COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Date: 13 April 2010
Ref.: CESR/10-417

CONSULTATION PAPER

CESR Technical Advice to the European Commission in the Context of the MiFID Review – Investor Protection and Intermediaries

Deadline for contributions: CESR invites responses to this consultation paper by **31 May 2010**. All contributions should be submitted online via CESR's website under the heading 'Consultations' at www.cesr.eu. All contributions received will be published following the close of the consultation, unless the respondent requests its submission to be confidential.

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Executive Summary

The Markets in Financial Instruments Directive (MiFID) entered into force in November 2007. Embedded in MiFID is a process for reviewing certain provisions in the Directive. The purpose of this consultation is for CESR to provide the European Commission (EC) with its technical advice on the MiFID Review by July 2010, so that the EC can report to the European Parliament and Council on possible changes to MiFID.

The main points in this Consultation Paper are under the following six headings:

Requirements relating to the recording of telephone conversations and electronic communications: In Part 1 of the Consultation Paper, CESR is consulting on the key elements of a possible common EEA regime for the recording of orders received/transmitted over the telephone or through electronic communications. CESR believes that such a regime would be an important step forward in terms of certainty, consumer protection, and surveillance of markets to achieve a credible deterrence in EEA markets. In CESR's view it is vital for regulators to be able to go beyond the EEA regime at national level to avoid repealing parts of existing national regimes and therefore it is not proposing a complete abolition of the discretion embedded in Article 51 (4) of the MiFID Level 2 Directive.

Execution quality data (Art 44(5) of the MiFID Level 2 Directive): Part 2 of the Consultation Paper considers whether or not regulatory intervention is required to ensure that necessary information to select appropriate execution venues is available in the market. The review discusses two main policy options in relation to the issue of execution quality data for shares. Both of these alternatives are assumed to take effect in a regulatory context in which the quality and comparability of post-trade transparency has been improved. The two options are:

(i) whether CESR should define key metrics of execution quality data for voluntary use of execution venues and data vendors; and
(ii) whether execution venues should be required to produce periodic reports on execution quality using metrics defined by CESR.

MiFID complex vs. non-complex financial instruments for the purposes of the Directive's appropriateness requirements: CESR proposes in Part 3 of the Consultation Paper amendments to clarify and to deliver a more graduated risk-based approach to the distinction between complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements.

Definition of personal recommendation: Part 4 of the Consultation Paper covers CESR's concerns on the current wording of Article 52 of the MiFID Level 2 Directive, with regards to the provision by intermediaries of personal recommendations through distribution channels. It suggests an amendment to the Directive to clarify that investment advice can be provided through distribution channels.

Supervision of tied agents and related issues: Part 5 of the Consultation Paper proposes amendments to the MiFID tied agents regime. The review focuses on three broad areas (i) further harmonizing the national rules on the use of tied agents (ii) enhancing transparency concerning the identity of tied agents; and (iii) enhancing investor protection through clarifying the passport regime for firms using tied agents (Articles 31 and 32 of MiFID).

MiFID options and discretions: The last part of the Consultation Paper proposes areas for further convergence with respect to the options and discretions in MiFID and its implementing measures.

1. Introduction

1. In November 2007, the Markets in Financial Instruments Directive 2004/39/EC (MiFID) and its implementing measures (MiFID Level 2 Directive 2006/73/EC and Regulation 1287/2006) entered into force.

2. MiFID extended the coverage of the former Investment Services Directive (ISD) and introduced new and more extensive requirements for firms, in particular for their conduct of business and internal organisation. It also harmonised certain conditions governing the operation of execution venues.

3. MiFID was a major part of the European Union's Financial Services Action Plan (FSAP), which was designed to help integrate Europe's financial markets. MiFID comprises two levels of European legislation. 'Level 1', the Directive itself, was adopted in April 2004. The requirements were supplemented by 'technical implementing measures', so-called 'Level 2' legislation. The EC's Level 2 measures were developed on the basis of advice provided by the Committee of European Securities Regulators (CESR) and were the subject of negotiation at European level in the European Securities Committee (ESC). They were formally adopted by the EC and published in the Official Journal of the European Union on 2 September 2006.

4. Since the implementation of MiFID, European financial markets have seen a number of changes. For instance there has been greater competition/pan-European trading, consolidation between exchanges, improved technology and innovation e.g. smart order routing, algorithmic trading and new clearing arrangements. In addition, there have been issues with post-trade transparency data including the fragmentation/consolidation of such data, delays, and costs. Furthermore, with the global financial crisis in the background, regulators have focused on selling practices regarding certain financial instruments to try and limit instances of investor detriment.

5. As part of the process embedded in MiFID for reviewing certain provisions in the Directive, CESR will provide the EC with its technical advice by July 2010 so that the EC can report to the European Parliament on possible changes to MiFID in early 2011.

6. CESR's general policy, with a few exceptions, has been to limit the issues under consideration in this Consultation Paper to those issues related to investor protection and intermediaries that incorporate a review clause in the MiFID legislative texts. These are:

   - Article 51 (5) of the MiFID Level 2 Directive, which requires the EC to report on the continued appropriateness of the discretion on recording requirements in Article 51 (4) in the MiFID Level 2 Directive on the retention of records under the record-keeping obligations in MIFID.

   - Article 44 (5) of the MiFID Level 2 Directive on best execution, which requires the EC to report on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues. As part of this review the EC has to decide whether or not a regulatory intervention is required to ensure that investment firms have the necessary information to select appropriate execution venues to include in their execution policies. Given that the EEA trading landscape is changing very rapidly CESR has considered that it is preferable to limit the work to best execution quality data. CESR is conducting Level 3 work on the overall operation of the execution regime with a view to publish Level 3 material on this topic later on during 2010.

   - Article 65 (3)(c) of MIFID which requires the EC to report on "the appropriateness of rules concerning the appointment of tied agents in performing investment services and/or activities, in particular with respect to the supervision of them.

- MiFID options and discretions. This was included in this Consultation Paper as a result the Ecofin Council conclusions of December 2007 which stated that Member States should keep under review the options and discretions implemented in their national legislation and limit their use wherever possible. The Ecofin Council conclusions of May 2008 and June 2009 more generally called for enhanced European supervisory convergence.

7. CESR has also included in the Consultation Paper two areas that have arisen from Level 3 work, these are:

   - Complex/non complex financial instruments. This was included in this Consultation Paper as a result of a CESR consultation in May 2009[1] on MiFID complex and non-complex financial instruments, where the industry requested CESR and its members to provide further clarification on the types of MiFID products that might be categorised as complex/non-complex products for the purposes of the appropriateness requirements.

   - Definition of personal recommendation. This was included in this Consultation Paper as a result of a CESR consultation in July 2009[2] on investment advice, where CESR members considered that the current definition in Article 52 of the MiFID Level 2 Directive needed greater clarity.

8. CESR's technical advice on the MiFID exemptions for commodity derivatives business (CESR/08-752) published on 15 October 2008 remains valid. Therefore CESR is not providing further technical advice on the MiFID exemptions regarding specialist commodity derivative firms contained in Articles 2(1)(i) and (k) of MiFID.

Status of this consultation paper

9. This paper consults on the main policy lines that will form part of CESR's technical advice to the EC in the context of the investor protection and intermediaries' area of the MiFID Review. In some cases, CESR has identified and is already proposing drafting proposals for legislative changes. In other cases, CESR intends to provide technical advice to the EC without spelling out specific drafting proposals for legislative changes, but just setting out CESR's view on the policy approach that should be adopted.

Public consultation and timetable

10. CESR invites comments from stakeholders on this consultation paper. A list of the questions of this consultation paper is available in Annex 1. Respondents can post their comments directly on the CESR's website (www.cesr.eu) in the section "Consultations". The consultation closes on 31 May 2010.

11. This consultation paper has been prepared by the Investor Protection and Intermediaries Standing Committee of CESR chaired by Mr Jean-Paul Servais, Chairman of the CBFA. The rapporteur of the Standing Committee is Diego Escanero (descanero@cesr.eu).

[1] CESR Consultation Paper CESR/09-295
[2] CESR Consultation Paper CESR 09/665

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

Introduction and background

12. In its advice to the EC in 2005 on the MiFID implementing measures (Level 2 Directive 2006/73/EC)[3], CESR said that the MiFID Level 2 Directive should include a requirement on investment firms to record telephone conversations where firms received client orders. Such a proposal was discussed by the[4] ESC but was not included in the final MiFID implementing measures.

13. The MiFID Level 2 Directive does, however, contain two provisions that are relevant to this issue. Article 51(4) of the MiFID Level 2 Directive says *"Record-keeping obligations under Directive 2004/39/EC and in this Directive are without prejudice to the right of Member States to impose obligations on investment firms relating to the recording of telephone conversations or electronic communications involving client orders."*

14. This provision provides Member States with a discretion to set their own national rules about the recording of telephone conversations and electronic communications (which are described in the rest of this chapter as 'recording requirements') or to have no such rules. Article 51 (5) of the MiFID Level 2 Directive required the EC to report on the continued appropriateness of Article 51 (4) of the MiFID Level 2 Directive by 31 December 2009. This paper sets out CESR's proposed advice to the EC for the purposes of that review.

Issues under discussion

Use of the discretion for a recording requirement

15. CESR asked its members for details of what use, if any, is made of the discretion in Article 51 (4) of the MiFID Level 2 Directive in their Member State. In responding, CESR members were asked to consider whether their recording requirements (if any) fall within the categories of:

    (i) broker to broker orders,
    (ii) execution of client orders at the hub (trading desk) level only, or
    (iii) extended execution of client orders including receiving and transmitting orders from the client.

    The responses have been incorporated into the table in Annex 2.

16. The table in Annex 2 shows that of the 26 countries whose CESR member responded, 16 have a recording requirement which is incorporated in legislation or rules whilst 10 do not (although investment firms in these jurisdictions may be subject to recording requirements imposed by regulated markets). In the countries with recording requirements incorporated in legislation or rules, the obligations mainly appeared to cover the categories of (ii) and (iii) set out in the previous paragraph. Of these two categories, the vast majority of Member States fall into the category that require investment firms to record all client orders received by telephone. France, Germany and Sweden appear to require, inter alia, the telephone lines of traders/trading desks to be recorded.

Rationale for a recording requirement

[3] See Box 5 in CESR/05-024c: http://www.cesr.eu/index.php?page=document_details&from_title=Documents&id=2965

[4] See Article 13 in ESC/17/2005: http://ec.europa.eu/internal_market/securities/docs/isd/dir-2004-39-implement/esc-17-2005_en.pdf

17. From the point of view of competent authorities there are three main rationales for imposing recording requirements:

- to ensure that there is evidence to resolve disputes between an investment firm and its clients over the terms of transactions;
- to assist with supervisory work in relation to conduct of business rules; and
- to help deter and detect market abuse and to facilitate enforcement in this area.

18. In some Member States there appears to be little evidence that there is a large number of disputes between investment firms and their clients over the terms of transactions where the receipt of the order involves a telephone conversation or electronic communication. In particular, some CESR members are unaware of any significant problem concerning the orders of retail clients.

19. Records made as a result of recording obligations are not the sole material that any competent authority uses to assess investment firms ongoing compliance with conduct of business obligations. But they can help to assist a competent authority to check compliance with, for example:

- the requirements in MiFID and in the MiFID Level 2 Directive on information to clients and potential clients;
- the requirements in MiFID on best execution; and
- the requirements in MiFID and the MiFID level 2 Directive on client order handling.

20. Where firms are not complying with their conduct of business obligations recordings of telephone conversations and electronic communications have been used as part of the evidence in enforcement cases.

21. The prosecution of market abuse presents significant challenges. Evidence collected through recording obligations can provide additional material for discovering the facts of a case. It can also provide evidence that may not be available through other sources such as documents and oral testimony. In particular, recordings more often help to show the intention behind trading and the knowledge of the person at the point at which they trade which are matters which are often not easily established but may be crucial in a successful enforcement case.

22. A small minority of CESR members (BaFin and the FMA), do not think that records held as a result of a recording obligation are of significant assistance in supervisory and market abuse monitoring work. They believe that most of the material kept as a result of a recording requirement is unlikely to be of interest to competent authorities and raises a significant issue of proportionality, especially in view of the costs arising out of such new requirements. These CESR members also feel that due to already existing documentation requirements, there is plenty of other information available to competent authorities to enable them to check an investment firm's compliance with its conduct of business obligations. They point to the fact that the record keeping obligation in Article 13(6) of MiFID requires firms to keep records of their business "*…which shall be sufficient to enable the competent authority to monitor compliance with the requirements under this Directive, and in particular to ascertain that the investment firm has complied with all obligations with respect to clients or potential clients*" as indicating that a recording requirement is not necessary for conduct of business purposes.

