

Towards the Independent Financial Advisors' self-regulation



INTRODUCTION

TO THE PLAN

FOR ADAPTATION

TO THE DIRECTIVE

ON MARKETS

IN FINANCIAL

INSTRUMENTS

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Madrid, January 2005



Index

Introduction	3
1. What targets do we try to reach?	3
2. Why doing this proposal right now?	4
3. What's new into European Union Law?	4
4. Which is the starting point?	5
5. What does "investment advice" mean?	5
6. What does "independent" mean in this context?	6
7. Which are the conditions to comply with for giving investment advice?	7
8. Will the reform affect financial agents?	7
9. How is the present regime for financial agents by now?	8
10. Which are ANAF-AIF's rules in this process?	10
11. Which must our first moves be for reaching investment advisors self-regulation?	11
12. What extent will the self-regulation have?	12



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Introduction

Within the variety of measures trying to strengthen the investors' confidence in securities markets, and joined to the reinforcement of rules for transparency and good corporate government, the most outstanding are those directed to improve the investment advisors' activity.

Until now, this activity was considered as a complementary stuff to investment services, and now the Directive for markets in financial instruments recognizes it as an investment service essential for the right behaviour of the market. This new guideline must be taken up to reach the independent investment advisors' recognition as a new market subject (as IFAs).

The ANAF-AIF's present proposal for self-regulation of IFA's profession is settled into this actual framework. We're going to introduce it by twelve questions including the target of this proposal, its opportunity and justification and references to the novelties it shows compared with the present regime. We will also explain in detail the essential aspects of this proposal, such are the new concept of investment advice and the foreseeable extent of the new regulation, attending to the experiences existing in the nearest international scene.

1

What targets do we try to reach?

The normative change compels to regulate the independent advisors, giving them the possibility to delegate this issue to the association they are represented for. Precisely, this propose wants to get ANAF-AIF's recognizing as a representative association of financial advisors, with the intention of providing the professional self-regulation into the framework established by the Directive on Markets in financial instruments.

The investment advice is a service which, due to its merely advisory character, doesn't demand any special prudential regulation. The financial advisors don't receive any cash or specie, nor correspondent stocks from the operations made effective thanks to the advising they give. This is why it is an investment service which regulation must be based on their professionals' behaviour. On the other hand, this profession is distinguished by the high number of professionals practising it, what will result very expensive for the financial supervisor; and to establish an administrative control regime similar to that existing in these financial companies that receive and keep people funds and stocks, would be quite unjustified. In this situation, it is wanted the collaboration of the sector itself, organized through their professional associations, to regulate the profession.

2***Why doing this proposal right now?***

This proposal is doubly justified. On the one hand, the new issue into the European Union Law we have mentioned and, on the other, the evolution that the regulation of investment advice is having in the other countries around us, as it couldn't be any other way, due to the principles that have been established in the European Union.

3***What's new into European Union Law?***

As we are saying, a new Directive of the EU has come to improve the status of investment advice, to convert it into a new investment service.

What is called "New Regulation of Investment Services" or, more exactly, Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments, has allowed to the Member States the possibility of delegating to the representative associations the investment advisors' register, regulation and supervision.

It is important to pay attention to the application of this new Directive in the internal Law. It becomes the principal rule for financial regulation in the European Union, because the Directive on investment services has been abolished, and the regulated issues have increased. About we are interested on, this new Directive recognizes what important is for investors to have an independent advice. So, to protect the investors, it tries to identify the financial advisor's profession and to endow them with a status as a service lender in stocks market. With this aim in view, it establishes the requisites for admittance into the profession and the rules of behaviour in it, based on the principle of self-regulation.

In short, in financial advisors' perspective, the new Directive has two important novelties. First, to consider investment advice as a new investment service. Let's remember that under the regime of the Directive on investment services, the investment advice was a simple complementary activity to investment services, which practise didn't need administrative authorisation. Now, in the new Directive, advice is considered as an investment service subject to authorisation. Second, and closely tied to the new nature of the investment advice, the new Directive governs the requisites for admittance and practise in financial advice, with the intention to protect investors' rights to receive an independent advice if they want so.

