

POSITION PAPER



ESBG RESPONSE TO CESR ON INDUCEMENTS UNDER MiFID

27 April 2007



EUROPEAN SAVINGS BANKS GROUP

The European Savings Banks Group (ESBG) welcomes CESR's initiative to conduct a second round of consultation on the inducements under the MiFID. We have submitted our views to CESR in the framework of the first consultation in February 2007, asking for more clarification on certain points.

As a first comment, we would like to highlight that in general terms, we believe that the current proposal is more balanced and that it is in practice more feasible to comply with the guidelines in comparison with the first draft.

Recommendations

Recommendation 1: General

CESR considers that:

- (a) Article 26 of the MiFID Level 2 Directive applies to fees, commissions and non-monetary benefits paid by an investment firm or received by it in relation to the provision of an investment or ancillary service to a client. Such fees, commissions and non-monetary benefits include commissions or fees that may be paid or provided to or by an investment firm and which are standard in the market;
- (b) The application of Article 26 is the same in relation to a payment or non-monetary benefit provided/made to or provided by/received from a legal entity within the same group as the investment firm as it is to one provided/made to or provided by/received from a legal entity not within the same group as the investment firm.

No comments.

Recommendation 2: Article 26(a)

CESR considers that:

Article 26(a) applies when the payment is made/received by the client or by a person acting on behalf of the client. This includes where the client pays a firm's invoice directly or it is paid by an independent third party, such as an accountant or lawyer, acting on behalf of the client. The fact that the cost of a fee, commission or non-monetary benefit is borne by the client is not alone sufficient for it to be considered within Article 26(a). It will also be relevant whether the client has issued a specific instruction to the investment firm and has the power to vary the arrangement without reference to the investment firm (even if this does not affect the client's contractual liability for the amount of the fee or commission).

We are concerned that CESR is overstretching the requirements for an "agreement" between the investment firm and the client. In our view, a general instruction from the general terms and conditions of the contract might also be admissible, subject to permission by national civil law provisions.

Recommendation 3: Article 26 (c) of the Level 2 Directive

CESR considers that:

The list of items mentioned within Article 26(c) of the Level 2 directive is not exhaustive, but in considering whether items that are not specifically mentioned also fall within Article 26(c) the factors that are mentioned within it need to be considered. Of particular importance is whether an item by its nature cannot give rise to conflicts with the firm's duty to act, honestly, fairly and professionally in accordance with the best interests of its clients.



We agree with CESR that the list of “proper fees” provided by Article 26(c) should not be regarded as exhaustive and that there are a number of factors within Article 26(c) that must be considered.

We also consider that an item by its nature cannot give rise to conflicts with the firm’s duty to act honestly, fairly and professionally in accordance with the best interests of its clients. We therefore disagree with CESR that the possibility of a receipt of a standard commission or fee can by nature give rise conflicts. This puts under a “presumption of guilt” any payment, including all the “proper fees”, received by an investment firm that enables it or is necessary for the provision of services. On the contrary, we strongly believe that it should be clearly stated that, in principle, all “proper fees” by nature cannot give rise to conflicts of interest, as they should be paid in order to enable the provision of services. The entire purpose of Article 26 (c) would be in question if it is considered that all the proper fees can give rise to conflicts with the firm’s duty to act honestly, fairly and professionally in accordance with the best interests of its clients.

Recommendation 4: Factors relevant to arrangements within Article 26(b)

CESR considers that among the factors that an investment firm should consider in determining whether an arrangement may be deemed to be designed to enhance the quality of the service provided to the client and not impair the duty of the firm to act in the best interests of the client are the following:

- (a) The type of the investment or ancillary service provided by the investment firm to the client, and any specific duties it owes to the client in addition to those under Article 26, including those under a client agreement, if any;
- (b) The expected benefit to the client(s) including the nature and extent of that benefit, and any expected benefit to the investment firm; the analysis about the expected benefit, can be performed at the level of the service to the relevant client group;
- (c) Whether there will be an incentive for the investment firm to act other than in the best interests of the client and whether the incentive is likely to change the investment firm’s behaviour;
- (d) The relationship between the investment firm and the entity which is receiving or providing the benefit (although the mere fact that a group relationship exists is not by itself a relevant consideration);
- (e) The nature of the item, the circumstances in which it is paid or provided and whether any conditions attach to it.

