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FBF'S ANSWER TO THE CESR CONSULTATION ON ITS TECHNICAL ADVICE TO THE EUROPEAN COMMISSION IN THE CONTEXT OF THE MIFID REVIEW – INVESTOR PROTECTION AND INTERMEDIARIES

Introduction:

The French Banking Federation (FBF) represents the interests of the banking industry in France. Its membership is composed of all credit institutions authorised as banks and doing business in France, i.e. more than 500 commercial, cooperative and mutual banks. They employ 500,000 people in France and around the world, and service 48 million customers.

First of all, the FBF welcomes the opportunity given by CESR to give its views on the different aspects contained in this consultation I the context of the MiFID review.

Preliminary Remarks:

At its origin, on its distribution side, MiFID had the two-fold aim of protecting investors and ensuring the smooth operation of securities markets, which where implemented in the national legislation in November 2007. After two years and a half, it appears that the enforcement of an integrated European financial market shall be revised and adapted with regard to proved market failures and with a clear conscience of the decrease of investments done by retail investors in the context of the financial crisis. If everyone understands the necessity of the reviewing process in consideration of the market changes, the situation shall not justify a deep review of the dispositions linked to the protection of the investors. Implementation of MiFID already had large impacts in terms of cost, staff training and procedure adaptation and each evolution regarding investor protection would necessarily implies supplementary investments in an area where all consequences of the MiFID implementation hasn't still be really assessed and where no need for a change has been expressed.

In order to keep a consistent reasoning of its position on each subject, FBF decided to answer to this consultation subject by subject rather that question by question.

1- Requirements related to the recording of telephone conversations and electronic communications.

Compulsory distinction between market activities and retail activities

Upfront, the FBF would like to make a distinction between telephone and electronic communication recording between professional traders, and the same in the retail markets. The FBF would support mandatory telephone and electronic communication recording between investment professionals, especially in the detection, understanding and proof of market abuse practices.

Moreover, we would like to underline that in France, from a practical point of view:

- First, the distribution of financial instruments is mainly done through UCITS with written process, and the crisis has led to a decrease of the number of individual shareholders;
- Second, the investment by retail investors in Equities[1] is made:
    - For at least 70%, *via* Internet and recorded electronic networks;
    - For about 25%, *via* recorded call centres;
    - For a very small part, via Sales offices and for a more limited part through non recorded phones in Sales offices. In this context, the orders transmitted via non recorded phones are always confirmed *via* written process (telecopy most of times or e-mails).

This is the reason why the question of telephone and electronic communication recordings in France mainly concerns Investment banks and why there is no need for any mandatory telephone and electronic communication recordings in the Sales offices.

Overall, the FBF recognises that supervisors consider telephone recordings helpful to detect or prove market abuse. The FBF therefore supports mandatory recordings in the professional markets.

In the retail markets, the experiences made in those Member States where telephone recording is already in place today demonstrate that recorded orders can be helpful to solve disputes and speed the settlement and resolution process. Nevertheless, there are other ways of achieving this objective. Besides, should this idea thrive, it should be supported by an impact study on the consumer's view of the proposed recording requirement.

Scope of the recording requirement

Relating to the scope of the recording requirement suggested by CESR, the FBF generally agrees with a mandatory recording of client orders when these are given to staff based in a trading room or in a centralised receipt centre. Such a requirement could subsequently also apply to the reception of orders and the conclusion of deals, where staff based in a trading room or in a centralised order receipt centre is involved. Client conversations with other departments or offices in the bank should not be recorded, for privacy reasons and in view of cost-benefit considerations. Furthermore, such policy may lead to important social consequences.

With respect to portfolio management services recording, the FBF does not support such a requirement which would not be necessary, as the conversation will be taped at the receiving end, *i.e.* by the person receiving the order.
France has set up national rules to require investment firms to record telephone conversations "*of traders of financial instruments and of relevant persons, other than traders, who are involved*

[1] There is no retail bond market in France except a very limited "buy and hold" retail market on French government bonds.

in business relationships with clients, whenever the compliance officer deems it necessary in view of the amounts involved and the risks incurred with regards to the orders"[2]. "*The purpose of recording telephone conversations shall be to facilitate monitoring to ensure that transactions are lawful and that they comply with clients' instructions*"[3] .

