



- THE CHAIR -

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Mr Jonathan Faul
Director General
DG Internal Market and Services
European Commission

Mr Martin Merlin
Director
Directorate Financial Markets
DG Internal Market and Services
European Commission

Mr Mario Nava
Director
Directorate Financial Institutions
DG Internal Market and Services
European Commission

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Dear Sirs,

LEVEL PLAYING FIELD

As you may know, the European Financial Markets Lawyers Group is a group of senior legal experts from the EU banking sector dedicated to making analysis and undertaking initiatives intended to foster the harmonisation of laws and market practices and facilitate the integration of financial markets in Europe. The Groups is hosted by the European Central Bank¹.

This letter aims to make you aware of the existing unlevel playing field created as a result of uncoordinated local developments of existing or future European legislation and to kindly request the authorities and, more specifically, the European Commission (the "EC") to adopt measures to protect the single market at EU level and make a call to take care of this important topic.

¹ More information about the EFMLG and its activities is available on its website at www.efmlg.org.

1. A LEVEL PLAYING FIELD OF INVESTOR PROTECTION RULES

Maintaining a level playing field and harmonized set of organizational requirements and operating conditions for all investment firms across the EU has always been one of the main objectives of the whole EU legal framework, and specifically, in the investor protection field.

This objective is more important than ever now that the EC has launched the Capital Markets Union initiative, recognizing the need to overcome the barriers that are fragmenting markets in the EU and to enforce the principle of free movement of capital, for which requirements imposed at national level could constitute an unjustified barrier.

1.1. The MiFID package

With the abovementioned aim, Directive 2006/73/EC² (“MiFID L2”) stated that Member States (“MS”) and national competent authorities (“NCAs”) should not add supplemental binding rules when transposing and applying it, save in exceptional circumstances.

These exceptional circumstances were expressly prescribed in Article 4 of MiFID L2, which defined the procedure to be followed when a MS wished to retain or impose additional requirements to the rules relating to investor protection in the Directive. This possibility was restricted to those exceptional cases where additional requirements were objectively and proportionately justified in order to address specific risks to investor protection or to market integrity that were not adequately addressed by MiFID L2. Additionally, it was required that any MS willing to impose such additional requirements had to notify the EC at least one month before the date appointed for that requirement to come into force, including a justification for that requirement. The EC, in turn, was required to communicate to all MS and make public on its website the notifications received in accordance with Article 4 of MiFID L2.

This regime has been recently re-inforced in an even stricter way by Article 24.12 of Directive 2014/65/EU³ (“MiFID 2”):

“Member States may, in exceptional cases, impose additional requirements on investment firms in respect of the matters covered by this Article. Such requirements must be objectively justified and proportionate so as to address specific risks to investor protection or to market integrity which are of particular importance in the circumstances of the market structure of that Member State.

Member States shall notify the Commission of any requirement which they intend to impose in accordance with this paragraph without undue delay and at least two months before the date appointed for that requirement to come into force. The notification shall include a justification for that requirement. Any such additional requirements shall not restrict or otherwise affect the rights of investment firms under Articles 34 and 35 of this Directive.

² Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ L 241, 2.9.2006, p. 26–58.

³ Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ L 173, 12.6.2014, p. 349–496.

The Commission shall within two months from the notification referred to in the second subparagraph provide its opinion on the proportionality of and justification for the additional requirements.

The Commission shall communicate to Member States and make public on its website the additional requirements imposed in accordance with this paragraph.

Member States may retain additional requirements that were notified to the Commission in accordance with Article 4 of Directive 2006/73/EC before 2 July 2014 provided that the conditions laid down in that Article are met.”

1.2. Regulation (EU) 1286/2014⁴ (the “PRIIPs Regulation”)

The concern that “*differences in national regulation in this area [disclosures to be made in packaged retail and insurance-based investment products] create an unlevel playing field between different products and distribution channels, erecting additional barriers to an internal market in financial services and products*” has also been referred to very recently in Recital 3 in the PRIIPS Regulation, which adds:

“Member States have already taken divergent and uncoordinated action to address shortcomings in investor protection measures and it is likely that this development would continue. Divergent approaches to disclosures relating to PRIIPs impede the development of a level playing field between different PRIIP manufacturers and those advising on, or selling, these products, and thus distort competition and lead to unequal levels of investor protection within the Union. Such divergence represents an obstacle to the establishment and smooth functioning of the internal market.”

