

**ABI response to CESR's
consultation on
Inducements:
Good and poor practices**
(Ref. CESR/09-958)

22 December 2009

General remarks

The Italian Banking Association (ABI), which represents the entire Italian banking industry with over 800 member banks, welcomes the opportunity to contribute to the definition of a more harmonised interpretation and application of MiFID provisions on inducements.

Considering the significant implications brought by the regulation on inducements with specific regard to the mechanism of banks' remuneration, it seems appropriate that this regulation will have to be the same across the different Member States, so as not to penalise – especially the revenues for fees and commissions – banks and financial intermediaries located and operating in those Member States which have already given and adopted a more strict interpretation of these aspects of the MiFID, as it is for Italy.

Undoubtedly the approach taken and implemented in Italy is thorough, analytical and more stringent than in other Member States, characterised by peculiar clarity in the interpretation of the MiFID, achieved by CONSOB's two main regulatory acts on this subject: i). "First guidelines on inducements" (October 2007); ii). "Level 3 measures on investment research and the portfolio managers - broker/dealers' relation" (January 2009). Furthermore, MiFID implementation in Italy embraces not only investment and ancillary services, but also distribution of funds directly marketed by management companies, collective management service, distribution of financial-insurance products (i.e. unit- and index-linked policies) by intermediaries.

Hence, ABI considers appropriate to indicate, via the answers provided below, a detailed indication on the strict Italian regulation, in order to provide further elements for CESR to choose and decide the final approach to adopt homogenously at a European level.

ABI regards that the work and analysis carried out by CESR should eventually provide further clarifications and indications to achieve the ultimate goal: a uniform and homogeneous application of the regulation on inducements at a European level.

Classifying payments and non-monetary benefits and setting up an organization to be compliant.

Questions 1-3

Do you agree with CESR's views about the arrangements and procedures an investment firm should set up?

Do you have any comments on CESR's views that specific responsibilities and compliance controls should be set up by investment firms to ensure compliance with the inducements rules?

What are your comments about CESR's view that at least the general approach the investment firm is going to undertake regarding inducements (its 'inducements policy') should be approved by senior management?

Answer

ABI agrees with CESR's findings, analysis and considerations in Part III of the consultation document and the Italian financial industry is already compliant with those indications.

In particular, ABI agrees with CESR's view regarding:

- the responsibility of senior management for approving arrangements and procedures set up for inducements rules (in Italy this set of rules falls within the "inducements policy");
- the segregation between the 'inducements policy' and that on 'managing conflict of interest';
- compliance functions being responsible for the definition of the inducements policy, ensuring its application, and monitoring its relevance and consistence over time, also in case of new (business) relationships originating payments or non-monetary benefits;
- inducements being part of the compliance reports to senior management;
- the record-keeping and tracking system that intermediaries (and management companies according to Italian regulation) have to implement in order to track the various inducement policies adopted over time, as well as the information on inducement provided to clients over time.

As a matter of fact, the newly drafted regulation by CONSOB (under public consultation) about the information and documentation that intermediaries and management companies have to send to the regulator, with effect from 2011 on policies issued/defined from 2010 onwards, includes their inducement policies.

ABI considers extremely useful that CESR provides further clarity on the kind of controls the compliance function has to carry out on the inducement policy's provisions and measures, given that these controls should mostly be ex-ante and that the whole set of controls demanded to the intermediaries needs, in our view, the involvement and coordination of both the internal audit and compliance.

Proper fees

Questions 4-6

Do you agree with CESR's view that all kinds of fees paid by an investment firm in order to access and operate on a given execution venue can be eligible for the proper fees regime (under the general category of settlement and exchange fees)?

Do you agree with CESR's view that specific types of custody-related fees in connection with certain corporate events can be eligible for the proper fees regime?

Are there any specific examples you can provide of circumstances where a tax sales credit could be eligible for the proper fees regime?

