



THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

Ref: CESR/07-318

## THE PASSPORT UNDER MIFID

Recommendations for the implementation of the Directive  
2004/39/EC

Feedback Statement

May 2007



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## Background

1. This Feedback Statement provides a summary of the main comments received by CESR to its consultation on passport issues along with some explanation of the approach that CESR has adopted in response to the various comments raised by stakeholders. It complements the publication by CESR of its recommendations to its members. This consultation published on the 15th December 2006 presented proposals and questions for a common approach on the notification procedures for the passport set out in Articles 31 and 32 of MiFID and on the future collaboration between the home and host authorities.
2. The main aims of this proposals and questions can be summarized as follows:
  - maximum harmonisation of the notification procedures;
  - uniform interpretation of Articles 31 and 32;
  - enhancing collaboration between host and home regulators during the authorisation and supervision phases;
  - clarifying some aspects regarding the supervision of tied agents, Multilateral Trading Facilities (MTF) and representative offices.;
  - elaboration of pragmatic solutions for the transition from the ISD passport to the MiFID passport;
  - prioritisation of those aspects where investment firms need clarity in the short term.
3. The public consultation allowed CESR to understand and to take into account the views of market participants (industry and consumers). All public responses were published in the CESR web site in the section “consultations”.
4. The consultation was closed on the 9 February 2007. CESR received 36 written answers, mainly from Industry representatives. An open hearing took place on the 2 February 2007 and the consultation paper was also discussed at CESR's consumer Open Day. Overall, respondents mostly agreed with CESR's approach and its proposals.
5. Following the consultation, CESR decided to issue recommendations to its members for them to apply in their day-to-day supervisory practices.

FEEDBACK ON RESPONSES TO THE FIRST CONSULTATION ON PASSPORT ISSUES

A. THE TIMETABLE IN THE NOTIFICATION PROCEDURES (ARTICLES 31 (3) AND 32 (6) OF MiFID)

1. In its consultation paper CESR proposed some recommendations regarding the timetable referred to in article 31 and 32 of MiFID. CESR asked the following questions:

*Question 1: 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 in to the host Member State under a passport? If not, for which reasons?*

*Question 2: 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?*

*Question 3 Do you agree with the proposal set out in paragraph 24?*

2. Some respondents stated that the one month period established in article 31(3) should be considered as a maximum period after which there is an automatic right for an investment firm to commence the relevant cross-border activities irrespective of whether there has been a notification or not by the Competent Authority of the home Member State to the Competent Authority of the host Member State. CESR believes that this interpretation is not acceptable and that under article 31(3) the investment firm may only start to provide investment services in the host Member State once the notification has been sent by the Competent Authority of the home Member State to the Competent Authority of the host Member State. This is because the Competent Authority of the home Member State has responsibility for the regulation of the business of a firm conducted on a cross-border basis and so needs to prepare to be in a position to fulfill this responsibility. It is also important that the notification has first been sent to the Competent Authority of the host Member State in order that it is put on notice that the firm in question will be doing business in its State and has the comfort that the home Member State knows that this is the case.
3. Regarding the application of the timetable under article 32 the respondents were especially concerned about the possibility that in some countries non-MiFID additional commercial requirements could prevent the registration of the branch taking place within the two month period. Respondents asked for clarity to the effect that for the purpose of MiFID, there should be nothing to stop the branch operating at the latest two months after the transmission of the communication by the Competent Authority of the home Member State to the Competent Authority of the host Member State. CESR is clear that under MiFID the two months is a maximum period for the Competent Authority of the host Member State to handle the notification, after which the firm is entitled to conduct MiFID investment business through its branch.
4. Respondents were nevertheless very much concerned about paragraph 24 where CESR proposed its members, where necessary, to advise the firms to consult the host's website in order to be informed about the additional commercial requirements that must be met before the branch can be recorded in the host register. In some Member States there are additional legal requirements for establishing a branch outside the scope of MiFID concerning the filing of the branch in the companies' registry, which in some cases can take more than two months to complete. The CESR proposal in the consultation paper - to facilitate the notification process by referring firms to information on companies' registry requirements maintained on the website of the relevant host Competent Authority - was therefore made simply in order to help



firms identify (and so comply with) the relevant non-MiFID legal requirements, so as to reduce any possibility of conflict with the two months period in MiFID.

## **B. THE DIVISION OF HOME/HOST RESPONSIBILITIES REGARDING BRANCHES**

5. In its consultation paper CESR proposed a methodology and different possible outcomes regarding the model of cooperation between Competent Authorities in applying article 32 (7) of MiFID. In the paper CESR asked a number of specific questions. A lot of respondents also provided a number of general comments on this issue.

