TRAVERS SMITH

10 SNOW HILL
LONDON EC1A 2AL
TEL: +44 (0) 20 7295 3000
FAX: +44 (0) 20 7295 3500
DX 79 LONDON
WWW.TRAVERSSMITH.COM

Mr Stuart Willey
Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

YOUR REF:
OUR REF: MAC/CD1
DOC ID: 6695832
DIRECT LINE: +44 (0) 20 7295 +44 (0)207 295 3233
EMAIL: margaret.chamberlain @traverssmith.com

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Dear Stuart

**MiFID Implementation PS 07/18: Financial Promotions Questions and Answers**

I am writing to raise with you two areas of concern that have been discussed at the City of London Law Society Regulatory Committee, which I hope you will be able to pass to the relevant colleagues for further discussion.

The first is a relatively self-contained matter, but which highlights an important point of principle. Where the FSA becomes aware of an error in a rule that has been made, which it proposes to change, then we would like to ask the FSA to communicate to the regulated community and their advisers the nature of the error and the fact that it will be corrected. A substantive change was made to COBS 6.1.7(4) in Policy Statement 07/18. COBS 6.1.7(4) had, in the rules as made in May, required firms to communicate to professional clients certain items which they were also required to communicate to retail clients. In the rules made in May the material to be provided to professional clients included material in COBS 6.1.7(4)(e). A change was made at the end of October to change the cross reference to paragraph (d). This change affects the obligation placed on a firm as to the information that it must provide to a professional client, and over the last few months firms will have been having regard to the rules as published in preparing their new procedures. The change that has been made to the rule is obviously required properly to implement the Directive. However, it would be helpful if substantive changes of this kind could both be flagged in the Policy Statement itself and indeed highlighted in advance as soon as it is known that they will be made. We would not class this change as administrative or clarificatory and we think that everyone would find it helpful if more steps were taken to highlight such changes and give advance notice of them, where it is known that a mistake has occurred.

The second issue we wish to raise with you concerns the new financial promotion rules in COBS 4 and the document issued by the FSA in October which contains questions and answers and case studies in relation to communications with clients and financial promotions.

We appreciate that the production of the chapter on communicating with clients has been a complex matter and we welcome the fact that the FSA has taken into account comments made during the

consultation process in producing the final draft, which we think is very helpful. Inevitably there are a number of points which will continue to give rise to some questions and we therefore welcome the development of the questions and answers document. We have some suggestions in relation to that document on issues that we have identified, where we believe that further useful material could be included.

There are therefore a number of detailed but important issues that we would like to discuss as noted below. There is also one very important point of principle. This concerns Case Study 3 in the series of case studies on direct offer financial promotions. The introductory text of that case study says (in referring to the example promotion):

> "The promotion... satisfies the criteria to be a "direct offer financial promotion", a term which is now interpreted as having wider applicability than that understood historically."

The definition of direct offer financial promotion has not changed as a result of the implementation of MiFID. We hope you would agree that the interpretation of a definition cannot be subject to "change" by the FSA making a statement of this kind and we hope that this is not an example of "principles based regulation". It has been clear to some members of the committee for some time that the financial promotion policy unit would like to take a wider view of the term 'direct offer financial promotion', but it cannot do this indirectly in this way. If the FSA considers that there is a case for extending the relevant rules to promotions which have not previously been treated as 'direct offers' then it needs to follow due process, which is not achieved through a reference in a single case study on the FSA website (or even a succession of references). The rules relating to direct offer financial promotions are potentially quite onerous on firms and it is therefore very important that a firm can identify when it is dealing with a direct offer financial promotion. The definition encompasses what would be thought of in contractual terms as either an offer or an invitation to treat (with, of course, the means of application), and this has been the position since the 1986 Act. If the FSA wishes to interpret it more widely, then there will obviously be some significant issues for firms and the issue needs to be addressed in accordance with the standard consultation and related procedures.

The other matters that we would like to raise on the question and answer document are as follows:

1. We think that under the heading "What rules apply and when?" it would be helpful if a new second bullet point could be inserted to the following effect:

   > *"Is the communication a marketing communication to a client of the firm's MiFID business in relation to that business?*
   >
   > *Where the communication is to such a person, then those provisions which apply to MiFID communications will be relevant and firms will not be able to rely on the exclusions in the Financial Promotion Order."*

   We think it would be helpful if this situation could be contrasted, for example, with the situation where a communication is made to a person who is a corporate finance contact. They are not receiving a client communication and therefore the exemptions in the FPO may be relevant and applicable.

