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CESR's Consultation Paper on Inducements under MiFID (Ref: CESR/06-687)

Who are BlackRock?

BlackRock is one of the world's largest publicly traded investment management firms. As of December 31, 2006, the assets under management of BlackRock were US$1.125 trillion (€853 billion). The firm manages assets on behalf of institutions and individuals worldwide through a variety of equity, fixed income, cash management and alternative investment products. In addition, a growing number of institutional investors use BlackRock Solutions® investment system, risk management and financial advisory services. Headquartered in New York City, the firm has approximately 4,700 employees in 18 countries and a major presence in key global markets, including the U.S., Europe, Asia, Australia and the Middle East. BlackRock is a premier provider of global investment management, risk management and advisory services to institutional and retail clients around the world. In September 2006 BlackRock and Merrill Lynch Investment Managers merged transforming the business into a truly global asset management business.

As the third largest cross border UCITS provider in Europe, with close to US$100 billion (€75.8 billion) in UCITS funds under management, the issues surrounding the implementation of MiFID have a direct impact on our business. Our response is therefore based on our experience of the regulatory and commercial marketplace.

BlackRock Investment Management (UK) Limited is a member of both the IMA and EFAMA, and is generally aligned and supportive of the position they have adopted on the CESR Inducements paper.

BlackRock's view on the consultation paper:

At a high level we are concerned that CESR is taking a too broad approach to the interpretation of MiFID Articles 21 & 26. CESR is introducing the concept of 'proportionality', but the examples given do not, in our opinion, provide sufficient clarity to make proper determinations around what will or will not be acceptable. That said the paper could also be viewed as too narrow. It is difficult to conclude from the consultation paper anything other than an intention by CESR to create a pricing regime which, once again, appears to target specifically the investment funds industry – notably UCITS. We accept that MiFID is intended to capture more than just investment funds, but we are concerned that the apparent focus of your paper on funds will help promote the use of more structured product, certificates and other listed instruments which are able to present their charges in a very opaque way.

The most successful of the cross-border UCITS firms are those firms without large scale distribution channels of their own. These firms (which include BlackRock) have to 'rent' the shop window of distributors; and adequately remunerate firms for this service, bearing in mind that the cost of establishing

and running a distribution network can be extremely expensive. These distributors can be retail banks, insurance firms, intermediary networks or transaction platforms to name a few. UCITS firms negotiate terms with distributors which generally include a payment of a proportion of the annual management charge (AMC) to the distributor. This is a commercial arrangement between two professional firms. The role of regulation should not be to determine the levels and rates of such payments. Regulation should instead make sure that fees and charges are disclosed to investors and provide investors with a benchmark to determine whether those rates are commensurate with similar products, services and market practice. Ultimately the goal should be for the investors to have sufficient access to the information they need to determine whether they are happy to pay what they are for the product and service they receive.

We are therefore somewhat concerned that, although CESR claims not to wish to limit or prohibit retrocession or commission payments, national regulators may seek to use the CESR guidelines as presently drafted to attack such retrocession payments. For example paragraph 6 states that 'it is clear that the possibility of a receipt of a standard commission or fee can act as an incentive for an investment firm to act other than in the best interests of its client'. This is a very negative statement, and ignores the benefit of the impartiality that standardised payments can achieve. Specifically, if a result of the guidelines was distributors are obliged to accept lower or no retrocession payments for non-advised transactions, their costs would rise, potentially causing distributors to reconsider the provision of such products or, if applicable, result in them promoting more own group manufactured product, thereby internalising the full revenue flow. The latter would represent a return to own label products, reversing the trend towards open-architecture, and thus restricting investor choice – contrary to one of the stated aims of the EU Commission. It is our view that the current system of retrocession payments is an integral and extremely efficient way of product providers without their own distribution network funding access to European investors. This provides retail investors with access to better structured and managed products, presents greater consumer choice and stimulates commercial competitiveness within the industry.

On the positive side, we are not adverse to disclosure. We fully support the need for investors to receive appropriate and consistent information on TERs and fees and commissions. The focus should be on the work to amend the Simplified Prospectus requirements and to get to a disclosure mechanism that is consistent and understandable across the EU.