CESR's proposals which go beyond the French obligations that modulate the recording obligation based on the risk shall be restricted to clients' order recording as we do not want to widen the scoop of the requirement up to all the business telephone conversation and electronic communication. Beside the huge cost incurred to record and store such a considerable amount of information, it will render the extraction of the requested information unworkable

Equipment involved

The FBF would like to underline that recording requirements must be limited to some determined lines that are explicitly dedicated to the reception of orders.This might includes mobile phones, when it is accepted that orders can be transmitted *via* mobile phones. In the view of the FBF it would not be possible, or acceptable from a cost- and data-protection perspective, to mandate the taping of the private mobile phones held by banks' staff. FIs usually have internal rules in place to regulate the use of the firm equipment in particular the use of mobile phones which recording shall be limited to explicitly authorised situation where the staff may receive or give orders through its professional mobile phone.

Recording duration

To this limit, CESR's proposal scope of obligation is from our point of view appropriate and well balanced, with the exception of the five years record retention.

Indeed, a period of five years would be far too long, considering CESR's objectives. In terms of investor protection, if there is any confusion about orders given this will become apparent within a few weeks, or at the maximum within a few months (in the written documents such as the statement of account, or the broker's contract note). A retention requirement of about at least six months or one year, for example, would be appropriate, with flexibility.

We understood that CESR's grounds to request firms to keep the records for at least five years is the fact that "*the most common period of retention is 5 years with four Member States imposing this timeframe on investment firms*" (§53). However, the three most important financial centres, that is to say English, German and French markets allow a much shorter retention period.

Beside a compulsory cost and impact study, we would support flexibility allowing FIs to decide, for the retention period within a compulsory bracket from 6 months to 5 years. This would allow each FIs to adapt its recording policies with the risk incurred by the transaction. Besides, the competent authorities (supervisor, judge) may always request the firm not to destroy recordings for investigation purposes, thereby saving the risk of early destruction.

Level playing field

Regarding the scope of investment firms submitted to the recording requirement, the FBF does not support the possibility for firms complying with specific criteria to be exempted of such recording requirement, as far as in our opinion, it contravenes to a same level playing field amongst all FI's.

[2] Article 313-51 of the General Regulation of the French Market Authority (AMF)
[3] Article 313-52 of the General Regulation of the French Market Authority (AMF)

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2- Execution quality data

Firstly, the FBF underlines that banks suspect that from a retail investor protection perspective, CESR attaches too much significance to the question of best execution. While banks take the best execution requirement seriously, other factors are arguably more important for the investment outcomes and the satisfaction of retail investors, including for example the quality of investment advice and the timing of orders.

Secondly, regarding the following mentioned elements (data prices, costs, volumes, likelihood of execution and speed across all trading venues), it is true these information, to some extent, suffer from the shortcomings in the quality of post-trade data.

At the same time, banks would see some benefits in the use of uniform metrics across different trading venues to refine their judgement.

However, banks are sceptical that such metrics could be defined through regulation, certainly not at Level 1 of the Lamfalussy process. Overly bureaucratic solutions would not be workable, in view of the great level of detail that would be necessary for such rules to be meaningful.

Therefore, the FBF considers that regarding the options proposed by CESR, the one consisting for CESR to define key metrics of execution quality data only for voluntary use of execution venues and data vendors should prevail.

3- MIFID complex *vs* non complex financial instruments for the purposes of the directive's appropriateness requirements

The EBF has in the past expressed the view that the principle of distinguishing between "complex" and "non-complex" products is flawed in itself. At the same time, workable solutions have been found by FIs to deal with the MiFID provisions. Therefore, the FBF does not find changes to MiFID in respect of these provisions helpful at this point in time.

