Financial Services Consumer Panel
AN INDEPENDENT VOICE FOR CONSUMERS OF FINANCIAL SERVICES

Consumer Panel response to consultation document on the Review of the Markets in Financial Instruments Directive

The Financial Services Consumer Panel was established under the Financial Services and Markets Act 2000 by the Financial Services Authority to represent the interests of consumers. The Panel is independent of the FSA. The main function of the Panel is to provide advice to the FSA, but it also looks at the impact on consumers of activities outside the FSA's remit. The Panel represents the interests of all groups of consumers.

This is the Panel's response to the consultation document on the Review of the Markets in Financial Instruments Directive (MiFID). The Panel will also be responding to the review of the Insurance Mediation Directive (IMD) and the consultation on legislative steps for the Packaged Retail Investment Products (PRIPS) initiative.

Overview

The Panel has responded to the issues covered in the review that impact directly on retail consumer interests.

Overall the Panel supports the strengthening of the consumer protections within MiFID and the future application of the MiFID framework to the sales of all PRIPS. We believe that MiFID could be further strengthened by the introduction of an overarching principle that financial services advisers and sales staff should act in their clients' best interests. This is the simple premise on which the retail financial services market should be based and would provide a fundamental protection for consumers which is currently implied, but not explicit, within MiFID.

We have some concerns about the potential limit on, or even abolition of, the execution-only regime. There are large numbers of consumers who have the capability and justified confidence to buy financial products on a non-advised basis. It is not entirely clear to us whether complete abolition is one of the options under consideration, but it would in our view be detrimental to consumer interests if those able to buy without advice were effectively required to obtain it. This would increase costs for consumers and ultimately benefit no-one.

In the UK the Financial Services Authority (FSA) is in the process of implementing changes to the retail distribution market following an in-depth review and extensive consultation period lasting a number of years. These changes focus on issues such as the meaning of "independence"; adviser remuneration and incentives; professionalism; disclosure; and 'labelling' of services. Much of what we have seen in this Review document reflects, but is not identical to, the post RDR framework. Consequently we are supportive of many of the proposals, but we would not wish to see a comprehensive maximum harmonisation approach that removed much-needed flexibility at national level to address particular markets, products or practices. On a related issue, we do not support the abolition of Article 4 of MiFID as proposed in the Paper.

We have responded below to a number of the specific questions within the review document.

Specific questions

Section 7: Investor protection and provision of investment services

Q84: What is your opinion about limiting the optional exemptions under Article 3 of MiFID? What is your opinion about obliging Member States to apply to the exempted entities requirements analogous to the MiFID conduct of business rules for the provision of investment advice and fit and proper criteria? Please explain the reasons for your views.

We support the proposals to limit the optional exemptions under Article 3, although we believe that the same level of protection should apply to all consumers whether buying cross-border or in their own Member State. It is in the interests of consumers that excluded firms deal only in a limited range of investments, do not hold client money and are subject to requirements analogous to MiFID in respect of key investor protection requirements including fitness and propriety tests; disclosure; suitability - an appropriateness test should be applied as well as an overarching requirement to act in the clients' best interests; and inducements/conflicts of interest.

Q85: What is your opinion on extending MiFID to cover the sale of structured deposits by credit institutions? Do you consider that other categories of products could be covered? Please explain the reasons for your views.

We agree that the relative complexity of structured deposits means that sales should be covered by the protections within MiFID.

Q86: What is your opinion about applying MiFID rules to credit institutions and investment firms when, in the issuance phase, they sell financial instruments they issue, even when advice is provided? What is your opinion on whether, to this end, the definition of the service of execution of orders would include direct sales of financial instruments by banks and investment firms? Please explain the reasons for your views.

This would appear to be a logical extension of investor protection, but it is not clear to us how this would work in practice. We would like to see specific examples of when such sales have gone wrong in the past and how the proposals in this paper would prevent such detriment occurring in future.

