments Directive (MiFID)

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

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Introduction

The European Association of Co-operative Banks (EACB) would like to thank the Committee of European Securities Regulators (CESR) for the opportunity to share its views on the important consultation on investor protection and intermediaries in the context of the review of the Markets in Financial Instruments Directive (MiFID).

In the following outlines EACB would like to point out responses to selected questions raised by CESR in its consultation document.

Part 1: Requirements relating to the recording of telephone conversations and electronic communications

Questions:

1. Do you agree with CESR that the EEA should have a recording requirement? If not, please explain your reasoning.

EACB would like to highlight that there should be a clear distinction between recordings of telephone conversations between professional traders and between retail clients and their branches. While we have no objections against recording obligations for telephone conversations between trade desk staff we are strictly against mandatory provisions on the recording of telephone conversations with retail clients at a European level.

As stated by CESR in its consultation paper (10-417, page 13, paragraph 58) the benefits of such European wide obligations are unclear. Article 51 (4) of the MiFID level 2 directive (2006/73/EC) – that provides the Member States with a discretion to set their own national rules on the matter of recording telephone conversations and electronic communications involving client orders – should remain unchanged. Keeping in mind the special circumstances in each Member State, in particular the market structure, the decision on an introduction of mandatory obligations of telephone recordings should be left to each single Member State.

European co-operative banks are mainly small and medium sized and characterized by a decentralized structure. Especially for such type of banks a mandatory obligation at European level to record telephone conversations with clients would be a very costly burden. The purchase of recording facilities and the respective maintenance would imply very high costs for them. Imposing mandatory provisions at European level could lead to the effect that especially smaller and medium sized and/or decentralized banks will not be able to offer investment services or at least investment services via telephone anymore. This would lead to a significant reduction in the landscape of investment service providers, a development clearly against the interest of the end investor who would have less choice in the institutions he wants to entrust with his investments. Also it would create an unlevel playing field at the financial market at the expense of smaller and medium sized and/or decentralized banks. Not least for this reasons some Member States have explicitly refrained from providing a mandatory obligation to record telephone conversations with clients.

Furthermore we would like to point out that we are not aware of drawbacks relating to telephone conversations between investment firms and clients that would justify a mandatory provision at European level. We find the proposed measures not in proportion to the expected benefits which by the consultation paper's own admission are unclear.

In addition we would like to highlight, that clients in many European markets are extremely sceptical towards telephone recording. From our experience such an obligation

would not be well received by the majority of clients. Also because it would be raising serious questions in relation to data protection EACB is opposing a mandatory obligation at European level.

2. If the EEA is to have a recording requirement do you agree with CESR that it should be minimum harmonising? If not, please explain your reasoning.

As outlined in our answer to question 1 we are against a mandatory introduction of telephone recordings in the European Economic Area.

3. Do you agree that a recording requirement should apply to conversations and communications which involve: the receipt of client orders; the transmission of orders to entities not subject to the MiFID recording requirement; the conclusion of a transaction when executing a client order; the conclusion of a transaction when dealing on own account?

From our point of view it would make sense to distinguish in this respect between telephone conversations between professional traders and telephone conversations between retail clients and their branches.

4. If you do not believe that a recording requirement should apply to any of these categories of conversation/communication please explain your reasoning.

As outlined in our answer to question 1 we are against a mandatory introduction of telephone recordings in the European Economic Area.

5. Do you agree that firms should be restricted to engaging in conversations and communications that fall to be recorded on equipment provided to employees by the firm?

In principle a restriction for investment firms to engage in conversations and communications that fall to be recorded on equipment provided to employees by the firm is acceptable. It remains open if such a restriction would solve issues around data and privacy protection.

However, recording requirements should be limited to lines explicitly destined to receive orders.

6. Do you agree that firms providing portfolio management services should be required to record their conversations/communications when passing orders to other entities for execution based on their decisions to deal for their clients? If not, please explain your reasoning.

We have no objections against recording of telephone conversations with trade desk staff. However a duplication of recordings at portfolio management level does not make sense.

7. Do you think that there should be an exemption from a recording requirement for: firms with fewer than 5 employees and/or which receive orders of a total of €10 million or under per year; and all orders received by investment firms with a value of €10,000 or under.

As outlined in our answer to question 1 we have strong objections against mandatory recording requirements of retail clients with their branches.

8. Do you agree that records made under a recording requirement should be kept for at least 5 years. If not, please explain why and what retention period you think would be more appropriate.

The amount of recorded material in this respect is huge. Therefore a retention period of five years is very burdensome. Disputes concerning miscommunication and investigation into market abuse usually begin after a much shorter time lag. We therefore suggest to adjust the retention period accordingly and consider a retention period of 12 months as sufficient.

