Association for Financial Markets in Europe
Futures and Options Association

Response by AFME and FOA to CESR's consultation on understanding the definition of advice under MIFID

14th December 2009

In considering the application of the investment advice definition, and the suitability rules, it is important to distinguish between retail and professional investors. Although CESR does not make it clear, it seems, given its content, that CESR's consultation focuses primarily on dealings with retail clients. Our comments below relate specifically to firms' dealings with professional investors in wholesale markets. Under MIFID and the implementing Directive, the suitability rules apply in a more limited way to professional investors than to retail investors. But it is also important to recognise that in wholesale markets the types of communication and the relationship between the firm and the investor are different from firms' relationship with retail clients in ways that have an important bearing on CESR's interpretation of the investment advice and suitability provisions insofar as they do apply to professionals. We therefore ask CESR to make clear in its future documents on this issue that these interpretations apply mainly to retail clients, and that different considerations will typically apply to professional clients.

III. Part 1: Does the service being offered constitute a recommendation?

Q.1. Do you have any comments on the distinction between the provision of personal recommendations and general information?

In general we share CESR's analysis. We agree that a statement of opinion may constitute advice if it is presented as a recommendation or in the interests of an investor. However, a statement of opinion may also fall outside the scope of advice if it is intended simply to inform the investor. Such statements of opinion, giving the firm's view on a security, are common in the wholesale markets, where investment firms provide commentary on 'market colour' to professional clients, without any intention of giving a personal recommendation, and without any expectation on the part of clients that they are seeking a personal recommendation. There are analogies to CESR's comments on filtering in paragraph 24 ("In such cases, the ability of the clients to make their own choices about the features they are looking for, and the absence of apparent judgement about which features or products they should choose, would make it unlikely that the service offered would be viewed as investment advice"), and with CESR's comments on portfolio managers in paragraph 79 ("where an investment firm provides a recommendation to a portfolio manager, it will usually be the case that the investment firm is not giving investment advice to the portfolio manager's client but is simply providing a general recommendation, such as an investment tip").

Furthermore, in paragraph 11 CESR suggests that a recommendation not to buy a financial instrument could constitute a personal recommendation. It is important not to open a channel in this way to vexatious claims of unsuitable advice in cases where it emerges only in retrospect that a client suffered an opportunity cost by not investing.

Q.2 Do you agree that the limitation that filtered information is "likely to be perceived by the investor as, assisting the person to make his own choice of product which has particular features which the person regards as important." is a critical criterion for determining whether filtering questions constitutes, investment advice?

We do not have any comments on this question.

IV. Part 2: Is the recommendation in relation to one or more transactions in financial instruments?

Q.3. Do you believe the distinction between general recommendations/generic advice and investment advice is sufficiently clear? Do you have examples of types of advice where the designation is unclear?

It is important to be clear about the distinction between advice which relates to the generic nature of a product, which should always be treated as generic, and advice which is client specific. For example, in the context of the comments on exercising a right in the second bullet of paragraph 28, if advice is based on the mere fact that a product is in the money, it has a generic character, and should not be treated as specific to the client's circumstances.

V. Part 3a: Is the recommendation presented as suitable?

Q.4. Is there sufficient clarity as to when an implicit recommendation could be considered as investment advice? If not, what further clarification do you think is necessary?

We consider that there is sufficient clarity. As CESR says in paragraph 44, the criterion should be whether the firm seeks to influence the client's choice: see our comments under Q1 above on 'market colour', which is intended to inform, but not to influence.

We agree that a disclaimer should not be determinative of whether or not a communication constitutes investment advice. However, the more clear a communication is that any opinion it contains has not been prepared taking into consideration any one particular person's circumstances, the stronger the presumption should be that it is generic advice, and not a personal recommendation.

VI. Part 3b: Is the recommendation based on a consideration of the person's circumstances?

Q.5. Are the circumstances where it is clear the firm is making a personal recommendation sufficiently clear? Would further clarification be helpful?