23. The discussion about a recording requirement in the context of the negotiation of the MiFID Level 2 Directive mainly focused on the rationale of dealing with resolving disputes between investment firms and their clients. At one point the proposals for a recording requirement in the papers discussed by the ESC included a requirement that recordings would be the sole evidence to be relied upon in the event of a dispute. The discussion above shows that competent authorities in jurisdictions with a recording requirement believe that the requirements serve a wider purpose. CESR believes that it is important that in considering a possible EEA recording

requirement that the EC takes account of this. CESR believes that the EC needs to consider the wider context, in particular the use of recording requirements in relation to tackling market abuse.

Nature of a recording requirement

24. The EU's Economic and Financial Affairs Council conclusions in June 2009[5] included the following statement:

> *"… the Council invites the Commission and all other relevant parties to take the appropriate initiatives, which i.a. should aim at:*
>
> *Moving towards the realisation of a single rulebook, with a core set of EU-wide rules and standards directly applicable to all financial institutions active in the Single Market, so that key differences in national legislations are identified and removed."*

25. CESR has borne this context in mind in discussing the continued appropriateness of the discretion in Article 51(4) of the MiFID Level 2 Directive. However, in the light of the specific context of this issue CESR members do believe that it is not possible to recommend a maximum harmonising approach to a possible EEA recording requirement to the EC.

26. As illustrated previously the current position across Member States in relation to the discretion is varied. A single common approach would inevitably mean that as new obligations would have to be introduced in some Member States, in others existing obligations would have to be removed. Competent authorities in the Member States who potentially would need to reduce the scope of their existing obligations attach importance to these obligations in their supervisory and enforcement work. They believe that losing existing obligations would do damage to investor protection and efforts to prevent and detect market abuse. CESR does not therefore believe it is appropriate to recommend to the EC that a maximum harmonising recording requirement is included in EEA legislation.

27. Most CESR members believe that it is sensible for the existing discretion in Article 51 (4) of the MiFID Level 2 Directive to be replaced by a minimum harmonising obligation. This would avoid competent authorities losing any recordings to which they currently have access whilst at the same time making progress towards harmonisation and a single rulebook. CESR's views on the substance of an EEA rule on the recording of telephone conversations and electronic communications included in this Consultation Paper are therefore predicated on the assumption that such a rule will be minimum harmonising. It should not be assumed that CESR members would hold the same views about the substance of the proposal if a maximum harmonising rule was proposed.

28. Support from CESR members for a minimum harmonising EEA rule on the recording of telephone conversations and electronic communications is not unanimous. A small minority of CESR members (BaFin and the FMA) does not believe that the benefits of recording telephone conversations and electronic communications are proportionate to the costs which would be imposed on firms. They believe therefore that the existing discretion in Article 51 (4) of the MiFID Level 2 Directive should be retained. If Article 51(4) of the MiFID Level 2 Directive cannot be retained, they strongly support exemptions for small branches and/or small orders with respect to their specific market situation.

Policy arguments

Scope of a recording requirement

[5] http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/108392.pdf

29. CESR decided that the best way to define the scope of a possible recording requirement was in two stages. First, to decide which investment firms would be subject to the requirement by reference to investment services and activities to be covered. Second, to define what telephone conversations and electronic communications in relation to those services and activities would have to be recorded.

30. CESR considered five main investment services and activities as potentially being relevant to a recording obligation. These were: reception and transmission of orders, execution of orders on behalf of clients, dealing on own account, portfolio management and investment advice.

31. Reception and transmission and the execution of client orders obviously involve the receipt of client orders which is relevant both in the context of conduct of business supervision and detecting market abuse. CESR believes that conversations and communications relating to these services should therefore be inside the scope of a recording requirement. Covering conversations and communications relating to the transmission of orders raises the issue of duplication. CESR believes this should be taken into account in framing a recording requirement. This issue is explained in more detail in the next section of the paper.

32. Including the execution of client orders within the scope of a recording requirement will inevitably capture some investment firms who deal on own account. This is because some investment firms execute client orders by dealing on own account. But where investment firms dealing on own account are not executing orders on behalf of clients this proprietary trading activity is potentially of interest from a market abuse perspective. CESR therefore believes that communications and conversations relating to dealing on own account should be inside a recording requirement.

33. When providing the service of portfolio management, investment firms act on behalf of clients but do not transmit or execute orders that have come directly from clients. This trading activity is potentially of interest from both a conduct of business and a market abuse perspective. However, covering the trading activities of investment firms when providing the service of portfolio management raises the issue of duplication. CESR is currently proposing that because of this, it is not necessary for firms to be covered by a recording requirement when providing the service of portfolio management (but it is seeking specific views on this question as part of the consultation). This issue is explained in more detail in paragraph 41 of this paper.

34. The quality of investment advice is obviously a crucial factor in consumer protection. However, a lot of advice will be given on a face-to-face basis and other record-keeping obligations around this service should provide competent authorities with a significant amount of information with which to judge the quality of investment advice. CESR does not therefore think it is appropriate to include investment advice in the scope of a recording requirement.

35. The specific conversations and communications that CESR believes should be recorded in relation to the services outlined above are:

- the receipt of an order from a client (both where the investment firm will transmit the order and where it will execute it);
- the transmission of an order; the conclusion of a transaction which executes a client order;
- the conclusion of a transaction when dealing on own account; and
- the transmission to another entity of a decision to deal by a portfolio manager. It is not intended that this would capture internal conversations and communications within investment firms (although it would capture conversations and communications between two investment firms in the same group).

Duplication

36. The scope of a recording requirement raises issues of potential duplication (i.e. a situation where both parties to a conversation or communication are under an obligation to record that conversation or communication). There are several ways in which this can occur:

- transmission of an order from an investment firm with authorisation to receive and transmit orders to an investment firm with authorisation to execute orders on behalf of clients;
- transmission of an order from an investment firm with authorisation to undertake portfolio management to an investment firm with authorisation to execute orders on behalf of clients;
- conclusion of a transaction between two investment firms with authorisation to deal on own account.

37. Duplication will not occur 100 per cent of the time because EEA investment firms will not always be dealing with other EEA investment firms in the situations set out above. Orders might be transmitted to or transactions concluded with entities based outside of the EEA.

38. From a supervisory perspective there is an advantage to such duplication. It more easily enables supervisors to review recordings relating to any individual firm. Elimination of some part of the duplication means that it will be more difficult for supervisors to collect information on individual firms.

39. Conscious of the need for any recording requirement to be proportionate, CESR believes that some of the duplication should be eliminated. It believes that investment firms with authorisation to receive and transmit orders should not have to record the transmission of orders when those orders are sent to other MiFID investment firms subject to the recording requirement. They should be required to record the transmission of an order where it is sent to an entity which is not a MiFID investment firm.

40. The issues in relation to investment firms with authorisation to undertake portfolio management are more finely balanced. This is because they will include firms responsible for a very significant level of trading activity, including hedge fund managers. At this stage CESR is not recommending that portfolio managers should be included in the scope of a recording requirement but is seeking feedback on this point through a specific question to consultees. In the light of the responses will reconsider this issue before providing its final advice to the EC.

41. CESR considered whether or not an exemption for investment firms when they provide the service of portfolio management should apply when the entity to whom orders were passed was not an EEA investment firm. It decided that if the exemption did not apply in these circumstances it could lead the firms concerned having to apply recording in a blanket fashion. Therefore it decided the exemption should apply whether or not the entity to whom an order was passed was an EEA investment firm.

42. The exemption for portfolio management is only intended to apply to an investment firm when it is performing the service of portfolio management. Therefore it will not apply where an investment firm that performs the service of portfolio management receives an order from a client and executes or transmits that order. However this is not intended to cover situations where an investment firm is discussing the portfolio management agreement with a client.

Financial instruments to be recorded

43. CESR has considered whether a recording requirement as described above should apply to orders and transactions related to all financial instruments covered by MiFID. MiFID conduct of business protections extend to transactions in all instruments covered by the definition of a financial instrument in Annex 1 of MiFID. There is also a requirement for investment firms under Article 25 of MiFID to uphold market integrity which implicitly applies to all financial instruments covered by the directive. However, the market abuse directive only applies to a subset of MiFID financial instruments. In order to ensure full investor protection and in the

interest of simplicity it is proposed that no differentiation should be made between financial instruments to be recorded.

Mobiles and electronic communications

44. The recording requirements currently imposed by Member States with regard to recording mobile conversations appear to fall into two broad categories (Annex 2). Firstly, the majority of Member States who currently impose the broadest level of telephone recording obligations also require that mobile phones be recorded where client orders are received this way. Secondly, a number of Member States either; require traders to apply for special authorisation to trade via a mobile phone; prohibit the reception by traders of orders via mobile phone outside of a company mobile phone; or allow a special recording exemption to client orders received on a mobile phone. In Germany, most investment firms prohibit traders to trade via mobile phone. The UK FSA is currently consulting on removing its current exemption for conversations on mobile phones[6]. CESR believes that a recording requirement should be technology neutral and apply to all ways of making/receiving telephone calls and electronic communications.

45. It is envisaged that electronic communications would, for example, include email, chat/instant messaging, text messages/SMS and FIX Protocol communications.

Privacy

46. European legislation provides a framework to protect the privacy of the communications and of data held about individuals (in several EEA countries there are also constitutional provisions which touch on these issues). Of most relevance here are the E-Privacy Directive 2002/58/EC and the Data Protection Directive 95/46/EC. This legislation does not prevent the recording of telephone conversations and electronic communications, but it does limit the circumstances in which recordings can be made and places safeguards around the handling of the recordings.

47. The scope of a recording requirement is likely to impact on the ability of firms to comply with it whilst also complying with their obligations under the above legislation. Firms are likely to face particular difficulties where conversations which are subject to the recording requirement take place on equipment, such as mobile phones, which are not the property of the investment firm. This suggests that a recording requirement should therefore only apply to conversations and communications which involve equipment provided by an investment firm to its employees. However, this risks creating a loophole whereby conversations and communications can take place on equipment which is not provided by the firm. This loophole could be closed by requiring firms to ensure that conversations and communications which fall within the scope of the recording requirement only take place on equipment provided by the investment firm to its employees.

Proportionality

48. A recording requirement which covers the receipt of client orders (either for transmission or execution) will cover a wide diversity of investment firms and offices of investment firms or credit institutions offering investment services. Some of the investment firms covered will be small firms, including possibly firms which are operated by a single natural person. Some of the offices of investment firms covered will largely undertake other business (such as banking business).

49. CESR has therefore considered the issue of whether or not there should be an exemption from a recording obligation on the grounds of proportionality for smaller investment firms or offices providing investment services which receive few telephone orders. In its advice to the Commission on the MIFID implementing measures CESR included the following proposal to deal with concerns about proportionality:

[6] CP 10/07 http://www.fsa.gov.uk/pubs/cp/cp10_07.pdf

Where, in view of the low frequency of orders given and/or received by an investment firm on a global basis or on any of its telephone lines, the requirement in the previous subparagraph would not be proportionate, the competent authority may exempt that investment firm from that requirement on a global basis, or as applicable, in respect of that telephone line."

50. A small minority of CESR members (BaFin and the FMA), believe that an exemption of this nature is necessary. However, they believe that the proposal above is insufficiently precise. Instead they propose that there should be an exemption for investment firms with five or fewer employees and/or for investment firms which handle orders that amount to € 10 million or under per year, and that all investment firms should not be required to record orders with a value of € 10,000 and below.

51. The BaFin and FMA believe that their proposal would deal with the significant concerns they have about the costs of a recording requirement. In their countries there are lots of offices of credit institutions which receive telephone orders for financial instruments on an infrequent basis, and the BaFin and FMA believe that the exemptions are compatible with efforts to tackle market abuse. Whilst the BaFin and FMA recognise that investment firms could deal with a recording requirement by requiring all telephone conversations regarding orders for financial instruments to be channelled through specified telephone numbers, they believe that this would diminish the quality of service provided to consumers.

52. Most CESR members do not believe that it is appropriate to have an exemption of the sort set out above. In relation to consumer protection they believe that there are no grounds for providing the protection of telephone recording only for the clients of medium and large sized firms or to clients talking to call centres or large offices of investment firms. In relation to market abuse they are concerned that this exemption creates a loophole to enable those seeking to commit market abuse to be certain that their conversations with an investment firm will not be recorded. The CESR members taking this view include some jurisdictions with a significant number of small credit institutions whose offices receive client orders by phone only on an infrequent basis relative to the number of phone calls they receive on other matters.

