

CESR'S CALL FOR EVIDENCE
Provisional Mandates
Financial Instruments Markets Directive

Response of The Royal Bank of Scotland Group of companies

This paper comprises our response to the above CESR request for views.

Please treat our response as confidential.

February 2004

Introduction

The Royal Bank of Scotland Group welcomes the opportunity to respond to CESR's call for evidence with regard to the Commission's Provisional Mandates under the Directive on Financial Instruments Markets.

Founded in 1727, the Royal Bank of Scotland Group is one of Europe's leading financial services groups. The Bank is the second largest in the UK and Europe, and fifth in the world based on market capitalisation. In 2003 we were included in the Forbes A-List of the World's best big companies for the fifth year in a row.

The Group owns nationally and internationally recognised brands including Royal Bank of Scotland, NatWest, Ulster Bank (which operates in both the UK and the Republic of Ireland), Coutts, Lombard, Direct Line, Comfort Card (which operates in Europe), and Citizens Financial Group in the US. Within Europe, we have a presence in Germany, Spain, Italy, Ireland, France, Greece, Austria and Belgium, in addition to the UK. For this reason we have a very strong interest in the implementation of this directive and in providing feedback to assist CESR in its guidance to the Commission.

General Comments

The review of the Investment Services Directive (ISD) is clearly a cornerstone of the updated legal framework being created for the European securities markets under the Financial Services Action Plan (FSAP). We support the objectives of this review that has led to the Financial Instruments Markets Directive (FIMD).

The FIMD will, in effect, create the regulatory underpinning for European securities markets for the foreseeable future, and have as its key objective promoting markets that are fair, competitive, and efficient, have integrity, and inspire confidence among all market users. The regime thus needs to be robust and durable, yet flexible enough to respond to future market developments without the need for repeated Level 1 and 2 revisions. We therefore wish to make the following general observations:

- The Provisional Mandates (particularly when read with the Technical Annex) appear to envisage excessive detail at Level 2 that will inhibit flexibility and development – quite the reverse of the objectives of the FIMD itself and the Lamfalussy model. We have provided some specific examples of this in the course of our response, but the remark certainly holds true for most of the “indicative elements” in the Technical Annex as well as for elements of the main Mandates. **This means, that in our view, when providing advice to the Commission, CESR should be prepared to recommend that no additional Level 2 measure is needed on a number of points.**
- We do not think that Level 2 measures should aim to prescribe how firms should run their businesses, e.g. when written procedures are required and when control functions should be split, the minimum content of accounting procedures, and what tasks Compliance and Internal Audit should perform. Repeatedly, the Mandates (and Annex) envisage prescriptive EU requirements at a level of micro-management not previously seen in a FSAP measure. We do not believe that this is appropriate, as EU standards ought to be capable of being implemented with due account taken of a range of different types of firms and different risk-profiles.
- We believe that CESR's advice should aim to stress, at every point where the Directive allows, the need to differentiate in the standards and protections appropriate for (a) professional clients and (b) non-professional clients; and reflect the need to maintain a flexible and proportionate EU regulatory regime, with high standards of investor

protection, but standards that do not disadvantage EU markets as against their US and other non-EU competitors.

- Particular relevant national characteristics ought also be respected (whether national company law, legal traditions such as UK Trust Law, or others).

It follows from our general comments that we hope to see CESR apply principles of cost/benefit analysis in developing and framing its advice. We support work towards greater consistency of EU regulatory standards, in principle, but the costs of detailed changes to national rules and regimes, (with the resulting impact on firms, in terms of systems, documentation, and on consumers and their understanding of how regulation operates) should have adequate justification. We therefore hope that CESR will agree that existing national standards that already comply with the FIMD should not be changed simply for the sake of harmonisation.

We would be happy to expand upon, or explain further, any of the points in this paper and to assist CESR in any way we can in its work over the coming year.

Specific points on particular elements of the Provisional Mandates

Organisational requirements (Article 13)

In our view, sections 3.1.1 and 3.2.2 are examples of where the Mandates risk excessive detail and inflexible prescription and risk laying down through EU legislation detailed requirements on how businesses should be run and managed. We would urge CESR to consider this view in its advice.

We would make two particular points on this section. With regard to the minimum basic elements of compliance tasks, policies, procedures, etc, we assume that CESR will seek consistency with work being done by the Basel Committee (notably its October 2003 paper on the Compliance function) and IOSCO. Second, the personal transaction standards will of course need to fit with the Market Abuse Directive regime.

