

**ESME'S REPORT ON DURABLE MEDIUM - DISTANCE MARKETING
DIRECTIVE AND
MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE**

Introduction and Summary

The purpose of this report is to consider the use of the term "durable medium" in the Distance Marketing Directive ("DMD") and the Markets in Financial Instruments Directive ("MiFID"). There has been confusion about how to interpret this term in the context of the DMD when considering communication methods other than paper. Greater clarity and a common approach to this issue are desirable, particularly now that the term has such importance in the MiFID context. Whilst its usage in the DMD only affects firms who provide services to consumers, the reach of MiFID is wider. There is an increasing demand from consumers and professional clients to move away from paper communication. It is therefore essential that firms understand what their obligations are when using non-paper methods of communication and how they might meet them.

The purpose of this report is to identify:

- whether there are any inconsistencies between its use in the two Directives which are difficult to justify and which cause problems for firms;
- whether or not the term has any inherent uncertainties which could cause difficulties for firms and enforcement authorities.

The principal issues which arise from the comparison are:

- whether MiFID requires a client to be offered the choice between receiving information on paper or in another durable medium. If it were so interpreted, it would create a disparity between financial services firms who are subject to both MiFID and DMD and those who are only subject to the DMD. It is suggested there is no need for such an interpretation;
- MiFID permits some information to be provided by a website, even when the website does not constitute a durable medium. The DMD requires the same information to be given only in a durable medium. A MiFID firm that is also subject to the DMD needs to be aware that it cannot take advantage of the additional flexibility in MiFID and regulatory authorities should ensure that this point is understood;

- the key uncertainty for firms concerns the circumstances in which the use of a website and associated facilities will meet the criteria for providing information in a durable medium. In practical terms, this is a very important issue given the increasing desire on the part of consumers to use non-paper forms of communication. Some suggestions are made as to the circumstances in which a website could qualify either as a durable medium itself or as a proper means through which information may be provided in a durable medium.

DMD and MiFID - Scope Comparison

Activities covered

The DMD applies to distance contracts "concerning financial services concluded between a supplier and a consumer".

Financial service is defined as "any service of a banking, credit, insurance, personal pension, investment or payment nature". Thus the DMD covers the sale of products such as savings products, insurances, UCITS, agreements for the provision of services such as discretionary management and stockbroking, the opening of bank accounts and the sale of deposit-based products.

It would seem that any activity that is within the scope of Section A, Annex 1 MiFID (and at least some of the activities in Section B) would be within the scope of the DMD. The DMD covers a wider scope of activities than those covered by MiFID - in particular, in relation to deposit-taking (and certain other banking activities the subject of the Banking Directive) and insurance activities.

Clients

The DMD only applies to relationships with a consumer. A "consumer" is any natural person who is acting for purposes which are outside his trade, business or profession.

The MiFID requirements concerning the use of a durable medium apply to a wider range of entities, in some cases including professional clients.

Definition

"Durable medium" is defined in the DMD as:

“any instrument which enables the consumer to store information addressed personally to him in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored”.

Recital 20 of the DMD states:

"Durable mediums include in particular floppy disks, CD-ROMs, DVDs and the hard drive of the consumer's computer on which the electronic mail is stored, but they do not include Internet websites unless they fulfil the criteria contained in the definition of a durable medium."

The MiFID definition of "durable medium" in the Implementing Directive is essentially the same as that in the DMD, being:

"Any instrument which enables a client to store information addressed personally to that client in a way accessible for future reference for a period of time adequate for the purposes of the information stored and allows the unchanged reproduction of the information stored."

There is no MiFID equivalent to Recital 20 but it is suggested that Recital 20 is of use in interpreting the term when used in MiFID. There is therefore no substantive distinction between the Directives in terms of the definition.

Choice of durable medium

MiFID Implementing Directive Article 3(1) states that where information is required to be provided in a durable medium it may only be provided in a durable medium *other than on paper* if:

- the provision of the information in that medium is appropriate to the context in which the business between the firm and the client is or is to be carried on; and
- the person to whom the information is to be provided, when offered the choice between information on paper or in that other durable medium, specifically chooses the provision of the information in that other medium.

