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**London Investment Banking Association (LIBA)**  
**Securities Industry and Financial Markets Association (SIFMA)**  
**Swedish Securities Dealers Association (SSDA)**

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## **Response to CESR's consultation on the Passport under MIFID (06-669)**

The associations welcome the opportunity to comment on CESR's Public Consultation on the Passport under MIFID (December 2006, CESR/O6-669).

### Key comments

1. We strongly support CESR's proposals to streamline firms' and branches' ability to exercise the passport promptly.
2. We strongly support CESR's identification of the need to find practical arrangements to make branch regulation as simple as possible, and to avoid duplicative regulation of branches' business. We do not believe that competent authorities should take their own view on the interpretation of 'in its own territory'
3. We consider that the most appropriate, practical, and effective regulation of branches' business is regulation by, and under the rules of, the branch competent authority in relation to those services and activities undertaken by the branch, on a characteristic performance basis, wherever the client is located.
4. We hope that the European Commission will follow this interpretation. We think that CESR should complement the legal position by developing, within the proposed protocol, a more coordinated and comprehensive approach to regulating branch business on a characteristic performance basis.
5. When applying the characteristic performance test, it will be important to examine carefully in which territory the essential service or activity is undertaken. For example, while it is appropriate to apply host State conduct of business rules to all the services that a branch provides, if the branch transmits the relevant transactions for

execution to the head office, transaction reports should be made to the home State authority and under its rules.

### Introduction

Paragraph 5: We stress the importance to CESR's analysis of MIFID Level 1 Recital 32's description of the practical application of Article 32.7.

Paragraph 8: We stress the importance to firms of the last of the aims that CESR lists: prioritisation of those aspects where investment firms need clarity in the short term. One of the most important areas where firms need clarity in the short term relates to which Member State's rules apply to their branch business.

Paragraphs 10 to 11: We recognise that CESR cannot give binding interpretations of EU legislation. However, in line with the last point in paragraph 8, it will be important for CESR members to give a strong commitment to apply the most practical interpretation of the legislation in a consistent way that gives firms the clarity that they need.

Paragraph 11: CESR says that it has drafted Section B 'considering that there may be different interpretations of what "in its own territory" means and has therefore developed a flexible set of solutions to cater for all possible applications of this point'. While we welcome CESR's practical approach towards supervisory responsibility (see detailed comments below), we note that it will also be very important for firms with branches to understand which country's rules they must comply with. We understand that the European Commission is expected to comment on this question in February, and we hope that the Commission will support an interpretation based on the 'characteristic performance' test. Taking account of the Commission's opinion, and in order to avoid divergent interpretations, it is important that CESR does not concede too easily, as Paragraph 11 appears to, that competent authorities may take their own view on the interpretation of 'in its own territory'.

### A. The Timetable in the Notification Procedures

CESR proposes a number of helpful coordinated approaches to ensure that investment firms can take full and prompt advantage of the MIFID passport to provide services cross-border or through a branch. In order to ensure that the same approach applies to all firms providing investment services or conducting investment activities, CESR should work with CEBS to ensure that the same implementation approach applies also to banks that derive their passport from the Capital Requirements Directive (recast) [2006/48/EC].

*Q1. As regards Article 31(3) do you agree with the above regarding what should be the date from which a firm can start to provide cross-border investment services into the host Member State under a passport? If not, for which reasons?*

We strongly agree with CESR's proposal that the firm may commence cross-border activities from the date when the notification has been dispatched by the home regulator to the host regulator, and that there is no requirement to wait for the firm to appear on the host's register. We believe, however, that it would be helpful if CESR

could, as far as possible, obtain the agreement of, or commitment from, all EU regulators regarding timescales for publication on host registers, so that the status of a firm providing cross-border services into an EU Member State for the first time is clear to potential clients.

Currently, we understand that, in practice, not all EU regulators may deal with notifications to provide cross-border services in the same manner. For example, a firm may have to make a direct application to the Host State regulator and notify the Home State that it has done so. We hope, therefore, that CESR will encourage all regulators to adopt its proposal and strictly adhere to the process set out in Article 31(3) of MiFID.

Paragraph 23. We strongly agree that once the firm has either received communication from the competent authority of the host Member State or two months has elapsed, whichever is the sooner, the branch may be established and commence business under the passport, and that the branch should not have to wait until the host competent authority has registered the branch before it can commence operations.