Recital 4 of the PRIIPs Regulation expressed the main objective of the Regulation, in terms of preserving the EU level playing field:

“To prevent divergence, it is necessary to establish uniform rules on transparency at Union level which will apply to all participants in the PRIIPs market and thereby enhance investor protection. A regulation is necessary to ensure that a common standard for key information documents is established in a uniform fashion so as to be able to harmonize the format and the content of those documents. The directly applicable rules of a regulation should ensure that all those advising on, or selling, PRIIPs are subject to uniform requirements in relation to the provision of the key information document to retail investors.”

It can be concluded that preservation and protection of the level playing field has been and continues to be a great concern in the application of investor protection rules, particularly, in relation to the information to be provided to retail investors. This concern has motivated both the limitations established in Article 24.12 of MIFID 2 and the publication of the PRIIPs Regulation.

1.3. The Capital Markets Union initiative

Furthermore, the recently published Green Paper “*Building a Capital Markets Union*” by the EC affirms that, among others, a Capital Markets Union should be based on key principles such as the creation of “a

⁴ Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products (PRIIPs), OJ L 352, 9.12.2014, p. 1–23.

*single market for capital for all 28 Member States by removing barriers to cross-border investment within the EU and fostering stronger connections with global capital markets*⁵.

The objectives of the Capital Markets Union can only be achieved if harmonization is fostered at all levels in the EU and the possibility for local development and gold-plating of EU rules is strictly controlled and restricted. Both conditions are also applicable, to the fullest extent, to investor protection rules and, for this purpose, it is necessary that the European regulatory bodies make use of all the tools at their disposal. The more fragmented these rules are at national level, the further away the Capital Markets Union will be.

2. THE STATE OF PLAY IN EUROPE

However, it seems that many MS, moved by the objective to protect their national retail investors, have been adopting, during these intervening years, a host of new laws and regulations and publishing policy papers and guidance, many of which have not even been notified to the EC as per the requirements in MiFID L2.

Below is a list of such cases of MS 'gold plating' which provide evidence of the increasing legal uncertainty and unlevel playing field created as a consequence of this additional regulatory drive at national level.

2.1. The Risk Label requirements for financial products.

Legislation requiring investment firms to provide its retail clients and potential retail clients with a type of uniform label indicating the risk level of each particular product has been introduced in some MS in these last years⁶:

- (i) Denmark issued on 15 April 2011 an "Executive Order on Riks-Labeling of Investment Products", breaking down the types of investment product into three labeling categories: green, yellow and red.
- (ii) In the Netherlands a regulation was issued by the Netherlands Authority for the Financial Markets, currently included in the 'Nadere regeling gedragstoezicht financiële ondernemingen Wft'⁷, requiring the provision of a risk indicator divided in five categories graphically presented as a stick man that carries more weight as the risk increases.
- (iii) Portugal issued its CMVM Regulation No. 2/2012 on "Disclosure Duties Relating to Complex Financial Products and Marketing of Unit-Linked Insurance Agreements and Operations" where up to seven different warning symbols have to be provided to retail clients in four different level of risk in green, yellow, orange and red.
- (iv) (iv) The Belgium Financial Services and Markets Authority (FSMA) issued in April 2014 a regulation on risk labelling (then approved by a Royal Decree dated 24 April 2014) due to come into force as from 12 June 2015 It introduces risk labels for certain financial products in five different levels

⁵ Section 1 of the Green Paper, page 5.

⁶ For further detail, Section 3.7 of the Discussion Paper on the Key Information Document for PRIIPs issued on 17 November 2014 by the ESA (ESMA, EBA and EIOPA) (http://www.esma.europa.eu/system/files/jc_dp_2014_02_-_priips_discussion_paper.pdf), when debating the best way to present the level of risk of financial instruments to retail investors, reviews indicators and graphical figures adopted in some MS, evidencing the different solutions adopted among them and unlevel playing field resulting therefrom.

⁷ See http://wetten.overheid.nl/BWBR0020540/geldigheidsdatum_10-04-2015 (in Dutch).

corresponding to dark green, light green, yellow, orange and red. However, following various initiatives, this regulation has now been postponed sine die.