It would seem that MiFID does not require the client to be offered such a choice. Such an interpretation would be consistent with the DMD - under the DMD a consumer is entitled to change the means of distance communication used - unless to do so is incompatible with the

contract with the supplier of the service or the nature of the financial service provided. Thus where a supplier only offers one means of communication, the consumer cannot elect for another (although it should be noted that under the DMD he always has the ability to request the contractual terms in paper form). It is suggested that Article 3(1) should be read in a manner which is consistent with the DMD - in which case the only difference between the DMD and MiFID will be the DMD requirement that a consumer be able to request the contractual terms in paper at any time. There is no similar requirement in MiFID although the basic agreement with a retail client required by MiFID must either be in written form or in a durable medium.

Information to be supplied

DMD

Article 5 of the DMD requires the following to be communicated to the consumer "on paper or on another durable medium":

- all the contractual terms and conditions;
- the information referred to in Article 3(1). This information includes detailed information about the supplier, the financial service, fees, charges and expenses, details concerning withdrawal and redress rights;
- any other prior information requirements required by other Community legislation governing financial services (**N.B. This would include MiFID prior information requirements**);
- any other Member State prior information requirements.

In addition, Article 5(3) provides that the consumer is entitled at any time on request to receive the contractual terms and conditions on paper.

Thus a MiFID investment firm, which is also subject to the DMD, will never be able to take advantage of the MiFID provisions which enable information to be supplied via a website when that website is not a durable medium or a proper means through which that information may be provided in a durable medium. It is suggested that this impact of the DMD should be highlighted to firms as it would not necessarily be obvious to them from the MiFID implementing measures.

MiFID

The MiFID Implementing Directive requires the following information to be provided in a durable medium:

Article 22(4) - disclosure under Article 18(2) of MiFID of conflicts of interest.

Article 28(2) - notice of right to request different client categorisation.

Article 40 - firms other than portfolio managers must, when they have carried out an order, promptly provide the client in a durable medium with the essential information concerning the execution of the order. In the case of retail clients, the information must be "sent" within a specified period.

Article 41 - portfolio managers to provide each client with a periodic statement in a durable medium.

Article 41(4) – a portfolio management client may elect to receive transaction by transaction information upon execution of transactions, in which case the essential information must be supplied in a durable medium.

Article 43(1) - firms that hold client financial instruments or client funds must send a statement in a durable medium of the instruments and funds held.

MiFID requires the following information to be given either in a durable medium, or (provided that the information is not personally addressed to the client) via a website which meets the Website Conditions set out in Article 3(2) of the Implementing Directive

Article 29(1) - retail client to be provided with:

- the terms of the agreement for the provision of services;
 - the information required by Article 30 (information about the firm and its services);
 - all the information required by Articles 30 to 33 (information about the firm, its services, about financial instruments and safeguarding of client assets and funds.)
- The Appendix to this report lists the detail in Articles 30 to 33. It must be noted that Article 32(7) of the Implementing Directive requires information regarding securities financing transactions to be provided in a durable medium. This overrides the position that would otherwise apply under Article 29(4) and it will not be sufficient only to supply this information on a website which is not also a durable medium.

Article 29(3) - professional client to be provided with the information referred to in Article 32(5) and (6).

Article 46(2) - retail clients to be provided with execution policy.

(N.B. Article 29(6) - notification about material changes to the information provided under Articles 30 to 33 - notification to be given in a durable medium if the information to which it relates is given in a durable medium.)

In addition to the above information requirements Article 39 of the Implementing Directive requires firms to enter into a written basic agreement with a retail client, and requires this to be either in paper or in another durable medium. Thus although information about the terms can be provided under Article 29(4) by means of a website even where that does not constitute a durable medium., this alone will not satisfy the requirement of Article 39.

Thus some of the articles in the MiFID Implementing Directive require information to be provided in a durable medium, but other requirements state that the information can be provided either through a durable medium or by means of a website (when the website does not constitute a durable medium). In this respect, MiFID has greater flexibility than the DMD and a firm which is subject to both MiFID and DMD would have to comply with the stricter DMD requirements when there is an overlap in relation to the information required to be provided by the two Directives.

