POSITION PAPER

ESBG draft response to CESR's consultation on Inducements under MiFID

13 February 2007

EUROPEAN SAVINGS BANKS GROUP

The European Savings Banks Group (ESBG) welcomes this opportunity to comment on CESR's consultation on the inducements under the MiFID.

Question 1: 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?

First of all, we would like to note that the approach proposed in the consultation paper puts under a "presumption of guilt" any payment received by an investment firm with regard to an investment service.

The ESBG does not consider this to be the right approach. Rather, we deem that payments or benefits should be considered inducements *only* in those cases which give rise to a conflict of interest. Moreover, we consider that a payment sould be regarded as an inducement if it represents an attempt to make someone act in a way that he/she would not otherwise have done.

Article 26 of the MiFID implementing Directive sets the conditions that must be met in order for an inducement not to be prohibited. We therefore consider that it applies to fees, commissions and non monetary benefits that will necessarily give rise to a conflict of interest and that are paid to or provided by an investment firm in relation to the provision of an investment or ancillary service to a client. If we take into account the wording of recital 40 of the MiFID level 2 Directive, which refers to "certain inducements", and also taking into account that inducements must involve conflicts of interests, we consider that Article 26 should be read, contrary to CESR's assertion, in the context of Article 21. Consequently, if the fee, commission or non monetary benefit does not give rise to a conflict of interest, it is not necessary to assess if it is permitted or not, and therefore Article 26 is not applicable.

On the other hand, we agree with CESR that Article 26 does not deal with payments made within the investment firm, such as internal bonus programmes, even though these could constitute a conflict of interest covered by Article 21 of the MiFID implementing Directive.

With respect to Article 26 (c), we deem that CESR wrongly considers that this Article has a narrow application. We believe that the concept of "proper fees" should be interpreted broadly, thus including other payments derived from provided services. Consequently, not all the fees, commissions and non monetary benefits paid to or provided by a third party or a person acting on behalf of a third party must fall under Article 26 (b), as they may be included in Article 26 (c).

As explained above, inducements should be treated in the context of conflicts of interest, and therefore, we believe that disclosure should only be required in a limited number of situations.

The approach we are proposing may operate as follows:

- the investment firm should identify what kinds of inducements (only the inducements that are paid or provided by a third party and not the client) give rise to conflicts of interest;
- only for those types of inducements (and after assessing that they cannot be treated as "proper fees"), the investment firm has to establish organisational and administrative arrangements to avoid detrimental effects for its clients;
- if the firm cannot guarantee the protection of its clients' interests, the inducement shall be prohibited, unless three requirements are fulfilled, namely:

- prior disclosure,
- inducement designed to enhance the quality of the service and,
- impairment test of compliance with the firm´s duty to act in the best interests of its clients.

Question 2: Do you agree with our analysis of the general operation of Article 26 of the MiFID Level 2 implementing Directive?

We do not agree with CESR's analysis of the general operation of Article 26 of the MiFID Level 2 implementing Directive. Please see the explanation given for Question 1.

Question 3: 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 do not agree with CESR's view, as we consider that Article 26 (a) should not be limited to cases in which a third party acts on a specific instruction. We deem that under this Article there may be other situations, as the drafting of the MiFID provisions supports a wider interpretation.

Moreover, we do not consider that circumstances in which a product provider pays a share of a commission to an investment firm will always be dealt with under Article 26 (b) (paragraph 15 of CESR's proposal).

Question 4: 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 consider it helpful to identify specific circumstances. We however believe that it covers all circumstances in which the payer or receiver acts on the client's behalf, including for example commission sharing arrangements that represent a remuneration for the recipient's contribution to the service, and do not induce the recipient to act in a way that would materially affect the client's interests.

Question 5: Do you have any comments on the CESR analysis of the conditions on third party receipts and payments?

As already stated, an inducement will be under Article 26 if it gives rise to a conflict of interest and the entity has not established organisational and administrative arrangements to avoid detrimental effects on its clients. Moreover, as CESR states, inducements that fall under Article 26 which are not "proper fees" that are paid to the investment firm by a third party (or which the investment firm pays to a third party) and not the client are dealt with under Article 26 (b).

Therefore, after assessing if an inducement paid to the investment firm by a third party (or which the investment firm pays to a third party) and not the client is under Article 26 gives rise to a conflict of interest, it should be also decided if it falls under Article 26 (c) and, if not, then Article 26 (b) will be applicable.