Q87: What is your opinion of the suggested modifications of certain categories of instruments (notably shares, money market instruments, bonds and securitised debt), in the context of so-called "execution only" services? Please explain the reasons for your views.

The Panel is not in a position to comment on the detail of the suggested modifications. It seems however that there is currently a lack of clarity over whether particular assets constitute non-complex products and this has to be addressed. We are keen to ensure that no unnecessary restrictions are placed on investors who wish to buy products on an 'execution only' basis. We support moves to ensure greater clarity without adversely impacting on investor freedom of choice. We do not wish to see consumers who are in position to take an informed decision obliged to take financial advice which they do not need.

Q89: Do you consider that all or some UCITS could be excluded from the list of non-complex financial instruments? In the case of a partial exclusion of certain UCITS, what criteria could be adopted to identify more complex UCITS within the overall population of UCITS? Please explain the reasons for your views.

UCITS products enjoy an almost unique position in retail investments and are subject to specific, tailored requirements. Any consideration of refining definitions/categories should be considered in the context of the UCITS regime, rather than MiFID and PRIPS.

Q90: Do you consider that, in the light of the intrinsic complexity of investment services, the "execution only" regime should be abolished? Please explain the reasons for your views.

No. We believe that there are many investors with sufficient knowledge and confidence to invest on an execution-only basis and we would not wish to see that option restricted unnecessarily or removed entirely, particularly as any advised sale would involve additional cost to the investor as well as unneeded advice. We would have no objection to the introduction of an appropriateness test for all purchases of financial services products, although it is not clear how this would be applied in practice – for example, would a firm refuse to act for an individual who was told that the product to be purchased did not meet the test? Freedom of choice is a basic consumer entitlement and many investors successfully opt to buy on an execution only basis knowing that advice is available, should they need it. The abolition of the execution only regime could cause detriment and disadvantage to particular groups of consumers with no real benefit to anyone else. The complexity of investment services in itself is not an argument for banning execution only, rather it enforces the need for consumers that wish to do so to have access to suitable advice and clear information about the products and services that are available.

Q91: What is your opinion of the suggestion that intermediaries providing investment advice should: 1) inform the client, prior to the provision of the service, about the basis on which the advice is provided; 2) in the case of advice based on a fair analysis of the market, consider a sufficiently large number of financial instruments from different providers? Please explain the reasons for your views.

and

Q92: What is your opinion about obliging intermediaries to provide advice to specify in writing to the client the underlying reasons for the advice provided, including the explanation on how the advice meets the client's profile? Please explain the reasons for your views.

In the UK the Financial Services Authority is in the process of putting in place new requirements covering these and other issues following an extensive review of the retail distribution market, the Retail Distribution Review (RDR), and a comprehensive consultation process. From the Panel's perspective we consider the proposals put forward in this paper as being consistent with – but not identical to – the outcome of the RDR. We strongly support the RDR and also, therefore, the objectives in the paper. It is clear that national markets vary in structure as well as product range and distribution models, so it is important that MiFID requirements do not hinder national regulators in addressing issues particular to their own markets while incorporating basic levels of consumer protection set out in MiFID. The argument for enhanced definitions and labelling of advice services, for example, is well made for the UK market and we would not wish to see these welcome changes to MiFID having an unintended, adverse impact on the RDR outcomes. It would

not be unreasonable for advisers to be required to specify in writing to the client the underlying reasons for the advice provided – a suitability letter – given that the adviser is likely to have produced a similar document for his/her own use in the advice process.

Q93: What is your opinion about obliging intermediaries to inform the clients about any relevant modifications in the situation of the financial instruments pertaining to them? Please explain the reasons for your views.

and

Q94: What is your opinion about introducing an obligation for intermediaries providing advice to keep the situation of clients and financial instruments under review in order to confirm the continued suitability of the investments? Do you consider this obligation be limited to longer term investments? Do you consider this could be applied to all situations where advice has been provided or could the intermediary maintain the possibility not to offer this additional service? Please explain the reasons for your views.

