STATE STREET.

The Committee of European Securities Regulators
11-13 Avenue de Friedland
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February 13, 2007

RESPONSE TO CESR / 06-687: CONSULTATION PAPER ON INDUCEMENTS UNDER MIFID

State Street Corporation, headquartered in Boston, U.S.A., specializes in providing institutional investors with investment servicing, investment management and investment research and trading. With $11.9 trillion in assets under custody and $1.7 trillion in assets under management, State Street operates in 26 countries and more than 100 markets worldwide. Our European-based workforce of over 5,500 employees represents 20% of our global headcount. As of December 31, 2006, State Street holds assets under custody from clients in Europe totaling $1.8 trillion and European clients' assets under management totaling $425 billion.

Dear Sirs, dear Madams,

State Street Corporation would like to thank CESR for the opportunity to comment on the Consultation Paper on inducements under MiFID. Please find attached our answers to the questions posed.

We would be happy to discuss with you, in further detail, any comments you may have. Please do not hesitate to contact Gabriele Holstein at 0041 44 560 5101.

Sincerely,

Stefan Gavell
Executive Vice President
Industry and Regulatory Affairs

Dr. Gabriele Holstein
Vice President and Director of
European Industry and Regulatory Affairs

State Street Corporation's specific responses to questions in the CESR Consultation Paper on Inducements under MiFID (the "Consultation Paper")

Introduction

This memorandum contains State Street's views on CESR's proposals as set out in the Consultation Paper. We welcome CESR's effort to elaborate on a common approach to the operation of Article 26 of the Level 2 Implementing Directive and appreciate the opportunity to comment on the proposal prior to the development of a formal recommendation.

General Explanation and Relationship with Conflicts of Interest

MiFID refers to inducements in both Articles 21 and 26 of the Commission Directive.

Article 21 sets out *minimum criteria that a firm must take into account in identifying relevant types of conflict of interest*. One such criteria is if the firm receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

Article 26 sets conditions that must be met in order for a *fee, commission or non-monetary benefit not to be prohibited.* This is the case under two general circumstances, namely (i) if the item is paid or provided to or by the client or a person acting on behalf of the client (Art 26 (a)) or (ii) if the item is a "proper fee" that enables or is necessary for the provision of investment services (Art 26 (c)). Art 26 (b) deals with fees and other benefits that are paid or provided to or *by a third party* and which are *not* considered "proper fees,". In order for Article 26 fees and benefits not to be prohibited there must be (i) clear, prior disclosure to the firm's client and (ii) the item must be designed to enhance the quality of the service to the client and it must not impair compliance with the firm's duty to act in the best interests of the client.

According to CESR, Article 26 is to be interpreted so that it (i) applies to all fees, commissions and non-monetary benefits that are paid or provided to or by an investment firm “in relation to the provision of an investment or ancillary service to a client” and (ii) broadly applies to payments including "standard commissions or fees" that may be paid or provided to or by an investment firm. Furthermore, the term "proper fee" is to be interpreted narrowly, with a wide range of receipts or payments subject to prohibition. Specifically, any items that are not of a type similar to the costs listed (i.e. custody costs, settlement and exchange fees, regulatory levies or legal fees), are considered unlikely to fall within the allowable exception.

Q1: Do you agree with CESR that Article 26 applies to all and any fees, commissions and non-monetary benefits that are paid or provided to or by an investment firm in relation to the provision of an investment or ancillary service to a client?

We generally agree, but would be concerned if the term “in relation to the provision of an investment or ancillary service” were to be interpreted too narrowly. In our view, CESR should provide clarity regarding the extent to which services can be considered as normal business expenditures, and as such, outside of the definition of an inducement.

Q2: Do you agree with our analysis of the general operation of Article 26 of the MiFID Level 2 Implementing Directive and of its interaction with Article 21?

We agree with the analysis.

Article 26 (a): Items "Provided to or by the Client"

Q3: Do you agree with CESR's view of the circumstances in which an item will be treated as a " fee, commission or non-monetary benefit paid or provided to or by … a person acting on behalf of the client"?

We agree with CESR's view that Article 26 (a) applies only in fairly restricted circumstances and that for an item to be treated as a fee, commission or benefit paid or provided to or by a "person acting on behalf of the client," it is not sufficient that the cost of a fee, commission or non-monetary benefit is borne by the client, but also requires acting on the instruction of the client. We therefore agree that a product provider paying a standard commission to an investment firm should be dealt with under Article 26(b).

Q4: What, if any, other circumstances do you consider there are in which an item will be treated as a " fee, commission or non-monetary benefit paid or provided to or by the client or a person acting on behalf of the client"?

We do not see any other examples in addition to those listed in the paper.

Article 26(b): conditions on third party receipts and payments

Q5: Do you have any comments on the CESR analysis of the conditions on third party receipts and payments?