Conflicts of Interest (Articles 18 and 13(3))

Obviously this element is of great interest to all regulated firms who have had to manage compliance with numerous national requirements introduced over recent months, addressing potential conflicts arising from research activity. We would urge CESR to take careful account of existing standards and recommendations such as those of the Forum Group on Financial Analysts, which reported to the Commission late last year, as well as the requirements of the Market Abuse Directive. It is also vital that CESR pay full regard to the differences between the conflicts that can arise in relation to equity and non-equity research.

We also believe that CESR should avoid trying to draw up an exhaustive list of circumstances, or business combinations, that give rise to potential conflicts of interest, and should adopt a high-level, principles-based approach (on as many elements of the Mandates as possible). Changing business models and continuing product innovation would inevitably result in any list requiring frequent updating. CESR will also, presumably, wish to avoid calls for impractical new organisational barriers between business activities or areas (e.g. between client and own-account trading), some of which were briefly considered and rejected during FIMD negotiations.

Conduct of Business Obligations (Article 19)

We think that it will be particularly important here that CESR:

- (i) differentiates between the protections (including disclosure, risk-warnings, etc) required by professional and non-professional clients in the different markets;

- (ii) avoids excessive detail which would result in an inflexible EU Rulebook incapable of accommodating market developments and evolution.

The work that FESCO and CESR have previously done on common EU standards for conduct of business would be a useful starting point and model for this work. (This will also include client order handling rules under Article 22.)

We are concerned that the whole package of the new FIMD ‘harmonised’ customer classifications for conduct of business purposes, and the detailed rules that will apply to each type of customer, has the potential to cause material confusion and dislocation, and increased costs to customers, throughout the EU markets. We hope that CESR shares our desire to minimise such upheaval.

Best Execution (Article 21)

In principle, we welcome the FIMD’s broader new concept of best execution, encompassing a wider range of factors and considerations than simply benchmarked “best price”. However, it is important that Level 2 measures do not inadvertently undermine the benefits of this sensible new model – to both firms and customers – through excessive and unnecessary prescription. We do not see the need for additional Level 2 measures of the range and detail envisaged by the Commission. For example, we do not see the need for CESR to advise on the relative importance of factors to be taken into account in determining best execution, or to advise on the criteria for determining execution venues. We also trust that CESR will be careful not to recommend over-mechanical monitoring and review requirements.

If CESR is to recommend additional detail, however, this should take into account the differences that exist in applying the concept of “best execution” to different types of client and in different markets. Considerations will be quite different, for example, across the equity market, the debt market and the commodities market.

Regulated Markets Transparency (Articles 25, 28-30, 43, 44)

A sensible and proportionate deferred reporting regime (both pre/post trade) will, of course, be vital to the continued efficiency and success of the EU markets once the FIMD is implemented.

The Royal Bank of Scotland Group
February 2004

ANNEX A

Regulated firms in The Royal Bank of Scotland Group**Name of Firm**

Adam & Company Investment Management Ltd
 Adam & Company plc
 Churchill Insurance Company Limited
 Coutts & Co Investment Management Limited
 Coutts & Company
 Direct Line Financial Services Limited
 Direct Line Insurance plc
 Direct Line Life Insurance Company Limited
 Direct Line Unit Trusts Limited
 Hallmark Insurance Company Limited
 Indemnity Insurance Limited
 Lombard and Ulster Ltd
 Lombard Bank Ltd
 Lombard North Central Plc
 Nat West Stockbrokers Ltd
 National Westminster Bank Plc
 National Westminster Life Assurance Limited
 Privilege Insurance Company Limited
 RBEF Ltd
 RBS Collective Investment Funds Limited
 RBS Financial Products Plc
 RBSUTM Limited
 Royal Scottish Assurance plc
 Star 1 (general partner) Limited
 Star Capital Partners Limited
 Tesco Personal Finance Ltd
 The National Insurance and Guarantee Corporation Limited
 The Royal Bank of Scotland Group Independent Financial Services Limited
 The Royal Bank of Scotland plc
 The Royal Bank of Scotland Portfolio Management Ltd
 UK Insurance Limited
 Ulster Bank Ltd
 Ulster Bank Ireland Ltd