4

Which is the starting point?

Into the current internal Spanish Law, the investment advice is a complementary activity to the investment services, which practise doesn't need administrative authorisation. So, the financial advisor work is considered a free practise.

The article number 63.2 of Spanish Law on Securities Market is the one that enumerates financial advice into the list of complementary activities for investment services. As we say, its practice is free, but the principles of conduct mentioned in the article number 79 of the Law must be respected. Likewise, financial enterprises that give their advice services must build the foreseen "Chinese Walls" mentioned in the article number 83 of this Law, to avoid the abuse of information when it may exist clash of interests, for instance, between the departments of "stock-settlement" that work in the interest of flotation and those dedicated to advice to the investors.

Due to its Juridical nature, the investment advice is an untypical contract of services lending based on confidence. Just by analogy, it belongs to the category of contracts for collaboration which is ruled by the contract for commission of the Trade Statute.

Talking about its characteristics, it is a bilateral contract in which the advisor assumes an obligation for activity, not for results. The advisor is subject to responsibility when giving his service falls into deceit or negligence, as it is established in Civil Law, article number 1101. Negligence will exist when the advisor doesn't comply with the rules of behaviour that the Spanish Law on Securities Market establishes.

Those aspects about private Law won't be changed by the system coming soon, but the major concretion in the investment advisor's obligations with professional diligence.

5

What does "investment advice" mean?

The arisen initial problem when talking about regulating the profession of investment advice is its proper designation. Nowadays, it seems anybody is able to call himself an "investment advisor".

In Italy, "CONSOB" (Italian supervisor of securities market) defines our profession as that consisting in provide to the client some practise indications to

take decisions about investment and advising about the most appropriated operations concerned to the client's economic situation and targets.

At the same time, the new Directive defines investment advice as the act of giving personalized recommendations to a client about one or more operations related to financial instruments. This definition is very useful, because when the service is designed, we can recognise the professionals who are working on it, and make a clear difference between them and those who pretend to use this name without deserving it.

In short, the new regulation pretends to identify the real professionals who will give this service, giving to the consumers the confidence for asking to a financial advisor to take their financial decisions and so planning their future. The intention of this rule is to give to the investors a new investment service that is what the financial advisors can do. Anyway, this service could also be offered by those financial agents working for a financial entity, but without the adjective of "independent", of course.


6

What does "independent" mean in this context?

The investment advisors must keep independence of those who make flotation and placement of the instruments they recommend. If there is a clash of interests, it must be leaked out and the client must know all about it.

The Italian "CONSOB" thinks that the financial advice is an activity with four characteristics:

- a) A bilateral and personalized relationship between the advisor and the client
- b) The advisor's structural position of independence about the investments he recommends
- c) The advisor's inexistent predetermined limits about the investments he recommends
- d) The existence of just one remuneration to perceive by the advisor, which will come from the client in whose interest the advice is given to.

So, there is a clear separation between the independent financial advisor and the one who works for a financial entity. They are two very different characters. Now the advisors must choose between keeping themselves working in the market as tied or as independent professionals, having recourse to the new

statute for independent financial advisors. It is an opportunity for working in the market in a different way.

7

Which are the conditions to comply with for giving investment advice?

Into the new Legal framework, the necessary information about the client's knowledge, experience, financial situation and targets must be taken up; so it will be able to recommend him the most convenient financial instruments. Into this general framework, the advisor must evaluate whether the product is appropriated for the client and if it is not, he will have to give him an unfavourable report. At the same time, in the supposition that the client doesn't want to give enough information, the advisor will advertise him about the circumstance that such decision don't allow him to choose the appropriate product.

The enterprises that are just allowed to give advice services about investment stuff and whenever they don't keep funds or securities belonging to their clients, must have an initial capital of 50.000 euros or an insurance for professional civil responsibility of one million euros for damages claims and one million euros and a half per year for the whole claims (or a mixed initial capital and insurance being equivalent to them).

Giving advice in investment services is not conditioned by some kind of juridical nature. The physical people that complies the regulated requisites will be able to practise this profession.

8

Will the reform affect financial agents?

The delivery of financial instruments in the market is closed to the advisor's activity and it will be affected by the new Directive.