While CESR's proposals are for the most part mainly meant to clarify the current requirements, banks do not believe that the issue of complex / non-complex products should at all be re-opened in the current MiFID review.

In other words, the FBF considers that the "complex / non-complex" distinction shall be strictly limited to the cases where the investor never receives any investment advice – i.e. execution only – and not extended to investment advice. In this area, the relevant distinction used by professionals has always been based on the market risk of the product. In this perspective, the FBF underlines that some products are not complex but risky while others are risky but not complex.

4- Definition of personal recommendation

Broadly speaking, we regret that MIFID has not distinguished, in a better way, between protection rules for retail clients and those applicable to professional clients. This is particularly the case concerning investment advice. This has led to excessive formalism, which is not adapted to wholesale markets and clients' expectations.

In particular, it appears that the concept of "personalized recommendation", which is at the heart of investment advice service, has not the same meaning, depending on whether the investment service provider deals with a retail client or a professional client, and *a fortiori* when he deals with an eligible counterparty.

As MIFID is currently drafted, certain regulators see the "investment advice" service in a monolithic way, whatever the nature, the capacity and the sophistication of the client. As a consequence, investment service providers are obliged to formalize a "suitability test" (which implies the sending of a questionnaire) even when they deal in "plain vanilla" products with professional clients, and sometimes with eligible counterparties, which is totally inappropriate. The counterparties themselves do not expect the ISP to provide them with investment advice and are, most of the time, reluctant to communicate their investment objectives and their strategies (in particular in the domain of cash equity and flow derivatives).

Moreover, investment advice, as an investment service, should not be confused with advice in relation to merger and acquisition operations and financial analysis, which are both ancillary services.

In other words, the scope of investment advice should be defined in a more precise manner.

More specifically, the FBF would like to remind, with respect to the personal recommendation, its position settled in its answer to the CESR consultation paper on the definition of advice under MiFID dated December 14th 2009 :

We are of the opinion that it cannot be considered that filtered information given *via* a website always constitutes investment advice.

The last paragraph of article 52 of Directive 2006/73/CE specifies that "*A recommendation is not a personal recommendation if it is issued exclusively through distribution channels or to the public.*"

As regards the Internet, a distinction should be made between the public and the secured part of a website.

On the public part of a website (no identification of the client), the provisions of article 52 should apply. It should not be possible to apply the provisions of the investment advice.

On the other hand, the secured part of a website (the client is identified) may lead an investment firm, if all the conditions are met, to provide investment advice. If an email or a message is received by a client through this secured section, criteria such as the language or the formulation used (for example, "*this share complies with your needs…*" or "*we recommend you to buy this share…*") may lead one to think that investment advice is provided.

However, a mail or message could only be considered as providing investment advice if it takes into account and complies with the financial circumstances, the experience and the needs of the client. In this regard, we emphasize the fact that it would imply very specific software able to update its information from the client database, to analyse the client's needs and to perform the suitability test. As of now, most of the French banks do not have such technical facilities

Beside, the FBF does not feel that the proposed wording would achieve greater clarity of the legal text. Indeed, the FBF is unsure about the rationale behind this recommendation. Generally, it is of great importance to maintain a clear distinction between personal advice, research, and marketing material.

The definition of personal recommendations, specifically, should not depend on the medium of communication, but rather on the way in which recipients are addressed.

The key criterion in this respect is whether or not correspondence is clearly based on the analysis of an individual's investment needs. While some media are better suited than others to personally address investors in this way, the medium used does not automatically determine whether a communication amounts to investment advice.

The Market Abuse directive strictly bans the assimilation between personal recommendation and financial Analysis (even if this latter may be considered as a support of if).

5- Supervision of tied agents and related issues

The FBF supports CESR propositions.

6- MIFID options and Discretions

The FBF agrees with the proposed deletions and amendments. For banks' considerations with regard to telephone and electronic communication recording, please cf. the remarks in part 1 of this response.