

**COMMENTS ON THE CESR DOCUMENT ON “INDUCEMENTS UNDER
MIFID”(APRIL 2007) DRAWN UP BY THE WORKING GROUP ON MIFID
ESTABLISHED BY THE FOGAIN MANAGING ENTITY, COMPRISING
THIRTEEN SPANISH INVESTMENT FIRMS**

1 – General commentary.

In general terms the second paper, compared to the first one, seems to have a more positive perception of the charging of fees in certain cases where they enable certain widespread operations and they have not hampered the professional, honest and fair treatment given to clients, for instance in the marketing structures of securities and financial instruments.

However, we must insist that the appropriate place for analysing these kinds of structures (where it may even be proposed that the interests of the investment firm may prevail over those of the client) is that of conflict of interest. The regulation of inducements should be left for cases in which the regulation of conflicts of interest does not appear to be a sufficiently prepared instrument for such purposes.

This interpretation has not been included in CESR’S second consultation paper, therefore we must state our belief that the basic approach on which the paper is grounded is the wrong one.

2 – Commentary on the recommendations.

1st Recommendation.

According to the position held thus far and in our first paper with commentaries, we cannot agree that charging standard fees should require such a limiting and comprehensive regulation as provided in article 26 of the Level Two Directive. To guarantee that such situations do not affect the rights of clients, it would be sufficient that they be handled within each investment firm’s conflicts of interest handling policy.

2nd Recommendation

The interpretation of a rights limiting regulation such as article 26 of the Level Two Directive should take place, as proposed in this Recommendation, in an expansive manner. Instead it should be interpreted in such a way that its literal wording is not extended so as to limit any other actions other than those specifically stated in said article.

Because of this, it is considered that the demand for added requirements for the application of article 26 (a) is not adequate. The Recommendation not only requires that the payment be made by the client, but he/she (i) must have given the investment firm

express instructions and (ii) must be able to vary the terms of the agreement by virtue of which part of the cash is transferred from one investment firm to another.

The application of article 26 (a) should be left to its natural scope of application, without establishing any added requirements such as those set out in the Recommendation. What is proposed in the CESR paper is actually a limitation of the assumption of lawfulness of payments and charges, but the need for that is not apparent.

3rd Recommendation

We consider that it is a mistake to conclude that charging a standard fee represents, ‘by its nature’, a situation that gives rise to a conflict for the adequate treatment of clients.

The analysis of the nature of the network of relations and interests arising from the charge of a standard fee must not be done in an abstract manner. The quantitative aspects and the situation of the investment firm in respect of each client are essential if we are to determine that it is a fact that the nature of the situation impairs the duty of giving the client a proper treatment. Aspects such as the daily running of investment firms, the low relative importance for investment firms of the individual investment decisions of some clients, the acceptance of some of these practices as accepted and widespread market practices, not representing an element of actual competition between investment firms, all mean that there are actually not any situations of conflicting interests in many of the situations in which a fee is charged. Because of this, a merely abstract analysis is considered erroneous.

This recommendation should state that only “when the charging of fees, taking into account the circumstances, is of a nature such as to impair the possibility of giving the client a fair, impartial and professional treatment” should [the charging of fees] be considered to be within the scope of article 26 (b). Otherwise they should be comprised under section (c).

The simplification included in the Recommendation as set out in the CESR paper may be very useful for supervision purposes insofar as it provides absolute and abstract criteria, but it does not stand up to reality, where an analysis must be made of the true consequence of each situation, to determine whether it is possible to speak of a situation that ‘by its nature’ may affect the treatment given to clients.

4th Recommendation.

- Paragraph 15 of the paper establishes that investment firms will have to take into account the joint or common interests shared with other investment firms so that they may arrive at the conclusion that such joint or common interests (which are not limited to a charge or payment) are not affecting the interests of clients.

This consideration is not to be included within the scope of article 26, but within the more general scope of the handling of conflicts of interest. Because if these kinds of considerations were to be made within the scope of article 26, we would arrive at an absurd situation in which it would be necessary to disclose to a client the entirety of the

relations that in this or that jurisdiction there might be in place between the investment firm and another firm supplying the product, for instance.

Therefore, it is proposed that, in order to avoid causing uncertainty regarding this matter, this paragraph should clearly state that the analysis is to be made within the scope of the handling of conflicts of interests, in such a way that it be made clear that there is no need to disclose all the possible interrelations between different investment firms (which in certain cases, for instance investment firms belonging to the same group, could go on without end and be referred to matters which in no way would affect the possible treatment given to a client at any given moment and they have no 'relation' with the rendering of a specific service to the client, as required by the Directive). For instance, imagine an investment firm in the Group that renders custodian or sub-custodian services for all the investment firms in their Group, and it also provides brokerage services and, in some cases, financing certain operations, research services, etc. And then another investment firm in the Group is the source for a product that is placed via the former investment firm.

It does not seem that from the text of article 26 it is to be concluded that in such a situation the client must be given a detailed account of each and every one of the implications in the complex relations between the two investment firms.

It is proposed, therefore, that these kinds of situations be placed in the CESR paper clearly outside the scope of article 26.

- Regarding the contents of the Recommendation:

Part a) – We consider positive that CESR establishes that analyses are to be carried out for each investment firm, taking into account their particular circumstances.