We agree that if the structure or functioning of an investment product changes significantly information should be provided to the client. More broadly our view is that where an adviser is being paid a continuing fee for advice (in the UK this is currently referred to as trail commission), we would expect the adviser to provide a continuing service to the client that related directly to the investment purchased. We do not think that in other circumstances this should be mandatory, but it is a service that could be negotiated between the adviser and the client. Advice on the continued suitability of an investment could be dependent on the changing financial circumstances of the client – this would of course involve a relatively expensive ongoing assessment of a client's changing financial circumstances. We would not wish to see intermediaries effectively prohibited from providing a straightforward one-off execution only service where that meets the consumer's requirements. In addition, for some products such as those with a set life span and no early redemption such as many structured deposits, requiring advisers to report regularly on a product's progress is unnecessary and would only add to costs for consumers. Many investments are long-term and reports on an annual rather than a quarterly basis would seem to be appropriate. Consideration should be given too to whether, for example, reports would be on the net aggregate change in the value of a portfolio, or on changes in the value of individual investments. It is important that MiFID requirements in this area are proportionate to the wide variety of products and portfolios that will be covered.

Q95: What is your opinion about obliging intermediaries to provide clients, prior to the transaction, with a risk/gain and valuation profile of the instrument in different market conditions? Please explain the reasons for your views.

We have responded separately to the Commission Services paper on Packaged Retail Investment Products and there is clearly a link between the issues outlined here and the eventual format of the PRIPS Key Investor Information Disclosure Document. We would like to see the PRIPS KIID developed further before being in a position to comment in detail. Whatever the final outcome of the consultation, we have recommended a post implementation review of the PRIPS KIID three years after it is introduced, based on a comprehensive survey to establish consumer understanding.

Q96: What is your opinion about obliging intermediaries also to provide clients with independent quarterly valuations of such complex products? In that case, what

criteria should be adopted to ensure the independence and the integrity of the valuations?

and

Q97: What is your opinion about obliging intermediaries also to provide clients with quarterly reporting on the evolution of the underlying assets of structured finance products? Please explain the reasons for your views.

and

Q98: What is your opinion about introducing an obligation to inform clients about any material modification in the situation of the financial instruments held by firms on their behalf? Please explain the reasons for your views.

and

Q99: What is your opinion about applying the information and reporting requirements concerning complex products and material modifications in the situation of financial instruments also to the relationship with eligible counterparties? Please explain the reasons for your views.

and

Q100: What is your opinion of, in the case of products adopting ethical or socially oriented investment criteria, obliging investment firms to inform clients thereof?

As we have said in response to question 94 of this paper, we see proportionality as the key question when considering reports to clients. We would like to see careful consideration of the feasibility of providing reports on the basis suggested and how useful consumers would find them. Further work would be needed to establish "materiality" for the wide range of products covered by the regime. As regards the use of product descriptions or advertising using terms such as "ethical" or "socially orientated", we see a role for a regulatory body or voluntary agency to set standard parameters or rules/principles for the use of such terms and to ensure that, when challenged, firms have the documentary evidence available to support compliance with the spirit and substance of their claims. The process could be similar to the policing of advertising standards.

Q101: What is your opinion of the removal of the possibility to provide a summary disclosure concerning inducements? Please explain the reasons for your views.

and

Q102: Do you consider that additional ex-post disclosure of inducements could be required when ex-ante disclosure has been limited to information methods of calculating inducements? Please explain the reasons for your views.

and

Q103: What is your opinion about banning inducements in the case of portfolio management and in the case of advice provided on an independent basis due to the specific nature of these services? Alternatively, what is your opinion about banning them in the case of all investment services? Please explain the reasons for your views.

