

REMARKS ON THE CESR DOCUMENT TITLED ‘INDUCEMENTS: GOOD AND POOR PRACTICE’ DRAWN UP BY A WORKING GROUP FORMED BY SPANISH INVESTMENT FIRMS AND ESTABLISHED BY THE FOGAIN (SPANISH ICS FOR INVESTMENT FIRMS)

I. GENERAL REMARKS

- In paragraph 41 it is stated that the qualification or otherwise of an inducement as a ‘proper fee’ will depend on an abstract analysis that should not take into account the actual result – whether or not said inducement has actually led to a conflict regarding the obligation of treating the client in an honest, fair and professional way.
The Working Group does not share this restrictive interpretation, because the analysis of the inducement and its capacity to lead to a conflict must be done based on the specific circumstances of each case. The abstract structure of the interests at stake must be considered, of course, but any other elements that might entail that in a specific case there is no such situation of actual conflict must likewise be taken into account.
Taking into consideration both abstract and concrete elements will lead to the fulfilment of the purpose of the rule, that is, that the client be given an honest, fair and professional treatment in every situation.
- In paragraph 57 it is stated that the rules on inducements are not related to non-monetary payments and benefits which are designated to act as an inducement to foster a given behaviour. And it also says that the purpose of the inducement is irrelevant for the application of the regime provided in the Directive.

In the opinion of the Working Group, this statement does not acknowledge that the regulation of the Directive on inducements is established in order to guarantee that clients receive an honest, fair and professional treatment and that this is the purpose of said regime. Therefore, inducements that may affect said qualities in the treatment of clients are meant to be prevented by the Directive and this circumstance must be taken into consideration when analysing concrete situations.

A whole different matter is the existence of a formal regime that is to be met by entities whenever the payment or reception of an inducement takes place. This formal regime (analysis of the inducement and classification of same under the corresponding section of article 26 and appropriate action) must be met in any event. But this does not entail that the very purpose of that regulation is separate from the attainment of an honest, fair and professional treatment of clients.

Therefore an entirely abstract approach towards the regulation of inducements, rather than on a case by case basis, as suggested by this paragraph of the CESR document, is not considered correct.

The Document should include an express reference to the fact that the Inducements regime seeks a concrete purpose, that of attaining an honest, fair and professional treatment of clients, and that the concrete measures in the Directive are geared towards that purpose.

- Example no. 3, 'poor practices', under the section titled 'acting in the best interest of the client and designed to enhance the quality of the service provided to the client' (pg. 25 of the document), considers that it is a poor practice to charge a fee from the marketer when the client who has subscribed the security has an investment advice relationship with the entity. And it is considered a poor practice even if (i) the conflicts of interest regime is applied strictly and (ii) a strong suitability test is conducted.

We do not share this opinion given in the CESR document in light of Recital 39 of the Level 2 Directive, which, as pointed out in the CESR document, states that it is legitimate to charge fees in these cases if it does not bias the advice. The way that CESR considers the charging of a placement fee as a poor practice includes those cases in which said collection has not influenced the direction of the advice, which is contrary to the above-mentioned Recital.

Although in respect of these situations it is especially relevant that the entity take adequate measures in terms of handling conflicts of interest, evaluation suitability and informing the client; once these are fulfilled there is no reason to consider that it is a situation featuring a conflict with the obligation of giving the client an honest, fair and professional treatment. In other words, there is no reason to think that the treatment of the client infringes the level of protection that the Directive is seeking for clients, according to the extensive terms of the above-mentioned Recital 39.

A close analysis of this concrete assumption (and therefore of an advisor's capacity to charge marketing fees) is particularly important in light of the expansive interpretation of advisory services that arises from the CESR Consultation Paper on this matter (Ref. CESR/09-665), pursuant to which any recommendations made to a client within the scope of the buying or sale of securities may be understood as establishing an advisory relationship between the client and the entity.

The combination of both elements (expansive interpretation of advice in respect of marketing, and impossibility of charging marketing fees when advice is given) would have the effect of substantially limiting the possibility of carrying out the marketing activity itself, which is a worrying effect in the opinion of the Working Group.

- Examples nos. 5 and 6 of 'poor practices' under the section titled 'acting in the best interest of the client and designed to enhance the quality of the service provided to the client' (pgs. 25 and 26 of the document), consider that it is a poor practice for an entity managing portfolios to charge a fee that is meant to remunerate either the partial refund of intermediation or similar costs, or the placement of securities.

The Working Group considers that it should be borne in mind that every investment service has its own remuneration structure. Thus when an entity places securities on behalf of the issuer/originator, it naturally receives a fee for doing so. The fact that among the clients acquiring the securities there are included clients for whom the entity renders a portfolio management service, should not make it compulsory that the placement service be provided free of charge. On the other hand, if the product that is placed is suitable for the client, then we were not technically facing a conflict of interests, since the Directive

requires that for a conflict of interest to arise, it is necessary that there can be a potential damage for the client.

