# The ABI's Response to the second CESR consultation on the "Inducements under MiFID" (ref: CESR/07-228)

*27th of April 2007*

ABI Position Paper

The Italian Banking Association (ABI) welcomes the opportunity to make some additional observations in the course of the second stage of consultation begun by the CESR regarding the regulations on inducements defined by the MiFID.

**General observations**

1. The stance taken by the financial industry with reference to the first document issued on the topic by the CESR emphasizes how the subject of inducements takes on great significance both for investor protection and for competition among intermediaries.

2. In our previous document, we asked to distinguish standard remuneration of services provided by intermediaries from incentives. This due to our conviction that also the L2 Directive takes into consideration such difference and consequently provides for different methods to protect investor interests.

3. We acknowledge that, notwithstanding certain aspects open to interpretation, the basic position of the CESR and, according to what is articulated in the new document, of the European Commission as well, remains distant from that expressed by the financial industry.

4. Accordingly, we generally confirm our opposition to the suggested interpretative approach relating to Articles 21, letter e) and 26 of the second level L2 Directive, calling the attention to what we already stated in our first document.

5. Having said this, and taking into consideration the invitation by the CESR to focus any additional observation on the innovative contents of the second consultation document, we articulate a number of requests for changes and integration with reference to what is herewith stated, as already previously mentioned during the open hearing held April 24.

**Question no. 1: Do you have any comments regarding the recommendation proposals?**

**Introduction**

6. In the Introduction to the new document (the paragraph is titled “General comments on responses to consultation”) the CESR clarifies that, “although Art. 26 is entitled “Inducements”, its content covers any fee or commission or non-monetary benefit that an investment firm may receive or pay in connection with investment and ancillary services to clients”.

7. This implies that not all the commissions/fees/benefits regulated by Art. 26 are inducements and that inducements are specifically listed under letter b); therefore, legitimate inducements are those which satisfy the requirements under letter b).

8. The issue is not very clear, as the Directive itself only uses the term inducements without ever clarifying its definition in accordance with Recital 39 and 40, Art. 21, letter e), and the heading of Art. 26.

9. We believe that the final version of the recommendations should clarify the significance of the term “Inducements” in order to overcome any uncertainty and to assist investment firms in carrying out the disclosure obligation provided by Art. 26.

10. In the same paragraph titled “General comments on responses to consultation”, CESR refers to “standard commissions and fees”, maintaining that they are “for example, those that are customary in and at the usual level in a particular market”.

11. We believe that identifying standard commissions and fees must de done exclusively on the basis of qualitative criteria, considering the normal commissions and fees that are customary in the market with respect to certain services.

12. Any reference to the quantitative nature should, in our view, be eliminated from the document, as it leaves the impression that it can be an assessment (presumably by the supervisory authority) on the amount of the commission or fee received and/or paid, in order to determine if it was “normal”. This refers to our concerns illustrated in our prior document on the issue of “value proportionality” of the inducements.

**Recommendation 2**

13. We believe that the interpretative criteria relating to Art. 26, letter a), aimed at defining when the commissions are to be intended paid by the client, are too detailed and too limiting and, as such, could unduly restrict the scope of application of the regulations in question. As a matter of fact, we believe that the requirement, as any payment arranged by third parties may be considered “made on behalf of the client” only when payment instructions (in any form) are given by the client and the latter has the possibility to change the agreement relating to said payment instructions, goes beyond the L2 Directive.

14. We therefore ask to simplify the wording of such recommendation, providing as sole requirement the condition that the payment be made directly by the client, in other words by third parties on behalf and by will of the client.

**Recommendation 3**

15. In our opinion, the conclusion, based on which the Art. 26, letter c), is not applicable to “standard commissions and fees” since they are of such nature as to possibly cause a conflict towards the client, is openly in contrast with the text of Art. 21, letter e), of the same Directive, which explicitly excludes from the envisaged conflicts of interest the commissions or fees normally invoiced for a service that are received by or paid to investment firms by/to third parties.