This Directive allows to the Member States to recognise the existence of financial agents tied to just one enterprise for investment. It is important to notice that those who lend investment services in the name of more than one enterprise will not be able to be considered as tied agent, but investment enterprises. On the other hand, it is a matter of fact that tied consultants work under the whole and unconditional responsibility of the investment enterprises.

The financial agents could be able to choose between keeping themselves exclusively tied to the enterprise and settling as independent advisors. It will

also be possible to create links with several financial entities. So we are facing an important event of openness in market, where there will be more competitiveness between the financial advisors. This pattern is similar to the United Kingdom's one in which, after the reform signed in December 2004 (Depolarisation reform), the tied agents live together with multi-tied agents and independent financial advisors (IFAs).

9

How is the present regime for financial agents by now?

The Directive on markets in financial instruments empowers to the Member States to decide give permission to the enterprises for investment services to select tied agents with the intention of promote their services, to captive business or to receive the clients' orders and to pass them on, to put financial instruments in, or even to give their advice about those instruments and financial services offered by the investment enterprise.

According to the present legal status in Spain, financial entities can operate in the market through representatives, known in the market as "financial agents". They are physical or juridical people that compromise themselves with a financial entity in a continuous and exclusive way to promote and conclude some financial services in the name of that entity, in exchange of remuneration and without assuming risk or fortune from such operations. They are distinguished by the nature of the enterprise they represent.

In the securities market, the enterprise for investment services can give representation power to physical or juridical people for the promotion and commercialisation of the investment services that belong to their schedule (art. 23 RD 867/2001). The agents, according to such given power, can take up the third person's business, to mediate in flotation and public sales offers and to lend their advice about investment. The Law 12/1992, May 27, about contract of agency, is not applicable to "the agents operating in official or regulated secondary securities markets" (art 3.2). Those agents from securities or credit entities working in the regulated markets in financial instruments must comply what is written in the art.65.3 of LMV, explained in art. 23 and 25 of RD 867/2001.

In bank, agents are people who received power from a credit entity to work frequently with clients in the typical operation business of their object, doing it in the name and in charge of that entity (art. 22.1 RD 1245/1995). Those

agents representing credit entities, according to their work on bank and "para-bank" services, are ruled by what is said in art. 30 bis.2 of LDIEC, explained in the Law about contract of agency (because an applicable Law does exist in fact, as it is said in art. 3.1. of the Law 12/1992).

The contract of agency we are talking about is special, due to the object (promotion and conclusion of financial contracts), to the subject (the most important must be always a qualify financial entity) and to the content (exclusivity is included as a feature defining the character). The agent is just able to work representing to a certain financial entity.

The contract of financial agency shares in the general notes of the commercial agency, and, so, it belongs to the common tree of the commission. It means a business promotion. The financial agent is obligated to promote and sign financial services. It is a contract of collaboration between businessmen. It means, as any agency, acting for someone else's account. The financial agent works in the name of the entity he is representing to, and from which he receives a commission. It is, moreover, a contract for length of time, which requires permanence and stability.

The financial agent needs representing power to do his job. The representing power is an essential element in the contract. He must be able to conclude the contracts in the name of the principal one. The agent must works by his own, or by his job assistants, the promotion or conclusion of financial services. To work by "sub-agents" is forbidden to him (art. 22.8 RD 1245/1995).

The financial agent cannot lend by his own those services which contract he has been obliged to promote. Generally he is not considered as an entity, so he is not qualify to lend financial services by his own. But in those cases when the agent is considered like that, we must understand that the prohibition of concurrence mentioned in the art. 7 of the Law for the contract of agency must be applicable. Such prohibition explains the agent's situation faces to the clients. The compromise to lend the financial service must be assumed by the represented entity.

Those conditions are not going to change when the new Directive takes effect. What the Directive does is to reinforce the control for acceding to the financial agent profession and the obligation for transparency faced to the clients. The inscription in the Public Register obligates to check the agent's professional honour and his appropriated knowledge to give to the client the

exactly and complete information about the suggested service. The enterprises in investment services working through tied agents must be sure that the agents tell about the ability they have to operate and about the enterprise they represent when they are talking to any client. Something new is that the tied agents will be allowed to manage the client's money or financial instruments in the name and under the complete responsibility of the investment enterprise he is working for.

