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Dear Sirs

CP07/9: Conduct of Business Regime: Non-MiFID Deferred Matters

The City of London Law Society is the local Law Society of the City of London. Members of the Committee advise a wide range of firms in the financial markets, including banks, brokers, investment advisors, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as trading, clearing and settlement systems.

We are commenting on selected aspects of the Consultation Paper, to address issues that concern us as lawyers advising on the Conduct of Business rules.

Chapter 18, Section 150

We think that in addition to the costs benefit analysis in relation to this particular proposal, important policy issues also arise. Whilst we note that in many cases a consumer will go to the Financial Ombudsman Service, we do not think that this fact of itself is sufficient to justify what we see as a widening of the type of claim that might be brought under section 150. The FSA currently provides that a contravention of the Principles does not give rise to a right of action by a private person under section 150. This is for the very good reason that these Principles set very high level standards which are not suitable for assessment by a court of law. There are a number of provisions which result from MiFID - for example, the implementation of Article 19(1) - that are, to all intents and purposes, the same high level principles as the existing Principles.

We believe that the current proposal to give section 150 rights in respect of all new COBS rules is therefore a substantive legislative change from the current regime, which takes the high level of principles out of the scope of this remedy. We believe that this should continue to be the principle that applies. The FSA had a positive reason to disapply section 150 rights in respect of the existing Principles, and we believe that these reasons remain valid reasons in respect of any new COBS rule which is akin to a high level principle. If this is not

recognised then there is clearly a reduction in the value of the existing execution from the scope of section 150. For example, section 150 would not apply to a breach of the principle to pay due regard to the interests of customers and treat them fairly but would apply to the very similar high level principle in COBS 2.1.1(1). We consider that clients have sufficient remedies via the Financial Ombudsman Scheme and other general law remedies without the need to alter an approach that has not been shown to have any defects over the last few years.

We would also note that we have concerns about the implications in the discussion section of this chapter. During the MiFID process, we expressed concern about the use of absolute requirements in the MiFID terminology as opposed to the UK approach which uses phrases such as "take reasonable steps". It was our understanding that the language in the Directive was not intended to be construed as creating an absolute standard, merely that it reflected a continental style of drafting which by implication achieves a similar result to more Anglo-Saxon phraseology. From the discussion section it appears that (contrary to the position we had understood the FSA would be adopting) the FSA now intends to construe these rules as absolute requirements. This would be particularly important in an enforcement context. The effect of what the FSA is saying is that if the Ombudsman decided that a consumer did not have a claim because it was not fair and reasonable in the circumstances, then the consumer would still have a court action under section 150 on the basis of the absolute requirement terminology copied out from MiFID. This is a substantive change from the current position which could work very harshly and unfairly on firms. We therefore believe that further serious thought must be given before giving section 150 rights in respect of provisions which are expressed in such absolute terms. It may well be the case that in other jurisdictions the section 150 issue does not arise and, therefore, the wording of the requirements becomes a matter between the firm and its regulator rather than between the firm and its client and judged by a court of law. If the FSA intends to continue with this approach, then it may be necessary for further legislative provision so that a section 150 claim cannot be brought for breach of an absolute requirement where the firm has taken reasonable steps to meet the requirement.

We therefore do not agree with the FSA's proposed approach to section 150 rights of action and we believe that the proposal raises some significant policy issues.

Client Classification Issues

There are some types of firm who will be carrying on non-MiFID business within, for example, an exclusion from MiFID. It is well known that the MiFID client classification criteria impose on the UK market significant limitations compared with the current regime, in relation to the types of person that may be treated as a professional client. We think that for non-MiFID business there is a preference for flexibility (which we acknowledge may bring complexity) for firms. In particular, for non-MiFID business, we believe that the category of professional client should be equated to the current categories of intermediate client rather than just disapplying the stringent MiFID quantitative tests.

Whilst we welcome the proposal to disapply the quantitative criteria for opting up of a retail client to elective professional status in relation to non-MiFID business, we think this is but one aspect of a larger issue. For example it is not clear to us why for non-MiFID business the professional client category should include only those large undertakings which were previously capable of being opted up to market counterparty status and not those current intermediate customers which pass the existing £5 million plus net assets test. Nor is it clear

to us why other useful categories, such as listed companies and collective investment schemes whether or not regulated. These categories are important not only for immediate customer classification but also for matters such as the boundary of the best execution obligation for operators of collective investment schemes and the issue of financial promotions in relation to Lloyd's business. In each of these cases the consultation paper gives the impression that there will be few significant changes but the change to customer categorisation could in fact bring significant changes.

Promotion of Collective Investment Schemes

We note that the restrictions on the marketing of unregulated collective investment schemes do not fall within the scope of MiFID. It is also our view that a firm which is marketing a collective investment scheme will not necessarily (or indeed usually) be providing an investment service to the prospective investor in relation to the marketing activity. We agree that any boundary for promotion of schemes should be the same for both MiFID and non-MiFID firms (otherwise there would be the curious situation where an operator of the fund could promote it more widely than could an adviser or other service provider to the fund or its discretionary manager). We do not however think that there is any need to adopt MiFID client classification criteria when determining the identity of persons to whom a scheme may be promoted. We note the new proposals to remove the MiFID quantitative criteria in the elective professional "opt-up" and to retain the COB quantitative criteria in determining a "large undertaking"; we assume these were inserted to deal with this particular issue. However, the expert/elective professional opt-up process involves additional cost and administration and is not always one that would be understood or welcomed by the prospective investor. If the MiFID terminology is adopted (albeit on a modified basis) firms are likely to find themselves either having to undertake this potentially burdensome opt-up process on a much more frequent basis, or having to curtail their marketing activities to persons whom, under the existing regime, would be intermediate customers.

We believe, therefore, that there is no reason to alter the boundary as to the identity of the type of persons to whom a collective investment scheme may be promoted and that this should not be changed from the existing criteria which enabled promotions to be made to persons who fall within the definitions of intermediate customer and market counterparty. If, for ease of its own administration, a firm wished to impose upon itself such an additional restriction, this would be a matter for it. We do not think that there is justification for changing the boundary as a result of MiFID.

We hope you find the above comments helpful. Please do not hesitate to contact us if you would like further elaboration or information. We would be very happy to discuss this response with the FSA. Please contact the chair of the Regulatory Law Committee: Margaret Chamberlain, Travers Smith, 10 Snow Hill, London EC1A 2AL, Tel: 020 7295 3233, Fax: 020 7295 3500, e-mail: margaret.chamberlain@traverssmith.com.

Yours faithfully

Margaret Chamberlain

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Chairman
City of London Law Society Regulatory Committee