We welcome the fact that CESR is no longer pursuing the requirement of proving the enhancement of quality for each individual investment service. As a basic principle, we consider that the approach now favoured in item 14 of giving evidence of the enhancement at the level of "business lines" is reasonable. It should be left to the competent authority to lay down the specific requirements of the “enhancement-test” related to the actual business lines of the respective market participants.

On the other hand, we do not believe that CESR should define what it means by “to be designed to enhance the quality of the service provided to the client and not impair the duty of the firm to act in the best interests of the client”. We consider that in most cases it is difficult to consider payments or benefits in isolation from other factors surrounding them and that this task can be best addressed by the market participants themselves. To this end, we believe that the factors referred to in the recommendation 4 may help in determining whether an arrangement may be deemed “to be designed to enhance quality of the service provided to the client and not impair the duty of the firm to act in the best interests of the client”, but there may also be other specific factors that may change the final decision of the market participant.



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Recommendation 5: Recital 39 to the Level 2 Directive

CESR considers that:

- (a) Recital 39 makes clear that where an investment firm provides investment advice or general recommendations which are not biased as a result of the receipt of commission then the advice or recommendations should be considered as having met the condition of being designed to enhance the quality of the service to the client. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty to act in the best interests of the client – must be met;
- (b) Recital 39 is relevant to cases in which an investment firm is giving unbiased investment advice or general recommendations. It is not exhaustive and does not prohibit other distribution arrangements under which an investment firm receives a commission (from, for example, a product provider or issuer) without giving investment advice or general recommendations. For these cases, payments can be seen as being designed to enhance the quality of the service to the client by allowing a given investment service to be performed over a wider range of financial instruments. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interests of the client – must be met.

Firstly, we welcome the wide interpretation of Recital 39, covering not only investment advice but also transactions conducted without the provision of advice.

Secondly, we agree with CESR that commissions received from product providers are legitimate, provided the investment firm's advice or general recommendation to its client is not biased as a result of the receipt of that commission. We nevertheless also consider that it is sometimes difficult for a firm to prove that it is acting unbiased, as its results might sometimes reflect the contrary. In such cases we believe that other factors should be taken into account in order to draw a conclusion as regards the firm's behaviour. We therefore believe that in the distribution of financial instruments the payment could be seen as being designed to enhance the quality of the service to the client by allowing that investment service be performed in respect of a wider range of financial instruments.

Recommendation 6: Disclosure under Article 26(b) of the Level 2 Directive

CESR considers that:

- (a) in order to contain the "essential terms" a summary disclosure must provide adequate information to enable the investor to relate the disclosure to the particular investment or ancillary service that is provided to him, or, to the products to which it relates, to make an informed decision whether to proceed with the investment or ancillary service and, whether to ask for the full information;
- (b) a generic disclosure which refers merely to the possibility that the firm will or may receive or pay or provide items within Article 26(b) is not sufficient to enable a client to make an informed decision and therefore will not be considered as providing the "essential terms of the arrangements" referred to in Article 26 of the Level 2 Directive;
- (c) when a number of entities are involved in the distribution channel, each investment firm that is providing an investment or ancillary service must comply with its obligation of disclosure to its clients.

No comments.

3. Illustrative examples to show the application of the Recommendations

We believe that the list of examples is helpful. We urge CESR to retain flexibility in terms of making no final judgment on the inadmissibility of inducements that are regarded as problematic with regard to the enhancement-test. Rather, market participants should be left with the possibility to prove if an impairment of customer interests is to be feared.



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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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