*Q2. Concerning Article 32(6) do you agree with the referral of the firm by the home regulator to the host regulator's or CESR's website when applying for a branch passport, when necessary?*

See our answer to Q3.

*Q3. Do you agree with the proposal set out in paragraph 24?*

CESR's proposals for CESR Members voluntarily to agree, where necessary, to advise the firm to consult the host State's website to ascertain any additional commercial requirements that must be met before the branch can be recorded in the host State's register would provide firms with helpful information. However, it will be very important to be clear that additional commercial requirements should not be used to extend the two-month limit under paragraph 23.

#### B. The Division of Home/Host Responsibilities Regarding Branches

In considering this issue, it is important to bear in mind the legal and practical background, which points strongly towards the conclusion that regulatory responsibility and the applicable rules should be determined according to the entity from which a service is provided (regardless of the territory where the client is located), or in which an activity is conducted. Thus, for example, the provision of services by a branch should be regulated by and under the rules of the competent authority where the branch is located, regardless of the location of the client. However, if certain activities are centralised in the head office (for example, the booking of transactions transmitted from branches), that activity should be subject to home country supervision and under the rules of the home country competent authority. A similar approach should apply where the provision of services or execution of transactions takes place in different branches, rather than in a branch and head office. It will be important to be precise about which entity provides the service or executes the transaction, and full weight should be given to the contractual arrangements between the firm and its clients, and the internal arrangements between

the head office and the branch, in enabling firms to determine precisely where services are provided or activities undertaken, so that they know which rules apply. The same interpretation should apply to transactions ‘executed’ (Article 25) or ‘concluded’ (Article 28) within the territory. If a branch executes its clients’ transactions itself, it should report them to the host regulator, but if, for example, it passes them to head office for execution, the head office should report them to the home regulator.

The following provisions support this approach, which also provides the most sensible, efficient, and practical regulation, as well as the most effective investor protection:

- MIFID Level 1 Recital 32 makes clear that Article 32.7 should be interpreted on the basis that the competent authority where the branch is located is closest to the branch and therefore best placed to detect infringements and intervene, and therefore provides the most practical and effective way of regulating the services provided from the branch.
- The Commission’s 1997 Interpretative Communication on the Freedom to Provide Services and the Interest of the General Good in the Second Banking Directive [SEC(97) 1193 final] interprets similar “within the territory” wording in the Second Banking Directive: “In order to determine where an activity was carried on, the place of provision of what may be termed the ‘characteristic performance’ of the service, i.e. the essential supply for which payment is due must be determined”.

Paragraph 30. We support the proposed development of a protocol for a common framework on the practice of branch supervision, but it should cover a broader range of home/host issues. We note that CESR’s analysis focuses on the position of regulators, and the agreements between them. It is also vital to recognise that firms need to know which rules apply to which parts of their business (see paragraph 36 below).

Paragraph 32. We do not agree that ISD should necessarily be interpreted as requiring firms that provide cross-border services to understand and apply the rules of conduct of each host State into which they passport services. Such an interpretation is inconsistent with the Commission’s 1997 Interpretative Communication on the Banking Directive. However, we do agree that under MIFID a firm need focus only on the home rules for domestic and cross-border services provided by the head office, and the rules of the host States in which it has branches for services provided by those branches on a characteristic performance basis (whether domestic or cross-border).

Paragraph 35. We agree with CESR’s analysis of the position under MIFID and the the issues facing branches with respect to the division, although it is important under (c) to interpret responsibilities between home and host state regulators. It is, however ‘services provided within the territory where the branch is located’ according to the characteristic performance test (whether the service is provided domestic or cross-border). Thus we do not agree where CESR says that ‘when a branch is conducting business outside its territory, responsibility...rests with the home state regulator’.

Paragraph 36. We agree that a clear understanding among firms and regulators as to how a firm operates its business across the EU, as well as close cooperation between regulators, will be required.

*Q4. What are your views on the exposition given in paragraphs 31-36 above? What grounds do you have to support your views?*

See our comments above.