CESR says in paragraph 6 that "Where the recommendation is in fact based on a consideration of the client's circumstances… this will constitute investment advice regardless of what the client believes or knows".

CESR also says in paragraph 50 that "if a firm has information about a client's circumstances, including information on areas like his investment objectives or financial situation, it might reasonably be expected that this information is being used to create a picture of his needs and wants to form the basis of a recommendation."

In wholesale markets, the mere fact that the firm has such information should not be the determining factor. The relevant considerations should be whether the recommendation is related to the information and takes account of specific objectives stated by the client. This approach is consistent with CESR's acknowledgement of this point in paragraph 51 – "if a firm has accumulated information on a person's circumstances – either during a single interview or during the course of an ongoing relationship – <u>and it might reasonably be expected that this information is being taken into account</u>".

Even if a firm does on occasion provide personal recommendations to professional clients, this will often take place in the context of a client relationship where advice is not normally given, and where the client does not reveal to the firm information about its broader investment objectives beyond those which are specifically relevant to the transaction in question. In this context, reflecting the fact that for per se professional clients Article 35.2 of the MIFID Level 2 Directive applies a suitability test based solely on the client's objectives, firms should need only to assess the suitability of the particular transaction in the context of the particular advice the professional clients seeks in the specific circumstances at the time of the transaction, and there should be no expectation that a firm need collect or assess more general information about client objectives Such an approach reflects the MIFID Level 2 Directive's expectation (Recital 44) that "professional clients should, subject to limited exceptions, be able to identify for themselves the information that is necessary for them to make an informed decision, and to ask the investment firm to provide that information".

We agree that a disclaimer in a client agreement does not change the nature of a communication if advice is in fact given. However, a statement in the firm's terms of business, to the effect that unless otherwise agreed with the client the firm will not be providing personal recommendations and therefore no communication to a client is to be taken as a personal recommendation, should suffice to avoid bringing the firm within the scope of the suitability obligations other than on an exceptional basis, where it is combined with systems and controls to give effect to that policy.

VII. Part 4: Is the recommendation issued otherwise than exclusively through distribution channels or to the public

Q.6. Are there other criteria you believe should be considered when determining whether messages to multiple clients constitute investment advice?

No other criteria need to be considered, but the focus, when determining whether those messages fall into the category of investment advice, should be on a combination of factors - explicit statements, media, and presentation style, taken together, would need to signal that the investment was presented as "suitable" to the clients. The clients also should consider such information as one of the factors in making an informed investment decision. As noted in response to Q1 above, in wholesale markets opinions or judgements are often given to clients without the intention, or the expectation, that they are to be treated as personal recommendations. In the context of, for example, of a best products list (paragraph 59), where such a list is product-specific rather than client specific, it should be treated as generic advice.

VIII. Part 5a: Is the recommendation made to a person in his capacity as an investor or potential investor

Q.7. What information would be helpful to assist in determining whether or not what firms provide constitutes investment advice or corporate finance advice?

Q.8. Are there specific examples of situations you would like considered, where it is difficult to determine the nature of the advice

In paragraph 76 CESR argues that corporate finance advice and investment advice are not mutually exclusive, and that it is possible for a firm to provide both the same client, giving the example of a firm that is providing advice to the owners of a family-owned company. In our view it would be more appropriate to separate the investment advice given to individual family members as investors from the corporate financial advice given to the enterprise which they own/operate. While it is possible that a firm may provide both services, it is important to assess each service separately, to recognise that advice is provided to different clients, and not to confuse the two. When the firm is engaged solely to provide advice on acquisition, sale, or merger, the engagement agreement will likely state that the advice is being proffered to the company and not to its shareholders as investors. In such cases it must be assumed that the investors have either made their own investment decisions, or have obtained investment advice elsewhere. Only where the firm makes specific recommendations to shareholders as investors and in terms of their personal investment objectives would the advice be properly considered investment advice. This approach would be consistent with the separate legal personalities involved.