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BlackRock response to CESR questions:

Q1	**Do you agree with CESR that Article 26 applies to all and any fees, commission 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?**
Response	We agree that Article 26 is intended to capture any payments or benefits provided by or to an investment firm that are directly linked to the provision of an investment of ancillary service to a client or clients. We would not want this to be extended so as to prohibit legitimate indirect benefits, such as product training and capabilities events designed to improve the knowledge and understanding of one investment firm's understanding of another investment firm.
Q2	**Do you agree with our analysis of the general operation of Article 26 of the MiFID Level 2 Implementing Directive and of its interaction with Article 21?**
Response	We agree.
Q3	**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"?**
Response	We agree.
Q4	**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"?**
Response	While we do not disagree with the description and example provided, we would like CESR to clarify whether the position of commission/retrocession payments from, for example, a collective investment scheme manager (Investment Firm B) to the client's intermediary firm (Investment Firm A). Specifically could Client B permit Investment Firm A to receive from Investment Firm B a proportion of the annual management charge of a fund as a retrocession payment? As the AMC is paid by the Client, if they are aware of or even acknowledge that a payment is made, would this not represent a fee or commission covered by Article 26(a)?

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Q5	**Do you have any comments on the CESR analysis of the conditions on third party receipts and payments?**
Response	We are concerned that the examples provided in this section of the CESR paper make or suggest a number of vague conditions that need to be met. There is prevalent use of the word 'disproportionate', but without a clear benchmark provided. Traditionally fund firms have paid either a renewal commission (UK) or retrocession (most of the EU). UK renewal is normally at a fixed percentage and is paid on the value of the client's holding each year. These payments are disclosed up front by the adviser firm, and post-sale by the product firm. Retrocession payments on the other hand are normally negotiated at the beginning of a distribution relationship. The product firm agrees to pay a proportion of the AMC across to the distributor based on the value of assets held. In effect the product firm is renting the 'shop window' of the distributor. Importantly the rate of commission or retrocession is not determined by the type of sales channel (advised or execution only), it is set at the product level (say 50% of AMC). It could be a consequence of the CESR paper that retrocession rates will need to differ depending on the sales channel. This is something that product providers have no knowledge of, and would represent additional complexity and cost for firms. Moreover, if distributors are unable to receive a universal retrocession for the sale of another firm's products then they may be encouraged to revert to in sourcing of asset management, thereby internalising revenues and reversing the trend to 'open-architecture' and thus reducing choice for European consumers.
Q6	**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 the client and not impair the duty to act in the best interests of the client? Do you have any suggestions for further factors?**
Response	We agree that the provision of unbiased advice or recommendation should be deemed to enhance the quality of service.

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Q7	**Do you agree that it would not be useful for CESR to seek to develop guidance on the detailed content of the summary disclosures 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?**
Response	We agree that detailed requirements should not be proposed by CESR beyond the summary disclosure highlighted. It will however be important to establish a 'best practice' level of disclosure and it may be useful if CESR could provide some example disclosure methods. This should be guidance only, but would nevertheless provide firms with an indication of what is expected of them. Without this we believe that there could be a substantial amount of information flowing from product providers, to distributors, to advisers, to clients that would only lead to overflow of information and ultimately create investor confusion. We believe that one of the most important aspects is to provide consumers with a TER that has been calculated using an EU standardised methodology, as ultimately this is the annual cost to the investor. In addition, we support consumers being informed of the percentage of the TER or AMC that is received by the intermediary and the amount ultimately retained or passed on to the investor. This should be a fundamental goal of the eventual amendments to the Simplified Prospectus regime.
Q8	**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?**
Response	We agree. But would reference our response to Q7.
Q9	**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?**
Response	We agree with CESR's comments.

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Q10	**Are there any other issues in relation to Article 26 and tied agents that it would be helpful for CESR to consider?**
Response	Investors acquiring investments from a tied agent which is a subsidiary of a parent or group company need to be clearly informed of how remuneration or costs are allocated. We would not want a consumer to have the misconception, that although the agent may not be receiving a retrocession or commission payment directly from the product provider (as may be the case for a non-group company), the advice they are receiving is 'free' or the cost of acquiring the product is in some way cheaper (unless this is truly the case), when compared to a non-group company's products. This would apply both to tied agents and those distributors / intermediaries promoting both own group and open-architecture products.
Q11	**What will be the impact of Article 26 of the MiFID Level 2 Directive on current softing and bundling arrangements?**
Response	This is currently governed by domestic market legislation. We do not envisage Article 26 having a material impact on the process or disclosure(s) made.
Q12	**Would it be helpful for there to be a common supervisory approach across the EU to softing and bundling arrangements?**
Response	We would need to understand some of the detail first before commenting further.
Q13	**Would it be helpful for CESR to develop that common approach?**
Response	If a common approach were deemed beneficial, then yes it would be helpful for CESR to take the lead or be involved in some capacity.