Paragraph 37. We agree with CESR's comments on the need under MIFID for home regulators to trust each other to regulate cross-border business. The same argument applies in relation to branch State regulation of branch business. We note CESR's comments that firms will need to take their responsibilities in respect of such business seriously, and are confident that they will do so.

Paragraph 39. We agree with CESR's objective to find practical arrangements that mitigate the complexity of branches being subject to two conduct of business rule-books and dual supervision.

As discussed above, an interpretation of 'services provided within the territory where the branch is located' according to the characteristic performance test, will be critical to the proper functioning of conduct of business regulation of branches and to the provision of sufficient clarity for firms; thereby enabling them to determine, where there is a possibility of confusion or overlap, which of their activities are subject to which regulations.

*Q5. Do you agree with the practical supervisory challenges as identified by CESR? Are there any others that you envisage may occur and could benefit from consideration by CESR?*

Yes. See comments on Paragraphs 37 and 39 above.

A further practical challenge that the paper does not address is the common situation where locally incorporated subsidiaries are located alongside the branch. Unless the characteristic performance approach applied, it would be a significant additional challenge, and one bound to cause confusion within such offices, to decide which rules would apply to a particular transaction or service depending not only on which of three entities (the head office, the branch, or the subsidiary) had undertaken the service but also whether within the relevant territory or not. In that sense the chart in paragraph 33 provides only a simplified description of the complexity that firms using both branch and local incorporated subsidiary, potentially working alongside each other, will encounter.

*Q6. Do you agree with the suggested desired outcomes? Are they capable of being shared for the benefit of all stakeholders?*

Yes. We strongly support CESR's comments under paragraph 42 on the need not to create unnecessary burdens to the provision of cross border services or activities through a branch. We think that an approach based on host country supervision of all the services provided from and activities undertaken in a branch (but not those which are provided from or undertaken in the head office) is the only practical way to achieve this objective. Under paragraph 40, as noted in our previous comments, it is

important not only to have practical arrangements governing compliance and supervision, but also clarity about which country's detailed rules apply.

That said, whilst we recognise the desirability of firms with branches being able to develop corporate governance and procedural arrangements which will deal with any potential overlapping of regulatory responsibilities, in practice, unless firms have a clear regulatory template to apply, such an outcome is unlikely to be achievable.

*Q7. Do you agree with the broad 'criteria' outlined above and as set out in more detail in Annex 2, against which CESR will evaluate possible solutions? Do you have any comments? Are there any others you would suggest that could be material when considering the relative merits of different practical solutions?*

Broadly, we agree with the criteria proposed, which point strongly towards an approach based on regulation and supervision by and under the rules of the jurisdiction from which services are provided or activities undertaken. We have the following additional comments:

Annex 2.a.i. As noted above, clarity as to which country's rules apply is also an important success criterion.

Annex 2.b.i. We stress the importance of the legal costs that may arise if the law applicable to contracts differs from the law governing supervision.

Annex 2.b.ii. We agree with the need to avoid the waste associated with duplicative application and supervision of different sets of rules to a branch's business.

Annex 2.b.v. A branch could well be at a competitive disadvantage to a separately incorporated legal entity if it were subject to different rules for different aspects of its business, or was required to report transactions to different competent authorities, depending on where the client happened to be located.

Annex 2.c.i. The question of how easily a firm can acquire and develop understanding of local host markets to enable it to control its business as a whole should not be a relevant consideration. Branches will need to acquire and develop such understanding in any case in order to operate the branch. Any requirement to have regard to home country requirements as well for certain parts of the branch's business could impede and distort such understanding.

Annex 2.c.iii. The development of an integrated environment with a shared compliance culture should not be a relevant consideration, since firms with branch networks would need to do this anyway.

Annex 2.e.i. The regulatory treatment of transactions should be determined according to where the centre of activity in relation to them is. All of the transactions executed by a branch should be treated as carried out within that branch territory. Where the branch provides services to clients, but transactions are executed in head office, the transactions should be treated as carried out in the head office territory. In all cases, the regulatory treatment should follow the way in which the business is structured and carried out.

Paragraph 47. We support CESR's argument that common standards created by MIFID provisions, together with enhanced understanding between regulators and convergence in supervisory practices, should ensure that cross-border business operates smoothly. The same argument supports branch State regulation of cross-border branch business.