MiFID and websites

It is clear from the DMD and MiFID that a website can constitute a durable medium. In addition, some of the MiFID requirements can be satisfied by the provision of information through a website even when the website does not constitute a durable medium, provided that the conditions in Article 3(2) of the Implementing Directive are met ("the Website Conditions").

For example, Article 29(4) of the Implementing Directive states:

"The information referred to in paragraphs 1 to 3 shall be provided in a durable medium or by means of a website (where that does not constitute a durable medium) provided that the conditions specified in Article 3(2) are satisfied."

The words underlined appear in a number of the MiFID provisions concerning information provision.

Article 3(2) does not itself state that a website which only meets the Website Conditions is not a durable medium - but this is to be implied from the cross references such as the one referred to in Article 29(4). The conditions that must be met are:

- the information must not be information that is addressed personally to the client;
- the provision of that information in that medium must be appropriate to the context in which the business is carried on with the client;
- client must specifically consent;
- client must be notified electronically of the website and the place where the information may be accessed;
- the information must be up-to-date;
- the information must be accessible continuously for such period of time as the client may reasonably need to inspect it.

Overlap between DMD and MiFID

There is certainly some overlap between the requirements of the DMD and MiFID. A firm whose activities are subject to the DMD would not be able to rely on supplying information on a website which only meets the Website Conditions, to do this the website would also have to be a proper means through which that information may be provided in durable medium, if the DMD requires the information to be communicated in a durable medium.

The principal information which the DMD requires to be communicated in a durable medium is the contractual terms and conditions and information about the supplier, the service and costs. All of this information is also required to be supplied by MiFID, but it would appear that firms have the option under MiFID to provide this information either in a durable medium or via a website which only meets the Website Conditions (but see note above concerning retail client agreement).

It is possibly odd that a firm could use a website to convey information under MiFID, but if it is providing a distance service, might be unable to use a website to meet its DMD obligations. There would seem to be no particular policy reason for such a disparity. In practice, it may be that the principal issue for firms is that they need to be aware that compliance with the MiFID requirements will not necessarily be sufficient to meet their obligations under the

DMD. Regulatory authorities could assist firms by ensuring that the Member State implementing measures remind firms that there may be other obligations which override the MiFID requirement.

When is a website a durable medium?

Both the DMD and MiFID clearly acknowledge that a website may provide a means of providing information in a durable medium but neither Directive contains any further guidance as to the circumstances in which a website would be considered to constitute a durable medium. It would seem by inference that a website which only meets the Website Conditions would not be a durable medium or a proper means through which information may be provided in a medium that is a durable medium.

The definition of durable medium incorporates the concept that it is an instrument which enables a client "to store information addressed personally to that client". It is clear from Article 3(2) of the MiFID Implementing Directive that a firm can only supply information under MiFID via a website which is not a durable medium when "that information is not addressed personally to the client".

More certainty is needed, however, as to what is required for a website to qualify as a durable medium or as a proper means through which information may be provided in a medium that is a durable medium. There may be a distinction between types of website which could usefully be explored.

A website which is a dynamic electronic host or portal, which is frequently changed and from which the user cannot necessarily save or print pages ("Ordinary Website"), might be distinguished from other websites ("Sophisticated Websites") which either (i) act as portals for the provision of information in another "durable medium"; or (ii) may actually constitute "durable mediums" themselves. The first type of Sophisticated Website can:

- allow users personally to address e-mails to themselves attaching .pdf files of, for example, terms and conditions which are sent to and immediately stored on the user's computer. It is suggested that this method of providing information, at least where clear, simple and accessible guidance is given to the user as to how he may create such an e-mail, would satisfy the DMD and MiFID requirements to provide information in a durable medium - it is the e-mail stored on the hard drive that is made available "through" the website that contains the required information; or
- permit (or even require before access to a service is granted) users to print off the information in question, at which point, the information has clearly been provided in a

durable medium.

Accordingly, whilst this type of website may not in *itself* constitute a durable medium it is a proper means through which information is provided in a medium that is a durable medium. In other words, the website is giving the user the means to receive the information in a durable information and, therefore, is making that information available in a durable medium.