Retention of records

53. In analysing the current retention periods that investment firms are required to maintain telephone records for, a varied timeframe emerges (see Annex 2). The retention periods currently stipulated by Member States range from 3 months to 10 years. The most common period of retention is 5 years with four Member States imposing this timeframe on investment firms. In choosing 5 years, Member States are securing consistency with MiFID. However, it is likely that most issues requiring access to previous telephone conversations/electronic communications will arise in a shorter time period. In introducing requirements in this area, it must be considered whether the period of retention will strengthen or make obsolete the rationale behind these obligations e.g. there is no benefit in introducing recording requirements if investment firms can delete them before any related issue come to light. A period of retention of less than 1 year would seem inadequate in meeting the rationale behind these minimum requirements especially in meeting the purposes of investor protection.

54. CESR believes that there is no specific justification for records created under a recording requirement to be kept for a period of time that is different to the general MiFID record keeping requirement of at least 5 years. This is because in part the recording obligation is aimed at protecting investors in the same way as the general record keeping requirement. On its own, tackling market abuse would not provide a justification for keeping the documents for such a length of time as most market abuse investigations start well within 5 years after the events to which they relate.

55. Whatever the current length of the retention period in each individual Member State it is the practice of competent authorities to require investment firms to hold recordings for longer where

the recordings may be relevant for an investigation. If there is a harmonised EEA recording requirement competent authorities must retain this flexibility to request that firms should not destroy recordings. Alongside this flexibility it is also obviously important that competent authorities try to target requests to hold on to recordings, and when decisions are made that the recording is no longer needed that this is quickly communicated to the relevant investment firms.

56. Article 51 (2) of the MiFID Level 2 Directive sets out conditions applying to the records kept by investment firms. These require, amongst other things, that records need to be accessible by competent authorities and in a way that means they cannot be manipulated. CESR can see no reason why the same standard should not apply to records created by a recording requirement.

Impact assessment

Benefits

57. The mechanism for economic benefits to flow from a recording requirement is as follows:

- recorded communications may increase the probability of successful enforcement of conduct of business rules and market abuse rules;
- this reduces the expected value to be gained from violating conduct of business and market abuse rules; and
- this, in principle, leads to improved consumer and market outcomes.

58. Improved consumer and market outcomes deliver benefits not only to consumers but also to investment firms by encouraging greater investor participation. Whilst the mechanism to deliver benefits is clear, the extent of the benefits that will be delivered is less clear. Most CESR members believe, largely based on their supervisory experience, that the benefits are significant. A small minority of CESR members believe that because of other information that is available the benefits are modest.

Costs

59. The incremental impacts of the proposals depend on a number of factors which vary across Member States. In that context, CESR is mindful of the broadness of the cost involved.

Current recording and retention requirements

60. The proposals will lead to additional costs e.g. capture and retention of conversations and associated data protection costs for the Member States which have to adapt their regime in order to reach the proposed minimum requirements. See Annex 2 for an overview of the current recording requirements. The incremental cost for firms also depends on whether or not firms are recording (and/or keeping the records) over and above the current regulatory requirements for their internal purposes.

Structure of the financial services sector

61. To a large portion, the cost impact depends on the additional number of telephone lines which have to be captured due to the proposals and the fact that some Member States do not yet have such requirements at all and will have to set up such telephone recording systems. The number of lines (relative to the size of the market) which need to be recorded depends on the structure of the financial services industry in Member States. Therefore the cost impact on the industry relative to the size of the market will be higher in some Member States than in others. The impact will be particularly high in Member States such as Germany where the market is highly

fragmented and not dominated by few large firms. We give indications for the costs per line below.

Cost of fixed-line recording

62. In its Policy Statement 08/01[7] the UK's FSA provided estimates of the costs of recording fixed-line telephones. The analysis dates from 2008 and costs may be different today due to technological progress. The UK per-line estimates for fixed line telephone recording are summarised in Table 1.

Table 1: UK cost estimates for fixed-line telephone recording

		Small Company		Medium Company		Large Trader	
		Design/ Install/ Commission Per User (£)	Annual Operational Cost per User (£)	Design/ Install/ Commission Per User (£)	Annual Operational Cost per User (£)	Design/ Install/ Commission Per User (£)	Annual Operational Cost per User (£)
Fixed telephone							
Recording	Low cost	79*	0	200**	20	160***	16
	High cost	2,610	644	414	145	216	74
Storage for 1 year & Retrieval	Low cost	N/A	N/A	N/A	N/A	N/A	N/A
	High cost	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording
Storage for 3 years & Retrieval	Low cost	N/A	N/A	N/A	N/A	N/A	N/A
	High cost	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording	Included in the cost of recording

* For the Small Company, the provider teams up with a third party supplier for providing fixed line recording systems.

** For the Medium Company the provider supplies a fixed line call recording system (from a third party supplier) purchased by the customer with an annual maintenance fee.

*** For the Large Company the fixed line prices are based on the incremental cost per 100 additional users to upgrade the call recording system from 400 to 500 users.

63. The German Banking Federation (Bundesverband Deutscher Banken - BDB) produced its own estimates of the costs of recording telephone lines in 2008 which the BaFin considers to be credible estimates of the likely costs of a recording requirement in Germany. The BDB, based on a survey of its members, put the one-off cost per telephone line at €3,528 and the ongoing annual costs at €1,500 per line. Because of the structure of the German banking industry the BDB said that these costs per line implied one-off acquisition costs for the German banking industry of €632 million.

64. Investment firms that point to the cost argument should also consider the potential litigation savings made by investment firms in having irrefutable evidence to dismiss fraudulent/erroneous complaints.

Mobile phones

[7] See Annex 3 at: http://www.fsa.gov.uk/pubs/policy/ps08_01.pdf

65. Annex 2 shows that a majority of Member States currently imposing taping requirements include mobile phones in these obligations.

66. The UK FSA commissioned a study by Europe Economics to estimate the costs of mobile phone recording (published in CP 10/7[8]). Table 2 provides estimates of the UK one-off costs per line for different forms of mobile phone recording. Table 3 provides estimates for the annual ongoing costs. These estimates are provided separately for small, medium, and large firms. Again, it has to be considered, that costs in other Member States may vary.

Table 2: UK cost estimates for mobile phone recording – one-off cost per user

	Small firm (low cost) £	**Small firm (high cost) £**	**Medium firm (low cost) £**	**Medium firm (high cost) £**	**Large firm (low cost) £**	**Large firm (high cost) £**
Voice from mobile	95	1094	85	208	170	80
SMS	0	40	0	40	0	40
MMS	65	65	60	60	50	50
IM	65	40	60	60	50	60
Video	95	95	85	85	75	75
Email	65	65	60	60	50	50
Pin to pin	65	65	60	60	50	50

Table 3: UK cost estimates for mobile phone recording – ongoing cost per user

	Small firm (low cost) £	**Small firm (high cost) £**	**Medium firm (low cost) £**	**Medium firm (high cost) £**	**Large firm (low cost) £**	**Large firm (high cost) £**
Voice from mobile	160	835	150	283	83	383
SMS	60	492	60	235	60	182
MMS	100	100	90	90	80	80
IM	50	442	45	421	45	362
Video	300	300	260	260	240	240
Email	80	80	75	75	75	75
Pin to pin	50	50	45	45	45	45

67. Ultimately, investment firms will decide whether they wish to use mobile phones to take client orders. Some firms, who currently permit the use of mobile phones but do not currently record relevant conversations, may well choose to ban their use in order to avoid compliance costs. If an exemption for mobile phones is included it will weaken the rationale behind the imposition of minimum requirements.

Retention period

[8] See www.fsa.gov.uk

68. The required retention period does have an impact on storage and retrieval costs for firms. This impact will depend on the systems used by firms. The UK cost estimates for fixed-line telephone recording provided in Table 1 included storage costs and are based on a retention period of one year.

CESR's proposals

69. Taking into account the analysis and proposals explained in this Chapter, most CESR members believe that it is appropriate for the EEA to adopt a minimum harmonising recording requirement. They believe that such a recording requirement should have the following scope and following record-keeping standards.

Scope of obligation

70. The obligation should apply to investment firms who provide and/or perform the following investment services and activities: reception and transmission of orders in relation to one or more financial instruments; execution of orders on behalf of a client and dealing on own account.

71. The investment firms mentioned above should be required to record telephone conversations and electronic communications where one of their employees:

- receives from a client an order to be transmitted to another entity for execution or an order to be executed on behalf of a client[9];
- transmits an order to an entity not subject to the MiFID recording requirement when providing the service of the reception and transmission of client orders;
- concludes a transaction with an execution venue when executing an order on behalf of a client;
- concludes a transaction when trading on own account on behalf of the investment firm, regardless of whether or not a client is involved in the transaction.

72. This obligation would apply to orders and transactions relating to all financial instruments covered by MiFID. It would also apply to all forms of telephone conversation and electronic communication. Employees of investment firms would only be allowed to undertake conversations and communications of the sort set out above on equipment belonging to the investment firm.

Record retention

73. The record made under the obligation above should be kept in accordance with the standards set out in Article 51 (4) of the MiFID Level 2 Directive. This means investment firms would need to keep the records for at least five years and that they should be stored in a way that makes them accessible by regulators and that prevents them from being altered.

Questions:

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

[9] For the purposes of this Directive eligible counterparties should be considered as acting as clients, see Recital 40 of MiFID. This is consistent with the second paragraph of Article 24(2) of MiFID.

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?**

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

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.**
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.**
10. **In your view, what are the benefits of a recording requirement?**
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[10].**
12. **What impact does the length of the retention period have on costs? Please provide quantitative estimates where possible.**

[10] It would be helpful if quantitative responses to this question could be based on retaining records for five years and in the following tabular form:

Costs per user (in €)	One-off installation costs	Ongoing annual costs
- Fixed line telephones		
- mobile phones		
- electronic communications		

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

Introduction and background

74. The MiFID best execution obligation[11] requires firms to take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order (execution factors). The execution arrangements by which the firm achieves the 'best possible result' should be set out in an order execution policy and should include details of the venues used to achieve the best possible result.

75. Firms are required to review, on a regular basis, the execution venues used to deliver the best possible result for the client and to consider whether they need to make changes to these execution arrangements. This assessment should require data on execution performance, for each of the venues, over a period of time.

76. During the negotiations on the MiFID Level 2 Directive, there was a debate about whether a regulatory requirement was needed to ensure that investment firms had adequate information to assess the relative merits of execution venues. During the negotiations the EC proposed that an obligation be imposed upon execution venues to provide information on execution quality for all financial instruments. The proposal was as follows:

77. The proposal discussed aimed to require execution venues to make available to the public on a reasonable commercial basis, data relating to the quality of execution of transactions on each of them on at least an annual basis. CESR could have been asked to establish the content and the format of the data to be made available[12].

78. During the course of those negotiations, it was considered that it was premature to impose such an obligation and that the market should be given a chance to show that it could deliver adequate information. The obligation therefore turned into a review clause in Article 44(5) of the MiFID Level 2 Directive:

79. *"Before 1 November 2008 the EC shall present a report to the European Parliament and to the Council on the availability, comparability and consolidation of information concerning the quality of execution of various execution venues."*

80. As part of this review the EC has to decide therefore whether or not a regulatory intervention is required to ensure that investment firms have the necessary information to select appropriate execution venues to include in their execution policies.

Issues under discussion

Venue selection

81. The starting point for a review of the issues related to the data that investment firms need in order to select execution venues has to be an assessment of what information firms need to assess execution venues. As set out in MiFID, an investment firm's obligation when executing client orders is to obtain the best possible result taking into account a range of execution factors (although total consideration – price plus costs directly related to the execution – prevails for retail clients). Therefore adequate data on all execution factors relevant to the firm's execution policy is required to assess which venues may deliver best execution.

[11] Article 21 of MiFID and Articles 44 to 46 of the MiFID Level 2 Directive
[12] ESC/23/2005 – REV1

82. The simplest execution factor, price, requires data on prices offered or achieved. For the other factors, different data is required – for example data on volumes may be used to evaluate a venue's market share and liquidity. However, it should be appreciated that for some factors, aggregate or objective data may not be easily available– for example assessments of counterparty risk or information leakage. At a minimum, it seems reasonable that data on prices, costs, volumes, likelihood of execution and speed should be available. However, it is acknowledged that many firms may require other data in order to make assessments of particular other factors.

83. Many firms use market share data to filter out venues which have insufficient liquidity before making an assessment on factors such as price. In this case they will not need data from all the venues. Conversely, firms that slice orders into smaller portions may not want to apply any filter at all. Therefore, while for firms individually data on all venues may not be required, for the market as a whole data on all venues is necessary.

84. Finally, there is the issue of how frequently investment firms need data. Given that the best execution policy review should take place at least annually the data is needed on at least an annual basis. However, given that firms have to monitor the effectiveness of their order execution arrangements and policy, such information may be needed on a more frequent basis.