We have already referred to the changes underway in the UK retail distribution market as a result of the RDR. The questions of inducements and remuneration for advisers have been addressed in the review and commission-based remuneration for investment advice will effectively be banned in the UK. Again we see the measures set out in this paper as being broadly consistent with the RDR and we support in principle the measures set out here to ensure that clients/potential investors are aware of any inducements that could influence the advice that is being provided. But it is important that sufficient flexibility is available at national level to accommodate protection already in place. We would like to see a broad definition of "inducements" within MiFID that would continue to encompass non-cash inducements such as prizes, holidays and sponsored events, as well as more innovative inducements that might be designed in response to the new regime. Greater clarity is required around the differing roles of advisers and sales staff, which are important distinctions for customers.

Q104: What is your opinion about retaining the current client classification regime in its general approach involving three categories of clients (eligible counterparties, professional and retail clients)? Please explain the reasons for your views.

We are not aware of any particular concerns about the current client classification regime for individual consumers, but of course the losses suffered in the recent financial crisis by bodies such as local authorities are well known. We are not persuaded that the client classification regime is the appropriate vehicle through which to address this issue however.

Q105: What are your suggestions for modification in the following areas:

a) Introduce, for eligible counterparties, the high level principle to act honestly, fairly and professionally and the obligation to be fair, clear and not misleading when informing the client;

b) Introduce some limitations in the eligible counterparties regime. Limitations may refer to entities covered (such as non-financial undertakings and/or certain financial institutions) or financial instruments traded (such as asset backed securities and nonstandard OTC derivatives); and/or

c) Clarify the list of eligible counterparties and professional clients per se in order to exclude local public authorities/municipalities? Please explain the reasons for your views.

We are supportive of (a), which seems entirely appropriate, but we are not in a position to comment on (b) and (c). We do think however that the complex/non-complex product approach is generally unhelpful for consumers and it would be better to approach definitions on the basis of fluctuations in underlying value and levels of risk.

Q106: Do you consider that the current presumption covering the professional clients' knowledge and experience, for the purpose of the appropriateness and suitability test, could be retained? Please explain the reasons for your views.

The Panel is not in a position to respond to this question in detail, but there are risks for retail consumers who are wrongly classified by firms as "professional". While this might ultimately involve 'sharp practice' rather than regulatory loopholes, we would like to see further work carried out on the effectiveness of the current classification, the root cause of problems and how these could be addressed.

Q107: What is your opinion on introducing a principle of civil liability applicable to investment firms? Please explain the reasons for your views.

and

Q108: What is your opinion of the following list of areas to be covered: formation and reporting to clients, suitability and appropriateness test, best execution, client order handling? Please explain the reasons for your views.

This would be an additional protection for retail investors and in principle we would support its introduction. The list of areas to be covered seems to include all the key issues that might give rise to a civil claim. But while we would like see this provision introduced, we are unsure as to how frequently it would it be used in practice and how cost effective it would be. If as a result of the introduction of a principle of civil liability firms were to require different or greater levels of indemnity insurance there is a risk that costs could rise for investors, which could overall be more detrimental to their interests than the absence of the principle of civil liability. We would be interested to hear the views of others including the Commission on how frequently they would expect the civil liability route to be used and how effective it would be.

Q110: What is your opinion of the requirements concerning the content of execution policies and usability of information given to clients should be strengthened? Please explain the reasons for your views.

We support the objective of improving standards in this area, particularly as the Commission services has had feedback from investors on this point. We would need to see detailed proposals before being able to comment further however. The Commission's own report Consumer Decision-Making in Retail Investment services: A Behavioural Economics Perspective[1] found that people buying online only paid attention to information on conflicts of interest and remuneration when it was flashed in red as a health warning on the screen.

Q113: What is your opinion on possible MiFID modifications leading to the further strengthening of the fit and proper criteria, the role of directors and the role of supervisors? Please explain the reasons for your view.