16. As a matter of fact, the above-mentioned Art. 21, letter e), requires to make a distinction between standard commissions, normally applied when providing a service, and other commissions. We believe that such differentiation is not only relevant to the purpose of determining the types of conflicts of interest, but also to the purpose of the application of rules established by Art. 26 for legitimizing the different types of payments made/received by investment firms.

17. Such differentiation in treatment is, on the other hand, totally missing from the document under consideration. In relation to this, we ask to bring standard commissions, usually recognized by market practices, back within the scope of application of Art. 26, letter c), since they fulfil:

    - the requirement inherent to the fact that they allow or are necessary to providing investment or associated services;
    - based on the text of Art. 21, letter e), the additional requirement of not causing conflicts with the duties of the investment enterprise to act honestly, professionally, and to protect client interest in the best way possible.

**Recommendation 4**

18. We acknowledge the greater flexibility of interpretation put forth by the CESR in order to evaluate the compliance of the agreements with the two legitimacy requirements established by Art. 26, letter b), inherent to being aimed at enhancing the quality of services provided to clients and at not being in contrast with the general duty of firms to act in accordance with the best interests of the client.

19. With respect to that point of view, it is useful to identify the 5 relevant criteria to assess whether the agreements fulfil the above stated requirements and to acknowledge that such criteria are indicative, not strict or exhaustive and are not uniformly applied to all the various cases.

20. Therefore, it is necessary to obtain clarifications on the modality on how to use interpretive factors and, specifically, the one under letter c), concerning the possibility that there is an inducement for investment firms to act in a way that is not in the best interest of their clients that is to influence the conduct of the investment firm. We believe that the recommendations must consider the importance of the internal regulations' impact upon the former, including those relating to managing conflicts of interest, aimed at guaranteeing that the investment firm acts in the best interest of the client.

21. We believe, moreover, that it is necessary for the recommendations to recognize the importance of standard market commissions/fees, and specifically that as long as the commission/fee is appropriate for certain services, the requirement aimed at enhancing the quality of the services provided to clients is deemed satisfied.

**Recommendation 5**

22. We would like to point out the importance of clarifying such recommendation under letter b), that by providing what has been requested by the financial industry, it acknowledges the role of the distribution service and therefore the commissions and fees received also on a continuous basis from a distribution network satisfy the requirements aimed at enhancing the quality of the services provided to clients.

**Question no. 2: What other examples should be proposed?**

23. We believe it would be appropriate to insert examples aimed at clarifying which intermediaries are exempted from the disclosure obligation under Art. 26 in systems characterized by more than one intermediary, who participate, for various motives, in the production/distribution network.

**Question no. 3: Do you have any comments on the analysis of examples?**

24. We believe that the analysis presented with reference to example no. 5, with regard to the hypothesis in which a portfolio manager receives commissions by providers, whose products are included in the managed client portfolios in the form of retocessions of client costs for investing in the above-mentioned products, is conducted following limiting criteria and, as such, not in compliance with the above-mentioned "interpretative flexibility" to which the CESR itself refers to in the introduction to its own document.

25. In particular, the conclusion according to which it would be difficult to justify the receipt of the above-mentioned commission retrocessions, when they are not returned to clients, does not in any way take into account certain significant factors aimed at guaranteeing the protection of client interest and at enhancing the quality of the services provided to them. As a matter of fact, we believe it is essential to point out that the retrocession of the above-mentioned commissions to an investment firm providing portfolio management service, could combine with the following forms of client protection: i) the application of lower commissions for the portfolio management service; ii) the abolishment of any initial investment costs on products included in the managed portfolios; iii) the adoption of a policy for handling conflicts of interest that ensures that the selection of product providers is not done based on the level of retrocessions as of yet, but instead on the quality of products and services offered by the providers themselves.

26. We therefore ask to integrate the comment to example n. 5 with such considerations.

27. We believe it is necessary to elaborate on the comments to example no. 9, considering the circumstance that the idea of the distribution network of commissions, under the retrocession form, even on a continuous basis, connected to internal regulations aimed at protecting the client's interest (e.g., instituting a policy guaranteeing that the selection of providers, to whom client

requests are sent, is carried out not only at the retrocession level but also on the basis of the quality of products and services offered by the same providers) would allow the requirement to act in the client's best interest to be met.