85. To assist with its work on best execution, CESR circulated a questionnaire to investment firms, regulated markets, Multilateral Trading Facilities (MTFs) and CESR members. This focused mainly on best execution and share trading and the following description of the current views in relation to the availability of data relating to share trading draws on the responses to the questionnaire.

Share trading

86. Under MiFID there are requirements relating to trading in shares for certain information to be made publicly available about pre and post-trade transparency. The pre-trade transparency obligations apply to individual regulated markets, MTFs and systematic internalisers. The post-trade transparency obligations apply to regulated markets, MTFs and investment firms.

87. Despite the public availability of pre and post-trade information on shares, CESR has not seen since the implementation of MiFID the emergence of data sets showing aspects of execution quality by execution venue based on commonly accepted statistical definitions. There are at least four main reasons why CESR has not seen such data emerge:

- First, as several respondents pointed out in their responses to the questionnaire, market structure differs significantly across the EEA. In some Member States most share trading is still heavily concentrated on a single regulated market with, at most, limited Over the Counter (OTC) trading. In other Member States, however, there are a plethora of regulated markets and MTFs and a significant amount of trading is conducted on an OTC basis. For the time being, there is significant competition between trading venues only in relation to the minority of shares traded across Europe. A review of execution venues for a firm executing client orders is obviously a very different proposition in the former type of market structure as opposed to the latter[13].

- Second, the needs of investment firms are not uniform when it comes to information about execution. Large firms are in a position to develop their own IT infrastructure to warehouse data from live feeds and to analyse execution, or to buy large amounts of data and analytical tools from data vendors. Smaller investment firms will likely have access to less data and fewer analytical tools.

[13] CESR acknowledges that the full complexity of market structure should also be taken into account. For instance in the UK, most retail client orders are executed through market makers operating on the London Stock Exchange and PLUS whilst orders from professional clients and eligible counterparties are executed on order books or through OTC trades.

- Third, there is significant competition between providers of data and analytical tools whether they are regulated markets, MTFs or data vendors. This competition inevitably involves efforts to differentiate products.

- Fourth, MiFID itself did not set any standards for benchmarks relating to execution quality.

88. Investment firms currently have three main sources of information about execution:

    - Regulated markets, MTFs and third parties disseminating trade reports. All regulated markets and MTFs provide live data feeds which enable market participants to look at pre and post-trade information. They also provide varying amounts of pre and post-trade historical data. The biggest demand for data from regulated markets and MTFs is for the live feeds, although responses to the questionnaire suggested the demand for historical data has risen since the introduction of MiFID. Some investment firms will warehouse information provided through live feeds from execution venues in order to help them analyse execution. In some cases the live feeds from regulated markets are provided not directly by the regulated market but by third parties licensed by the regulated market to onsell their data. Third parties disseminating trade reports of OTC transactions also provide data feeds.

    - Data vendors. There are a range of information companies (and regulated markets and MTFs) who take pre and post-trade data from the original sources and then aggregate the data and sell it to investment firms in various packages.

    - Record keeping. MiFID has various record keeping obligations in relation to client orders and transactions which mean that investment firms themselves hold a lot of information about their own trading activities.

89. Both the data vendors and some of the regulated markets and MTFs offer analytical tools to enable investment firms to analyse their trading activity. This includes transactions cost analysis, something which developed first in the US and involves looking at trading performance against a variety of possible benchmarks.

90. Most firms executing client orders who responded to the CESR questionnaire were of the view that they did not have significant problems obtaining and analysing data for their review of their execution policy and arrangements. They were also of the view that execution venues provided adequate data and assistance.

91. However, despite this high-level picture of contentment the responses identified several detailed areas of potential concern. Several respondents referred to the sorts of problems with the quality and consolidation of post-trade data. In addition, the respondents also said that the availability of data, particularly historical data, varies from venue to venue. They also said that venues use a variety of different ways of calculating concepts such as liquidity and Volume Weighted Average Price (VWAP).

92. The issue of inconsistencies in the calculation of key statistics also appears to extend beyond the regulated markets. Data vendors frequently offer transactions cost analysis services to help firms executing client orders and portfolio managers to assess their compliance with their best execution obligations. A recent report on such services[14] indicated that the same is also true for the transaction cost analysis (TCA) tools that are being offered for the industry. It went on to suggest that data vendors should come together to agree a common methodology for calculating key statistics such as VWAP and Best Bid and Offer (BBO).

93. In their responses to the questionnaire portfolio managers and receivers and transmitters said they do not usually receive information about execution quality from the investment firms who

[14] European Data Consolidation – White Paper, Thomson Reuters

execute their orders (although some is made available in response to a specific request). They said they got information from data vendors for the purposes of monitoring execution.

94. Regulated markets and MTFs said that the main data they provide to market users is real-time market data. Some regulated markets and MTFs provide historical data and there is tentative evidence of an increase in demand for historical data post MiFID. The regulated markets and MTFs were of the view that it was not difficult to compare the information that they provide using straightforward conversions between different formats used.

Trading in financial instruments other than shares

95. Whilst the CESR questionnaire did ask for information on the trading of classes of financial instruments other than shares, CESR received very little information on issues affecting venue selection for those classes of financial instrument. However, it is certainly the case that there are some important differences between trading in shares and trading in other classes of financial instrument.

96. One important difference is that MiFID does not require the publication of pre- and post-trade information for these financial instruments. This does not mean that no such information is available but the type of information available will differ depending on the nature of the instrument and the nature of the trading venue.

97. More trading in shares happens rather on regulated markets and MTFs than on an OTC basis (although OTC trading is still a significant component of share trading[15]). In some financial instruments other than shares, in some Member States, trading takes place largely OTC with liquidity providers operating on a 'request for quote' basis and therefore transactions may not involve investment firms executing orders on behalf of a client and thus may not have to provide best execution[16].

98. When trading financial instruments other than shares, investment firms will have available to them a variety of information sources which will help them to select execution venues. This will include information from regulated markets, MTFs, data vendors, price reporters and their own trading activity.

Policy considerations

Other relevant policy developments

99. As noted above, several market participants, and some competent authorities expressed concern in replies to the best execution questionnaire about the quality and availability of post-trade reporting. The EC is also obliged to review another issue related to information about trading. Article 65 (4)[17] of MiFID states:

100. "By 30 April 2008, the EC shall present the European Parliament and the Council with a report on the state of the removal of the obstacles which may prevent the consolidation at the European level of the information that trading venues are required to publish."

101. This review is concerned with pre- and post-trade transparency information in shares that trading venues are required to make public under MiFID. As such it is related to but separate from the review under Article 44 (5) of the Level 2 Directive. They are related because both reviews are concerned about data on transactions completed on trading venues but are separate

[15] Figures were provided in CESR's report on 'impact of MiFID on secondary markets functioning' (CESR/09-355)
[16] A copy of a letter from the EC setting out its view on how best execution applies in markets where trading takes place on a request for quote basis can be found in CESR/07-320: Best Execution under MiFID
[17] As amended by Directive 2006/31/EC of the European Parliament and of the Council of 5 April 2006.

because they have different focuses. Article 65(4) of MiFID is looking at data from the point of view of price formation whilst the review under Article 44 (5) of the Level 2 Directive is looking at data from the point of view of venue selection.

102. CESR is consulting separately on its advice for this review which will also address the quality and ease of consolidation of post-trade data for shares.

103. There are also significant policy developments in train which will affect the availability of trade data for classes of financial instruments other than shares. In its October 2009 communication[18] on OTC derivatives the EC indicated that as part of the MiFID review it intends to bring forward comprehensive proposals dealing with pre and post-trade transparency for classes of financial instruments other than shares. It also set out its intention to bring forward legislation on trade repositories in the middle of this year.

US SEC Rule 605 reports

104. As reported in the previous section of this paper, some of the respondents to the best execution questionnaire raised the issue of a European Best Bid and Offer benchmark for trading in shares. These ideas are similar to features of the US market for share trading under its national markets system (NMS). Another feature of this system is the requirement for 'market centres' to make available on a monthly basis reports in a uniform, readily accessible and usable electronic format covering various dimensions of execution quality.

105. Rule 605 reports have to be categorised by security, order type and order size. They have to include information on:

- the number of orders cancelled prior to execution;
- the number of orders executed at the market centre;
- the speed, within set time bands, with which orders were executed;
- realised and effective spreads;
- the extent to which orders are executed with price improvement and the extent of the price improvement; and
- the extent to which orders are executed outside the quote and the extent of the price shortfall relative to the quote.

106. Obviously the entire range of price statistics that market centres are required to produce only makes sense in the context of the NMS. That is because the NMS incorporates a consolidated Best Bid and Offer tape across the participating market centres (and consolidated post-trade information). This provides a benchmark against which price information can be judged and harmonised statistics for spreads and price improvement can be produced. There is currently no such regulatory benchmark within the EEA.

107. Also under Regulation NMS firms executing client orders are required to produce quarterly reports on order routing, that is, they have to show the top ten market centres to which they sent orders over the latest quarter. The intention is to allow clients to judge the efficiency of the order routing practices of the firms executing their orders.

Key policy considerations

[18] COM(2009) 563 final: Ensuring efficient, safe and sound derivatives markets: Future policy actions

108. A key consideration for the review under Article 44 (5) of the Level 2 Directive is whether an improved quality of post-trade reporting on shares is sufficient to be comfortable that investment firms have access to adequate information to enable them to make an effective selection of execution venues for the purpose of their execution policies. There are several issues that are not directly addressed by post-trade data. In particular it does not address the issue of a lack of a commonly agreed basis for measuring execution quality amongst execution venues and data vendors or the ease of consolidating the historical data sets currently available from execution venues.

109. Requiring data on execution quality would inevitably require data on the prices realized for orders against some form of price benchmark. This raises several issues. First is the extent to which the creation of a price benchmark cuts across the best execution rule (the assessment of which is based on a wider range of factors, albeit that price is likely to be the most important factor). Second, whether it is appropriate to place the burden of constructing (or buying in) a consolidated Best Bid and Offer tape on execution venues for the purposes of facilitating comparison between execution venues.

Impact Assessment

110. Best execution rules exist to correct potential market failures that result from an asymmetry of information between clients and investment firms with regard to the execution of client orders (i.e. execution quality is more directly observable by the firm than by the client). The issue of execution venues producing data on execution quality is linked to this issue but is also a bit more complex.

111. The production of data on execution quality by execution venues should help to reduce the information asymmetry between investment firms and their clients with regard to execution quality. In this sense it would therefore work with the obligation on the firm to help ensure that the interests of clients are protected when they rely on an investment firm to execute an order acting as the agent of the client.

112. In turn, however, the investment firm is also provided with additional information. This is not necessarily about dealing with an information asymmetry between the investment firm and an execution venue, but potentially about dealing with an externality. The benefits to the marketplace and investors of investment firms having comparable data on execution may exceed the private benefits to the execution venues of producing the data. A regulatory obligation may therefore be necessary to ensure that the socially optimal amount of such data is available.

113. CESR has not, at this stage, done any specific work on the costs of an obligation on execution venues to produce reports on execution quality. During the period of the consultation CESR will talk to market participants about the possible costs.

114. The SEC produced a cost-benefit analysis[19] (CBA) of Rule 605 when it published the final rule towards the end of 2000 (when the rule was called Rule 11Ac1-5) – the rule took effect in 2001. The validity of the CBA was contested by some of those who responded to a previous consultation on the draft of the rules but the SEC rejected the criticisms made by those arguing the costs would be substantial and the benefits minimal.

115. This CBA said that the SEC expected the rule would bring benefits to broker dealers and to investors. Broker-dealers would be better able to fulfill their best execution obligation, whilst investors would be better able to have meaningful input into how broker-dealers executed their orders. The SEC argued that the rule would not just reallocate income from broker-dealers to investors but would create additional income through ensuring the more efficient execution of orders. It mentioned the very significant savings available to investors for relatively small

[19] http://www.sec.gov/rules/final/34-43590.htm

improvements in spreads. The CBA also pointed to academic studies which suggested that lower transaction costs would reduce the costs of capital.

116. The SEC put the annual cost of compliance with Rule 605 at $21.8 million a year (which was made up of labour costs at the market centres for data collection and the costs of services provided by data vendors to generate the required reports). It was expected that each market centre would pay $2,500 a month to data vendors to generate the reports and that there were 627 market centres caught by the rules.

117. The benefits of an obligation on execution venues in Europe would be similar to those the SEC described in the US. It is very difficult to say whether the costs of an obligation in Europe would be similar to those in the US. Obviously it will depend on the number of execution venues who have to report, how much information they have to report, how frequently they have to report and how competitive is the market for providing services to execution venues to generate the reports.

