

# ZENTRALER KREDITAUSSCHUSS

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## **Zentraler Kreditausschuss (ZKA)<sup>1</sup> Response to CESR 2nd Consultation on „Inducements under MiFID“**

**Ref. CESR/07-228**

27 April 2007

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<sup>1</sup> The ZKA is the joint committee operated by the central associations of the German banking industry. These associations are the *Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR)*, for the cooperative banks, the *Bundesverband deutscher Banken (BdB)*, for the private commercial banks, the *Bundesverband Öffentlicher Banken Deutschlands (VÖB)*, for the public-sector banks, the *Deutscher Sparkassen- und Giroverband (DSGV)*, for the savings banks financial group, and the *Verband deutscher Pfandbriefbanken (VDP)*, for the mortgage banks. Collectively, they represent more than 2,500 banks.

## **A. General Remarks**

We welcome the fact that CESR is conducting a second round of consultation on the subject "Inducements under MiFID" which is as important as it is complex. The first consultation showed that some proposals and recommendations of CESR raised more questions than answers, and would have posed considerable problems in practice. In this respect, it is appropriate to give the market participants the possibility once more of commenting on the revised recommendations of CESR. At the same time, a longer period for response would have been desirable.

With regard to its contents, the consultation paper now presented represents considerable progress in relation to the first consultation. This relates in particular to the question as to which requirements are to be met in respect of the "designed to enhance the quality of the investment service" -test in accordance with Art. 26 (b) of the Level-2 Directive (2006/73/EG). We strongly welcome the fact that CESR is no longer pursuing the approach of a proportionality between the amount of the inducement and the value of the investment service and that CESR no longer requires a direct relationship between the individual inducement and the enhancement of quality of a particular investment service provided to a customer. This would have caused in practice hardly solvable problems concerning the proof and the documentation of the "enhancement-test". The recommendations 4 and 5 now submitted on this question are, by comparison, considerably more on the ground, without losing sight of the necessary investor protection.

It is further to be welcomed that CESR restricts itself to clarifying the relationship between Art. 26 and Art. 21 of the Level-2 Directive without giving recommendations as to the provisions of Art. 21 of the Level-2 Directive, which relates to the subject "compliance" and - in contrast to Art. 26 - is no conduct of business rule.

Furthermore, we also explicitly welcome the interpretation of Recital 39 of the Level-2 Directive according to which the "enhancement-test" can also be met in cases where no investment advice is given, but the receipt of a commission allows a given investment service to be performed.

Overall, the second consultation paper accordingly earns our emphatic support.

The following remarks are therefore limited to a few points on which, in our view, further clarification would be helpful.

## B. Specific Remarks

**Question 1: Do you have any comments on the content of the draft recommendations?**

- **Recommendation 1: General**

No comments.

- **Recommendation 2: Art. 26 (a)**

As to the question whether instructions have been issued by the client for the making and/or receipt of a payment, CESR considers it 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"*.

In no case should the requirements for an "agreement" between the investment firm and the client be overstretched. Firstly, we consider it at least very doubtful whether a requirement of a "specific instruction" from the client can actually be derived from Art. 26 (a) of the Level-2 Directive. The guidelines of Art. 26 (a) of the Level-2 Directive do not imply such particular form of instruction. Rather, a general instruction, such as could result from the "General Terms and Conditions" might also be admissible in so far as permitted by national civil law provisions.

Furthermore, contract law as applicable in Germany provides that a party to a contract has no unilateral right to change the contents of the contract - unless he is expressly granted the same. We do not consider it appropriate to prescribe such a unilateral power to make changes to a contract by means of supervisory law, as CESR apparently has in mind. In any event, no such specification is to be derived from Art. 26 (a) of the Level-2 Directive.

We therefore ask CESR to delete the relevant section in Recommendation 2, or to provide at least further clarification hereon.

- **Recommendation 3: Art. 26 (c) of the Level-2 Directive**

No comments.

- **Recommendation 4: Factors relevant to arrangements within Art. 26 (b) of the Level-2 Directive**

We expressly welcome the fact that CESR is no longer pursuing the requirement of proving the enhancement of quality for each individual investment service and that it is sufficient instead, if an inducement - with a view to its general nature - is designed to enhance the quality of the investment service. As a basic principle, we also 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 then 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 participant.

It goes without saying that inducements can, from an abstract point of view, constitute an incentive for an investment firm to act against the customer's interests. However, this does not imply that inducements would not be permissible for this reason alone. If an investment firm implements measures which ensure that this potential risk will not materialise (in particular, through suitable organisational precautions, such as a corresponding conflict of interests policy or a work procedure according to which only products which are in the client's interest may be selected) this will satisfy the requirements laid down in Art. 26 (b) (ii) of the Level-2 Directive. Although we feel that this is to a certain extent reflected by Recommendation 4 (c) (where the question "whether the incentive is likely to change the investment firm's behaviour" is proposed as a relevant factor) we propose the following explicit clarification in Recommendation 4 (c):

*(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; in this respect it should be taken into consideration whether the investment firm has taken **adequate organisational measures to ensure that the receipt or payment of the fee, commission or non-monetary benefit will not have any impact on the investment firms behavior;***

- **Recommendation 5: Recital 39 to the Level-2 Directive**

The wide interpretation of Recital 39 proposed by CESR, which not only covers investment advice but also transactions effected without the provision of advice, is strongly welcomed.

- **Recommendation 6: Disclosure under Art. 26 (b) of the Level-2 Directive**

No comments.

***Question 2: Will the examples prove helpful in determining how Art. 26 applies in practice? What other examples should be covered or omitted?***

***Question 3: Do you have any comments on the analysis of the examples?***

We consider the list of examples to be helpful. We further welcome the fact that CESR has integrated a series of "positive examples" into the list.

In our view, and as already stated in question 1 concerning Recommendation 2, it is important that CESR, in such cases as can be regarded as problematic with regard to the enhancement-test, makes no final judgment on the inadmissibility of such inducements, but leaves the market participants the possibility of counter proving, e.g. in the form of suitable organisational measures, that no impairment of customer interests is to be feared. This relates in particular to the examples IV, V and VIII where CESR strongly puts the permissibility of an inducement pursuant to Art. 26 (b) of the Level-2 Directive in question.

It should hence be clearly expressed that the CESR examples only give an indication which, in view of the diversity of distribution models, can lead to diverging results in individual cases.

In any case, CESR should avoid giving the impression that in some examples Recommendation 4c might only be of minor importance.

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