

International Swaps and Derivatives Association  
International Securities Market Association  
International Primary Market Association  
Association Française des Entreprises d'Investissement  
Association of Norwegian Stockbroking Companies  
Bankers and Securities Dealers Association of Iceland  
The Bond Market Association  
Danish Securities Dealers Association  
Finnish Association of Securities Dealers  
Futures and Options Association  
London Investment Banking Association  
Swedish Securities Dealers Association

### **Directive on Markets in Financial Instruments**

#### **CESR call for opinions on professional client agreements**

The Associations listed above (the "Associations") welcome the opportunity to respond to the call for opinions by the Committee of European Securities Regulators ("CESR") on its draft technical advice on possible implementing measures of the Directive 2004/39/EC on Markets in Financial Instruments ("MFID") regarding professional client agreements (ref.: CESR/04-689, December 2004).

The Associations believe that there is no need to regulate how investment firms contract with their professional clients or to prescribe detailed rules as to the contents of their contracts. Professional clients are presumed to be capable of making their own investment decisions and understanding the risks involved. It would be over-prescriptive and unjustified for regulators to seek to impose their own views as to what is appropriate on a professional client relationship. In addition, imposing requirements of this kind is likely to exacerbate the transitional issues relating to the implementation of MFID, particularly if firms are required to meet new standards with respect to existing relationships with their professional clients.

In any event, Article 19.7 of MFID does not require an investment firm to keep a record which sets out the rights and obligations of the parties. Nor does it seek to prescribe what those rights and obligations should be. It merely requires that the firm establishes a record which includes the document or documents agreed between the firm and its client, if they exist, and the other terms on which the firm will provide services. Thus the Level 1 text does not provide a basis for the Commission to regulate how firms contract with their professional clients.

Therefore, the Associations consider that CESR should advise the Commission to make clear in its implementing measures that article 19(7) MFID merely requires firms to establish a record including the document or documents (if any) agreed with the professional client. Otherwise, there is a risk (as CESR points out) that Member States may read and apply the level 1 text in different ways. The Associations consider that CESR should make clear that the question of whether there is a client agreement should be a matter for commercial practice. CESR should, at level 3, seek to minimise the imposition of super-equivalent national requirements. Thus, we do not agree with the options set out in CESR's call for opinions.

In particular:

1. Investment firms must address the critical business needs of professional clients promptly, whether the client is seeking the execution of transactions or the provision of services such as investment advice. Any requirement for a prior written agreement could seriously frustrate the intentions of those clients, and the ability of EU-based firms to act in their best interests.

- (a) In inter-professional business it may not be necessary, as a commercial matter, for every transaction to take place pursuant to a prior written agreement. There are many different types of services which firms may provide to their professional clients, including one off or individualised transactions which might need to be executed on short notice and for which no written agreement is required. In other cases, it may be sufficient for detailed documentation to follow after the oral agreement of a transaction. Requiring a written agreement (and especially a prior written agreement) in all cases would be disproportionate and unduly burdensome and costly and would disrupt normal commercial business. The parties should be the judge of their own best interests. Indeed, firms typically devote significant resources to putting in place written documentation with clients in cases where this is significant to the firm.

- (b) If there is a requirement for a written agreement, this will inevitably involve some restrictions as to timing. With respect to retail agreements, CESR is proposing to prevent firms providing services to their retail clients unless they have provided the written terms in good time beforehand (subject only to limited derogations). It would be inappropriate to impose such restrictions on a professional client relationship and it could interfere with legitimate business. In particular, it would be wholly inappropriate to impose a requirement for an investment firm to provide written terms prior to providing any investment advice, especially where there is no specific charge for the advice. This would limit professional clients' access to services. In many cases, advice is provided informally and without charge, for example as part of the development of a possible transaction or relationship before the client decides whether or not to proceed with a transaction or to establish a relationship. In corporate finance situations, it may be necessary to provide advice in advance of obtaining a

formal mandate or there may be an overall written agreement with one party but advice is provided which is used by other group companies of the client.

2. Nor do we consider that it is necessary or appropriate to impose requirements for written agreements with respect to any particular type of service, such as portfolio management or investment advice. It is unclear what market failure would justify regulatory intervention of this kind. CESR does not put forward any evidence that professional clients routinely are deprived of the opportunity to enter into written agreements. In relation to portfolio management, in most cases, it will be in both the firm's and the client's interests to have a written agreement, although there may be cases where firms are given investment discretion on a short term basis where it would not be necessary. In relation to investment advice, the position is much more complex. Even if CESR proposes a relatively narrow definition of investment advice, it is likely that many relationships will involve some specific or transaction related advice (albeit not separately charged for) so that a requirement for a written agreement would, in effect, amount to an across-the-board requirement for a written agreement for all services.
3. Furthermore, it would be inappropriate to impose restrictions as to the method by which a professional client must consent to any written terms. With respect to retail agreements, CESR is proposing to require signature or an equivalent alternative mechanism. However, many professional client relationships are documented by reference to terms of business which are sent to the professional client and are accepted by conduct or by reference to general terms of business without a requirement for a signature or equivalent action by the client. Implementing a requirement for signatures or equivalent action would clearly involve costs, without any clearly defined offsetting benefits.
4. The Associations do not believe that it would be appropriate to prescribe the content of inter-professional agreements which will be the subject, in many cases, of detailed negotiations between parties who are presumed to be capable of looking after their own interests. There is no evidence of market failure which suggests that this might be necessary. To the contrary, there is strong evidence that market participants give a high priority to ensuring appropriate documentation for their transactions, as evidenced by the many market standard forms prepared by industry associations, such as the International Swaps and Derivatives Association, the International Primary Market Association, the International Securities Market Association, The Bond Market Association and the Futures and Options Association.
5. The Associations would also point out the potentially significant costs if new requirements were imposed with respect to existing client relationships. Firms would be required to review all existing interprofessional relationships to determine whether existing documentation meets whatever standards were being proposed. Where there are gaps, they would have to contact their clients and, if the clients failed or refused to

respond positively to the request by the deadline for implementation, cease transacting business or providing services to the client (which might require termination of existing ongoing services). It is wholly unclear how this process would benefit customers and clearly, for a firm with many clients, it could be very costly to the firm. Furthermore, changes to documentation would impose costs on clients. For example, professional clients often use the services of law firms to review changes to documentation. Some professional clients may turn to non-EU institutions for service, rather than incur costs or accept less prompt service from EU-based investment firms.

6. Annex II already provides protection to smaller undertakings and others who are to be classified as professional clients on request under Section II of that Annex. Firms must give those clients a clear written warning of the protections they would otherwise have as a retail client and must obtain their written consent to the loss of protection. There is no need for any further documentary requirements.

In summary, in response to CESR's specific questions:

*Q1 Should a written client agreement be necessary for professional clients of an investment firm?*

A. The nature of the agreement between a firm and a professional client should be agreed between the parties. It might be in writing (including electronic form), but might take other forms, as explained above. The nature of the agreement should not be subject to regulation, and there should be no requirement for a written agreement.

*Q2 If so, should the agreement be limited to certain investment services (portfolio management and investment advice) or should it be requested for other investment and ancillary services?*

A. Not applicable.

*Q3 If such a requirement is introduced, do you think that this would create additional costs? Please provide details of the nature and likely amount of these costs.*

A. Yes. See above.

*Q4 If you consider that no such requirements should be introduced, please specify the reasons why.*

A. We do not consider that any such requirements should be introduced for the reasons set out above.

18<sup>th</sup> February 2005