Policy proposals

Execution quality data for shares

118. It would appear that there are two main policy options in relation to the issue of execution quality data for shares. Both of these alternatives are obviously assumed to take effect in a world in which the quality and comparability of post-trade reporting has been improved. The two options are:

- CESR would define key metrics of execution quality data for voluntary use of execution venues and data vendors;
- execution venues would be required to produce periodic reports on execution quality using metrics defined by CESR.

119. The purpose of defining some key metrics of execution quality would be to provide a framework that execution venues and data vendors could use to provide comparable information to members and clients. The purpose would not be to stop the production of other sets of statistics; individual firms are always likely to have specific requirements and CESR would not want to discourage innovation in this area.

120. There would appear to be significant merit in adopting a similar approach to that used in now well-established US rule 605 reports. This would require CESR to define:

- the types of orders relevant to include in key metrics of execution quality;
- a market share statistic for trading in individual shares;
- a measure of the likelihood of execution based on looking at orders filled relative to orders received (including looking at orders cancelled);
- appropriate statistics to measure the speed of execution;
- a formula for calculating Best Bid and Offer (BBO - which, amongst other things, would need to cover which bids and offers were eligible for inclusion);
- formulas for effective and realized spread; and
- indicators of the result of the execution of orders compared to the BBO.

121. The option for an obligation on execution venues would be based on the types of statistics mentioned in the previous paragraph. However, it would also be necessary to specify which execution venues the obligation would be imposed upon, how frequently the reports would have to be published and how and where the data had to be presented.

122. It seems appropriate that, in order to minimise costs, any obligation should, at least in the first instance, be relatively tightly drawn. This is because of uncertainties about how the data would be used in practice and because it would enable the EEA to learn from its own experience (which, given differences in market structure, is likely to be different from that of the US). Therefore an obligation on execution venues might start by applying:

- to regulated markets, MTFs and SIs;
- only to liquid shares as defined under MiFID; and
- on a quarterly basis.

123. There are somewhere in the region of 10,000 shares admitted to trading on regulated markets and MTFs across Europe. Many of these, however, currently only trade on a single execution venue. Therefore investment firms have little choice as to which execution venues to use when executing orders for these shares. This is much less likely to be true of liquid shares and that is why, in the first instance, CESR is proposing that the obligation to produce reports should only apply to these shares.

124. In line with the US requirement for Rule 605 reports, it would seem sensible that the data would need to be produced in a consistent format and made available for downloading from an internet website that is free and readily accessible to the public.

125. It is obviously uncertain as to what impact CESR producing definitions of key metrics of execution quality would have. They may or may not be taken up by execution venues and data vendors. CESR is therefore of the view that in relation to the trading of shares, it is appropriate that to improve venue selection there should be an obligation on execution venues to produce data on execution quality of the sort set out above. CESR also believes that it would be worth reviewing the operation of such an obligation after a year of it taking effect to see whether or not there is a case for extending it to a wider set of execution venues or to a wider range of shares.

Classes of financial instruments other than shares

126. CESR has provided advice to the EC on the expansion of transparency requirements for financial instruments other than shares[20]. This advice argued for an EEA post-trade transparency regime covering corporate bonds, structured finance products and credit derivatives. The EC has also indicated as part of its work on OTC derivatives that it expects to bring forward proposals for increased transparency for financial instruments other than shares. It said[21]:

127. "Harmonising pre- and post-trade transparency requirements for the publication of trades and associated prices and volumes across the various organised venues needs to be carefully considered, also in the case of OTC markets".

128. However, given that the full details of the new EEA regime for post-trade transparency are not currently available, CESR does not believe that now is the right time to bring forward proposals for obligations on execution venues to produce execution quality data for classes of financial instruments other than shares. However, CESR believes it would be worth returning to this issue in the future when the initiatives which are currently in train have taken effect. This

[20] http://www.cesr.eu/index.php?docid=5800
[21] http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2009:0563:FIN:EN:PDF

would enable a better view to be taken of whether there are data shortfalls which can best be addressed through additional regulatory action.

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?**
14. **How frequently do investment firms need data on execution quality: monthly, quarterly, annually?**
15. **Do you believe that investment firms have adequate information on the basis of which to make decisions 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?**
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?**
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?**

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.**
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?**

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

Introduction and background

129. In 2009 CESR consulted on a proposed analysis and interpretation of MiFID's distinction between complex and non-complex financial instruments for the purposes of the Directive's appropriateness requirements. The first Consultation Paper was published in May 2009 (Ref. CESR/09-295), with a Feedback Statement (Ref. CESR/09-558) published in November 2009. During this time CESR also considered its policy approach on this topic in a set of Q&A (Ref. CESR/09-559).

130. In the Feedback Statement, CESR explained its view that, as drafted, MiFID did not deal adequately with certain categories of financial instruments for the purpose of the Directive's appropriateness requirements. CESR suggested that MiFID should therefore be amended in certain areas in the interests of clarity, to deliver a more graduated risk-based approach. This Part sets out CESR's proposed amendments to MiFID in the light of this work.

131. CESR believes that the amendments it is proposing would improve legal certainty and give more clarity and transparency with regard to the categorisation of MiFID financial instruments for the purposes of the appropriateness test. However, these proposals cannot reflect any changes that may be necessary in the future as a result of the outcome of discussions on a new EEA regime for Packaged Retail Investment Products.

Issues under discussion

132. The MiFID appropriateness requirements aim to increase the protection of clients (particularly retail clients) who are contemplating transactions in MiFID-scope financial instruments without receiving advice from the investment firm in question. They also aim to prevent complex products being sold on an 'execution-only' basis to retail clients who do not have the experience and/or knowledge to understand the risks of such products. In summary, where the appropriateness test applies, a firm must ask its client to provide information about their knowledge and experience relevant to the specific type of product or service in question, so that the firm can assess whether the product or service is appropriate for the client. A firm is required to determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded, and to warn the clients if the firm determines that the product or service is not appropriate for them.

133. Essentially, therefore, MiFID lays down three sets of requirements in this area:
(i) where a MiFID firm is providing investment advice or discretionary portfolio management, it must do so in accordance with the suitability requirements set out in Article 19(4) of MiFID and Articles 35 and 37 of the MiFID Level 2 Directive;
(ii) where a MiFID firm is providing investment services other than investment advice or discretionary portfolio management, it must do so in accordance with the appropriateness requirements set out in Article 19(5) of MiFID and Articles 36 and 37 of the MiFID Level 2 Directive. These requirements are commonly referred to as the 'appropriateness test'; and

(iii) as an exception to (ii), in certain prescribed circumstances, a firm may provide some investment services —reception-transmission and execution of orders— involving some types of financial instruments on an 'execution-only' basis, without having to apply the appropriateness test. These prescribed circumstances are set out in Article 19(6) of MiFID (hereafter referred to as Article 19(6)) and Article 38 of the MiFID Level 2 Directive.

134. The risk-based way in which the requirement applies, and what it should involve in each case, depends particularly on the nature of the client (i.e. whether retail or professional) and on the type of MiFID financial instrument that is involved in the transaction envisaged. In terms of the type of instrument or financial product, the way in which the appropriateness requirements apply differs according to whether the instrument/product is deemed 'non-complex' or 'complex' for these purposes. In practical terms, this distinction matters because the appropriateness test must always have been undertaken by a MiFID firm where the service or transaction involves a 'complex' product. For 'non-complex' products, the test does not need to be undertaken in certain specified circumstances - meaning that the resulting transactions can be carried out in a way that can be described as 'execution-only'.

135. Article 19(6) lists specific types of instruments/products that can always be treated as non-complex for these purposes. Article 38 of the MiFID Level 2 Directive, then provides in a set of criteria for 'other non-complex' products not specifically listed. These provisions together also indicate some specific types of MiFID products that should always be treated as 'complex' for the purposes of the appropriateness requirements. However MiFID does not seek to provide definitive or complete lists of all types of products and how they should be categorised, and since MiFID was agreed, CESR and its members have received requests for clarification of how types of products might be categorised. This was one of the drivers for CESR's 2009 initiative on this topic.

Policy arguments and rationale

136. This Chapter deals in turn with each category of financial instrument mentioned in Article 19(6), i.e. shares, money market instruments, bonds, other forms of securitised debt, UCITS and other non-complex financial instruments. It then presents two additional proposals, of which one is a minor drafting clarification.

Shares

137. With regard to shares, CESR expressed the view in its Feedback Statement and Q&A that, consistent with the definition of 'transferable securities' in Article 4(1)(18)(a) of MiFID, the reference to shares for the purposes of Article 19(6) should be interpreted as capturing shares in companies where those shares are admitted to trading on a regulated market or an equivalent third country market, but excluding other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares. Instruments other than such shares in companies admitted to trading should be assessed against the criteria for "other non-complex financial instruments" set out in Article 38 of the MiFID Level 2 Directive (hereafter referred to as 'the Article 38 criteria'). CESR stated that shares admitted to trading on a third country market should also be assessed against the Article 38 criteria until such time as a list of equivalent third country markets is published by the EC.

138. Any type of share that embeds a derivative, including convertible and callable shares, should be treated as complex for the purposes of the appropriateness test. This would be the effect of applying the Article 38 criteria.

139. In addition, CESR believes that shares in a non-UCITS collective investment undertaking are first and foremost investments in a collective investment undertaking and that (for the purposes of the appropriateness requirements) this should prevail over the legal form they take (i.e. whether units or shares) in the interests of a consistent regulatory treatment of such investments for the purposes of the appropriateness requirements. CESR believes that shares in a non-UCITS undertaking should therefore be assessed against the Article 38 criteria, unless the final Directive on Alternative Investment Fund Managers prescribes a different treatment.

140. CESR believes that this approach should deliver reasonable outcomes for those shares not considered as automatically non-complex.

141. One particular issue that arose in CESR's work related to the treatment of subscription rights/nil paid rights. CESR stated in its Feedback Statement that where the exercise of the subscription rights involves the purchase of financial instruments which are different to the shares which gave rise to the subscription rights, then the exercise of such subscription rights should be regarded as complex or non-complex depending on the classification of the financial instrument being offered for purchase.

142. If the type of share itself is non-complex, the market acquisition (and exercise) of subscription rights/nil paid rights up to the number strictly necessary to round up the initial allotment, should also be classified as involving a non-complex instrument for the purposes of the appropriateness test.

143. If, on the other hand, the share is classified as complex, then the market acquisition and exercise of subscription rights/nil paid rights should also be classified as complex for the purposes of the appropriateness test. However, in the case of market acquisitions of subscription rights for non-complex shares beyond those strictly necessary to round up the initial allotment, these rights ought to be classified as falling within Article 4(1)(18)(c) of MiFID, and therefore are complex products for the purposes of the appropriateness test.

144. CESR felt that retail clients faced additional risks in non-advised secondary market acquisitions which warranted the application of the appropriateness test. On the other hand, market disposals of subscription rights by shareholders to whom these instruments have been granted, regardless of the classification of the underlying shares, can be regarded as necessary actions to obtain monies equivalent to dividends. Therefore the application of the appropriateness test to such transactions would be unnecessary and disproportionate in these circumstances.

145. In view of all the above, CESR therefore suggests an amendment to the 'shares' reference in the first indent of Article 19(6), by clarifying that those shares that may be treated as automatically non-complex are shares admitted to trading on a regulated market or on an equivalent third country market- where these are shares in companies, and excluding shares in collective investment undertakings, convertible shares and other shares that embed a derivative. The possible legal text under 'Proposals for changes to the text of MiFID Article 19(6)' of this paper is intended to achieve this effect.

146. The treatment of subscription rights/nil paid rights in respect of shares will depend on the nature of the transaction including the nature of the particular share/right involved. However, CESR believes that this could better be clarified at MiFID Level 2 rather than MiFID Level 1.

Money market instruments, bonds and other forms of securitised debt

147. In its Feedback Statement and Q&A, CESR explained that Article 19(6) suggests that 'money market instruments, bonds and other forms of securitised debt' are non-complex instruments for the purposes of the appropriateness requirements, unless they embed a derivative. CESR stated that it sees the 'embed a derivative' consideration applying to all of these instruments since they are all forms of securitised debt. CESR considered that most asset-backed securities and structured products would also be considered complex for the purposes of the appropriateness test[22].

