



BVI · Eschenheimer Anlage 28 · D-60318 Frankfurt am Main

Bundesverband Investment
und Asset Management e.V.

CESR the Committee of European
Securities Regulators
11-13 avenue de Friedland
75008 Paris

Contact:
Timm Sachse
Phone: +49.69.154090.260
Fax: +49.69.154090.160
timm.sachse@bvi.de

FRANCE

December 22nd, 2009

Consultation on Inducements: Good and poor practices

Dear Sir or Madam,

BVI¹ is grateful for the opportunity to comment on CESR's initiative for a consultation on "Good and Poor Practices" in the application of the rules on inducements under Art. 19 (1) of MiFID and Art. 26 of the MiFID Level 2 Directive.

We welcome CESR's aim to further clarify practical issues in the application of the inducement provisions under the MiFID. These rules, in particular considering the way they are implemented and applied by the relevant market participants in Germany, have proven to be highly effective in ensuring that investment firms, when providing investment services and/or ancillary services, do act honestly, fairly and professionally in accordance with the best interests of their clients.

Nevertheless, in summing up CESR's positions with regard to the distribution of fund units we are concerned about the general implications in respect of certain market and fee structures, namely ongoing payments, as per se more risk-entailing to potential conflicts of interests. It is common practice in Germany as well as other European countries to remunerate advice and distribution in terms of fund units by forwarding of generally the

Director General:
Stefan Seip
Managing Director:
Rudolf Siebel

¹ BVI Bundesverband Investment und Asset Management e. V. represent the interest of the German investment fund and asset management industry. Its 86 members manage currently assets of EUR 1.7 trillion both in mutual funds and mandates. For more information, please visit www.bvi.de. BVI is filed in the EU register of interest representatives (1575282143-01).

Eschenheimer Anlage 28
D-60318 Frankfurt am Main
Postfach 10 04 37
D-60004 Frankfurt am Main
Phone: +49.69.154090.0
Fax: +49.69.5971406
info@bvi.de
www.bvi.de



entire fee and parts of the management fee to distribution entities. These structures have proven to be highly effective and particularly beneficial for retail investors. The German legislator as well has ascertained that inducements for the purpose of building up and maintaining efficient and high-quality infrastructures for the purchase and selling of financial instruments could be appropriate to enhance the quality of the respective service (see preamble to § 31d WpHG).

Therefore, we request for a reasonable application of the inducement provisions of the MiFID on a case-by-case basis rather than disavowing well established market structures in general without considering the merits.

In more detail:

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

Question 1: Do you agree with CESR's views about the arrangements and procedures an investment firm should set up?

We agree with CESR's view that arrangements and procedures are essential in fulfilling investment firms' obligations under the MiFID inducement rules.

With regard to CESR's approach to verifying that a firm's relevant payments and non-monetary benefits are compliant with the MiFID inducement rules we consider the three step process for handling inducements (identification, classification and evaluation) as a appropriate and feasible procedure, which already seems to be market practice for German investment firm's.

We also share CESR's position that investment firms do enjoy a certain degree of flexibility in the approach to be adopted according to the nature, scale and complexity of their business. This concept is already reflected under German law by § 13 WpDVerOV.

However, in our view CESR's position set forth in para. **35** of the consultation paper, should be reconsidered. To perform a standardized periodic review of recurring payments/non-monetary benefits, e.g. relating to the distribution of collective investment schemes without any concrete reason seems to be overly burdensome. In order to make such requirements



more proportionate we suggest that such reviews and reassessments should only be required in case of material changes in the terms of or the circumstances surrounding such payments/ non-monetary benefits.

Question II: 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?

We agree with CESR's view that specific responsibilities and compliance controls should be set up by investment firms to ensure compliance with the inducements rules. The general obligation to implement such a system is already set forth in several provisions of German law (e.g. § 13 WpDVerOV), so that investment firms in Germany already have a respective legal obligation. In order to provide a level playing field for the financial industry, the main regulatory focus should be to ensure that these rules are implemented and comparable standards are applied and enforced in all EU member states.

Question III: 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?

We agree with CESR's view that at least the general approach the investment firm is going to undertake regarding inducements should be approved by the senior management (meaning the "board of directors" or other persons who effectively conduct the business of the investment firm).