However, it should also be concluded that such analyses may lead to the application or otherwise of article 26 itself, because if there is no 'inducement' for acting against the legal standards for treating clients, this situation should not be considered as being within the scope of article 26.

Part b) – The criterion set out is reasonable. This criterion, once again, refers to a situation of conflict, which is the basis of the regulation of these kinds of structures in client protection regulations (within the scope of handling conflicts of interest). We therefore consider that this CESR analysis is adequate but, once again, the conclusion should lead to the application or otherwise of article 26 to a specific situation, but not to determining whether the items in part (b) of said article are present.

Part c) – If the situation stated in part c) arises, we understand that there is no inducement under the terms of article 26. Article 26 is to be interpreted as what it is: a regulation of 'inducements'. Therefore, when the charge or payment does not represent an inducement, the situation is outside the scope of article 26 .

Any other interpretation would seem to move away from the spirit and the purpose of the regulation.

Part d) – Consistent with what is stated above, the joint or common relations among investment firms should not be included in article 26. The contrary goes beyond the Directive, among other reasons, because those other relations among investment firms are not ‘related’ to the rendering of a service to a client considered in isolation, therefore they are not within the scope of article 26. In our opinion this part should be deleted from the recommendation and it should be specified that those other relations among investment firms are not to be analysed within the scope of article 26.

Part e) – This part seems reasonable, but in its present wording it is very open and lacks concretion.

5th Recommendation.

Regarding this Recommendation, the preceding commentaries apply, insofar as article 26 should not be applied to situations of charges or payments which, bearing in mind the circumstances, do not represent an inducement for the investment firm to act in one sense or other.

6th Recommendation.

Everything relating to the level of disclosure to clients is discussed in the CESR paper only from the standpoint of (i) the general principle of sufficiency of the information provided in reduced form, (ii) the consideration that a generic reference to charges or payments is not sufficient, and (iii) the disclosure of information in referrals to a chain of investment firms involved.

What we think is missing is the statement that investment firms should only disclose the information that is reasonable, bearing in mind the circumstances. A general principle of outright full disclosure as apparently mandated by the CESR paper could give rise to abuse on the part of clients and other investment firms, which could have access to the sales terms in all of the distribution agreements of the competition.

Such a situation should be avoided. In order to do so, in determining the level and detail of the information to be disclosed to clients, we propose to introduce the concept of ‘reasonableness’, ‘given the circumstances’. Some of the measures of reasonableness could be the following:

- (i) That sufficient information be deemed to be that including a bracket of percentages charged per type of financial product. For instance, “for the sale of real estate funds, this investment firm charges the creator of the product a fee between x and y%.”
- (ii) That it be disclosed whether more is charged for selling one product or another, without giving details of the different agreements.

3 – Commentary on the illustrative examples.

Example IV -

If an investment firm can prove that the criteria for selecting the brokers with which it operates are professional, neutral and not linked to charging fees from each broker, this charge should not be considered as representing an inducement.

Example V -

This example at first seems to allow this way of operating, but then it says that this way of operating entails a substantial risk of unfair, partial or non-professional treatment of clients.

This example should be developed further to give a clear indication as to when it is considered to be lawful and when it is not.

Example VI -

We consider that in respect of the service that (F) cannot furnish, (C) is not a client of (F) by definition, because (F) does not provide that service, therefore the application of article 26 cannot be requested.

Example VIII -

We do not understand why charging an off-bonus is considered as not allowing compliance with the requirements of article 26 (b).

The structure is the same as when the fee charge is linear depending on the volume sold. Therefore it is just as useful that other structure plan of fees to improve the quality of the service given to the client. And in the end, if a disclosure is going to be made to a client, the latter may have a clear idea of the interests at stake.

Example XI -

The training received by the investment firm's sales staff (i) is good for the client and does not represent, in its own nature, an inducement for the investment firm to go against the interests of the client, and (ii) it is not received 'in relation to' a specific brokerage service for the client but in a general manner instead, before sales begin (a specific training course is not given in order to assist each client). When the training is given it is not even known whether the client is going to come along and subscribe the product.

Therefore, these kinds of relations should be analysed outside the scope of article 26.

Analysing them within the scope of that article, aside from being considered inappropriate, gives rise to somewhat absurd situations regarding disclosure to the client. What must be disclosed? What was the training course about? Was the course given by the person who should naturally give the course, that is, the product creator? What sense does it make to disclose that information? Should clients be told that having received that training course may be bad for them? Will clients understand? Does this situation fall within what is supposed to be regulated by article 26?

We propose either to exclude these kinds of situations from article 26 or fit them within part c), insofar as they are something necessary for rendering the service to the client.

Example XII -

The example should clarify that, whenever the instruments that are supplied are done so for the service to be rendered (screens, point to point lines, etc.), they should not be considered inducements (once again they are not given 'in relation to' the rendering of a service to a client, but as a more general operating structure) and they should not be included in article 26, or at the very most they should be included in part c) of article 26, because they are necessary means for rendering the service.

This example also poses reasonable doubts about the level, type and form of the information that is to be provided to the clients. It seems that it would be useful that CESR reflect on this in the paper.

23-4-07