ASSORETI

Associazione Nazionale delle Società
di Collocamento di Prodotti Finanziari
e di Servizi di Investimento

Secretary General

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Via CESR's website

Subject: Inducements under MiFID – Public consultation.

The Assoreti – National association of Companies (mainly, banks and investment firms) that provide outside the premises of the investment firm financial instruments and investment services through financial promoters – has carefully read the consultation paper and wishes to express its utter appreciation for the hard work executed by the CESR in finding legislative solution addressed to protect clients from improper behaviour of investment firms that receive inducements.

Under this perspective of client protection, Assoreti belives that a less deep approach should be followed, as to avoid over-regulation that can lead to attract the notion of remuneration for provision of financial services in the notion of inducements.

This subject is quite general; the present paper will consider only the case in which, on the one hand, the product provider pays the remuneration to the investment firm for the provision of financial services, such as placement (*retrocession of commissions*) and, on the other hand, the investment firm pays the remuneration to the tied agent.

1. The commission agreement between the product provider and investment firm

First of all, it has to be noted that the Level 1 Markets in Financial Instruments Directive 2004/30/EC does not regulate the inducements; these are regulated exclusively in the Level 2 Implementing Directive 2006/73/EC (hereinafter, Level 2 Directive).

The Level 2 Directive does not provide for by a definition of inducement; it is however clear that the notion of inducement, by its true nature, cannot be confused with the notion of remuneration for the provision of services. Actually, the term "inducement" means something *additional and different from* the remuneration, that may impair the investment firm's compliance with the best interests of the client. Moreover, art. 21(e) of the Level 2 Directive explicitly states that *standard* commissions or fees for the provision of services are not inducements.

That being stated, it has to be noted that in Italy the product provider *usually* pays a remuneration, to the bank and the investment firm that place financial instruments and financial services, that is represented by a percentage of the product charges made to the client (*i.e.* commission to enter, the *causa* of which is given by the mere fact of placement of financial services, and maintenance commission, the *causa* of which is given by the activity of customer care provided by the investment firm or by the bank, during the contract).

This common market practice is known as *retrocession of commissions*. Indeed, in the substance, it is a way according to which the product provider pays the remuneration to the investment firm that places financial instruments; it is not different from the payment made by the investment firm to the tied agent.

The case in issue, *per se*, never falls within the scope of inducements. Hence, Assoreti disagrees with CESR's interpretation of such case of retrocession of commissions, according to which it constitutes inducement and that it will be permitted only if the proportionality test is met. *Should the "proportionality" test be applied to remuneration, the principles of market economy – on which European legal framework is built, its financial segment included – will be denied!*

Indeed, it is true that certain ways of remuneration's determination may likely create a potential conflict of interest, as set out in some examples of CESR Consultation Paper: these cases may be *only* dealt with conflict of interests and never with inducement. A different interpretation entails a serious danger to the level of remuneration and /or the terms of payment; moreover it dangers the chain of value, in contrast with the principle of neutrality of regulatory framework in respect with the practical formalities adopted by the investment firms.

In this contest, Assoreti would like to issue remarks on four examples of the Consultation paper, in which it is clear that the retrocession of commissions is remuneration and does not fall within the scope of art. 26.

Example n. 1 – An investment firm gives investment advice to a client to buy a particular collective investment scheme and receives a commission from the management company paid out of the product charges made to the investment firm's client.

According to CESR's view this retrocession of commissions can be considered as designed to enhance the quality of investment advice (as Recital 39 of

the Level 2 Directive makes clear), but also the other conditions of art. 26 (b) have to be met; hence, if the commission is disproportionate to the market, it is likely that it will impair the investment firm's duty to act in the best interests of its client. Again, in CESR's view, there should not be any cap on the level of commission that may be received («*after all, the services that the investment firm provides could be extensive or the quality of its service very high*»); however, among the conditions that have to be met, there is the requirement of proportionality between the benefit to the investment firm and the corresponding benefit to the client.

Assoreti does not share CESR's view on this subject, because it is based on the qualification of third party remuneration for a service as inducement: this implies a clear strain that is represented by the necessity of distinguish between remuneration which is proportionate (*i.e.* the commission paid out of the product charges) and remuneration which is disproportionate.

In practice, the criterion of proportionality entails the risk of legal uncertainty, as it cannot be unequivocally determined when the cap of proportionality is exceeded.

