

**Futures and Options Association
International Primary Market Association
International Securities Market Association
International Swaps and Derivatives Association
London Investment Banking Association
The Bond Market Association**

Georg Wittich
Chairman
Forum of European Securities Commissions
17 Place de la Bourse
75082 Paris Cedex 02
France

5th April 2001

Dear Herr Wittich

FESCO's Conduct of Business proposals

In February FESCO published its consultative document 'Standards and Rules for Harmonising Core Conduct of Business Rules for Investor Protection'. We welcome FESCO's open consultation on the proposed rules. We will be commenting in detail on FESCO's proposals, but we felt that we needed to write to you at this stage about our immediate concerns on the harmful effect the FESCO proposals threaten in a number of important areas. In particular, the publication of the rules has enabled us to assess more accurately the effect of FESCO's proposals of last year on investor categorisation.

FESCO has confirmed its proposals for a two-tier 'professional'/'non-professional' categorisation of investors. Large corporations and other institutional investors, which participate in wholesale markets, are treated under the FESCO proposals as 'non-professional' unless they opt for 'professional' status.

In FESCO's proposed conduct of business rules, this two-tier approach translates into very detailed rules for all business conducted with 'non-professionals', and a reduced (but still quite considerable) number of rules for business with 'professionals'. The rules for business with 'non-professionals' do not differentiate significantly between business with large and institutional investors, and with other categories of 'non-professional'.

FESCO's proposals would increase the burden for business with significant numbers of wholesale market participants. Experience in those Member States where companies must currently opt into professional status suggests that those which are eligible to elect for 'professional' status very rarely do so. Firms would thus be required to treat business with some of Europe's largest and most sophisticated

companies in the same way as business with unsophisticated individuals. This would disincentivise financial services firms from being able to provide the latest techniques for efficient treasury management to such investors. This would be disproportionate and inefficient, and cannot be in the European public interest. In order for European markets to be internationally competitive, and to accord with accepted corporate governance principles, corporates must take responsibility for their actions. Public policy thus requires that entities above an appropriate size or with an appropriate level of expertise be treated as professionals.

FESCO's proposed approach could also significantly increase the burden of conduct of business rules for cross-border (or branch) business with large and institutional investors in some Member States, because:

- In some Member States large and institutional investors are currently automatically classed as professionals, so that implementation of FESCO's proposals would re-classify them as 'non-professionals', and thus subject business with those investors to more detailed rules.
- In some other Member States the rulebook, while it does not distinguish between professionals and non-professionals, is nevertheless restricted to a small number of rules or general principles, so that implementation of FESCO's proposals would again increase the burden of regulation for business conducted with large corporate and institutional investors.

This issue is particularly acute for cross-border business because the Commission's recent Communication on Article 11 of the ISD suggests that Member States could move now to apply the country of origin approach, but only to business with 'professionals' as defined by FESCO's categorisation. In practice, because large and institutional investors are unlikely to elect to be treated as professionals, this would probably secure the country of origin approach only for business between firms authorised under the ISD. The Commission's Communication on Upgrading the ISD suggests use of the FESCO definition of 'professional' to define a 'retail' category, where business would continue to be governed by host State rules pending satisfaction of unspecified conditions for moving to country of origin control. But because of the effect of FESCO's proposals on the rules of some Member States described above, together with the greater certainty that host State rules would apply to 'non-professionals' (as defined by FESCO) which such a revision of the ISD would bring, the existing unacceptable state of affairs - overlapping, conflicting rules, inappropriately applied - is likely to get significantly worse, not better.

The immediate objective at this stage must be to secure appropriate treatment for all business in Europe, both as regards:

- whose rules apply - country of origin (with any exception only for unsophisticated consumers, and then only if necessary, and subject to sunset provisions), and
- what rules apply - in particular, appropriate, not full retail, rules for major corporates even if they do not elect to be treated as professional investors.

In our view the appropriate way to address at least the latter problem is to define the category of professional investors to include:

- a) Those entities automatically treated as professional under FESCO's categorisation;
- b) Large corporate and other institutional investors as defined in FESCO's categorisation, without any need for them to elect to be treated as professional;
- c) Sophisticated individuals and other investors who have been assessed as having the necessary expertise in a manner similar to that proposed by FESCO, including that they have agreed to be treated as professionals.

In addition to this adjustment to the boundary between professionals and non-professionals, there is a need for variation of the rules which apply within the professionals category in order to provide an appropriate gradation of conduct of business protection which takes account of a wider range of requirements for protection than a twofold categorisation can provide.

This could be provided for by a further differentiation of how conduct of business rules apply to different types of professional investor. For example, few (if any) rules should apply to business with those professional investors in category (a) above and very large corporations that would otherwise fall within category (b), but which meet an additional size or expertise test. However, these very large corporations might be given the option to be treated in the same way as other large corporate and institutional investors falling within category (b) which do not meet the additional size requirements. More rules would apply to business with other professional investors falling within categories (b) and (c) than would apply to those in category (a) and very large corporations, but the range of rules would still be limited compared to the full regime that would apply to non-professional investors.

The main benefit of such a regime would be that the ability of financial service providers and investors to make the most of the single market would be maximised:

- expert individuals would benefit from access to a broader range of services, but be able to do so without losing all the protections which would result if they were treated in the same way as authorised entities, very large corporate and institutional investors, and governments;
- corporate and institutional investors would gain the benefit of appropriate protections, but would benefit from easier access to a broader range of services than if they were subject to a retail investor protection regime;
- very large corporate and institutional investors, authorised entities and governments, because of the very limited high-level professional regime, would have readier access to a full range of essential but sophisticated investments and investment techniques than would be the case if business with them were subject to FESCO's undifferentiated proposed rules for professional investors. If large corporates opted for greater protection, they could do so in a way which would

give them easier access to a broader range of services than would be available under a retail investor protection regime.

In addition, we think the following modifications should be made to FESCO's categorisation:

- FESCO's definition of large and institutional investors should be expanded to cover subsidiaries and parent companies of large and institutional investors, and companies listed on recognised third-country markets. We also suggest a simpler size test based on the investors' net assets.
- FESCO's procedures for the assessment of smaller companies and individual investors impose pre-conditions (volume of trading, size of portfolio, professional position requiring knowledge) on any decision to assess an individual as having the requisite expertise. We think that these considerations should not be pre-conditions, but factors which should be taken into account, along with others, as indicators of whether or not the investor has the necessary expertise.

We hope that final positions have not yet been taken on categorisation and the types of rules which should apply to each category, and we look forward to providing further input to FESCO on the details of the proposed standards and rules themselves.

Yours sincerely

Sir Adam Ridley
Director General, London Investment Banking Association

Cc Fabrice Demarigny, Secretary General, FESCO
 Jacob Kaptein, Chairman, FESCO Expert Group on Investor Protection