148. In its Feedback Statement, CESR also stated that it was of was of the opinion that the EC should consider the treatment of fixed income products in its forthcoming MiFID review. CESR had also previously stated in paragraph 65 of its May 2009 CP that '…the development of fixed

[22] For the purpose of Article 19(6) CESR reads the term 'securitised debt' as meaning debt that is incorporated in a security, and not solely debt that has undergone a securitisation process (i.e. pooling contracts or assets and issuing new securities backed by the pool).

income markets in the last decade on both volumes and complexity has been very significant, and it is doubtful that Article 19(6) as it currently stands is a helpful starting point to achieve an appropriate degree of investor protection. Particularly given recent developments in the financial markets, CESR believes that the risks associated with these instruments, and therefore the risks faced by retail clients considering a transaction without taking advice, are likely to warrant a more differentiated approach than the listing of money market instruments, bonds and other forms of securitised debt' in Article 19(6).

149. CESR therefore proposes that MiFID be amended so that the categories of money market instruments, bonds or securitised debt in Article 19(6) are further differentiated. CESR believes that the current approach produces an oversimplified treatment of the instruments in that list that does not reflect their profile in terms of investor awareness of the associated risk.

150. Furthermore, CESR now believes that there are grounds to go further than it proposed in its first consultation on this issue in terms of the treatment of bonds under Article 19(6). It believes that the evolution of the markets and particular instances of consumer detriment that have been experienced in some markets justify an approach to bonds that is analogous to the treatment of shares that are eligible to be treated as automatically non-complex and so not requiring an appropriateness test to be satisfied. This means that only bonds admitted to trading on an EEA regulated market or equivalent third country market would be automatically non-complex, and even here excluding some types of bonds. Other types of bonds would need to be assessed against the Article 38 criteria to determine whether an appropriateness test needs to be carried out.

151. CESR therefore suggests that the references in Article 19(6) to these types of debt instruments cover as non-complex instruments:

- bonds admitted to trading on a regulated market or on an equivalent third country market - excluding those that embed a derivative such as convertible bonds and exchangeable bonds, or incorporate a structure which makes it difficult for the client to understand the risk involved, such as structured covered bonds;

- money market instruments - excluding those that are asset-backed or embed a derivative); and other forms of securitised debt - excluding asset-backed securities and other structured instruments that embed a derivative or incorporate structures which make it difficult for the client to understand the risk involved.

152. The proposed legal text below is intended to achieve this effect.

153. The above categories would continue to be categories under Article 19(6) and these financial instruments should continue to be available on an execution only basis for the purposes of the appropriateness test. All the excluded instruments would on the other hand be considered as automatically complex.

154. CESR believes that the further breaking down of these categories in this way would provide more clarity and certainty regarding how certain financial instruments should be treated for purposes of the appropriateness test. It would also ensure that certain instruments are not brought back in as non-complex through the Article 38 criteria when it is clear that such instruments would not pass if the Article 38 criteria are applied, as MiFID intended, only to those instruments whose classification is not addressed by Article 19(6).

UCITS and other collective investment undertakings

155. In its Feedback Statement, CESR stated that nothing in Article 19(6) that requires a person to look through to the underlying investments of a UCITS for the purposes of the appropriateness requirements. Therefore, as drafted, Article 19(6) treats all UCITS as automatically non-complex. In its Consultation Paper however, CESR raised the question as to whether this remains a correct approach. As CESR reported in its Feedback Statement,

responses on this point were sharply divided, though some respondents felt that the treatment of the UCITS category for the purposes of the appropriateness requirements could better reflect the nature of the underlying investments.

156. However, CESR recognises that making any definitive proposals on the UCITS category at present would be difficult, and would raise wider issues about the established and agreed EEA UCITS regime (which regulators deem suitable) that are outside the scope of CESR's current exercise. In addition, recent enhancements such as the development of the Key Information Document disclosures also accommodate a risk-based differentiation between types of UCITS within the existing UCITS framework. Any further distinctions for the purposes of Article 19(6) would probably also require a fundamental review of the Article 38 criteria in a way that tested UCITS and non-UCITS investments and underlying assets consistently (CESR is not convinced that a meaningful basis for such a fundamental review of Article 38 of the MiFID Level 2 Directive could readily be found in time for the MiFID Review). A possible solution suggested by a minority of CESR members would be to amend Article 19(6) and exclude from the automatically non-complex list of financial instruments in MiFID those UCITS that use investment strategies or techniques that makes it difficult for the client to understand the risks involved. This would allow for further work to try and differentiate between UCITS, to be conducted possibly in the form of binding Level 3 material.

157. CESR also clarified in its Feedback Statement that shares and units in other (non-UCITS) types of collective investment undertakings within the scope of Annex I to the MiFID Level 1 Directive will need to be assessed against the Article 38 criteria.

Other non-complex financial instruments' under Article 38 of the MiFID Level 2 Directive

158. In its Consultation Paper, Feedback Statement and Q&A, CESR acknowledged the rationale for the criteria in Article 38 of the MiFID Level 2 Directive (i.e. that it is not practical for the MiFID Level 1 Directive to attempt to list all types of financial instruments that may, now or in the future, be treated as 'non-complex' for the purposes of the appropriateness requirements). CESR also noted that although there is scope for interpretation in applying some of the criteria, the high-level aim of Article 38 of the MiFID Level 2 Directive is to confine the scope of 'other' non-complex instruments to those products that are adequately transparent, liquid, and capable of being readily understood by retail clients. MiFID derivatives and certain similar instruments cannot qualify as 'non-complex' under the criteria. CESR does not propose any amendments to MiFID in this area.

159. In its Consultation Paper, Feedback Statement and Q&A, CESR briefly considered certain other instruments or products that had not been explicitly covered in previous sections of the Consultation Paper. CESR does not propose any changes to MiFID to accommodate explicitly any specific 'other products'. It cannot be expected that MiFID will explicitly cater for every combination or permutation of financial products that exists in the market, particularly as products are always evolving and changing. CESR believes that, if the other changes to MiFID that it recommends are pursued, the high-level Article 38 criteria for other non-complex instruments can continue to work effectively.

Additional proposals

160. Currently, Article 19(6) enables investment firms not to perform an appropriateness test "when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services." A strict application of the letter of this provision would permit a firm to provide the ancillary service of "granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction", in conjunction with the execution and/or the reception and transmission of client orders, without the need for an appropriateness test.

161. CESR questions whether this result is the correct one, since such granting of credits or loans will increase the client's leverage and risk exposure. CESR believes that if a firm is offering this ancillary service in conjunction with the execution and/or the reception and transmission of client orders, it should always be required to establish whether the client has the necessary knowledge and experience to understand the risks, regardless of whether the financial instrument concerned is complex or non-complex. CESR is aware of circumstances where firms have offered to provide loans to clients in order to incentivise them into a non-advised trade in a non-complex instrument.

162. Finally, one of the conditions under Article 19(6) is that "the client or potential client has been clearly informed that in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore the client or potential client does not benefit from the corresponding protection of the relevant conduct of business rules; this warning may be provided in a standardised format". It has been suggested that the reference in this condition to "suitability" but not to "appropriateness" seems strange, since the requirement in question is appropriateness rather than suitability. Therefore, CESR suggests that it would help avoid any confusion to include a reference to appropriateness in this condition, either instead of the reference to suitability or in addition.

Impact assessment

163. In the main, CESR believes that its proposals to amend the text in Article 19(6) are points of clarification in respect of the existing text rather than fundamental changes to its meaning. CESR believes that such clarifications should help firms in implementing the requirements with greater confidence and certainty as to regulators' expectations. Generally, CESR believes that its views are consistent with market interpretations of the MiFID text; particularly where firms have hitherto erred on the side of caution in interpreting the appropriateness requirements (for example, concerning structured investment products).

164. The exception to this is CESR's proposal for the treatment of bonds, where the suggested change is more substantial. The change would narrow the range of bonds that could be treated automatically as non-complex instruments for the purposes of the appropriateness requirements and would mean that firms would need to assess other types of bonds against the Article 38 criteria in determining whether the appropriateness test needed to be carried out. However, CESR believes that any additional controls that firms may need to introduce are likely to be justified on client protection grounds. If a firm is contemplating transacting for a retail client on a non-advised basis involving bonds not admitted to trading on a regulated market (or equivalent), it seems reasonable that an assessment of the characteristics of the instrument and any inherent risks is undertaken. If an instrument then fails to satisfy the criteria for being treated as a non-complex instrument, because the market is not characterised by suitable levels of liquidity and transparency to provide prompt, objective benchmarks, it also seems correct that a firm should seek to determine whether the client has the knowledge/experience to understand the risks involved.

165. CESR believes that the same arguments are pertinent in the case of the impact of the proposed clarifications in respect of structured investment products, to the extent that firms may have interpreted MiFID differently. In the light of recent market events and regulatory findings[23], CESR does not believe that it is sustainable for all such instruments to be treated automatically as non-complex instruments when they are being transacted for retail clients on a non-advised basis.

Proposals for changes to the text of MiFID Article 19(6)

[23] For example, the published findings of the UK FSA in respect of sales of structured investment products backed by Lehman Brothers.

166. Taking into account the analysis and proposals explained in this Chapter, CESR suggests that Article 19(6) of MiFID could be updated along the lines of the following:

167. Member States shall allow investment firms when providing investment services that only consist of execution and/or the reception and transmission of client orders with or without ancillary services to provide those investment services to their clients without the need to obtain the information or make the determination provided for in paragraph 5 where all the following conditions are met:

(a) the above services relate to any of the following financial instruments:

(i) shares admitted to trading on a regulated market or on an equivalent third country market, where these are shares in companies, and excluding shares in non-UCITS collective investment undertakings and shares that embed a derivative;

(ii) bonds admitted to trading on a regulated market or on an equivalent third country market, excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved;

(iii) money market instruments or other forms of securitised debt, excluding those that embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved;

(iv) UCITS; or

(v) other non-complex financial instruments.

A third country market shall be considered as equivalent to a regulated market if it complies with equivalent requirements to those established under Title III. The Commission shall publish a list of those markets that are to be considered as equivalent. This list shall be updated periodically;

(b) the service is provided at the initiative of the client or potential client;

(c) the service is not provided in conjunction with ancillary service (2) as specified in Section B of Annex 1;

(d) the client or potential client has been clearly informed that in the provision of this service the investment firm is not required to assess the suitability or appropriateness of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules; this warning may be provided in a standardised format:

(e) the investment firm complies with its obligations under Article 18."

Questions:

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

5. Part 4: Definition of personal recommendation

Introduction and background

168. In July 2009, CESR commenced its consultation on the definition of advice, with the aim of clarifying the definition of 'investment advice' and providing illustrations of situations where firms are deemed, or not, to be providing investment advice. The Consultation Paper (Ref. CESR/09-665), asked the market participants to consider whether the current definition of 'investment advice' under Article 52 of the MiFID Level 2 Directive needs greater clarity.

169. Currently, Article 52 of the MiFID Level 2 Directive states where the recommendation is made available exclusively through a distribution channel or to the public, it can be considered as not constituting investment advice, therefore falling outside the scope of Article 4 (1) (4) of MiFID.

170. CESR is concerned that the current wording of Article 52 of the MiFID Level 2, with regards to the issuance by intermediaries of recommendations exclusively through distribution channels, no longer adequately protects clients against the growing number of intermediaries who now use distribution channels such as the internet and other similar means to provide personal recommendations. Therefore CESR seeks to clarify that the provision of personal recommendations exclusively through distribution channels amounts to investment advice as defined under Article 4(1)(4) of MiFID.

171. CESR has made clear in its Level 3 work on investment advice that a personal recommendation can be provided through means such as the internet or mailings, and therefore suggests, that the words 'through distribution channels or' are removed from Article 52 of the MiFID Level 2 Directive in order to clarify that investment advice can be provided through distribution channels.

Question:

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

6. Part 5: Supervision of tied agents and related issues

Introduction/background

172. Pursuant to Article 65 (3)(c) of MiFID, the EC shall, on the basis of public consultations and in the light of discussions with competent authorities, report to the European Parliament and Council on "the appropriateness of rules concerning the appointment of tied agents in performing investment services and/or activities, in particular with respect to the supervision on them".

173. Article 4(1) of MiFID defines tied agents in number 25. The regulatory framework governing the use of tied agents by investment firms, including specific organizational requirements for investment firms using tied agents, is spelled out in Article 23 of MiFID.

174. Overall CESR believes that the regime governing investment firms' use of tied agents has worked well since the implementation of MiFID. In particular, CESR does not believe that there is a need to change the rules governing tied agents' supervision and investment firms' oversight of their tied agents. This does not however, pre-empt any future work to provide guidance on how investment firms oversee tied agents through effective internal controls and other arrangements.

175. CESR's proposed advice to the EC is therefore confined to technical issues related to the operation of the regime in Article 23 of MiFID, including recommendations for greater harmonisation.