- (v) Spain has recently consulted stakeholders with the aim to pass a Ministerial Order requiring investment firms to provide, among other information in the form of padlocks and exclamation marks, with risk labels in eight different levels, similar to those of the Belgium FSMA but not equivalent in the kind of instruments under each level⁸.

It is not possible to know if any communication to the EC has been made as no reference can be found in the EC web page to these additional requirements. The result of all these uncoordinated national level initiatives is easy to deduct: the same financial instrument would need, if distributed in more than one MS, to incorporate different graphical risk labels (one per MS that has such national level legislation) that will be eventually contradictory amongst themselves (i.e. a 2 year senior bond issued by a credit entity rated equal to or higher than the rating of the Kingdom of Spain would be considered light green in Spain while dark green in Belgium), increasing legal uncertainty (as it requires an investment firm to review each relevant MS national regulation with the assistance of local experts assuming that there is no common place to find all the relevant information), costs and unlevel playing field.

2.2 Other specific cases

Some other cases can illustrate the current patchwork situation:

(i) **The Spanish case requiring handwritten representations.**

Since August 12, 2013 a raft of handwritten statements have to be completed by retail investors when purchasing any financial instrument (i.e.: *“this is a complex product and it is considered not appropriate for me”*, or *“I have not received advise in this transaction”*...). If a product is acquired by electronic means, the investor has to type (it is not possible to tick a box) the referred legends otherwise required to be handwritten.

These requirements, to the best of our knowledge, have not been informed to the EC as per the then applicable Article 4 in MiFID L2.

(ii) **The Belgian cases.**

- The Belgian case requiring specific information on a 3 pages maximum document:

Like with the April 2014 Royal Decree on risk labelling, another Belgian Royal Decree approved in April 2014 a FSMA regulation on a mandatory informative fiche, including mandatory information and mandatory format, to be provided to retail investors when investing in specific financial products. This 3 pages maximum document was anticipating, but on a larger products scale and in a different way, the KID as required by the PRIIPs Regulation. However, following various initiatives, this regulation has now been postponed sine die.

⁸ Additionally, this proposal is defining a new set of complex products in relation to which an alert to be included in the documentation has to state *“Financial instrument which is not simple and that could be difficult to understand”*. Furthermore, a three (and only three, neither more nor less) scenario has to be provided to the client with the probability of performance at maturity (percentile 10, 50 and 90 of the probability distribution). Finally, there is an obligation to warn retail clients that the *“profitability of the product is below what should be attending to the risk it embeds”* whenever the difference between its price and such value is (including commissions) higher than 5% of the theoretical value or 0.6% multiplied by the years of live of the product.

- The Belgian case of the Moratorium on particularly complex structured products

During the 2011 summer, the FSMA drafted a so called “moratorium on the distribution of particularly complex structured products” that prohibits the commercialization of such products to retail clients if different conditions are not respected. It was presented as the first step in a process intended to lead to the adoption of a regulation on the distribution of complex products.

Intermediaries in banking and investment services and insurance intermediaries were invited, on a voluntary basis, to adhere to this Moratorium. Most of those actors felt that they had no other choice than to accept a regulation that was stricter than the European regulation and which is currently still applicable and still stricter than the European regulation.
- In terms of advertisement for financial products, Belgium has also its own specific regulation (the April 2014 Royal Decree on the commercialization of financial products to retail clients and its mandatory content for publicity that came into force in June 2015 and the FSMA recommendations on advertisements and other documents and announcement relating to public offers and admission to trading on regulated markets of investment products).
- Also in the Belgian law on public offer of securities, a bit of goldplating is also present such as, for instance, the requirement to have the prospectus made publicly available at least 3 days prior to the closing of a public offer or in case of events requiring a Supplement to the prospectus, the mandatory obligation to notify individually the securities holders or to publish a press release.

(iii) *The Italian case.*

Please see footnote 8 in next section regarding ESMA opinions.

3. ESMA OPINIONS

In addition to the above described trend of legislative initiatives at national level, ESMA has recently issued two Opinions that could be used as an argument to support such a trend and which do not contribute to the maintenance of the level playing field and legal certainty.