Actually, the provision of both services, investment advice and placement, may give rise to a "institutional" conflict of interests that the investment firm should to manage, as this can lead to clients not being sold the most suitable product for their needs. However, this *only* means that the investment firm must take all reasonable measures as to avoid the conflict of interests in the provision of investment advice service: this does *not* mean that placement commissions, received by the investment firm as soon as the client buys the advised product, constitutes inducement!

Example n. 6 – As example 1, except the investment firm receives a one-off bonus (or "*override*") payment under the sole condition that sales of a particular product reach an agreed level.

In CESR's view, such an arrangement appears unlikely to be designed to enhance the quality of the service to firm's client; on the other hand, it is more likely that the firm's advice will become biased that particular product, in breach of the duty to act in the best interests of clients.

It must be once again stressed that the *override* is part of the remuneration, which must not be confused with the inducement.

At least, it has to be assessed whether this case falls into the scope of conflict of interests. In this respect, Assoreti believes that the investment firm must disclose the *override – per se* absolutely lawful and unimpeachable – as long as it impairs the firm's compliance with its duty to comply with the best interests of the client, that is the case when, as in the referred example, the *override* is joint with the sale of one or more particular products.

Example n. 2 – An investment firm that is not providing investment advice or general recommendations has a distribution agreement with a product provider, such

as the management company of a UCITS, to distribute its products in return for commission.

Also in this case, CESR's view is that, although the condition of being designed to enhance the quality of the service to the client may be considered to be met, the other conditions of Article 26 (b) must also be met. Therefore, in CESR's view, a commission, that is disproportionate to the value of the service provided to the client, is likely to impair the firm's compliance with its duty to act in the best interests of the client.

Again, Assoreti has serious objections against this approach. Actually, this case neither represents an inducement, nor falls within the scope of potential conflict of interest. *A different approach would entail the consequence that the investment firm will be in conflict of interest whenever it will receive a payment for the provision of services.*

Example n. 3 – An investment firm acts as portfolio manager (or as a receiver and transmitter of orders) and transmits orders to brokers for execution. It charges a management fee (or a fee for the reception and transmission of orders) to its clients and has existing charging arrangements in place between itself and brokers and its clients for commissions to be charged to its clients.

In CESR's view also in this case the investment firm has an incentive to use only the broker offering the payment (for example, not providing the best execution).

Again, Assoreti believes that also this case must be dealt (only) within the scope of conflict of interest. Moreover, Assoreti sees the duty of the investment firm to disclose to the client its interest in choosing one broker, instead of another one.

To sum up: in our opinion, all these cases cannot be dealt under the inducements regime. Under a different approach, the normal remuneration received by the investment firm for the provision of financial services would be impaired. Whilst, the remuneration is submitted to contractual autonomy.

Should the remuneration repaid from the product provider to the investment firm constitute inducement, it will necessary to determine certain objective legal criteria. In particular, when the remuneration can be considered proportionate? The fact that it is impossible to answer to this question, confirms, in our view, that the remuneration does not constitute inducement.

2. Payment of commissions to the tied agent

In CESR'S view also the remuneration paid to the tied agent constituted inducement; this is the case, for example, in which the tied agent receives an amount €(x-y) from the investment firm, that is paid out of the commission €x received by the investment firm from the management company. In this case, in CESR's view, only

one disclosure is enough, because the investment firm is unconditionally responsible for the actions of the tied agent and therefore €x is the amount that is considered to be received by the investment firm.

Although Assoreti shares CESR's conclusions, Assoreti disagrees with the interpretation given, for the following reasons.

a) On the one hand, as above, CESR's view moves from the fake assumption that the remuneration of the tied agent constitutes inducement. On the contrary, it has to be stressed that the amount €(x-y) received by the tied agent constitutes its usual remuneration, *causa* of the agency contract entered into. Therefore, the amount €(x-y) cannot constitute inducement; otherwise, the agency statute will be injured (at least, in Italian legal system).

b) On the other hand, in CESR's view art. 26 is *a priori* applicable to the tied agent. On the contrary, it has to be noted that the wording of art. 26 only refers to the investment firm; therefore, it is not applicable to tied agent (whereas, only the rules on conflict of interests are expressly applied to the "relevant persons").

Essentially, in our opinion, the remuneration received by the tied agent should not be qualified as inducement.

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In conclusion, Assoreti hopes that this Authority, in its final paper, will distinguish between the remuneration and the inducement, regarding both the investment firm – as for the commissions received by the investment firm from the product provider – and the tied agent – as for the commissions it receives from the investment firm –.

Thank you in advance for your kind attention on the above-mentioned considerations.

Yours sincerely.

Marco Tofanelli