### **General responses on home/host division of responsibilities**

6. This chapter of the CESR consultation paper on Passporting attracted the highest level of response, particularly on the issue of the application of "within its territory" under Article 32(7). Respondents saw this as a critical topic, noting that one of the intended major benefits of MiFID to be an improvement of the conditions related to the smooth operation of the European passport for branches. Respondents were very strongly in favour of solutions that would achieve legal certainty and an outcome of single supervision of conduct of business requirements for services provided through a branch.
7. Broadly speaking, respondents agreed with the statements and proposals CESR puts forward in this chapter. The overarching concern was in regard to the need for certainty. Many respondents noted that it was imperative to have certainty regarding the division of responsibilities between home and host well prior to the implementation date to give the firms time to adopt the appropriate internal measures. Many respondents defended the "characteristic performance" legal test because this could give to the industry the certainty and the application of a single rulebook to branches that it sought.
8. There was a very clear call for CESR and its members to ensure that regulators deliver practical cooperation arrangements in a common and consistent manner. Some respondents linked what CESR described in its consultation to the conclusions of the Financial Services Committee (FSC) Report on Financial Supervision, as endorsed by the Member States at the May 2006 informal ECOFIN meeting.
9. Many respondents were concerned to avoid a case-by-case approach to the treatment of branches if possible, on the grounds that this could be potentially inconsistent, complex, opaque and costly. Some of these respondents suggested that a case-by-case approach could lead to the risk of underlaps and/or overlaps in supervision, which should be avoided.
10. Some respondents were of the clear opinion that the host regulator would often be best placed to supervise conduct of business of a branch and that Competent Authorities needed to deliver pragmatic solutions to ensure this. One possible solution put forth by some respondents would be to grant home states the power to deem compliance with host state rules as compliant with the home's, in order to reduce potential overlapping regulation. Other respondents wanted a clear definition of what constitutes the conduct of business rules mentioned in article 32(7) and what constitutes organisational requirements.

### **Responses on specific questions<sup>1</sup>**

**Question 4: What are your views on the exposition given in paragraphs 31-36 above? What grounds do you have to support your views?**

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<sup>1</sup> Please note: any paragraph numbers repeated in the questions refer to those in the consultation paper CESR/ 06-669.



11. Respondents agreed that regulators and firms should share a common interest in supporting any practical arrangements that help ensure that branch operations are controlled and supervised properly. Respondents also agreed on the key proposal that the respective home and host regulators agree and communicate their views to the relevant firms on how best in practice to carry out branch supervision.
12. Some respondents stated that the business model of the investment firm as well as its policies and procedures should be taken in to account and that reference should always be made to the location of the entity which ultimately provides the service or performs the relevant activity rather than the location of the client.
13. Almost all respondents emphasised the need for legal certainty, especially at the planning and implementation stage.

**Question 5: 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?**

14. All respondents agreed with the practical challenges identified by CESR. In addition, some identified a further challenge in situations where a firm has locally incorporated subsidiaries as well as branches, should the eventual outcome result in different conduct of business rules being deemed to apply to the branch compared to the subsidiary (established in the same Member State) .

**Question 6: Do you agree with the suggested desired outcomes? Are they capable of being shared for the benefit all stakeholders?**

15. Nearly all the respondents agreed that the desired outcomes CESR sets out are the correct ones that should help achieve greater certainty. However, some respondents advised that unless regulators were able to agree upon a common approach in practice, it would be difficult for firms with branches to develop corporate governance and procedural arrangements that dealt with any overlapping of responsibilities.

**Question 7: 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?**

16. Respondents generally agreed with the criteria with which to evaluate possible solutions, as set out in Annex 2 of the consultation paper. Some respondents noted that these criteria are broadly in line with the principles put forward in the context of the recent better regulation initiatives and welcomed the fact that CESR focuses on the cost to firms and the cost to supervisors when considering the efficiency of the practical arrangements.
17. Some respondents emphasised the need for any criteria applied by regulators to follow the way in which the business is structured and carried out. As an example of inseparability one respondent proposed that structured transactions should be considered as a whole and accordingly reference should be made to the location of the entity which ultimately provides the relevant structured transaction.

**Question 8: Do you have any comments on the possible solutions identified above? Do you have any others that you feel could help?**

18. Different respondents had different views on the various possible solutions identified in paragraphs 48 and 49 of the consultation paper, such that there were no clear preferred options. However, there was some shared concern that the solution should not result in different regulators agreeing different bilateral protocols and it was suggested that regulators, through CESR, should seek the most common approach as is practically possible to avoid uncertainty and duplication.