The UK regime has recently been reviewed and strengthened. Provided that the proposals would allow an appropriate degree of flexibility at national level while still setting high minimum standards, we would support this approach. We would like to see consistent measures across the board, providing a high level of protection for all consumers.

Q114: What is your opinion on possible MiFID modifications leading to the reinforcing of the requirements attached to the compliance, the risk management and the internal audit function? Please explain the reasons for your view.

We support the modifications proposed, but would like to see standards raised more widely as well as in MiFID.

Q115: Do you consider that organisational requirements in the implementing directive could be further detailed in order to specifically cover and address the

[1] Published November 2010 at http;//ec.europa.eu/consumers/strategy/docs/final_report_en.pdf

launch of new products, operations and services? Please explain the reasons for your views.

We strongly support the proposals for organisational requirements for the launch of products, operations and services provided that national regulators have flexibility to particular national issues. These arrangements should strengthen consumer protection by reducing the risk of the growth of unsuitable or inappropriately targeted products and services at an earlier stage than at present.

Q116: Do you consider that this would imply modifying the general organisational requirements, the duties of the compliance function, the management of risks, the role of governing body members, the reporting to senior management and possibly to supervisors?

We agree and would support such a move, including a requirement that reporting information to senior management should include the number and nature of complaints by consumers. We will be interested to see detailed proposals in this area.

Q117: Do you consider that specific organisational requirements could address the provision of the service of portfolio management? Please explain the reasons for your views.

These requirements, in essence, call for firms to produce and keep documentary evidence of how they implement their strategies for managing clients' portfolios, with separate requirements already applying to discretionary management on an individual client basis. This seems to be a sensible approach and one which we support.

Q118: Do you consider that implementing measures are required for a more uniform application of the principles on conflicts of interest?

The principles on conflicts of interest, including the remuneration of sales forces and incentives to distributors of financial products, are important for consumers. This has already been recognised in the UK as we have said elsewhere in this response, so we support the application of protection measures of this kind in principle. It is important that non-cash rewards – such as extra days' holiday - are included and so the definition should be as widely drawn as possible. There should still nevertheless be some flexibility at national level to accommodate specific issues in Member States. In particular we would not wish to see the FSA's work to, for example, ban commission based remuneration of investment advisers, be effectively rendered unworkable by harmonised, higher level provisions.

Q119: What is your opinion of the prohibition of title transfer collateral arrangements involving retail clients' assets? Please explain the reasons for your views.

In the UK the FSA is in the process of implementing a raft of enhanced requirements for firms handling client assets to ensure that clients' property is protected in an appropriate way, following findings of significant levels of non-compliance amongst many firms[2]. We welcome similar protection measures in MiFID, subject to the approach being the establishment of minimum standards rather than maximum harmonisation.

[2] www.fsa.gov.uk/pubs/other/cass_risk.pdf

Q121: Do you consider that specific requirements could be introduced to protect retail clients in the case of securities financing transaction involving their financial instruments? Please explain the reasons for your views.

and

Q122: Do you consider that information requirements concerning the use of client financial instruments could be extended to any category of clients?

and

Q123: What is your opinion about the need to specify due diligence obligations in the choice of entities for the deposit of client funds?

We support the proposals outlined in the paper, in particular the regular and active monitoring by firms of the adequacy of collateral provided for financing transactions involving client assets and the specific introduction of diversification requirements as part of firms' due diligence obligations.

Section 8: Further convergence of the regulatory framework and of supervisory practices

Q125: What is your opinion of Member States retaining the option not to allow the use of tied agents?

We have no objection to the retention of this option.

Q126: What is your opinion in relation to the prohibition for tied agents to handle clients' assets?

and

Q127: What is your opinion of the suggested clarifications and improvements of the requirements concerning the provision of services in other Member States through tied agents?

and

Q128: Do you consider that the tied agents regime require any major regulatory modifications? Please explain the reasons for your views.

