European Financial
Markets Lawyers Group

- THE VICE-CHAIRMAN -

European Commission
Mr. Jonathan Faull
Director General of DG Internal Market and Services
European Commission
1049 Brussels
Belgium

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Dear Sirs,

**EFMLG proposal on investment advice and legal certainty**

The European Financial Markets Lawyers Group (EFMLG) is a group of senior legal experts in the field of wholesale, corporate and investment banking, who have their professional careers in the major credit institutions of the EU, and meet regularly to review and discuss issues that have an impact on EU financial market integration. Among its tasks, the EFMLG monitors and discusses from a legal perspective any changes and prospective changes in the legislative framework and its application affecting the business of such credit institutions. You may wish to read more about the EFMLG in its website: www.efmlg.org.

We believe that MiFID, the Markets in Financial Instruments Directive, and its Level 2 legislation has improved investor protection all around the European Union, creating a level playing field in numerous aspects thus facilitating market integration. Nevertheless, MiFID presents a number of unclear legal requirements that have hitherto created significant insecurity among providers and users of investment services. This situation undermines legal certainty, which is the cornerstone of any modern and reputable legal system.

To a great degree, the various follow-up documents issued as clarificatory guidelines relating to the application of the Directive bear witness to the lack of clarity referred to above. One of these documents is CESR's *Q&A Understanding the definition of advice under MiFID* (the **"Q&A"**). These kinds of guidelines present the risk of going beyond what ought to be the norm at Level 3 of the Lamfalussy Process[1]. As a result, unless CESR's guidelines are limited to the convergence of supervisory practices rather that sanctioning interpretations which are both wide in scope and highly debatable, the result will most likely be an increased degree of legal

[1] Recital (12) of Directive 2006/73/EC clearly prescribes that the body competent to interpret MiFID is the Commission

uncertainty, worsening the current situation. At this point in time– (two years after the entry into force of MiFID), it would appear to be too late to issue interpretative documents like the Q&A, which goes beyond the plain meaning of MiFID and the interpretative criteria of the European Commission known so far.

By and large, the Q&A has have failed to eradicate the existing pockets of legal uncertainty as to the scope and limits of what constitutes investment advisory. In parts, it has even deepened the problem with the introduction of novelty concepts such as that of a "reasonable observer", which, whilst familiar to English lawyers only, it is alien to other European laws, to which the solution of the investment advisory conundrum seems to lie in a fuzzy, undefined concept, without tradition or meaning in Civil Law.

Two main topics would require the attention of the Commission, now that MiFID is being under review: first, the need for bringing legal certainty as to the specific service that both parties want to agree on; and second, the requirement to differentiate the requisites applicable to investment advice in respect of the type of client receiving the service.

## 1. Legal certainty as to the investment service provided

We first claim for legal certainty as a need to marry the financial entities' legitimate right and expectation to choose the kind of financial service they wish to provide, with the investors' right to receive an adequate protection of their rights, in a legal framework that provides certainty to both. The way in which these two very legitimate sets of interests may be reconciled is through transparency and the freewill of the parties involved.

If both, provider and receiver of the investment service are at all times aware of the kind of service provided and the risks and consequences associated with it and, on that basis, agree to go ahead with it, nobody will be able to claim that the provider is defenceless as it has no legal certainty about the service it is to provide, or that the receiver is unprotected, if the latter is fully aware of the implications and consequences that the service received carries. The receiver will not be entitled to claim that it expected to receive a service other than that agreed on and the provider will not be entitled to breach the legal requirements in respect thereof, alleging lack of clarity in the norm.

This is not to say that there should be a blanket acceptance of some stereotyped liability exclusion formulae, often applied almost mechanically by financial entities in their documentation regardless of the circumstances. It is a matter of not leaving these entities left to the unfathomable judgment of an imaginary "reasonable observer" in case they are faced with the claim of an unhappy investor alleging that it received a service different to that agreed.

In order to bolster legal certainty in respect of the requirements the investment service must meet, the matter must be dealt with at the institutional level, whether through guidance from the

Commission, or perhaps in a future MiFID revision. In that regard, we in EFMLG would like to put forward the following suggestions to the Commission:

(i) To set out the boundaries of what constitutes "investment advice", and to differentiate it from other investment services, such as non-personal recommendations or recommendations not presented as suitable[2]), and from other non-investment related services, such as marketing, We suggest that a rule be laid down, pursuant to which the parties should be free to expressly agree that investment advice shall not be provided in respect of a financial instrument, as long as:

- Such agreement between the parties is express and unequivocal, and is properly documented in the pre-contractual and contractual stages of the investment.
- The pre-contractual and contractual documentation referred to in the previous paragraph reflects the implications and consequences of the agreement not to provide investment advice services (i.e., that the financial entity takes into consideration neither the investment objectives, nor the financial situation of the investor (although these may be known to it at the time) and, as a result, the financial product being negotiated may not be suitable for the investor).

(ii) As for the potential confusion between "investment advice" (Directive 2004/39/EC, Annex I, Section A(5)) and the ancillary service of "advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings" (Directive 2004/39/EC, Annex I, Section B(3)), we suggest setting out a similar rule to that in paragraph (i) above, so that there is acknowledgement that a corporate finance service is being provided as long as:

- Such agreement between the parties is express and unequivocal, and is properly documented in the pre-contractual and contractual stages of the investment.
- The pre-contractual and contractual documentation referred to in the previous paragraph reflects the implications and consequences of such agreement.

Therefore, EFMLG encourages the Commission to pronounce itself in this regard, in order that legal certainty may be guaranteed in respect of the parties' right to freely decide on the kind of services they wish to provide and receive, as well as the right to do so in writing and the right to abide by what they have so agreed.

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2 This consists of giving recommendations of the kind subject to Article 1.3 of Directive 2003/125/EC,[2] which do not satisfy the conditions of Article 24.1 of Directive 2006/73/EC[2] and which MiFID terms "marketing communications".

**2. Different treatment for different investors.**

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

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

As MIFID is currently drafted, certain regulators see the "investment advice" service in a monolithic way, whatever the nature, the capacity and the sophistication of the client.

As a consequence, investment service providers are obliged to formalise a "suitability test" (which implies the sending of a questionnaire) even when they deal in "plain vanilla" products with professional clients, and sometimes in certain countries (as France) with eligible counterparties, which is totally inappropriate. The counterparties themselves do not expect the ISP to provide them with investment advice and are, most of the time, reluctant to communicate their investment objectives and their strategies (in particular in the domain of cash equity and flow derivatives).

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

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

Yours sincerely,

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Hubert de Vauplane

Vice-Chairman