Issues under discussion

176. CESR's work on tied agents in the context of the MiFID review can be grouped under three main headings:

- Work on further harmonisation of the rules on the use of tied agents and on the reduction of differences resulting from the discretions in Article 23 of MiFID;
- work to enhance investor protection through enhanced transparency, resulting from CESR members' supervisory experience; and
- work on the passport regime for firms using tied agents (Articles 31 and 32 of MiFID).

Policy arguments/rationale

Work on further harmonisation of the rules on the use of tied agents and on the reduction of differences resulting from the discretions in Article 23 of MiFID.

177. Article 23(1) of MiFID permits Member States to allow investment firms authorised in their jurisdiction to appoint tied agents. The vast majority of Member States allow firms to use tied agents. CESR believes that this discretion should be transformed into a rule in order to ensure a level playing field across the EEA.

178. CESR believes the discretion can be removed because on the basis of their practical supervision of investment firms using tied agents, CESR members have found the potential risks that this distribution channel poses can be appropriately managed. This requires that investment firms employ robust procedures to ensure that tied agents comply with high standards of integrity as well as legal requirements and internal guidelines. Requiring all Member States to allow investment firms for which they are the home Member State to use tied agents would also enhance investor protection as there would be a public register for tied agents in each EEA country.

179. The second paragraph of Article 23(2) of MiFID enables Member States to allow tied agents to handle client money and/or financial instruments in particular circumstances. The majority of Member States prohibit tied agents from handling client money/financial instruments. Even though investment firms remain fully and unconditionally responsible for any action or omission on the part of tied agents used by them, the fact remains that tied agents are not themselves authorised persons. Indeed, some investment firms employing tied agents are not authorised to handle clients' money and financial instruments because they are not subject to the full provisions of the Capital Requirements Directive. Therefore CESR believes that all tied agents should be prohibited from handling clients' money and financial instruments.

Work to enhance investor protection through enhanced transparency

180. The current MiFID passporting provisions allow for but do not prescribe the transmission of the identity of tied agents from the home competent authority to the host competent authority. Therefore further room for increased transparency exists with regard to the passport for investment firms providing cross border services through tied agents (Article 31 of MiFID). The CESR Protocol on passport notifications[24] already contains a voluntary agreement between CESR members to share the identity of any tied agent that the firm is using in a Member State other than the home Member State of the investment firm. From an investor protection perspective, it is important that investors can check with their regulator whether the person/firm they are dealing with is truly a tied agent. Therefore, CESR believes that the home competent authority should be obliged to transmit the identity of any tied agents acting cross border to the host authority, which should then disclose this information to the public.

Work on the passport regime for firms using tied agents (Articles 31 and 32 of MiFID)

181. Article 32(2) subparagraph 2 of MiFID states that in cases where an investment firm uses a tied agent established in a Member State outside its home Member State, such tied agent shall be assimilated to the branch and shall be subject to the provisions of MiFID relating to branches. CESR proposes that it is clarified that all tied agents established in a Member State other than the investment firm's home Member State are treated as if they were part of a branch regardless of whether the firm operates another place of business alongside the tied agents. This is to facilitate convergence on passporting notifications and to facilitate a common interpretation of Article 32(2)(2) of MiFID, given that a small minority of competent authorities have reported legal problems in their jurisdictions with the current drafting of the aforementioned MiFID provision. Therefore all tied agents established in the host Member State should jointly be treated as one single branch.

182. For example, if a Belgian firm appoints a tied agent established in Germany and provides cross-border services in Austria using this tied agent, the firm will need to make a notification under Article 32 of MiFID to the BaFin and another one under Article 31 of MiFID to the FMA.

183. Finally, there are level-playing field issues between tied agents of investment firms and tied agents of credit institutions that CESR believes should be tackled by the EC. Tied agents acting on behalf of credit institutions are not subject to the notification procedures under Articles 31 or 32 of MiFID and the CRD does not contain specific provisions for the notification procedures to be followed by credit institutions providing investment services that use tied agents.

184. This situation weakens investor protection because investors and competent authorities do not necessarily have full access to details of all tied agents operating in their Member State. Therefore CESR believes that these inconsistencies should be ironed out by requiring that the same notification procedures apply to tied agents acting on behalf of credit institutions providing investment services, as those applying to tied agents of investment firms. Furthermore CESR believes that tied agents of credit institutions providing investment services should be prohibited from handling client money and financial instruments. This is for the same reasons given earlier

[24] http://www.cesr.eu/index.php?page=contenu_groups&id=53&docmore=1#doc

for prohibiting tied agents employed by investment firms from handling client money/financial instruments, and to ensure that all tied agents operate on the same basis.

Impact assessment

185. Allowing firms to use tied agents by amending Article 23(1) of MiFID would grant firms more flexibility in setting up an appropriate infrastructure for the distribution of their services and products. The increased flexibility in appointing and recalling tied agents would enable firms to respond more effectively to changing market conditions. In particular, the costs for exiting a market will be lower than when using own employees. Therefore, allowing tied agents could translate under favourable conditions into lower fixed costs for firms which should result in a better provision of investment services. The proposals would also result in all tied agents being registered in the Member State in which they are established, bringing along greater certainty and increased levels of investor protection in the EEA.

186. Prohibiting tied agents from handling client money will have an impact on certain business models. CESR is keen to receive feedback through the consultation on this point to ascertain what kind of firms would be materially impacted by this proposal and in which way.

Proposals

187. Based on the above explanations, CESR proposes the following amendments to MiFID (amendments are underlined):

Amendments to Article 23 of MiFID

1. 'Member States ~~may decide to~~ shall allow an investment firm to appoint tied agents for the purposes of promoting the services of the investment firm, soliciting business or receiving orders from clients or potential clients and transmitting them, placing financial instruments and providing advice in respect of such financial instruments and services offered by that investment firm.

2. Member States shall require that where an investment firm decides to appoint a tied agent it remains fully and unconditionally responsible for any action or omission on the part of the tied agent when acting on behalf of the firm. Member States shall require the investment firm to ensure that a tied agent discloses the capacity in which he is acting and the firm which he is representing when contacting or before dealing with any client or potential client. Member States shall prohibit tied agents registered in their territory from handling clients' money and financial instruments.

Member States may allow, in accordance with Article 13(6), (7) and (8), tied agents registered in their territory to handle clients' money and/or financial instruments on behalf and under the full responsibility of the investment firm for which they are acting within their territory or, in the case of a cross-border operation, in the territory of a Member State which allows a tied agent to handle clients' money.

Member States shall require the investment firms to monitor the activities of their tied agents so as to ensure that they continue to comply with this Directive when acting through tied agents.

3. ~~Member States that decide to allow investment firms to appoint tied agents shall establish a public register.~~ Tied agents shall be registered in the public register in the Member State where they are established. Member States shall establish a public register for tied agents established in their territory.

~~Where the Member State in which the tied agent is established has decided, in accordance with paragraph 1, not to allow the investment firms authorised by their competent authorities to appoint tied agents, those tied agents shall be registered with the competent authority of the home Member State of the investment firm on whose behalf it acts.~~

Member States shall ensure that tied agents are only admitted to the public register if it has been established that they are of sufficiently good repute and that they possess appropriate general, commercial and professional knowledge so as to be able to communicate accurately all relevant information regarding the proposed service to the client or potential client.

Member States may decide that investment firms can verify whether the tied agents which they have appointed are of sufficiently good repute and possess the knowledge as referred to in the third subparagraph.

The register shall be updated on a regular basis. It shall be publicly available for consultation.

[…]

Amendments to Article 31 and 32 of MiFID

Article 31 (2)
Any investment firm wishing to provide services or activities within the territory of another Member State for the first time, or which wishes to change the range of services or activities so provided, shall communicate the following information to the competent authorities of its home Member State:

(a) the Member State in which it intends to operate;

(b) a programme of operations stating in particular the investment services and/or activities as well as ancillary services which it intends to perform and whether it intends to use tied agents in the territory of the Member States in which it intends to provide services. In cases where it intends to use tied agents, the investment firm shall communicate to the competent authorities of its home Member State the identity of those tied agents.'

In cases where the investment firm intends to use tied agents, the competent authority of the home Member State of the investment firm shall, ~~at the request of the competent authority of the host Member State and within a reasonable time~~ within one month of receiving the information, communicate to the competent authority of the host Member State the identity of the tied agents that the investment firm intends to use to provide services in that Member State. The host Member State ~~may~~shall make public such information.

[…]

Article 32(2)

Member States shall require any investment firm wishing to establish a branch within the territory of another Member State first to notify the competent authority of its home Member State and to provide it with the following information:

(a) the Member States within the territory of which it plans to establish a branch;

(b) a programme of operations setting out inter alia the investment services and/or activities as well as the ancillary services to be offered and the organisational structure of the branch and indicating whether the branch intends to use tied agents and the identity of those tied agents;

(c) the address in the host Member State from which documents may be obtained; and

(d) the names of those responsible for the management of the branch.

In cases where an investment firm intends to use tied agents established in a Member State outside its home Member State, such tied agents shall be ~~assimilated to the branch and shall be~~ subject to the provisions of this Directive relating to branches.

[…]

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

7. Part 6: MiFID Options and Discretions

Introduction/background

188. MiFID and its implementing measures include 41 discretions, allowing Member States to implement non-harmonised requirements at a national level.

189. Although the use of discretions within MiFID is fully legitimate, the Ecofin Council conclusions of December 2007 aimed at reducing discretions and the Ecofin Council conclusions of May 2008 and June 2009 more generally intended to enhance European supervisory convergence.

190. Indeed, the Road Map on the revision of the Lamfalussy process set up by the Ecofin Council in December 2007 invited Member States to keep under review the options and discretions implemented in their national legislation and limit their use wherever possible. In a similar way, the Communication of the European Commission of the 4th of March 2009 took on board the recommendations of the de Larosière Group on the need to develop a harmonised core set of standards to be applied throughout the European Union and the Ecofin recalled in its meeting held on 9th of June 2009 the following goal: "Moving towards the realisation of a single rulebook, with a core set of EU-wide rules and standards directly applicable to all financial institutions active in the Single Market, so that key differences in national legislations are identified and removed."

191. Therefore, based on the work conducted by CESR since 2007[25], options and discretions in relation to the MiFID and its implementing measures are considered in this section, with the aim to single out some possible areas for further convergence in light of the upcoming MiFID review, in relation of those options and discretions falling into the mandate of CESR's intermediaries area and for which it is appropriate at this stage to give an input to the European Commission.

Possible deletion of discretions

192. Articles 5(5), 16(3) and 17(2) of MiFID - Delegation of supervisory tasks

193. Article 5(5) of MiFID provides that Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the granting of an authorisation, in the case of investment firms which wish to provide only investment advice or the service of reception and transmission of orders under the conditions established in Article 3 MiFID.

194. Article 16(3) of MiFID provides that Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the review of the conditions for initial authorisation in the case of investment firms which provide only investment advice.

195. Article 17(2) of MiFID provides that Member States may allow the competent authority to delegate administrative, preparatory or ancillary tasks related to the regular monitoring of operational requirements in the case of investment firms which provide only investment advice.

[25] In October 2007, before MiFID came into force, CESR published an "Overview of National Options and Discretions under MIFID level 1" (CESR/ 07-703), which showed if and how Members States have exercised discretions in implementing MIFID and in 2008 and 2009, the Review Panel conducted two mappings on MIFID, one focusing on "Supervisory powers, supervisory practices, and administrative and criminal sanction regimes" (CESR 08-220) where some additional requirements were included, and another specifically focusing on the extent to which Member States introduced discretions, additional requirements and/or more stringent rules in their national legislation ("Report on the mapping of discretions in MiFID", CESR 09-833).

196. These discretions have not been exercised by any Member State.

197. Theoretically, the ability to delegate the above mentioned supervisory tasks may result in a more efficient allocation of the necessary human and economic resources. Nevertheless, CESR members do not see any need in maintaining such ability, because these tasks can be effectively undertaken using internal resources. Moreover, in case of delegation, CESR members face liability issues whenever the entity to which these tasks have been delegated would fail to comply with these tasks.

198. Given that no competent authority has made use of the above mentioned discretions the impact of deleting them will be negligible.

199. In light of the afore mentioned situation, CESR proposes to delete from the MiFID the following provisions:

- Article 5(5);
- Article 16(3);
- Article 17(2),

200. Therefore to exclude the possibility for Member States to allow the competent authority to delegate such administrative, preparatory or ancillary tasks.