Our understanding of the regulatory regime is that tied agents (or appointed representatives) are for all practical purposes part of, or an extension of, the principal authorised firm and are the responsibility of the authorised firm. If the principal was not authorised to handle client assets, then the tied agent should not be permitted to do so. We would welcome measures to ensure that the regime operates on that basis.

Q129: Do you consider that a common regulatory framework for telephone and electronic recording, which should comply with EU data protection legal provisions, could be introduced at EU level? Please explain the reasons for your views.

and

Q130: If it is introduced do you consider that it could cover at least the services of reception and transmission of orders, execution of orders and dealing on own account? Please explain the reasons for your views.

and

Q131: Do you consider that the obligation could apply to all forms of telephone conversation and electronic communications? Please explain the reasons for your views.

and

Q132: Do you consider that the relevant records could be kept at least for 3 years? Please explain the reasons for your views.

The paper refers to both a common mandatory regime and the need for Member State discretion, so the proposals are not completely clear to us. We would support measures to ensure basic minimum criteria in these areas – including telephone recordings of client orders and other instructions - and regard a minimum period of three years as appropriate, as this reflects the relative complexity of investment issues.

Q133: What is your opinion on the abolition of Article 4 of the MiFID implementing directive and the introduction of an on-going obligation for Member States to communicate to the Commission any addition or modification in national provisions in the field covered by MiFID? Please explain the reasons for your views.

We do not support this proposal. There may well be an argument for reviewing or re-working Article 4, but the alternative of adopting flexibility only where additional measures "do not contravene the letter or spirit of MiFID or of EU law in general" lacks sufficient clarity and would, we think, be unworkable in practice. MiFID is an invaluable consumer protection and, as is evident from this response, we are strongly supportive its key provisions. Nevertheless there could always be circumstances at national level which, in order to meet consumer protection needs, might require exceptional action by the national regulator that goes beyond MiFID requirements. It would not be in consumer interests for this flexibility to be removed. Article 4 ensures, we believe, that the case for exceptional action has to be demonstrated and justified and provides an appropriate structure for this to be done.

Q134: Do you consider that appropriate administrative measures should have at least the effect of putting an end to a breach of the provisions of the national measures implementing MiFID and/or eliminating its effect? How the deterrent effect of administrative fines and periodic penalty payments can be enhanced? Please explain the reasons for your views.

and

Q135: What is your opinion on the deterrent effects of effective, proportionate and dissuasive criminal sanctions for the most serious infringements? Please explain the reasons for your views.

and

Q136: What are the benefits of the possible introduction of whistleblowing programs? Please explain the reasons for your views.

and

Q137: Do you think that the competent authorities should be obliged to disclose to the public every measure or sanction that would be imposed for infringement of the provisions adopted in the implementation of MiFID? Please explain the reasons for your views.

We are not in a position to provide a detailed response to these questions. We do support the use of criminal as well as regulatory sanctions and greater transparency about those sanctions as an additional regulatory tool, for deterrent effect.

Section 9: Reinforcement of supervisory powers in key areas

Q142: What is your opinion on the possibility to ban products, practices or operations that raise significant investor protection concerns, generate market disorder or create serious systemic risk? Please explain the reasons for your views.

We support the introduction of power to ban products, practices or operations that cause significant investor protection concerns or otherwise create significant systemic or market risk at central EU level. The criteria for exercising this power would need to be fully consulted on and debated in depth. We think it most likely that in practice national regulators would be the most frequent users of powers to ban products, with the European Supervisory Authority taking such decisions at an EU level, as well as being responsible for monitoring action by national regulators to ensure consistency throughout the Member States.

Q144: Are there other specific products which could face greater regulatory scrutiny? Please explain the reasons for your views.

We have no specific suggestions at this stage, other than ETFs, but would support the development of a framework or set of criteria against which particular products could be assessed to identify potential high risk concerns.

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