Manuel Conthe
CESR
www.cesr.eu

Philip Buttifant
Director

Direct Line: +44 (0) 20 7216 8896
E-mail: Philip.buttifant@bba.org.uk

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Dear Senor Conthe

RESPONSE TO CESR's SECOND CONSULTATION PAPER ON INDUCEMENTS UNDER MIFID

Background

The BBA is the leading UK banking and financial services trade association and acts on behalf of its members on domestic and international issues. Our 219 members are from 60 different countries and collectively provide the full range of banking and financial services.

They operate some 130 million personal accounts, contribute £35bn to the economy, and together make up the world's largest international banking centre.

We are pleased to have the opportunity to feed into CESR's second consultation on inducements under MiFID. The BBA has also responded to CESR's earlier consultation on this issue, which we attach for your consideration.

Although we appreciate that CESR's does not wish respondents to reply to previous issues relating to the prior consultation, nonetheless we still believe that our earlier arguments – especially vis-à-vis scope, are still pertinent to your considerations.

Scope

In general terms, our members' view is that CESR has not taken sufficiently into account the views of industry that the scope CESR took of inducements in its first consultation paper was too wide, and appeared to encompass essentially any form of payment beyond pure commission.

This appears to go well beyond the legal definition of inducements, set out in Article 26 of the Level 2 Implementing Directive.

Taking such a broad definition of the scope of inducements would, in our view, cause a significant disadvantage and result in increased costs to firms and investors alike.

CESR should only focus on 2inducements" in those circumstances when payments induce firms to act in a way that is inconsistent with clients' interests.

It is not proportionate to take as a starting point a presumption that all payments should be disclosed unless proved otherwise. See our first response (attached as Appendix 2) for further detail on these points.

Status of the CESR recommendations

Our members are uncertain of the practical status of the recommendations and how CESR members will apply them on a day-to-day basis. The voluntary nature of the recommendations may result in regulatory arbitrage and create an unlevel playing-field. We would therefore welcome further clarity about how CESR expects regulators t make use of the recommendations.

We believe that it is important that CESR's recommendations do not, de facto, become additional rules, particularly given our view that they are superequivalent to MiFID and its implementing legislation.

Our view is that CESR's recommendations should not go beyond the strict remit set down in MiFID and the implementing legislation at Level 2, as set out in the interpretation provided in our first response.

Proportionality test

We argued in our first response that CESR's proportionality test added an unnecessary additional layer of complexity. We welcome that CESR is no longer proposing such a test now.

Finally, we welcome CESR's plans to publish final recommendations

If you would like to discuss any of the issues raised in further detail, please do not hesitate to contact me

Yours sincerely

Philip Buttifant
Director – Wholesale Policy

Appendix 1: Answers to specific questions posed

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

Our view is that the draft recommendations veer too far away from our preferred principles-based approach, and tend to converge more upon a strict, rules-based approach

Although we appreciate that CESR has the role of encouraging harmonisation, a “one size fits all” approach is not appropriate, given the wide variety of markets and product types within the European Community.

An over-legalistic approach raises the risk of weakening the EU’s current competitive advantage in financial services, which will be potentially detrimental both to the industry and to investors.

We are concerned that the requirement in Recommendation 6 that the summary disclosure must provide adequate information to enable the investor to relate the disclosure to the particular investment or service provided to the client a range of products including some which are outside MiFID's scope. Therefore, generic disclosure should be permitted where appropriate.

The complexity of arrangements around the provision of fees, commissions or non-monetary benefits are potentially complex. Therefore, we would welcome CESR developing this aspect of Recommendation 4 or alternatively providing an example to demonstrate how such payments or benefits can enhance the quality of the service provided to the client, particularly when such payments could benefit other clients or groups of client.

Paragraph 16 says that the factors in Recommendation 4 do not represent a "one size fits all approach". However, the recommendation says that these are factors which firms should consider. We suggest that should is changed to could.

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

Our view is that the range of examples provided by CESR is both sufficient and appropriate, and that no further examples are required.. CESR should provide further examples if requested to do so post the Directive's implementation.

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

We have no comments on this issue.

Appendix 2: BBA response to CESR consultation 06-687 of February 2007 re inducements under MiFID

Dear Sirs

Thank you for the opportunity to respond to your public consultation on inducements under MiFID (CESR/06-687).