9. Are there any elements of CESR's proposals which you believe require further clarification? If so, please specify which element requires further clarification and why.

A major uncertainty is the question on how data protection issues are supposed to be handled with respect to the recording requirements and the respective national rules and regulations, for instance national employment law and privacy considerations.

10. In your view, what are the benefits of a recording requirement?

The assumed benefits presented in the consultation paper can by no means justify the heavy burdens in case of a mandatory introduction of telephone recordings. There are also other ways of solving potential disputes and speed the settlement and resolution process that have less impact than a mandatory recording requirement throughout the European Economic Area.

11. In your view, what are the additional costs of the proposed minimum harmonising recording requirement (for fixed-line, mobile and electronic communications)? Please specify and where possible please provide quantitative estimates of one-off and ongoing costs.

Based on the feedback we received from our member institutions we assume that the additional costs of the proposed minimum harmonising recording requirements are substantial. Especially for our small and medium sized member institutions those obligations would be a very costly burden.

12. What impact does the length of the retention period have on costs? Please provide quantitative estimates where possible.

The longer the retention period, the higher the costs for storage space, administration and the respective backups.

Part 2: Execution quality data (Art 44(5) of the MiFID Level 2 Directive)

General remarks:

We fear that very detailed requirements for data providers might lead to higher prices for investment firms and also for clients. The question is whether the efforts involved in this initiative are in a reasonable proportion to the envisaged benefits for the market participants. Due to a missing impact assessment on the matter a scrutiny is not possible at the moment.

Questions:

13. Do you agree that to enable firms to make effective decisions about venue selection it is necessary, as a minimum, to have available data about prices, costs, volumes, likelihood of execution and speed across all trading venues?

We would like to point out that the mentioned data are already today available for market participants in Europe.

14. How frequently do investment firms need data on execution quality: monthly, quarterly, annually?

It is not possible to give a generic answer to this question, because there is no standard interval at which investment firms conduct their regular best execution policy review.

15. Do you believe that investment firms have adequate information on the basis of which to make decisions about venue selection for shares?

Yes, from our point of view investment firms have adequate information on the basis of which to make decision about venue selection for shares.

16. Do you believe investment firms have adequate information on the basis of which to make decisions about venue selection for classes of financial instruments other than shares?

Yes, we do.

17. Do you agree with CESR's proposal that execution venues should produce regular information on their performance against definitions of various aspects of execution quality in relation to shares? If not, then why not?

We disagree with CESR's proposal that execution venues should produce regular information on their performance as we do not see any added value for the market and its participants. Both the metric system defined by CESR and the period reports produced by the execution venues based on CESR specifications are not of practical value for calculating the best execution result. The existing information and measuring instruments are appropriate.

18. Do you have any comments on the following specifics of CESR's proposal: imposing the obligation to produce reports on regulated markets, MTFs and systematic internalisers; restricting the coverage of the obligation to liquid shares; the execution quality metrics; the requirement to produce the reports on a quarterly basis?

As already outlined in our answer to question 17 we consider imposing the obligation to produce reports on regulated markets, multilateral trading facilities and systemic internalisers as useless.

With respect to the execution quality metrics we consider the existing regulations as appropriate.

19. Do you have any information on the likely costs of an obligation on execution venues to provide regular information on execution quality relating to shares? Where possible please provide quantitative information on one-off and ongoing costs.

We have no further information on this aspect.

20. Do you agree with CESR that now is not the time to make a proposal for execution venues to produce data on execution quality for classes of financial instruments other than shares? If not, why not?

We fully welcome CESR's view that now is not the time to make respective proposals.

Part 3: MiFID complex vs. non complex financial instruments for the purposes of the Directive's appropriateness requirements

Questions:

21. Do you have any comments about CESR's analysis and proposals as set out in this Chapter?

We agree with the general consideration by CESR that its proposals are aimed at clarifying some aspects of the text rather than fundamental changes. We think this is a positive step in order to bring more certainty for clients and for financial providers.

This is clear by the case of CESR's analysis concerning subscription rights/nil paid rights, shares and UCITS. However, the new wording proposed by CESR in the case of bonds and money market instruments include a text stating that "excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved". We believe that such a wording is too ample and gives room for potential conflicts of interpretation. We therefore are against such a new wording, as it could include all types of different features, and lead to the discussion and uncertainty of whether they are "difficult to understand".

We suggest the following wording: "excluding those that embed a derivative or a structure that increases the capital recovery risk of the investment". Such a wording would cover those bonds or instruments that include features such as non capital protection and/or subordination, which are the structures we believe that would merit an appropriateness assessment.