We therefore, cannot agree with the manner in which the CESR document categorically defines these collections as poor practice, because if there is an adequate degree of information provided to the client, in such a scenario the charging of a placement fee should be deemed entirely legitimate.

II. CONSULTATION QUESTIONS:

II.1. CLASSIFYING PAYMENTS AND NON-MONETARY BENEFITS AND SETTING UP AN ORGANISATION TO BE COMPLIANT

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

We agree with CESR's views on the appropriateness of entities paying attention to (i) the establishment of internal procedures and mechanisms in relation to inducements, (ii) the prominent role of the Compliance function in this field, (iii) the conceptual steps to be taken in the evaluation of inducements, (iv) the incorporation of the inducements regime to the process of analysing new products or services, and (v) the involvement of senior management in the establishment of procedures and mechanisms.

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?

No comments on this section.

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?

The Working Group coincides with CESR in that a certain degree of involvement by senior management in this field is appropriate. However, the concrete manner in which this is to be implemented is up to each entity.

II.2. 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)?

Yes.

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?

Yes.

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?

N/A

II.3. 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 VII: Do you agree with CESR's view that in the 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?

No.

The Working Group does not see a relation between the specific manner of designing charges for the rendering of marketing services and an increase in the risk of the entity not acting in the best interests of the client. Neither do the terms of the CESR Document provide grounds for understanding that there may be a greater risk scenario.

Regarding this issue, the Directive should not be construed as favouring a certain payment of marketing services scheme over others. What is relevant here is the adequate compliance with the obligation of providing the client with summarised or more complete information—whenever the client requests the latter.

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?

The existence of a compliance function should entail that there be sufficient means for the performance of same. This general principle applies to any activities with compliance obligations for an entity, among which the inducements regime is included.

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?

It is a fact that both marketing and order execution are fields in which the Directive's inducements regime is particularly applicable, not only or most relevantly in the field of conflicts.

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?

The reply to this question depends on the idea (which can be more restricted or more extensive) one has of what is 'designated to enhance the quality of service', as well as on the idea one has of the purpose of regulating inducements.

In the opinion of the Working Group, the CESR document favours an excessively restricted idea in this point.

In other fields involving the rendering of services, mechanisms that favour the same service being rendered for less money would most likely be deemed to be enhancing service quality by the service provider.

This Working Group does not consider that the concept should be any different in the field of the rendering of investment services, or that this should make it possible to identify a breach of the purpose of regulating inducements.

Therefore, in principle, achieving a lower cost for the client should be considered an enhancement of service quality, and a mechanism achieving this could be understood, from an objective rather than a subjective standpoint, as being 'designed' to achieve that effect.

II.4. PAYMENTS AND NON-MONETARY BENEFITS AUTHORISED 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)?

In general terms, the comments in the document are correct. However, the Working Group considers that among the general recommendations, the one mentioned in paragraph 97 should be amended, because it is extremely difficult for entities to guarantee that the client 'has made an informed decision in relation to the service'.

The information provided to the client should be such as to objectively allow the average client to understand the nature and scope of the inducement, but the entity cannot be under the obligation of guaranteeing that with the information disclosed to the client (i) it guarantees that the client understands it correctly or (ii) it guarantees that 'the service' is understood, because purporting to guarantee that the client understands the service he is offered goes beyond the inducements regime and it affects the general regime of information given to the client on the services that are to be provided.

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

The comments in the document are considered correct, although here too (as in the reply to the preceding question) there is the need to adjust in the Document the purpose that is to be met by the information to be provided to the client, clearly stating that such purpose consists only in causing the client to have a reasonable awareness of the nature and amount of the inducement.

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

The Working Group coincides with CESR considering that the use of guidance bands is a good practice. And these bands should be adjusted so that they are suited to the furthest extent possible to the purpose of providing the client with correct information.

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

The Working Group does not share the opinion given in the Document whereby the delivery of information on different, supplementary documents constitutes a poor practice in all cases. Only if it can be proven that such a scheme makes it really complicated (objectively, that is) for a client to access the information may it be considered a poor practice. And this requires a case by case analysis.

Therefore Example no. 1 of 'poor practice', (pg. 38 of the document) should be restricted substantially.

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

Yes.

The Working Group considers that CESR's position regarding this aspect (allowing a lower level of information for professional clients, by way of a lenient interpretation of the Directive) is positive and a good example to apply in respect of other aspects mentioned in this Remarks document always with reference to the purpose of regulating inducements (the honest, fair and professional treatment of clients), and modulating the compliance with the apparently strict obligations of the Directive to the fulfilment of said purpose.