Answer

In ABI's view CESR's survey findings on proper fees needs additional clarification as the consultation paper does not provide a detailed list of payments and non-monetary benefits classifiable as 'proper fees'. ABI recommends CESR to summarise a list of these items (not necessarily wholly comprehensive) which can be classified as such.

To support CESR in the definition of such a list, ABI provides below a list of proper fees, drafted in 2007:

1. fees for data transmitted via telex about settlement, etc;
2. fees on the account activity relating to "mutual accounts";
3. fees, commissions for EBA clearing service ('Euro Banking Association');
4. custody and settlement fees (net, gross, and RRG service by "Monte Titoli – Borsa Italiana"), netting and clearing services, custody and management services provided for securities issuers;
5. expenses for operations run by depositary banks on securities issued abroad (i.e. in a different country) for which they are custodian;
6. commissions received by security issuers for corporate actions and other operations, such as those on share capital and reserves, long-term debt capital, or fixed assets of a company, rights on dividends, general shareholders' meetings;
7. payments (i.e. fees and commissions) to run the relevant investment service or a part of it, provided or received in outsourcing;
8. fees on currencies exchange (i.e. exchange rates);
9. tax payments;
10. legal fees and expenses.

With specific regard to the considerations above, ABI would greatly appreciate a clarification as to whether rebates of underwriting commissions for collective investment schemes (CIS) may be classified as proper fees.

Payments and non-monetary benefits authorised subject to certain cumulative conditions – acting in the best interests of the client and designed to enhance the quality of the service provided to the client

Question 7

Do you agree with CESR's view that in case of ongoing payments made or received over a period of time while the services are of a one-off nature, there is a greater risk of an investment firm not acting in the best interests of the client?

Answer

ABI agrees with CESR's position on this aspect. Indeed, in Italy the financial industry, compliant to CONSOB guidelines on inducements issued in 2007, is organised to ensure that on-going commission rebates – from a 'product issuer' (i.e. management companies, insurance companies) to distributors – remunerate the added value of the service provided by distributors to clients on an on-going basis:

- when rebates do not represent an obstacle for a financial intermediary to provide its clients with services they are actually interested in. To do so, among other things, an intermediary needs to adopt an internal policy where are set and defined the relevant processes and financial variables for the identification and selection of the products offered to clients;
- when distributors combine their investment advice service with a wide product-range 'selling' (i.e. placement and distribution);
- in those cases where a strictly-defined 'investment advice' service is not available, rebates are still possible and justified when these allow clients to have access to a wider range of products, pre- and after-sale services, hence enhancing the overall quality of the service provided to clients.

Question 8

Do you have any comments regarding CESR's view that measures such as an effective compliance function should be backed up with appropriate monitoring and controls to deal with the specific conflicts that payments and

non-monetary benefits provided or received by an investment firm can give rise to?

Answer

As for answer to questions 1-3, ABI agrees with the importance of an efficient and effective control run by the compliance function. This control though is to happen mostly ex-ante, and should be complemented by internal audit ex-post controls, permanently compliant with the internal procedures an intermediary has to adopt for the coordination of the activity of these two functions.

Question 9

What are your comments on CESR's view that product distribution and order handling services (see §74) are two highly important instances where payments and non-monetary benefits received give rise to very significant potential conflicts? Can you mention any other important instances where such potential conflicts also arise?

Answer

ABI considers the following four non-exclusive instances of services as those highly important cases where payments and non-monetary benefits received by investment firms give rise to very significant potential conflicts:

1. product distribution;
2. investment advice;
3. order handling services;
4. initial public offerings.

Also, ABI agrees with example n.1 on page 24 (included within the 'good practices') and its relevant commentary about legitimacy of soft commission reception including research, technical services and information technology from the firms which execute client orders. However, ABI deems as important to specify that also goods and services related to the execution of orders are included in the soft commissions listed above. Furthermore, we deem useful to specify –for each type of “soft commissions” included in example 1, i.e. “research”, “technical services” and “information technology” – a list of non-monetary benefits which could be considered included under the mentioned type of soft commissions together with a list of non-monetary benefits which could not be included under such soft commissions. Moreover, given the non exhaustive nature of the two lists, it would be appropriate to indicate the relevant principles which a firm should take into account in order to verify whether a specific non-monetary benefit can be remunerated through dealing commissions.