The potential inclusion of any type of structure within the appropriateness assessment would be too strict in terms of investor protection, would lead to great uncertainty, probably limiting product diversity and imposing an unnecessary burden to the industry.

22. Do you have any comments on the proposal from some CESR members that ESMA should work towards the production of binding Level 3 standards to distinguish which UCITS should be complex for the purpose of the appropriateness test?

We cannot see any benefit in any changes to the current rules in respect of complex/non-complex products. The detailed rules outlined in the UCITS directive already ensure a very high degree of investor protection. We are firmly against the production of such new standards, as any attempt to determine whether the strategies or techniques used by a particular UCIT makes it difficult for the client to understand the risks involved, will

undoubtedly lead to more uncertainty and additionally it is based on the wrong assumption that the understanding of all the internal investment strategies or techniques that the UCITS managers use is the main critical factor in order to assure investor protection. The production of such a "list" will be without doubt an issue of debate and conflict, possibly posing disproportionate costs and uncertainty risks to the industry without improving client protection.

We think that the correct approach is to see the product not from a technical perspective, but from a client point of view, which is the heart of the Key Information Document (KID). An initiative like the KID does help the client to understand the risk of her/his investment (which is actually most relevant for investor protection and not any type of "list" based on technical distinctions). Consumer protection is best served from this risk-based and client-point-of-view approach and not from a financial or technical analysis of intrinsic features, which should be avoided.

23. What impact do you think CESR's proposals for change would have on your firm and its activities? Can you indicate the scale or quantify of any impact you identify?

Co-operative banks will be heavily impacted by any change of MiFID provisions, as this piece of regulation affects directly our services for the retail investor. However, we acknowledge that clarification is a positive step for both clients and investment firms, although we ask CESR to take into account our answers to questions 21 and 22 as we believe that some of the changes pose in fact the risk of increasing uncertainty and/or focusing the efforts to improve client protection on technical distinctions instead on a risk-based and client-perspective approach.

Part 4: Definition of personal recommendation

Question:

24. Do you agree with the deletion of the words 'through distribution channels or' from Article 52 of the MiFID Level 2 Directive?

We would like to point out the importance of establishing a standard pan-European interpretation of the definition of advice, with the aim of creating a real level playing field and prevent attempts to circumvent the rules. Indeed, we observe different interpretations in the EU countries that might lead to different behaviours. At this end, we share what CESR suggested in the Feedback Statement on "Understanding the definition of advice under MiFID" (CESR/10-294). In case of distribution channels three elements should be taken into account: the target audience, the content and the wording used. In some special circumstances personal recommendations may take place also through distribution channels (e.g. the internet). In this meaning, we welcome the deletion of the words of "through distribution channels or" from article 52 of the MiFID level 2 directive (2006/73/EC).

Nevertheless, it is very important to maintain a clear distinction between personal advice, research and marketing material. The definition of personal recommendation should not depend on the medium of communication, but rather on the way in which recipients are addressed. Personal advice is clearly based on the analysis of client's investment needs. The medium used does not automatically determine whether a communication amounts to investment advice.

Part 5: Supervision of tied agents and related issues

Questions:

25. Do you agree with CESR that the MiFID regime for tied agents has generally worked well, or do you have any specific concerns about the operation of the regime?

According to the MiFID level 1 directive (2004/39/EC, Article 4 (1) 25) a tied agent may have only one investment firm on whose behalf it acts. The robust interpretation seems to be currently that this article means "only one investment firm or credit institution". It would be very important to reach the state of play where a tied agent may have several investment firms and/or credit institutions within the same group on whose behalf it acts (group level consideration). This would not weaken investor protection. Referring to article 3 of Directive 2006/48/EC the group should be understood as a central body and its affiliated institutions as a whole."

26. Do you agree with the proposed amendments to Articles 23, 31 and 32 of MiFID?

Yes, we agree with the proposed amendments.

27. Could you provide information on the likely impacts of the deletion of the ability of tied agents to handle client money and financial instruments?

No comment.

Part 6: MiFID Options and Discretions

Questions:

28. Do you agree with the suggested deletions and amendments to the MiFID texts proposed in this chapter?

Apart from CESR's proposal to Article 51 (4) of the MiFID level 2 directive 2006/73/EC (see our comments to part 1) we agree with the suggested deletions to the MiFID texts proposed in this chapter. Concerning the amendments we consider a rule to gather information for statistical or supervisory purposes is not necessary. The national regulators have already today the power to request information that it is interested in. An obligation to deliver certain information, e.g. for statistical purposes, could lead to burdens for investment firms. Therefore we would favour this aspect to be in the discretion of each national competent authority rather than introducing a binding rule.

Contact:

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

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