CESR

24 April 2007

EAPB position paper on

CESR's second consultation on "inducements under MiFID"

The European Association of Public Banks (EAPB) represents the interests of 25 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

The EAPB very much appreciates this second round of consultation on the complex but at the same time very important topic of "inducements" under the MiFID. We would like to thank CESR for the opportunity to comment on the six draft recommendations set out in the second consultation paper and would very much appreciate CESR taking our comments into account in the final paper.

A. General remarks

We very much welcome this second draft paper which, in our view, presents a major improvement to the first consultation paper.

This is especially true for the standards set for the "*designed to enhance the quality of the investment service – test*" under Art 26 (b) of the level 2 Directive. We would like to emphasise we appreciate that CESR does not pursue its approach of proportionality among the amount of the inducement and the value of the investment service. If CESR would have adhered to this requirement this would have caused nearly unsolvable practical problems regarding the proof and documentation of the enhancement of quality. The Recommendations 4 and 5 of the present paper do much more take into account practical considerations, respecting at the same time investor protection objective.

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Furthermore we appreciate that CESR now clarifies the relation between Art 26 and Art 21 of the Level 2 Directive. This without giving more detailed recommendations on the provisions of Art 21 concerning the issue "compliance" not representing a "conduct of business rule" (such as Art 26).

Against this background, the following comments are limited to a few issues where we think that a further clarification could be helpful.

B. Specific remarks

1. Question 1: Comments on the draft recommendation

- **Recommendation 1: General**

  no comments

- **Recommendation 2: Article 26 (a) of the Level 2 Directive**

  According to Recommendation 2, it is not only relevant that the fee, commission or non-monetary benefit is born by the client in order to be considered within Article 26 (a), but it is also relevant "*whether the client has issued a specific instruction to the investment firm and has the power to vary the arrangement without reference to the investment firm […]*".

  First of all we take the view that this last sentence of Recommendation 2 and its requirement of a "specific instruction" goes beyond the scope of Art 26 (a) of the Level 2 Directive.
  Apart from this legal consideration, we think that CESR makes too high demands on an "agreement" between investment firms and clients. In our opinion, a general instruction which may also be deduced from the "General Terms and Conditions" should be acceptable.

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Furthermore we would like to point to the fact that many national legal systems do not recognise a unilateral right to change an agreement, except this has been explicitly been provided for. Against this background, a unilateral right to change agreements should not be prescribed by supervisory authorities.

Given the arguments set out above, we kindly ask CESR to change or at least to clarify the wording of Recommendation 2.

- **Recommendation 3: Article 26 (c) of the Level 2 Directive**

no comments

- **Recommendation 4: Factors relevant to arrangements within Article 26 (b) of the Level 2 Directive**

We generally agree with the factors of Recommendation 4 and appreciate CESR's approach not to refer to "one size-fits all" and therefore not to apply the factors uniformly to all situations. Furthermore we want to stress that the fact a sector relationship exists should also represent a relevant consideration under Recommendation 4 (d) as said before.

Furthermore, we very much welcome that CESR does not intend to uphold its initial requirement that, for an inducement to be permitted, there has to be a direct link between an individual inducement and the enhancement of the quality of a specific investment service to the client. We think that the new approach (set out in item 14) holding that the requirement to enhance the quality has to be met at the level of "business lines" is a practicable solution. It may be than up to the competent supervisory authority to specify the proof which has to be given on the enhancement of quality, based on the "business line" of the respective market participant.

With respect to Recommendation 4 (c) we suggest to clarify the wording for the following reasons: If an investment firm takes appropriate measures to guarantee that benefits are not suitable as inducements to act against the interests of their clients (e.g. by way of

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organisational provisions like an adequate conflict of interest policy) the requirements set out in Art 26 (b) (ii) of the level 2 Directive are fulfilled. Although Recommendation 4 (b) makes to some extent reference to this issue, we propose to clarify this Recommendation as follows:

(c) Whether there will be an incentive for the investment firm to act other than in the best interests of the client and whether the incentive is likely to change the investment firm´s behaviour; by adequate organisational measures, the investment firm can assure that the receipt or payment of the fee, commission or non-monetary benefit will not have any impact on the investment firms behavior;

Finally, CESR refers to the relationship between the investment firm and the entity receiving / providing benefit in Recommendation 4 (d), stating at the same time that the mere fact that a group relationship exists is not by itself a relevant consideration. We would like to stress in this context that in most of the cases the existence of a group relationship or the relationship between banks being part of the same group of banks is a relevant consideration and should therefore be taken into account.

- **Recommendation 5: Recital 39 to the Level 2 Directive**

We very much welcome the proposed wide interpretation of Recital 39 which does not only take into account investment advice but also other distribution arrangements without giving investment advice.

- **Recommendation 6: Disclosure under Article 26 (b) of the Level 2 Directive**

no comments

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2. Question 2: Assistance of examples in practice

The EAPB generally appreciates the examples given. We think that they will prove helpful in determining how Article 26 applies in practice. We also welcome the number of “positive” examples integrated by CESR.

3. Question 3: Comments on the analysis of the examples

We appreciate the analysis. Nevertheless we would like to point out, that each case may require an individual examination. This is especially important for those cases which might be seen as problematic with respect to the enhancement of quality. No definite decision should be taken on the inadmissibility of inducements. The market participants should be given the opportunity to proof, e.g. in form of appropriate organisational precautions, that an impairment of the customer’s interests does not have to be feared. The latter concerns in particular examples IV, V and VIII.

Generally, we would like to stress that this flexibility should be maintained in the final CESR Recommendations on inducements.

With best regards,

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