According to CESR, Article 26 (b) is primarily concerned with circumstances in which the client of an investment firm will bear the cost of payment or receipt of monetary or non-monetary benefit to or by an investment firm. The analysis provided in Paragraph 18 seems to imply that any type of payment or receipt of benefit, which if not incurred would reduce the costs directly or indirectly borne by the client, and which are not considered to be "proper fees," would fall under the definition of third party receipts and payments. We are concerned as to the implications of such a potentially broad definition. Referring to our statements provided in Q1, we believe CESR should specify what are in fact normal business expenditures, and as such, outside of the definition of an inducement.

Q6: Do you have any comments on the factors that CESR considers relevant to the question whether or not an item will be treated as designed to enhance the quality of a service to the client and not impair the duty to act in the best interests of the client? Do you have any suggestions for further factors?

Recital 39 of the Directive refers to situations where investment firms are paid by commissions received from product providers (e.g. UCITS management company). We agree with CESR's view that the receipt of commission for unbiased advice or recommendation should be considered as having met the condition of enhancing the quality of the service to the client.

In the specific example where an investment firm provides unbiased investment advice to a client to buy a particular fund and receives a commission from the management company paid out of the product charges made to the investment firm's client (example 1) or where an investment firm that is not providing investment advice or general recommendations has a distribution agreement with a product provider, such as the management company of a UCITS, to distribute its products in return for commission (example 2), the condition to enhance the quality of services is considered to be met.

To satisfy the other condition of Article 26 (b), i.e. disclosure and the obligation not to impair compliance with the firm's duty to act in the best interests of the client, CESR suggests that the commission payment should not be "disproportionate" to the market or to the value of the service provided to the client. We are concerned as to the practicability of such a proportionality test.

Article 26(b): Disclosure

Q7: Do you agree that it would not be useful for CESR to seek to develop guidance on the detailed content of the summary disclosures beyond stating that: "such a summary disclosure must provide sufficient and adequate information to enable the investor to make an informed decision whether to proceed with the investment or ancillary service; "

We support CESR's position that a generic disclosure which refers merely to the possibility that the firm might receive inducements will not be considered to meet the requirements of Article 26. Beyond the suggested statement as to what a summary disclosure must provide, we agree that it would not be useful to develop guidance on the detailed content of the summary disclosure.

Q8: Do you agree with CESR´s approach that when a number of entities are involved in the distribution channel, Article 26 applies in relation to fees, commissions and non-monetary benefits that can influence or induce the intermediary that has the direct relationship with the client?

We agree with the suggested approach. Items required to be disclosed by Article 26 should only concern fees, commissions and non-monetary benefits received by or provided by the last intermediary in the chain, *i.e.* the investment firm providing the service to the client. This investment firm, which has the direct relationship with the client, should be required to disclose arrangements by which it could be influenced or induced.

Softing and Bundling Arrangements

According to CESR, softing and bundling arrangements are defined as goods and services supplied to a portfolio manager in return for business put through a broker due to which the broker's commission charges (which are borne by the portfolio manager's customers) are higher in order to offset these goods and services supplied ("softed"). Where the brokerage arrangements are "bundled" i.e. a single commission is charged to cover both broking services as well as softed goods and services, there is in CESR's view no transparency over the costs of the soft commission arrangements and therefore limited opportunity for the investment manager to ensure value for money.

Q11: What will be the impact of Article 26 of the MiFID Level 2 Directive on current softing and bundling arrangements?

As softing and bundling arrangements are regulated differently within individual Member States, an overall market impact is difficult to assess. In the U.K., the impact is likely to be the small, if any, as FSA regulation already requires portfolio managers to make full disclosure of services received which are paid out of trading commission and fees.

In reference to the response which we provided to the FSA consultation on Bundled Brokerage and Soft Commission Arrangements for Retail Investment Funds (CP05/13),

we generally believe that it would not be desirable to mandate disclosure of bundled and soft commissions directly to all retail investors and that the limited benefit of providing such information to all investors would not justify the cost to the investment managers. Such disclosure is unlikely to increase retail investors' understanding of product costs, and risks increased confusion and detraction from the information already provided. The recent introduction of the simplified prospectus and the focus on the Total Expense Ratio acknowledges the need for investors to receive clear and focused information. Interested retail investors, however, should have access to commission-related information upon request.

With respect to the wider provision of these disclosures, we support transparency in financial services and agree that information should be made available in the public domain. Publication on firm websites or in annual reports is a low-cost option for investment managers. It would provide interested parties, such as financial advisers and journalists who are better placed to understand the workings of the wholesale markets, with useful material in evaluating firms and their funds.

Q12: Would it be helpful for there to be a common supervisory approach across the EU to softing and bundling arrangements?

Yes, we do believe that a common supervisory approach would be helpful as long as it focuses on disclosure (Article 26 (b)) and does not widen the definition of softing and bundling beyond the asset manager – broker relationship. Furhermore the approach should not be overly prescriptive. An approach which is too detailed bears the risk of preventing innvoation in trading arrangements which should be avoided at all costs.

Q13: Would it be helpful for CESR to develop that common approach?

Yes, we do believe that there is a role for CESR to play.