**Question 9: Do you agree with the broad evaluation and conclusions as outlined in paragraphs 50-55 above? What does your own evaluation suggest? What evidence base can you provide to support your conclusions?**

19. A significant number of respondents agreed with many aspects of CESR's analysis.
20. Nearly all respondents asked for as much consistency and transparency as possible in any arrangements for the supervision of branches.
21. Some respondents supported the idea that the home regulator, whilst remaining legally responsible, be able to outsource or delegate supervisory tasks to the host regulator of the branch. They further suggested that the home regulator be able to confirm to the firm that it would deem compliance with the host state rulebook as compliance with its own home state rulebook.
22. A number of respondents supported the view that even if there was to be no agreed legal interpretation of article 32(7), a multilateral agreement between regulators would considerably assist firms. Such an agreement should include details of which rules apply and which Competent Authority polices them in accordance with recital 32.
23. A significant number of respondents noted CESR's commitment to regulatory cooperation as set out in the consultation paper and welcomed this. They also made clear that a crucial question to which firms sought an answer is which Member State's set of rules a branch would need to comply with. The majority of respondents generally favoured a 'characteristic performance' test to determining this.

#### **Feedback of CESR on responses**

24. CESR welcomes the remarks and constructive suggestions made by respondents. CESR recognises the importance of the home/host issue for branches and the desire of firms for a common, consistent and transparent approach where possible. The issue raises many challenges that must be solved in order to arrive at practical supervisory arrangements between regulators and so help achieve the common desired outcomes identified in the consultation paper and with which nearly all respondents agreed.
25. CESR has asked the European Commission for an interpretation regarding the meaning of the Level 1 Directive text under Article 32(7). The opinion of the Commission will inevitably shape the precise form of any collaboration arrangements among CESR members. However, CESR believes that whatever the outcome of this will be, CESR members should recognise the necessity to continue to work together to help deliver in practice outcomes consistent with better regulation. There are different models available for such collaboration.
26. CESR considers that members should be committed to the on-going work to agree effective mechanisms of practical cooperation for the supervision of branches. The results of this work must be transparent to stakeholders. Given the need for operational arrangements to be agreed as soon as possible CESR members will take all reasonable steps to achieve this goal.

## C THE CROSS-BORDER ACTIVITIES OF INVESTMENT FIRMS THROUGH TIED AGENTS

27. In its consultation paper CESR explored a number of practical issues for investment firms and for regulators regarding the use of tied agents, in particular:
- Regarding the organisational structure of the investment firm's cross-border activities, how does the investment firm, and the home regulator, evaluate the risks created? Are there any specific issues in addition to the way in which an investment firm might control an outgoing branch?
  - Where a tied agent is established in another Member State, how will the host regulator exercise ongoing conduct of business supervision over an unauthorised entity? Are there any special issues to consider?
  - How should complaints relating to a tied agent established in a Member State other than that of its principal investment firm be handled? Is it sufficiently understood that treating a tied agent as a branch means that the compensation mechanism of the home Member State covers losses attributable to a tied agent?
  - How should the host Member State verify that a tied agent complies with money laundering obligations? How can a home Member State be sure that the investment firm's procedures are adequately implemented?
  - How will Member States apply Article 23(6) in practice, and in a proportionate manner?

In its document CESR asked the following questions.

**Question 10: In the absence of a single public registry of tied agents, how might Member states enhance co-operation for the benefit of clients?**

**Question 11: Do you agree that there is a need for co-operation between competent authorities to help ensure that the requirements for good repute and possession of knowledge for tied agents can be met in practice? Do you agree that prior to registration the home Member State should be able to exchange information with the competent authority of the Member State where a tied agent is located to help establish that he has the required good repute and knowledge? Would any specific guidelines be helpful; if so, what are your suggestions?**

**Question 12: To help resolve the practical questions on the supervision of tied agents, good co-operation between regulators will be necessary. CESR is minded to conduct further work in this area. Do you have any practical suggestions or comments that could help CESR fine-tune its approach for tied agents?**

28. Respondents noted the need for proper and easily accessible information on tied agents. Some of the respondents suggested that the Member States or CESR should establish an internet-based system of linked registers, possibly on a single template basis, so that the individual information regarding tied agents is accessible at a European level. CESR agrees that it would be helpful if its Members could study the use of a common template for the registers of tied agents and their linkage through an internet-based system.
29. Most respondents supported the idea of a standardised registration process in all Member States.
30. The proposed coordination between Member State Competent Authorities was generally welcomed. According to respondents this cooperation is essential to:
- ensure that the requirements for good reputation and possession of knowledge can be met in practice;
  - clarify the responsibilities and tasks of the competent authority of the home and the host in relation to tied agents; and

- ensure a consistent interpretation of the rules across all Member States, in accordance with the provisions on branches and provision on cross-border services.