Finally, if an inducement falling under the application of Article 26 (b) meets the conditions of this Article, then such inducement is permitted and may be applied.

Question 6: 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?

In general, the consultation paper assumes that the proportionality of the inducement's material value in relation to the value of the investment service provided to the client is an unwritten prerequisite for admissibility in the context of Art. 26 (b) of the MiFID implementing Directive and of Recital 39 of the MiFID implementing Directive. We consider this to be inappropriate. On the one hand, in methodological terms, it is not evident what this criterion is based on. On the other hand, in practice it would be difficult to determine whether and when an inducement is "disproportionate" according to this definition.

We agree with CESR that in most cases it is difficult to consider payments or benefits in isolation from other factors surrounding them. Such factors will be the ones that should determine if a conflict of interest arises and therefore if the payment is an inducement or not.

Moreover we consider that the entity is the only one entitled to assess, taking into account all the surrounding circumstances, if an item is designed to enhance the quality of a service to the client and does not impair the duty to act in the best interests of the client.

Paragraph 19 illustrates the point that CESR intends to base the requirement of an enhancement in quality on the connection between a concrete inducement and a concrete investment service provided to a client. However, in practice it is almost impossible to prove the existence of such a connection. For example, it is not possible to establish a direct link between training, expert conferences, organised exchanges of experience and workshops on the one hand and a concrete enhancement in the quality of investment advice across various financial instruments on the other. Similar difficulties arise in the case of monetary inducements. Some infrastructure investments affect a whole batch of investment services while only a few actually affect individual services.

Furthermore, the required connection between a concrete inducement and a concrete investment service provided to a client is irreconcilable with the wording of the Implementing Directive ("designed to enhance"): According to the Directive, inducements must merely be designed to enhance the quality of the services offered by the investment firm.

We also deem necessary a broad interpretation of the requirement that an inducement falling under Article 26 (b), in order to be permitted, must be designed to enhance the quality of the services provided to a client. We consider that if the inducement enables the service to be provided, this may be considered as an enhancement of its quality in most cases,. Otherwise it would not be possible to provide most services.

Regarding the examples provided by CESR, we deem that most of them should not fall under Article 26 at all, unless they give rise to a material conflict of interest. Moreover, we consider that the examples provided in the consultation paper are almost exclusively focused on collective investment schemes. Therefore, we believe that it would be helpful if CESR would provide other examples focused on other financial products.

Question 7: 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 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; and that a generic disclosure which refers merely to the possibility that the firm might receive inducements will not be considered as enough?

Due to different civil law systems in Member States, we do not share the view that such an initiative would be helpful. Hence we support the assessment made by CESR in paragraph 31.

Question 8: 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 CESR in this respect.

Question 9: Do you have any comments on CESR's analysis of how payments between an investment firm and a tied agent should be taken into account under Article 26 of the Level 2 Directive?

A tied agent is a "relevant person" and as such not a third party. Therefore payments by investment companies to its tied agents should not be regarded as fees or commissions pursuant to Article 26 of the MiFID implementing Directive. It should be sufficient to mention in the conflicts of interest policy that tied agents receive fees and commissions (e.g. sales agents´ commissions).

Question 10: Are there any other issues in relation to Article 26 and tied agents that it would be helpful for CESR to consider?

No comments.

Question 11: What will be the impact of Article 26 of the MIFID Level 2 Directive on current softing and bundling arrangements?

No comments.

Question 12: Would it be helpful for there to be a common supervisory approach across the EU to softing and bundling arrangements?

We consider that it would be helpful to have a common supervisory approach in this regard.

Question 13: Would it be helpful for CESR to develop that common approach?

We believe that a common approach would be helpful as it is important that all Member States treat this issue in a similar way.

About ESBG (European Savings Banks Group)

ESBG (European Savings Banks Group) is an international banking association that represents one of the largest European retail banking networks, comprising about one third of the retail banking market in Europe, with total assets of € 5215 billion (1 January 2006). It represents the interest of its members vis-à-vis the EU Institutions and generates, facilitates and manages high quality cross-border banking projects.

ESBG members are typically savings and *retail* banks or associations thereof. They are often organised in decentralised networks and offer their services throughout their *region*. ESBG member banks have reinvested *responsibly* in their region for many decades and are one distinct benchmark for corporate social responsibility activities throughout Europe and the world.

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