*Q8. Do you have any comments on the possible solutions identified above? Do you have any others that you feel could help?*

We broadly agree with CESR's proposed approach to the boundary between 'organisational' and 'conduct of business' supervision set out in points (a) to (f) of paragraph 48. We do not think that these options need be seen as incompatible with each other.

We strongly urge CESR to follow option (b) in paragraph 49, which is both practical and consistent with MIFID. Options (a) or (c) would involve substantial inefficiency. However, even under option (b) firms would still need to have clarity as to which State's rules apply to the relevant business.

In practice, however, we wonder if it is over optimistic to assume that regulators might develop their own bilateral arrangements to deal with home / host state responsibilities? In addition, if different regulators agree different bilateral protocols it will result in inconsistencies with respect to the application of regulation and also confusion within firms which have multiple branches in different jurisdictions which will face different regulatory arrangements. We believe, therefore, CESR should consider establishing a defined template (Memorandum of Understanding), which EU regulators sign up to and which will be applied across the EU.

*Q9. Do you agree with the broad evaluation and conclusions as outlined in paragraphs 50-55 above? What does your own evaluation suggest? What evidence can you provide to support your conclusions?*

We agree with many aspects of CESR's analysis. The position of subsidiaries that operate alongside branches should also be taken into account at the evaluation stage. Similarly should this also be a practical issue to be taken into account at the evaluation stage.

However, under paragraph 52, we do not agree that the importance of a branch to the local market should be a relevant factor in determining the dividing line between organisational and conduct of business requirements.

Paragraphs 53 and 55 do not resolve for branches concerned the vital question of which State's rules apply. As we argue in response to Q17 below, even if no definitive legal interpretation of Article 32.7 is provided, a multi-lateral agreement between regulators that they will in practice determine which rules apply, and which competent authority polices them, in accordance with Recital 32 and the characteristic performance approach, would considerably assist firms.

Paragraphs 58-60. We welcome CESR's commitment to regulatory cooperation although see our comments on the need for formalisation. However, as CESR identifies in paragraph 59, the crucial question which needs to be resolved is which State's set of rules a branch needs to comply with. We broadly agree with CESR's proposed approach in paragraph 60, which corresponds broadly with the 'characteristic performance' of the activity or service concerned.

Paragraph 62. CESR refers to the possibility of Commission interpretative guidance. Compare the Interpretative Communication the Commission made on similar language in the former Consolidated Banking Directive (now the CRD) in 1997. We understand that the Commission will provide an opinion on this issue by February 2007.

### C. Cross-border Activities of Investment Firms through tied agents

We do not have any comments on this section of the consultation paper.

### D. The Cross-border Activities of an MTF

Paragraph 88. CESR's proposed interpretation based on the 'connectivity test', under which an operator of an MTF would be deemed to be providing cross-border services in another Member State where direct access is provided to users or participants in that other Member State, appears reasonable.

*Q13. Do you agree that a common approach on deciding what constitutes passporting for an MTF, as referred to in Article 31(5) and (6) MIFID, by all CESR members will benefit investors and industry?*

Yes.

*Q14. Do you agree with the suggested criterion ("connectivity test") for deciding whether an MTF is passporting its services/activities? If not, should the criterion be adjusted or replaced and elaborated on more and for which reasons?*

Yes.

### E. The Activities of Representative offices

*Q15. Do you agree with the arguments set out in this chapter?*

Yes.

### F. Transitional Arrangements

Paragraph 103. We agree with CESR's proposed recommendation that home regulators invite firms to request any additional authorisations that may be needed.

*Q16. Do you agree with the proposal of mapping ISD to MIFID proposed in Annex 1? What changes or possible alternatives would you suggest?*

CESR's proposed mapping appears sensible.

G. Further Harmonisation by way of a Protocol between Competent Authorities

*Q17. Do you consider the suggested approach appropriate and/or do you see other issues that should be handled in this protocol?*

We support the proposal for a protocol between competent authorities as a practical method of agreeing and allocating responsibilities. As far as possible, the protocol should cover the allocation of supervisory responsibility for branches, and which rules apply to them. Even if no definitive legal interpretation of Article 32.7 is provided, a multi-lateral agreement between regulators that they will in practice determine which rules apply, and which competent authority polices them, in accordance with Recital 32 and the characteristic performance approach, would considerably assist firms.