In any case, in order to provide further elements for CESR to choose and decide the final approach to adopt homogenously at a European level, we report the conditions for portfolio managers receiving investment research

by brokers, as provided by CONSOB regulation issued in January 2009. Namely, in Italy investment research¹ has to:

- provide 'new' information, i.e. complementing and not replacing the information the management company receives and uses for its investment operations/activity;
- represent new analytical judicious information, regarding new facts and scenarios or past events, but it cannot consist of a mere repetition or re-formulation of existing public information;
- consist of 'rigorous', accurate information;
- be meaningful, i.e. consisting of analysis and data aimed at inferring, achieving meaningful conclusions.

The circumstance where the investment research, provided by a dealer/trader/intermediary to a portfolio manager, is paid back through fees and commissions implies a management company having to comply with the duties and obligations detailed in the relevant best execution legislation/rules.

As the research by a portfolio manager from a trader/dealer/intermediary is not included within the scope of the best execution, the management company has to define a set of criteria to assess the net cost of negotiation to set and define a transmission policy pursuit the best result for the client.

Finally, other things being equal, a portfolio manager may base, on the research received, its selection of a trader/dealer/intermediary whom sending investment instructions to.

With specific regards to examples n.3-4 on page 25 ('poor practices'), ABI considers that example n.3 shall be brought as an instance of good practice if, and only if:

- the investment advice service provided to a client is offered solely in its own interest and benefit, and it allows the client to fulfil its actual financial needs;
- the intermediary allows for:
 - a panel of technical and financial variables to guide the selection of products in offer to its clients;
 - the implementation of an impartial, neutral (non-discretionary) model to assess the suitability (of its products to a certain client), in order to support the recommendations provided to clients within the frame of 'investment advice';

¹ For 'investment research', in this context, the Italian regulator refers to the investment research a management company paid for independently and debited to its relevant clients' managed portfolios in a bundled trading/dealing fee, in compliance with recitals n.52 and n.73 on inducements of Italian Intermediaries' Regulation ("Regolamento Intermediari").

- the adoption and implementation of a policy of (i) best execution and (ii) conflicts of interests management.

As for example n.4, ABI considers this case as a valid good practice, if and only if:

- the intermediary looks after, assists and supports pre- and post-sale activities, offering a tangible, actual assistance to its clients (e.g.: providing clients with regular valuations/pricing updates on the financial instruments included in their portfolios);
- the intermediary allows for... (see 2nd bullet point above)

Finally, regarding example n.6 page 26 (included within the 'poor practices'), ABI would ask CESR to integrate and strengthen the relevant commentary by explicitly mentioning that this case has been forbidden by CONSOB's guidelines on inducements issued in 2007.

Question 10

What are your comments on CESR's view that where a payment covers costs that would otherwise have to be charged to the client this is not sufficient for a payment to be judged to be designed to enhance the quality of the service?

Answer

ABI agrees with CESR's consideration that this case is not sufficient for a payment to be judged to be designed to enhance the quality of the service, as it is regarded as essential to provide added value in the provision of services to clients.

Payments and non-monetary benefits authorised subject to certain cumulative conditions – Disclosure:

Question 11

Do you have any comments on CESR's views about summary disclosures (including when they should be made)?

Answer

ABI agrees with CESR's considerations on summary disclosures. Nevertheless, with regards to introducing fees (example n.1 page 30), ABI would recommend CESR to clarify the criteria as to how on-going introducing fees might provide added value for clients, without impairments to the duty to act in the best interest of its clients.

Question 12

What are your comments on CESR's views about detailed disclosures?

Answer

ABI would recommend CESR to set out clearly that intermediaries are free to decide whether to provide prior detailed disclosure without having to provide as well, firstly, a summary disclosure and, secondly, further details to follow, whereas a client asks for it.