

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

Response from EuroInvestors – May 2010

EuroInvestors (the European Federation of Investors or EFI) was created in the summer of 2009, following the financial crisis which demonstrated the limits of the almost exclusive dialogue between regulators and the financial industry, largely ignoring the user side. EFI aims at representing and defending at the European level the interests of financial services users in order to promote training, research and information on investments, savings, borrowings and Personal Finances of individuals in Europe, by grouping the organisations pursuing the same objectives at a national or international level. Already about 45 national organizations of investors and other financial services users have joined us, and EFI already represents about two million European citizens.

Investor protection is one of the key objectives of the MiFID Directive.

EFI is pleased that CESR has launched a consultation on this critical issue, especially after more than two years of the MiFID enforcement and after the worst Financial crisis since 1929.

We are grateful to CESR to have organized a very interesting “Retail Investor Day” which included a presentation and discussion of this paper; unfortunately only one business day (28 May 2010) before the response deadline.

We are however disappointed that CESR did not consult all “stakeholders” on bigger issues relative to MiFID’s investor protection provisions.

Indeed, **the most critical issues for investor protection are not addressed** in this CESR 51 pager paper:

1. **The widespread and very misleading use of the “advice” and “advisors” words in MiFID:**

As long as financial intermediaries’ remuneration is mostly coming from the investment products providers, these intermediaries should not be allowed to label themselves as “advisers”: they are not advisers but salesmen. A fortiori, they are certainly not providing “independent advice” under those circumstances.

For example, a car dealer would never label himself as a “Transportation Adviser”. His “advice” will be anything but neutral. Why do regulators allow and promote such a misleading mislabelling of sales agents as “financial advisers” in the retail investments area that is so critical to the future well-being of EU citizens ?

2. The necessity for **unbiased advice** and in the interest of the client (linked to the issue above): *“recent developments in financial markets have highlighted how the sale of*

*financial products to retail consumers has been influenced by unbalanced fee structures and compensation mechanisms. In some cases, such compensation mechanisms compromise the ability of investment advisors to uphold the primacy of customers' interests. These professionals owe a fiduciary duty to their clients."*¹

3. The necessity for advice to be provided by **competent and knowledgeable intermediaries**: we have ample evidence that this is often not the case, especially for structured products.
4. The necessity for advice requirements to **cover all "substitute" investment alternatives or options for the client**, and not only – as it is currently the case – about only one fifth of retail Financial investment products offered to EU citizens: securities and funds. The "PRIPs" initiative is unfortunately unlikely to change this situation because of its much narrowed scope (we refer to our position paper on "PRIPs" on our website: www.Euroshareholders.org / About Us / EuroInvestors.org).
5. The **justification and disclosure of the so-called "inducements"** and sales-based remuneration of "advisors" by product providers: this key investor protection feature of MiFID is not properly enforced in Member States and is even ignored by CESR's "Consumer guide to MiFID" despite the demands from investor and consumer advocates since 2008.

On the issues raised by CESR:

1. The rules regarding **recording of Telephone and electronic Communications** should be harmonised including emails, and we agree with CESR that all such records be kept for at least 5 years.
2. **Execution Quality Data** - We doubt that the "best execution" reporting from the different market venues to professional firms will actually provide the metrics to evaluate the best execution for small and individual Investors, as the best execution of their trades will also heavily depend on what the retail brokers do. All analyses concur that "best execution" is not functioning to start with (we refer to our response to CESR consultation on secondary equity markets also closing on 31 May 2010, and to the EIWG report: "*the lack of effective implementation of best execution duties is another important source of concern and should be properly addressed in order to protect investors' interests at institutional and retail level. This problem is exacerbated by a fragmented trading landscape, which must be supported by consolidated data solutions.*")
3. **Complex / non complex financial instruments** - The scope of so-called "non complex" products in MiFID's jargon should be restricted to better protect Investors from mis-selling.

¹ The European Investors Working Group (EIWG) report "*Restoring Investor confidence in European Capital Markets*", February 2010:
<http://www.ceps.eu/book/restoring-investor-confidence-european-capital-markets>

We refer to FIN-USE's response to the CESR consultation on MiFID complex and non-complex financial instruments for the purposes of the Directive's Appropriateness Requirements of July 2009².

EFI believes that "Shares" categorized as non complex for the purpose of the appropriateness test should be only ordinary shares (voting or nonvoting).

Also, we do not agree that bonds, banks' EMTNs, and money market instruments such as treasury bills, certificates of deposit and commercial paper (either straight or asset backed) should be treated as non-complex instruments for the purpose of the appropriateness requirements, as they are traded on non transparent, unregulated and often illiquid (e.g. in 2008) markets with a very difficult access for the retail investor: to get quotes on bank EMTNs is extremely difficult, and to trade them on the secondary market even more. We have evidence of retail investors paying 100% price at the bank teller for an EMTN that is quoted at 85 on the secondary regulated market.

Any collective investment or mutual fund should be excluded from the "non complex" category and should be assessed against the criteria in Art. 38 of the Level 2 Directive. Even UCITS funds can be quite complex; for example structured funds or guaranteed funds where the seller himself often does not understand how the product works.

Deposits, mortgages and more importantly life insurance products are not included in MiFID's scope. The consequence is that life insurance policy holders for example get much less protection features than investors in MiFID-covered products, and certainly not the appropriateness' test one.

4. **Definition of "personal recommendation"** – WE agree with CESR's proposal to amend article 52 of the Level 2 Directive.

² http://ec.europa.eu/internal_market/fin-use_forum/docs/mifid_fin_instruments_en.pdf