With reference to CESR's example on a poor practice regarding the set up of specific arrangements devoted to the MiFID inducement rules the lack of a specific "inducement policy" does in our opinion not result in a poor practice per se. The evaluation of a firm's practice should not be based on the label attached to a policy but rather on the merits and effectiveness of the compliance system that is put in place. Therefore, we consider that a firm's approach to dealing with inducement issues, can basically also be an integral part of the firm's general conflict of interest-policy, which has to be reviewed by the compliance officer (and therefore also by the senior management) periodically under German law.



Proper fees

Question IV: 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)?

We agree with CESR's view. Without payment of these fees an order cannot be executed on a certain venue and there is no reason why such fees should impact the interest of the client. Besides, an investment firm already has to evaluate the fees charged by an execution venue under the best execution rules set forth in Art. 21 MiFID and Art. 44 of the Level 2 Directive.

Question V: 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?

We agree with CESR's view. In particular certain types of custody-related fees such as fees paid by the investment firm in connection with specific corporate events like shareholders' meetings, dividend distributions etc., and items such as payments to information service providers or consultants for the provision of investment related services can be eligible for the proper fees regime. In many instances, the failure to pay such fees would prejudice the clients rights in connection with his investment and therefore, such fees have to be eligible under the proper fees regime.

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

We have no specific example of circumstances where a tax sales credit could be eligible for the proper fees regime.



Payments and non-monetary benefits authorized 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 VII: 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?

We strongly disagree on CESR's position in para. 67. The level of risk that an investment firm will not act in the best interest of the client, which would be a violation of MiFID rules, does not depend on its general fee structure (up-front fee vs. ongoing payments) but rather on whether the fees charged in a specific case comply with Art. 26 of the Level 2 Directive. Therefore, the general statement or implication that a fee structure which is (at least partially) based on ongoing payments always bears more risk for the investor than a fee structure solely based on up-front payments is incorrect, misleading and not supported by empirical data.

Furthermore, the total amount of fees based on ongoing payments that is charged to an investor during the term of his investment is not necessarily higher than one-off fees since its calculation is based on the average (and recommended) term of an investment in the respective product.

Additionally it should be taken into account, that an investment firm that receives part of its fees based on ongoing payments has no incentive to churn the portfolio of investors in order to receive additional up-front fees but is rather incentivized to build a long term, loyal relationship with its client since a significant portion of its fees will only be received over time and based on the performance of the portfolio and hence investor satisfaction. Therefore, such a fee system, in general has a stabilizing effect on the markets.

As a result, whether a fee scheme based on ongoing payments is beneficial or detrimental to the investor must be determined on a case by case basis rather than on generalizing considerations. In making this determination it should be taken into account (i) whether the investment firm only provides a one-time service or also performs further ongoing services for the client either automatically or upon request and (ii) whether there is an up-front



payment at the time of the purchase of the investment product in addition to ongoing fees and, if yes, what the ratio between these two fee elements is.

In view of these facts, a general statement to the effect that fee schemes based on ongoing payments received over a period of time bear a greater inherent risk that the investment firm is not acting in the best interest of the client is certainly incorrect. It is, therefore, not justified to discredit certain, well established market structures which have proven to be highly effective and particularly beneficial for small retail investors without looking at each single case applying the criteria of the MiFID inducement rules.

Question VIII: 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?

From our point of view there is no necessity to implement an additional monitoring and control system to back up the existing compliance system. In Germany it is subject to the review of the firm's compliance function pursuant to Sec. 33 para 1 no. 1 of the German Securities Trading Act (WpHG), whether an investment firm is in compliance with its obligations under MiFID, including the rules on inducements.

Question IX: 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?

Payments or non-monetary benefits received by investment firms may give rise to potential conflicts of interest in general. However, such indirect fees in many instances facilitate access to the product or provide better knowledge and information on the product and are therefore designed to enhance the quality of the service. We do not see that such a fee structure is generally more risky for the client than other fee structures and the MiFID provides various mechanisms to deal with conflicts of interests in cases where they actually occur.



Question X: 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?