In general terms, our view is that CESR intends to take far too broad a definition of inducements, as defined in Article 26 of the Level 2 Implementing Directive. Taking such a broad definition of the scope of inducements would, in our view, be a significant disadvantage and cause of increased costs to firms and investors alike.

Our detailed points are set out below, and also in the attached Appendix that responds to the specific questions posed in your consultation.

Scope

Our view is that the CESR proposals extend the definition of "inducement" essentially to any third party payment. This excessively broad interpretation would capture many third party commission arrangements that are common in the industry, and are seen as good market practice.

Whilst Article 26 of the Level 2 Implementing Directive includes a wide range of payments within the definition of "inducement", it is clear that the interaction of Recital 40 and Articles 26(a) and 26(c) interact in a manner that narrows the scope.

In addition, Article 26 depends upon Article 19(1) of MiFID at Level 1, and must consequently be limited solely to instances where a firm may be regarded as not acting "honestly, fairly and professionally" on behalf of its clients. This fundamental limit to the scope of inducements is not reflected in the CESR public consultation.

Our view is that an inducement should involve a potential conflict of interest in order to be so classified (Article 21 of the Implementing Directive is relevant here).. Hence, Article 26(b) should only apply to third party payments contrary to the client's interest, by inducing the firm to act in a manner contrary to that in which it would have acted without the inducement in question.

As we discuss in more detail in our answer to question 1 below, this is also supported by Recital 40 of the Implementing Directive, which states:

"This Directive permits investment firms to give or receive certain inducements only subject to specific conditions, and provided they are disclosed to the client, or are given to or by the client or a person on behalf of the client."

Therefore, we believe that CESR should establish a clear distinction in relation to the definition and scope of "inducements" between:

- fees that are purely remuneration for services performed (such as, for example, permitting access to a distribution channel, payment for clearing and settlement services, or training services), and

- "inducements" per se, that are improper, and which do not pertain to the intention to induce the recipient to do anything other than provide the service that is paid for.

The former should not be regarded as "inducements" subject to the requirements of Article 26, as they do not ordinarily give rise to a potential conflict of interest. The latter clearly do give rise to a potential conflict of interest, and would therefore be prohibited under Article 26 where they did not satisfy the requirements of one of the specified exemptions.

Interpretation of exceptions

It should be emphasised that the MiFID legislation – both at Level 1 and Level 2 –specifically permits inducements in a number of specific circumstances. Our view is that CESR has defined the scope of permissible inducements too narrowly.

For example, Article 26 (c) of the Implementing Directive refers specifically to payments that "cannot, by their nature, give rise to conflicts" as being acceptable "inducements".

Therefore, our view is that the test of whether an inducement is acceptable or not should be predicated upon whether it can be perceived to cause a potential conflict of interest or not, rather than merely upon whether a payment or service has been provided.

In addition, our view is that a market-led approach would be more appropriate than CESR guidance in the interpretation of inducements.

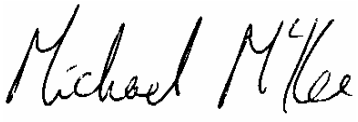
A good example of this is in the area of softing and bundling. In many member states, notably the UK and France, a market-led rather than regulator-led approach has been widely regarded as successful.

Certainly, a uniform, regulatory-led approach would have the disadvantages of being cumbersome to develop to the rapidly changing market practices that are essential to the financial services industry, and also would not be flexible enough to accommodate differing, but totally legitimate and appropriate market practices in different member states.

Our answers to the specific questions posed in your consultation paper are set out in the attached appendix.

If you would like to discuss our views on further detail, please do not hesitate to contact us.

Yours sincerely



Michael McKee

Philip Buttifant

Appendix: answers to specific questions posed in the consultation paper

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?

There is no definition of inducements at Level 1, which is unhelpful to CESR's work at Level 3. However, the basis for the provisions in Article 26 of the Implementing Directive is the obligation in Article 19(1) of MiFID, and they therefore need to be read in that context. In addition, Article 21 of the Implementing Directive is relevant here, specifically regarding the point that potential conflicts of interest are the hallmark of whether an inducement exists.

Our view is that CESR takes too broad an interpretation of inducements, which is potentially very harmful to the industry. For example, paragraph 2 of CESR's paper appears to take a very wide definition, and appears also to take an insufficient sense of the other factors involved. To apply such a definition to any fee, commission or non-monetary benefit is disproportionate and could ultimately lead to firms incurring additional costs that will ultimately be bourn by investors.