A second type of Sophisticated Website that can constitute the provision of information in a durable medium in its own right might contain secure storage areas for individual users which are accessed by a user code and password, this addresses any requirement that information be personally addressed. From a technological perspective, any such website could be set up so that it will be continuously accessible by implementing back-up arrangements. For example, the hardware on which the storage areas are saved could be run in duplicate such that there is very little risk of it not being continuously available. A website exhibiting these features would seem to exhibit the necessary features to constitute *itself* as a durable medium.

The secure storage areas might be analysed as analogous to the user's remote hard disk - the information is stored on a hard disk, the only difference is that it is not the consumer's own but must be accessed remotely via the Internet. Some telecoms providers offer a product which offers users a secure storage space via the Internet on which they can back up their own home computer hard drives and, it is suggested that this constitutes a durable medium.

Thus it seems to be the case that:

- a website from which one can print or e-mail will always permit the provision of information in a durable medium (provided clear, simple and accessible guidance is given to the user as to how this can be done);
- a website that can provide secure and individual personal storage areas that are continuously available to users could also fulfil the requirements of the definition.

Provision of information

There are, perhaps, ancillary issues that flow from the fact that information on a website might be considered to be provided "passively" in that the user needs to do something else to obtain it; whereas information that is sent by e-mail is provided "actively" in that it is addressed and specifically delivered to the intended recipient at the initiation of the supplier.

The DMD requires that the supplier "shall communicate to the consumer... on paper or on another durable medium available and accessible to the consumer in good time before the

consumer is bound".

MiFID Implementing Directive Article 29(1) uses the terminology of "provision", "provide the client with the following information in good time...", "the information... shall be provided in a durable medium". Article 40 (confirmation of transactions) "must promptly provide the client in a durable medium with the essential information".

It is suggested that there is no particular distinction to be drawn between the different provisions in the Directives in terms of their phrasing. The underlying issue concerns the supply of information to the client in a durable medium. The purpose of the Directives is to require information to be made available. The question as to where a mode of provision fits on the active/passive spectrum should not matter as long as it is manifestly clear to the consumer how to procure the information. Indeed, there is no difference between receiving letters which the recipient may decide not to open and, instead, giving the consumer clear, simple and accessible means to download information in durable form that he chooses not to take up.

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APPENDIX

Article 30(1) requires clients to be provided with the following information:

- name and address of the investment firm and the contact details necessary to enable clients to communicate effectively with the firm;
- the languages in which the client may communicate with the firm and receive documents and other information from the firm;
- the methods of communication to be used between the firm and the client including, where relevant, those for the sending and reception of orders;
- a statement of the fact that the firm is authorised and the name and contact address of the competent authority that has authorised it;
- where the firm is acting through a tied agent, a statement of this fact specifying the Member State in which that agent is registered;
- the nature, frequency and timing of the reports on the performance of the service to be provided by the firm to the client in accordance with Article 19(8) of MiFID;
- if the firm holds client financial instruments or client funds, a summary description of the steps which it takes to ensure their protection, including summary details of any relevant investor compensation or deposit guarantee scheme which applies to the firm by virtue of its activities in a Member State;
- a description of the conflicts of interest policy;
 - further details of that conflicts of interest policy at any time the client requests it in a durable medium, or by means of a website where that does not constitute a durable medium provided that the conditions specified in Article 3(2) are satisfied.

Article 30(3) - providers of portfolio management to retail clients must in addition provide:

- information on the method and frequency of valuation of the financial instruments in the client portfolio;
- details of any delegation of the discretionary management of all or part of the financial

instruments or funds in the client portfolio;

- specification of any benchmark against which the performance of the client portfolio will be compared;
- the types of financial instrument that may be included in the client portfolio and types of transaction that may be carried out in such instruments, including any limits;
- the management objectives, the level of risk to be reflected in the managers exercising discretion, and any specific constraints on that discretion.

Article 31 - general description of the nature and risks of financial instruments. This obligation applies to both professional and retail clients, although by virtue of Article 29(4) must arguably only be provided in a durable medium or on a website which satisfies the Website Conditions, when provided to a retail client.

Article 32 - provision of information to a retail client concerning the safeguarding of client financial instruments and client funds. Note Article 32(7) has a specific reference to information being provided in a durable medium concerning securities financing transactions and this overrides the provision of Article 29(4) which would otherwise permit the information to be provided by means of a website which only meets the Website Conditions.

Article 33 - information to retail clients about costs and associated charges.