We agree to CESR's view that the fact that a payment covers costs that would otherwise have to be charged to the client is not sufficient for a payment to be judged to be designed to enhance the quality of service.

However, Recital 39 of the Level 2 Directive shows that the European legislator in general takes a positive approach towards such payments, as long as the investment firm's advice is not biased as a result of the receipt of such commissions. Therefore, it is not justified to label such fee structure as "potentially bad and dangerous for clients" per se. As long as the advice is not biased (and there are several mechanisms under the MiFID rules to ensure this, including but not limited to the suitability test) it is generally beneficial for the client, when he does not have to pay the respective fee.

We distinctly disagree with CESR's comment on page 26 that "*an investment firm could avoid this conflict by charging clients directly for investment advice*". In our view the general fee structure (indirect payments vs. direct upfront charges to the client) is risk neutral with respect to potential conflicts of interest. Such conflicts of interest can arise in both fee structures and must be dealt by using the various mechanisms provided and required under the MiFID rules but not by generally favoring one specific fee structure, in particular since such fee structure may have other disadvantages for clients.

If, e.g., the upfront fee is charged as a percentage of the assets invested by the client, the advisor may have an incentive to advise the client to pay more money in the fee-based account than it is suitable for him. If, e.g., investment advice is charged to clients on a hourly ratio, the advisor may have an incentive to create unnecessary needs for advisory in order to maximize his billable hours.

As outlined in response to Question VII, there are circumstances as well as market structures and segments where a structure with payments and/or non-monetary benefits from product providers is the only possibility for large groups of investors, mainly retail investors with limited funds to invest, to have access to quality investment advice. These clients would not be willing and able to pay an adequate direct charge for investment advice and,



therefore, in these circumstances payments and/or non-monetary benefits are clearly designed to enhance the quality of the investment advice.

Therefore we consider it appropriate not generally classify certain fee schemes as "good practice" or "poor practice" but rather advocate to judge the merits and risks of each system on a case by case basis. Any other approach would be inconsistent with Recital 39 of the Level 2 Directive that deems indirect payments to investment firms to be as generally legitimate. For this reason, we do not see Example 3 on page 25 necessarily as poor practice. The question whether the advice is biased because of the rebate must be evaluated in each single case using the MiFID tests, including the suitability test.

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

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

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

We basically agree to the procedures outlined in CESR's views on summary and detailed disclosures. They are an essential part of the client's information about inducements. German investment firms already have to follow such procedures under the applicable provisions of German law.

Nevertheless, we consider it not necessary to, e.g. estimate the value of investment research in detailed disclosures, as mentioned in para. **100**. From our point of view a narrative description regarding the calculation of such issues would be as much sufficient to provide clients with more in-depth information compared to summary disclosures, as far as amounts can not be ascertained.

In para. **108** CESR refers to situations where the client requests a detailed disclosure after the provision of a service. This passage gives the impression that a investment firm is obliged to disclosure after having provided a service to a client per se, which is not in line with the MiFID rules and would lead to further practical issues. With reference to Art. 26 (b) of the Level 2 Directive it should be clarified that payments or non-monetary benefits must be clearly disclosed generally prior to the provision of the



relevant investment or ancillary service in order to provide sufficient opportunity for the client to make an informed decision.

Question XIII: Do you have any comments on CESR's views on the use of bands?

From our point of view the use of bands in an investment firm's disclosure should be permissible and, in particular in the summary disclosure, is necessary. We agree with CESR's position that the use of bands should be done in a sensible and reasonable manner in order to provide relevant information to the client.

Question XIV: Do you agree with CESR's views on the documentation through which disclosures are made?

We welcome CESR's view that there is no one-size-fits-all approach regarding the documentation through which disclosures are made. Nevertheless, information in fact should be disclosed in a clear, comprehensive and understandable way, which seems to be already standard in the German market.

Question XV: Do you agree with CESR's views on the difference of treatment between retail and professional clients?

We agree that a distinction could be made between retail and professional clients in determining what constitutes fair, clear and not misleading inducement disclosures. This distinction is allowed under MiFID in several areas and, therefore, in line with the general regulatory approach.

Yours sincerely

BVI Bundesverband Investment und Asset Management e.V.

signed: Alexander Kestler

signed: Timm Sachse