10

Which are ANAF-AIF's rules in this process?

The art. number 4 of Statute of ANAF considers their independent financial advisors members' recognizing as truthful financial intermediaries the most principal object. And this is what we try to reach, asking to the Administration Organisms the promulgation of a Law to recognise and regulate the independent financial advisor's profession.

The legal framework established by the new Directive clears and makes this associative object easier. Sense to this effect, ANAF-AIF is working in a plan of strength facing the adaptation of the profession to the new challenges that this new Directive about markets in financial instruments brings, to make it easier. We must bear in mind that, related to the enterprises in investment services lending just investment advertising, the new Directive empowers the Supervisor to delegate the administrative issues related to the concession of the initial authorisation, the revision of the conditions for that authorisation and even the periodical supervision of the operative requisites, in the representative association into the sector. ANAF-AIF is reinforcing its own capacity and resources to be able to assume such delegation. So ANAF-AIF is working on a proposal to establish the practise of delegation duties and the rules and conditions for this practise and in which the prevention of clash of interests and the protection against unfair competition are its principal issue.

We are now at the right moment for facing this challenge, and it is necessary:

- To define the Independent Financial Advisor (IFA).
- To establish the necessary competence or aptitude to sign in the register as a professional.
- To settle on the trustworthiness for working in the market

- To determine the principles of behaviour that must govern the relationship with the investors.

It is not only to participate in the consultative process and giving the opinion into the sector. The intention is the self-regulation of the profession, from the sector itself, in the interest of the investors and of the good operation in the market.

11

Which must our first moves be for reaching investment advisors self-regulation?

The new Directive just recognises, as a good alternative, the self-regulation with the collaboration of the representative associations in the sector. To reach a self-regulated system it will be necessary to recognise this system into a legal rule, while the internal Law hides behind the Directive, what will probably happen by means of the reform of the Law for Securities Market.

After the recognising in the Law for Securities Market, the minima requisites for delegating the self-regulation in a professional association and the importance this delegation will have, must be settle down in a rule of develop. Then, through the CNMV , the associations in charge of the self-regulation and their practises will be coordinated.

In short, the transposition of the Directive for Markets in financial instruments related to the present status of the independent financial advisors could be a large legal qualification for the due develop and a specific recognizing of profession. At the same time, this due develop should have to regulate the designation of the professional associations of independent financial advisors and the importance of delegating duties.

In France, the monetary and financial Code, after its reform made by the Law of financial security dated on August 1 of 2003, has pointed the obligation for all financial investments advisors to join to a professional association. Such associations must have been authorised by Authority of Financial Market (AMF), the equivalent for Spanish CNMV. Those associations must prove to obtain the AMF approval their conditions for competence and their code of good behaviour that all their members must comply. To practise the profession, the advisors must sign in the register of advisors, carried by the professional associations. The Decree dated on September 29 of 2004 regulates this carrying and other questions related to the regulation of this profession.

What extent will the self-regulation have?

It is already very soon to know the importance that delegation of duties could have in the process of self-regulation. It is the first time in Spain that the possibility of self-regulation for those who lend some financial services is recognised.

What is clear is that the opportunity for assuming the self-regulation of the profession is coming up, in a private sector and Administration collaboration. Through its Association, it endeavours to self-regulate by:

- Creating a register of professionals
- Settling down the requisites for professional competence, it means, training and experience that must be shown for being able to practise this profession
- Defining resources and insurances of responsibility, asked for the professional exercise and
- the rules of behaviour, prevention of clash of interests and transparency in the contract conditions to protect to the investors,
- Collaborating with CNMV in the vigilance for professional rules compliance.

They are duties of register, regulation and supervision of profession of public interest, which practise is due to CNMV, but in which ANAF-AIF can participate as representative association of professionals in the sector by delegation, in a process of self-regulation.

To reach this target it is necessary to strength our association, to give enough resources to it and to work in a proposal including the perceptive develop of the legal principles for register, access and practise of this profession.