Both Opinions, “*MiFID practices for firms selling complex products*” dated as of 7 February 2014 and “*Structured Retail Products – Good practices for product governance arrangements*” dated as of 27 March 2014, are issued based on Article 29.1(a) of Regulation 1095/2010 which allows ESMA to provide “*opinions to competent authorities*”.

As a matter of fact, these Opinions are identifying “*good practices*” that, presumably, NCAs should encourage investment firms to apply. These Opinions, however, are either anticipating MiFID 2 requirements⁹ that will only be legally applicable from January 3, 2017 or encouraging –and therefore, in

⁹ For instance, those included in Article 16.3 and Article 24.2 of MiFID 2 which are detailed in the second Opinion with a degree of detail comparable to the technical advice provided by ESMA to the EC regarding the Level 2 RTS (see Section 2.7 of the Final Report published by ESMA on 19 December 2014).

some way legitimizing - the extension of the existing requirements set in MiFID.¹⁰ This sort of “soft regulation” could increase legal uncertainty as firms do not know to what extent they should comply with requirements that will only be legally enforceable in two years but which NCAs are already encouraging firms to adopt¹¹.

In this context, it is of the utmost importance that all regulatory and supervisory bodies carefully consider the use of the tools they may have within their powers, in light of one of the most significant benefits of the EU legislation in this field, that of protecting the level playing field and the legal certainty, and avoid the promotion of initiatives and shortcuts that could trigger local solutions to become EU wide problems.

4. CONCLUSIONS

It is clear that the current situation of retail investor protection rules in the EU, when dealing in financial instruments, is characterized by considerable and increasing:

- (i) **disparity of national legislation** in each MS;
- (ii) **unlevel playing field**; and
- (iii) **legal uncertainty**,

resulting in **an increasingly disrupted EU single market**.

When the Capital Markets Union initiative called for more harmonization, when MiFID clarified that any additional requirement had to be exceptional, proportionate and duly justified, and when the PRIIPs Regulation established uniform rules on the information to be provided to retail investors, it was, most likely, with the purpose to avoid the current situation.

We therefore kindly request the authorities and, more specifically, the EC to adopt measures to protect the single market at EU level and make a call to take care of this important topic by highlighting to:

- (i) all MS the **importance of complying with Article 24.12 of MiFID when adopting additional requirements** in the investor protection area,
- (ii) all MS the importance of **carefully considering the impact, at this point in time, of introducing new rules** when both MiFID 2 RTSs and the PRIIPs Regulation are on their way,

¹⁰ By requiring, for instance, in paragraph 26 of the first Opinion, NCAs to monitor the provision by firms of warnings to clients in certain cases *“that the client is not likely to understand the risks involved in relation to these complex products”*, which clearly departs from the warnings required under Article 19.5 in MiFID.

¹¹ Whilst many NCA’s have not issued any statement to firms in relation to these Opinions to date, CONSOB in Italy has attempted to implement the Opinions through a communication, published on 22 December 2014, relating to complex financial product for retail investors (Communication No.0097996). CONSOB identifies in the communication a (non-exhaustive) list of products to be considered as high level complexity financial products. Within that list certain product types are identified which CONSOB expressly recommends that financial intermediaries do not distribute to retail investors. If those products are sold to retail investors the financial intermediary is required to take additional measures including informing the clients that CONSOB does not consider the product suitable for retail investors, and ensuring top management has approved such decision to act contrary to CONSOB’s recommendation. Effectively CONSOB has, in an effort to comply with the Opinions, implemented its own local level retail distribution restrictions in Italy.

Furthermore, the communication specifically refers to the Opinions and confirms that they should be followed by distributors and manufacturers. However, this communication only applies to complex financial products. As such, non-complex financial products are not within its scope. The Opinion titled “Structured Retail Products – Good practices for product governance arrangements” is not limited to complex financial products. This is an example of partial implementation of ESMA’s recommendations which will result in an uneven application the rules across Europe.

- (iii) all MS to internally assess the **possibility of suspending the application of certain rules not adopted in accordance with the MiFID** package (either Article 4 of MiFID L2 or Article 24.12 of MiFID 2), and
- (iv) ESMA the need to **permit investment firms to rely and be fully legally protected during transposition and phase-in periods** established in the EU legislation.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Petra Senkovic', with a stylized flourish at the end.

Petra Senkovic