efama
European Fund and Asset Management Association

REPLY TO CESR'S SECOND CONSULTATION ON INDUCEMENTS UNDER MiFID

The European investment management industry, represented by EFAMA[1], welcomes the opportunity to respond to CESR's second consultation paper on Inducements under MiFID.

GENERAL COMMENTS

EFAMA wishes to thank CESR for holding a second consultation, although a longer time frame would have been more helpful.

We welcome CESR's considerably improved Consultation Paper, particularly the product-neutral approach and the departure from the proportionality tests.

EFAMA also appreciates the fact that CESR has taken into consideration the investment management industry's comments on the existing lack of level playing field between funds and competing investment products. Although CESR has clearly stated (Para. 4 of the Introduction) that its Recommendations do not aim at discriminating between different financial instruments, it does acknowledge that regulatory arbitrage cannot always be resolved by MiFID. We therefore strongly encourage CESR (if necessary in cooperation with the other 3L3 committees) to:

- Fully exploit all existing possibilities under MiFID to create an even playing field for all savings/investment products with respect to disclosure (we refer to our prior comments in this respect);
- Actively report potential arbitrage due to MiFID's limitations to the European Commission and make a strong case for regulatory intervention at EU level.

Furthermore, EFAMA agrees with CESR's new interpretation of "designed to enhance the quality of the service", reflecting the different existing distribution models and acknowledging the fact that payments are necessary for the overall provision of the distribution infrastructure.

[1] EFAMA is the representative association for the European investment management industry. Through its 23 national member associations and over 40 corporate members, EFAMA represents about EUR 15 trillion in assets under management, of which EUR 7.5 trillion managed by around 46,000 investment funds. For more information, please visit www.efama.org.

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

EFAMA agrees with Recommendations 1, 2, 3 and 5.

Regarding Recommendation 4, we are of the opinion that the text needs to be clarified and completed.

First of all, there is currently no statement in the Recommendation of how the factors are supposed to be applied. As factor (c) is the most crucial one, it needs to be clearly stated (as CESR already does for factor (d)) that the mere existence of the incentive is not in itself a relevant consideration to determine whether the arrangements under consideration would meet the requirements of Art. 26.

We also suggest the modification of the wording of factor (c) to clarify that the simple presence of an incentive should not be relevant, but what is relevant is whether the incentive is likely to modify the firm's behaviour.

Most importantly, the text in BOX 4 should also state clearly that the factors must be considered together with the measures taken by the firm to prevent and manage conflict of interest, in order to judge whether any conflicts potentially arising from the payments are effectively managed.

EFAMA suggests the following modifications to Recommendation 4:

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, ***as a consequence,*** whether the incentive is likely to change the investment firm's behaviour ***(the mere existence of an incentive is not by itself a relevant consideration);***
(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.

The evaluation of factors (a) through (e) shall be carried out taking into consideration the steps taken by the investment firm to prevent and manage conflicts of interest.

EFAMA agrees with Recommendation 6 (c) that each intermediary in a distribution chain (to the extent that it is providing a MiFID service or activity) should comply with disclosure requirements to its immediate clients.

We appreciate the clear position in this regard expressed by CESR at the Open Hearing that only the last intermediary in the chain has the obligation to disclose to the final client. However, we would welcome a clarification by CESR (either by way of an example or through an explanatory remark) that, in case of exemption under Art. 3 of the firm providing the service to final client, disclosure would not be required from other MiFID entities higher in the distribution chain. For example, in case a financial adviser is exempt from MiFID by virtue of Art. 3, no disclosure would be required to the final client by the MiFID firm distributing the product to that adviser, or by any other MiFID entities at higher levels of the distribution chain, as they are not providing a MiFID service directly to the final client.

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

EFAMA believes that the examples can prove helpful, and we appreciate CESR's clear statement in Para. 26 that they "are for illustration purposes only" and that "although they are intended to be helpful in assessing cases that arise in practice, each such case must be assessed on its own merits and in accordance with its own circumstances."

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

Example V: EFAMA restates its belief that a receipt of a third party commission by a firm providing portfolio management services could be justified under Art. 26 when appropriate disclosure of the payments is made to the client.

Example VIII -: We repeat our comment that not all "override payments" should be prohibited under MiFID. What should be decisive is whether the investment firm has put in place appropriate conflict of interest mechanisms to protect client interests, in which case the payments must be possible under Art. 26(b). As we stated in our reply to question 1, the analysis of the factors in Box 4 must take into consideration the measures taken by the investment firm to prevent and manage conflicts of interest.

We remain at your disposal should you wish any clarification.

Steffen Matthias, Graziella Marras
27 April 2007