31. CESR will take the suggestions of the respondents into account regarding the need of cooperation between Competent Authorities. Furthermore CESR thinks it is important to see which kind of problems and questions will occur during the first year of application of MiFID. After November 2008, with one year of practical application of MiFID rules, CESR will be equipped with facts that will allow an informed decision on which further work should be conducted in this area.

#### D. THE CROSS-BORDER ACTIVITIES OF AN MTF <sup>2</sup>

32. In its consultation paper CESR developed a common approach to what exactly constitutes providing arrangements by an MTF in another Member State so as to facilitate access to and use of their systems by remote users or participants. CESR proposed that an MTF is rendering cross border services/activities in another Member State, as referred to in Article 31 (5) and (6) MiFID, where direct access is provided to users or participants by the investment firm or market operator operating an MTF in the territory of a Member State other than its home Member State. Therefore CESR asked the following questions.

*Question 13: 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?*

*Question 14: 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 or elaborated on more and for which reasons?*

33. There were only a few responses on the propositions of CESR regarding MTFs.
34. One respondent suggested a clarification of "direct access". According to this respondent "direct access" should mean that the user in the Member State has to be an investor participating in the MTF. Accordingly, "direct access" would not occur where an investment firm is a participant in an MTF (even where the firm is acting on behalf of its clients that are sending orders in the investment firm's name to the MTF)." CESR disagrees with this suggestion. CESR believes that an MTF is providing "direct access" not only where the user is a private investor, but also where the user is an investment firm (established in another Member State) because the firm (or the investor) can execute orders directly on the platform of the MTF.
35. A few respondents advised that an MTF could be organised by another kind of arrangement than just a trading platform. In this case it isn't clear how the connectivity test should be applied. CESR welcomes this comment and agrees with the analysis. In its recommendations CESR proposes complementary criteria for situations where a MTF is only composed of a set of rules.

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<sup>2</sup> The conclusions on this section specifically apply to MTFs.

## E. THE ACTIVITIES OF REPRESENTATIVE OFFICES

36. In its consultation document CESR made an analysis about the definition of a representative office and how it differs from a branch or a tied agent. CESR asked the following question.

*Question 15: Do you agree with the arguments set out in this chapter?*

37. There were only a few responses regarding representative offices. The respondents generally approved the analysis of CESR, noting that it is the precise activities carried out by the office that will determine its nature. The proposition of CESR according to which a representative office could be qualified in some circumstances as a tied agent was considered inconsistent. CESR agrees with this remark. A representative office will normally be a part of the same legal entity as the investment firm.

## F. TRANSITIONAL ARRANGEMENTS

38. To facilitate the transition between the ISD passport to the MiFID passport, CESR proposed a common mapping of ISD to MiFID on the basis of a mapping table included in Annex 1 of the consultation paper. CESR asked the following question.

*Question 16: Do you agree with the proposal of mapping ISD to MiFID proposed in Annex 1? What changes or possible alternatives would you suggest?*

39. Respondents welcomed the proposals for common mapping of MiFID investment services, activities and instruments back to those of the ISD.
40. Some respondents asked for particular attention to be given to the MiFID investment service of "investment advice". They argued that when investment firms under the ISD provide the service of reception and transmission of orders, they give in most cases personal recommendations to their clients. This reality should be recognised by the regulators and a procedure should be worked out to ensure a continuity of such activities. CESR considered that there could be no automatically mapping for the service reception and transmission of orders into the correspondent same service in combination with investment advice. However Competent Authorities in individual Member States are free to decide to provide a specific procedure for facilitating the notification of the service "investment advice".
41. A few respondents asked CESR to review the accuracy of the mapping of financial instruments. CESR considered there were no reasons to modify the map. The map does not affect the policy of the Competent Authorities in the Member States regarding authorisation. The map is simply intended to facilitate smooth transition of passport notifications between Member States on a harmonised basis.

**G. FURTHER HARMONISATION BY WAY OF A PROTOCOL BETWEEN COMPETENT AUTHORITIES**

42. In its consultation paper CESR proposed to negotiate a protocol among the various Competent Authorities. The paper contained a inventory of possible issues that should be covered in this protocol. CESR asked the following question.

**Question 17: Do you consider the suggested approach appropriate and/or do you see other issues that should be handled in this protocol?**

43. Respondents approved the propositions of CESR regarding the protocol.

Some respondents suggested that the protocol should also cover the allocation of supervisory responsibility for branches. We refer to chapter B of this document on this issue.