2. We think it would help to have an additional bullet point (possibly as a first bullet point) that makes it clear that, in relation to COBS 4, a person does not need to be a "true" regulatory client (i.e. a person to whom services are provided) in order to be classified as a type of client (i.e. retail, professional) for the purposes of the financial promotion provisions of COBS 4 which relate to non-MiFID communications. It is only where the question is whether the financial promotion relates to the firm's MiFID business that the term client has the narrower meaning. Thus, for example, a corporate finance contact which is not a regulatory client may still be classified as a professional client for the purposes of determining the requirements of COBS 4 in relation to financial promotions.

3. There is some confusion as to the relevance of the "eligible counterparty" classification under CASS 4. We assume (and the point could be clarified) that a communication could only be regarded as made to an eligible counterparty where that person is a "true" client and the communication relates to eligible counterparty business. In any event, whatever the FSA's view on this, it would be helpful if some guidance on the use of the eligible counterparty classification in connection with financial promotions could be added into the second bullet point.

4. The second sentence in COBS 4.1.6 could be clarified, as we are aware it is causing some confusion. The Committee understands it to mean that communicating to persons who are not "actual or potential" clients for a MiFID service is not to be treated as MiFID business. The phrase "other than a client or a potential client" is slightly confusing in the light of the wider meaning given to "client" for the purposes of COBS 4, which is why we suggest that this provision could helpfully be clarified.

5. We also had a number of specific comments on the case studies, which are set out in the Schedule to this letter.

Perhaps when you have had time to discuss this with your colleagues it might be appropriate for you (perhaps with others) to attend one of our meetings so that we could discuss the issues further. If you could let me know what dates suit you I will arrange a meeting-we tend to meet at lunch time but if another time suits you please let me know.

Kind regards.

Yours sincerely

Margaret Chamberlain

**MARGARET CHAMBERLAIN**

## SCHEDULE

## CASE STUDIES

While we appreciate that such matters are always a question of judgment in all the circumstances and that the main purpose of the case studies is to make firms think carefully about what they are doing, we did have some concerns about the balance of the approach to the case studies. In particular we found surprising the degree of criticism levied at the references to Europe and risk warnings in case study 2. Unless the investment policy and restrictions of the fund failed to permit investment principally/exclusively across the whole of Europe (if it did fail to do so then we agree the terms would be potentially misleading) it seems to us that the fact that more detail on the investment policy and restrictions would undoubtedly be needed in the prospectus / KFD should not prevent references to "resurgent Europe" or "Pan-European".

We were also surprised at the degree of criticism over the absence of further risk warnings in a very brief advertisement which contains a very clear warning of risk of failure to make profits and possible loss of capital. Had more detailed risk warnings been given at this stage it appears to us there would have been a greater risk of investors switching off and failing to take note of the warnings and/or of the firm using a smaller type face which is much easier for investors to ignore (as was in fact done in Case Study 4).

A particular reason why we found the balance of the case studies strange was that similar or stronger criticisms were not levied at Case Study 4 which was addressed to a less sophisticated audience. Instead it merely received approval for the provision of past performance information in a safe harbour table format, although the table does not appear to state what the figures relate to and is therefore difficult to follow (value of a unit? percentage growth? percentage decline? - only knowledge of the FSA rule or the source cited would give the answer). Yet the advertisement in Case Study 4 seem to us to be potentially more misleading in its impact on the target audience than Case Study 2. It has a number of strong positive words such as growth, take off and sky high, which are words easily understood, and a small type warning on the possibility of investments "becoming depressed" which is a phrase which will not necessarily communicate the idea that investors may lose money (i.e. using the flight analogy, the risk the plane might crash rather than have the flight postponed and sit on the runway for a bit). We think that the FSA should have made some of these points and also clarified whether its earlier comments on direct offer promotions in relation to Case Study 3 are thought by the FSA also to apply to Case Study 4 which seems to follow substantially the same process of going to a website or telephoning to obtain an application form. Neither in our view is a direct offer advertisement but if the FSA sees a distinction between them it should be clarified.