In its consultation paper, CESR states that Article 26 of the Implementing Directive "applies to all 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". We think this is far too wide a definition, and is not supported by the legal texts, for the following reasons:

- Article 26 depends upon Article 19(1) of MiFID, and must therefore be limited in scope to instances where a firm might be regarded as not acting honestly, fairly and professionally in accordance with the best interests of its clients. Please note in this context our earlier comments regarding Article 21 of the Implementing Directive, vis-à-vis conflicts of interest being the main signifier of a potential inducement.. In other words, by definition Article 26 can only ever be addressing fees, commissions and non-monetary benefits the payment or receipt of which by a firm would call into question whether the firm is acting honestly, fairly and professionally in accordance with the best interests of its clients. This fundamental limit to the scope of Article 26 is not reflected in the CESR Consultation Paper. Firms may well give and receive a number of fees, commissions and non-monetary benefits which could not reasonably be regarded as being inconsistent with their duties under Article 19(1), and these should therefore be regarded as falling outside the scope of Article 26.

- The word itself, "inducement", connotes a payment or other benefit that causes, or risks causing, someone to act differently from the way in which they would have acted in the absence of that payment or benefit. If that connotation had not been intended, one would have expected Article 26 to have been headed "fees, commissions and non-monetary benefits". The use of the word "inducements" strongly suggests that only particular types of fees, commissions and non-monetary benefits were contemplated.

In our view, therefore, Article 26 sets out three categories of payment which may be made notwithstanding the fact that they might otherwise be thought to conflict with Article 19(1) and Article 21 of the Implementing Directive. This interpretation is supported by Recital 40 to the Implementing Directive, which states:

"This Directive permits investment firms to give or receive certain inducements only subject to specific conditions, and provided they are disclosed to the client, or are given to or by the client or a person on behalf of the client."

Given the lack of certainty in relation to the legislation itself, our view is that CESR should take a narrower interpretation vis-à-vis the definition, and should ensure that appropriate carve-outs are put in place, that would be of benefit to the industry whilst not causing any concomitant loss of investor protection.

The MiFID text should be read in both a practical way and one clearly grounded in the terms of the Directive, in order that the inducement provisions are workable in practice for the benefit of both firms and investors alike.

In addition, it is important to note that without payments, many services would simply not be provided by firms, which would be a significant detriment to investors.

Question 2: Do you agree with our analysis of the general operation of Article 26 of the MiFID Level 2 Implementing Directive and of is interaction with Article 21?

As we point out in our answer to Question 1 above, our view is that CESR's construction of the definition of inducements is too wide, and that a more practical approach should be taken which is more clearly within the scope of Article 26.

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 believe that such payments or provisions should be considered within the scope of inducements in circumstances where there is no contractual relationship involved.

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"?

Our view is that this should be as limited in scope as possible. Please note our answer to Question 1 above.

We would like CESR to give further guidance on situations where execution-only products and services are sponsored and paid for by issuers on a business-to-business-to customer basis. For example, where issuers offer their shareholders a sponsored "Nominee Holding" service (provided by a MiFID firm) as an alternative to the public register, removing the need to publish personal data.

Another example would be a "Dividend Reinvestment Plan", which is another service sponsored by issuers for their shareholders. We believe such sponsorship payments to the relevant MiFID firm are "proper fees", as they enable or are necessary for the provision of the service. For example, if the sponsorship arrangement was not in place and the service was to continue, the client would incur custody costs.

Such sponsorship arrangements are commercially sensitive and agreed between the issuer and the service provider (the MiFID firm), therefore disclosure to the ultimate customer (the shareholder) is undesirable. They do not impact on the decision of the retail client concerning which investments to make, nor do they affect the quality of the service provided. In these circumstances, we would strongly argue that the sponsoring company should be treated as "a person acting on behalf of the client".

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

We believe that the examples provided are far from exhaustive, especially given that the nature of the industry and the way in which it develops so dynamically means that such examples will require frequent updating.

We would welcome some guidance in this area from CESR which will help ensure that national regulators interpret MiFID's requirements on inducements in a consistent matter. It may then be appropriate for national regulators to agree further guidelines with their industry counterparts that reflect the particular circumstances of the local market.

Turning to examples provided we have the following comments:

Example 1. We note that CESR does not believe that there should be any cap on the level of commission that may be received by an investment firm.

Example 2.It is difficult to see how a payment by a product provider to a firm which simply provides an administrative platform between the ultimate client and the product provider can be caught by the provisions of Article 26. We disagree with this example, therefore.