Possible transformation of discretions into a rule

- Article 23(1) of MiFID: Discretion for Member States to allow investment firms to appoint tied agents for certain purposes
- Article 23(2) of MiFID: Discretion for Member States to allow tied agents to handle client money
- Article 31(2) of MiFID: Discretion for the host competent authority to publish information on the identity of tied agents

201. Please see Part 4 of this Consultation Paper.

- Article 51(4) of Commission Directive 2006/73/EC – Discretion for Member States to impose obligations on tape recording – Article 13(6) MiFID

202. Please see Part 1 of this Consultation Paper.

Article 61 (1) and (2) of MiFID: Reports from branches

203. Article 61(1) and (2) of MiFID provides that Member States may:

- for statistical purposes, require all investment firms with branches within their territories to report to them periodically on the activities of those branches (par. 1);
- require branches of investment firms to provide the information necessary for the monitoring of their compliance with the standards set by the host Member State that apply to them (par. 2).

204. The majority of the Member States -14 for Article 61(1) of MiFID and 24 Members for Article 61(2) of MiFID have opted to exercise these discretions in order to increase information received from branches.

205. CESR is considering whether to propose an amendment of the MiFID text in order to transform such discretions into a rule, requiring all Member States to allow competent authorities to have the power to require certain information from all investment firms with branches within their territories, for statistical and supervisory purposes.

206. Indeed, it might be crucial for competent authorities to have the power to require information from branches in order to have a complete series of data of investment activities performed in their Member State on the one hand for statistical purposes under Article 61 (1) of MiFID and, on the other hand, to effectively discharge their duties when monitoring the branches' compliance with the applicable rules, for supervisory purposes under Article 61 (2) of MiFID.

207. In particular, it is important for competent authorities to have the ability to gather information on the activities performed by investment firms within their territory, irrespective of their status as a branch or an established home Member State firm, in order to have a wider perception of the market as a whole as well as to promote market integrity and improve investor protection.

208. Nevertheless, given the different supervisory approaches to this information within the EEA, it is considered more proportionate not to impose on competent authorities to gather (and make use of) the above mentioned information from branches established within their territory.

209. There is no significant impact arising from the proposed amendment.

210. In light of the above considerations, CESR proposes to change Article 61 of MiFID as follows, to grant to competent authorities the power to require from branches the information necessary for statistical and supervisory purposes (provisions which are not reproduced remain unchanged whilst amendments are underlined):

> 1. Host Member States <u>shall provide that the competent authority may</u>, for statistical purposes, require all investment firms with branches within their territories to report to them periodically on the activities of those branches.
>
> 2. In discharging their responsibilities under this Directive, host Member States <u>shall provide that the competent authority may</u> require branches of investment firms to provide the information necessary for the monitoring of their compliance with the standards set by the host Member State that apply to them for the cases provided for in Article 32(7). Those requirements may not be more stringent than those which the same Member State imposes on established firms for the monitoring of their compliance with the same standards.

Questions:

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

Annex 1 – Consultation Questions:

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

1. **Do you agree with CESR that the EEA should have a recording requirement? If not, please explain your reasoning.**
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.**
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?**
4. **If you do not believe that a recording requirement should apply to any of these categories of conversation/communication please explain your reasoning.**
5. **Do you agree that firms should be restricted to engaging in conversations and communication that fall to be recorded on equipment provided to employees by the firm?**
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.**
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.**
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.**
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.**
10. **In your view, what are the benefits of a recording requirement?**
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[26].**
12. **What impact does the length of the retention period have on costs? Please provide quantitative estimates where possible.**

[26] It would be helpful if quantitative responses to this question could be based on retaining records for five years and in the following tabular form:

Costs per user (in €)	One-off installation costs	Ongoing annual costs
- Fixed line telephones		
- mobile phones		
- electronic communications		

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

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?**
14. **How frequently do investment firms need data on execution quality: monthly, quarterly, annually?**
15. **Do you believe that investment firms have adequate information on which to make decisions about venue selection for shares?**
16. **Do you believe investment firms have adequate information on which to make decisions about venue selection for classes of financial instruments other than shares?**
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?**
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?**
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.**
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?**

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

21. **Do you have any comments about CESR's analysis and proposals as set out in this Chapter?**
22. **Do you have any comments on the proposal from some members that ESMA should work towards the production of binding Level 3 material to distinguish which UCITS should be complex for the purpose of the appropriateness test?**
23. **What impact do you think CESR's proposals for change would have on your firm and its activities? Can you indicate the scale of, or quantify, any impact you identify?**

Part 4: Definition of personal recommendation:

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

Part 5: Supervision of tied agents and related issues:

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

Part 6: MiFID Options and Discretions:

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

Annex 2 – Legislative or supervisory recording requirements in EEA member states27

Country	Scope of requirement	Mobile phones?	Duration
Austria	There are no legal or supervisory regulations which oblige the taping of telephone conversations. Although concerning treasury units of credit institutions it is usual that telephone conversations between the salesperson and the client are taped. In relation to the Vienna stock exchange there are no legal regulations which oblige the taping of telephone conversations, but it is usual to tape telephone calls related to the execution of orders.		
Belgium	No requirement.		
Bulgaria	No requirement.		
Czech Republic	All investment firms are obliged by the regulatory authority's rules to keep records of any communications with clients related to investment activity.	If the firm chooses to communicate with clients by mobile phones, it has to record such calls as well.	Ten years.
Cyprus	All Investment Firms are obliged by the Law to keep records for all the investment services and transactions undertaken. It is up to each Investment Firm to decide the type of record. In practice, if an order/advice is given by the telephone then it is recorded. Prior warning of the recording must be given.	If an order/advice is given through mobile phones, the Investment Firm should record it otherwise will not have other evidence to show its compliance with the relevant obligation.	At least five years.
Denmark	No requirement.		

[27] In some countries without legislative or supervisory recording requirements, investment firms are required to keep tapes under the rules of regulated markets. For example, The Irish stock exchange requires member firms to operate an effective telephone recording system in relation to any trading activities it undertakes on the exchange. Records must be kept for at least one month after the normal settlement period of the transaction to which they relate.

Country	Scope of requirement	Mobile phones?	Duration
Estonia	There is no direct requirement in place that would oblige the service provider to tape-record the telephone conversations with a client. Although, a requirement applies according to which the service provider must keep records *inter alia* of the communication between the client and the service provider and retain such records. The records must be retained in a durable medium in a way accessible for future reference by the Supervision Authority and in such a form and manner that the following conditions are met: 1) the Supervision Authority must be able to access the records readily and to reconstitute each key stage of the processing of each transaction; 2) it must be possible for the Supervision Authority to ascertain easily any amendments, and the contents of the records prior to such amendments; 3) it must not be possible for the records to be altered otherwise. In practice, many service providers are using tape recording to best fulfill the latter conditions.	Where firms use tape recording, mobile phones are usually not allowed if not equally taped as the office phones.	Firms keeping records *inter alia* of the communication between the client and the service provider, retain such records for 5 years.
France	Under the current AMF general regulation taping of phone lines within an investment service provider is required for traders (persons subject to approval by the firm according to a procedure defined by the AMF who is informed of all such approvals) and, where so decided by the head of compliance (because of the size or riskiness of the trades involved), additional staff participating in the commercial relationship with clients. In the Euronext market rules, there is a requirement for cash market members to voice record conversations relating to any transaction made, or intended to be made, on the securities market. With respect to the Euronext derivatives market, whether there is such a requirement depends on the market. On MONEP and MATIF,	Special authorisation by the firm is required for a trader to be able to conclude trades outside business hours or outside the firm's premises (which would involve using an untaped phone). Requirement applies to conversations regardless of the kind of telecoms equipment used if on the member's premises.	At least six months. Six months Six months

Country	Scope of requirement	Mobile phones?	Duration
	there is a requirement to have adequate procedures for recording telephone conversations pertaining to the reception, execution or confirmation of orders on a medium that allows subsequent verbatim reproduction of such conversations.		
Finland	All investment firms are required to keep records of client orders in financial instruments	Requirement applies regardless of telecom equipment used	Two years and maximum as long as there is a need for ensuring the execution of rights and obligations relating to the order
Germany	Credit institutions and financial services institutions are recommended by BaFin circular to tape traders' telephone conversations relating to transactions for the entity's own account. In addition, each Exchange has rules which apply to specialists operating on them, who will usually also be subject to a similar requirement. E.G., the Frankfurt Exchange requires specialists to tape every call which is related to the execution of their tasks as a specialist.	According to BaFin circular, the use of mobile phones is only exceptionally permitted if firms have implemented adequate organisational measures to minimise the risk resulting from the use of mobile phones. In practice, As far as recording of mobile phone calls in most cases cannot be ensured, most firms prohibit traders to trade via mobile phones. Mobile phone use is not allowed within the exchanges so calls must be made by land line.	Three months Three months
Greece	Since 2005 any person professionally arranging transactions in financial instruments is obliged to record telephone orders to trade. The caller must be notified, at the beginning of the call, that the	Receiving orders on a mobile phone is not allowed if this will not be recorded by the internal system of the investment	Recordings must be kept for at least one year, but the HCMC may order investment firms to retain the data for an additional period, up to two

Country	Scope of requirement	Mobile phones?	Duration
	conversation is being recorded, and, client contracts must include a specific term that provides that orders transmitted via telephone will be recorded and filed and put at the disposal of the HCMC, upon request.	firm.	years, when an investigation into market abuse is carried out.
Hungary	Pursuant to the regulations of Government Decree No. 22/2008 on the Business Rules of Investment Firm if an investment firm accepts orders from clients via telephone, fax or other electronic method the business rules of such firm shall provide for the detailed provisions: a) on the procedure for accepting such orders (voice recording or written recording by the person accepting the order)and preparation of a written contract, timeframe for preparing the contract in writing; b) on the retention period for voice recording. If the order is recorded the business rules shall regulate access rights to such recordings. Pursuant to consumer protection provisions effective as of January 1, 2010 investment firms shall provide for receiving complaints from clients via telephone. Such conversations shall be recoded and retained for a period of 1 year.		1 year
Italy	Intermediaries, including fund management companies, are required to tape all orders received from any customer.	The regulation applies regardless of the type of phone used.	Five years
Ireland	No requirement		
Latvia	Rules approved by the FCMC require that all telephone conversations where clients place orders shall be recorded. (This comes from the provision that investment firms should have in place evidence that orders are given by clients)	The regulation applies regardless of the type of phone used.	At least 10 years

Country	Scope of requirement	Mobile phones?	Duration
Lithuania	Rules approved by the Securities Commission require recording of telephone conversations in which a customer order is placed. The Rules apply to all companies providing investment and /or auxiliary services and carrying out investment activities that accept customer orders.	Not known.	At least 10 years (the general term of limitation of actions).
Luxembourg	No requirement.		
Malta	No requirement.		
Netherlands	No requirement.		
Norway	All brokers are required to tape record all buy/sell orders and indications of such orders made by telephone.	The regulation applies regardless of the type of phone used.	All recorded material has to be retained for three years from the day the recording was made.
Poland	Firms are required to tape orders received by telephone	The regulation applies regardless of the type of phone used.	All tapes have to be retained for five years.
Portugal	According to Portuguese law, telephone orders between a client and a financial intermediary have to be taped (Article 307.º-B PSC-Portuguese securities Code).	The regulation applies regardless of the type of phone on which the order is received.	All tapes have to be retained for five years.
Romania	Financial intermediaries are obliged to record on magnetic tape or by other similar means the transmissions of clients' orders and disclosure of information regarding conflicts of interest to the client. All clients must give written consent to telephone orders being recorded; where consent is not given then telephone orders cannot be accepted.	The requirement does not specify the type of phone and therefore applies to both landline and mobiles.	At least 5 years.
Slovakia	Not known		
Slovenia	Not known		
Spain	Entities providing investment services must tape record any telephone conversation in which an	The requirement does not specify the type of phone	Telephone recordings must be kept for a minimum of five

Country	Scope of requirement	Mobile phones?	Duration
	order is made. Prior warning of the taping must be given to the relevant client, which can be done in the contract which allows for orders to be made over the telephone.	and therefore applies to both landline and mobiles.	years. Whenever the transaction is disputed by the client, the recording must be kept until the relevant dispute is solved.
Sweden	All telephone conversation at the broker desk at an investment firm should be recorded. This also apply to conversations which relate to client orders on other telephones in premises with access to the trading system of a regulated market or an MTF, or premises which have been specifically adapted for financial instruments trading. The requirements apply to investment firms authorized by Finansinspektionen, not EEA-branches in Sweden.	Mobile phones used in the business should be owned by the investment firm/bank. Client orders received by mobile phone or in a meeting with the client, and therefore not recorded, should be documented according to the entity's guidelines.	At least five years.
UK	Conversations and electronic communications covering the receipt of client orders and dealing in financial instruments within the scope of the UK's market abuse regime. There is an exemption for portfolio managers.	The FSA will consult in March 2010 on removing an exemption for conversations on mobile phones.	Six months. The FSA can request a firm to hold records for longer.