Example 4. It is not clear what is meant by a "close link" between the training delivered and the service provided. Further clarification is needed. Furthermore to suggest that only training which is conducted on the premises of the investment firm can be considered proportionate is too restrictive. The investment firm may not have suitable premises at a central location capable of holding all relevant staff or it may be more cost effective for the training supplier to deliver training to the staff of several firms at a hotel. The key question as noted by CESR is that the location of the training should not impair the firm's duty to act in the best interest of its client. Therefore, we disagree with this example unless it is made much more precise.

Example 7. Provision of equipment such as a lap top may not be disproportionate if it is capable of being used to benefit the client e.g. by enabling straight through processing of an order. In such a case the quality of the service to the client is enhanced. Therefore, we disagree with this example unless it is made much more precise.

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 a client and not impair the duty to act in the best interests of the client? Do you have any suggestions for further factors?

Please note our answer to Question 1 above. We believe that these factors should be left as broad as possible, in order not to discourage innovation in the industry, which would be a significant disadvantage to investors.

It is also important that each case is considered on its individual merits.

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 disclosure beyond stating that such a 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?

We agree that no further guidance is required in this area. It would be impracticable to produce guidance covering all situations and circumstances, and there would also be logistical issues in keeping such guidance up-to-date to cover new situations that develop through market practice.

We also feel that rigid guidance would discourage innovation, and that it would be impractical to produce such guidance, in that it would require continual updating to remain up-to-date.

We would also welcome clarification by CESR that it is the responsibility of the last intermediary in the chain to disclose, and not the original product provider.

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 that the scope should only encompass the intermediary that has the direct relationship with the client, in order to avoid unnecessary complexity and duplication of effort.

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?

Although we agree with the general thrust of CESR's view that it is the sum paid to the investment firm that should be used for disclosure purposes, clarification is still required on how non-monetary benefits should be disclosed.

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

We have no comment to make on this question.

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

We are most familiar with the FSA rules, which establish the principle that dealing commission may only be used to pay for trade execution or investment research services. Guidance is given on the characteristics a service requires for classification as either trade execution or research. Such services would then be regarded as "permitted services". Services which do not meet these requirements are not be eligible for payment by dealing commission and are designated "non-permitted services".

The FSA has also extensively reviewed commission sharing agreements (CSAs) and has concluded that these agreements are permissible if: (i) the investment manager's clients understand their nature and purpose; (ii) commission flows are properly disclosed; and (iii) the agreement does not create conflicts of interest for the investment manager.

It is important to note that the new requirement for disclosure does not in itself amount to unbundling and bundled commission payment remains permitted in the UK. However, the FSA's rule changes have been the catalyst for many investment managers to decide to "unbundle" the purchase decisions for trade execution and investment research because: (a) the disclosure rule already dictates the establishment of separate prices; (b) the availability of CSAs allows transfer of investment research commission to third parties; and (c) trade execution decisions can now be made independently from the requirement to pay for research.

The benefits of the new use of dealing commission rules include:

- Giving investment managers the ability to receive and pay for what they want and need (i.e., allows investment managers to choose the execution partners and research providers and achieve the best service from the best suppliers);
- Increasing transparency and the perception of a strong regulatory environment, thereby instilling confidence in investment managers' clients that their money is being served well; and
- Using broker reviews to allocate the component of research commission to researchers that add the most value, thereby forcing investment managers to account for their expenditure on advisory services and to be far more efficient in their use of such services (this will also help the development of independent research houses).

We believe the above reasoning and resulting arrangements are entirely consistent with MiFID's underlying policy objectives of consumer protection and are broadly similar to the application of Articles 26(a) and 26(b) as laid out in paragraph 13 of the CESR document. We believe that such arrangements are acceptable, and would therefore argue for no further guidance in this area

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

If a consistent approach were to be adopted, it should be led by the market rather than by CESR, and should follow the approach developed in conjunction with the FSA. As demonstrated in the UK and France, a market-led approach has been successful given that the regulation of softing and bundling at present reflects the particularities of specific markets and investors in those markets.

Any move towards a uniform approach would need to avoid harming the existing pan-European market-led momentum on this issue. Our view is that CESR should not disturb this process, and instead should agree to partner with the industry on this.

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

Our view is that such a common approach would be more appropriate to emerge through market practice rather than through guidance from CESR.