

Response to CESR Document
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The following is based exclusively on the summary provided by CESR. The answers provided deal solely with the viewpoint of an intermediary dealing with a client and offering financial advice.

Question 1

The summary indicates that all fees paid to an intermediary are subject to consideration under Article 26. However, a slight caveat exists in the wording provided from Article 26(c) stating that a proper fee “enables or is necessary for the provision of investment services.” In cases where an intermediary is providing consultation and reporting to a client and is not charging fees for these services then the expectation of the receipt of a standard commission from an investment firm could be considered to be a proper fee for the services provided to offset costs incurred in providing such consultation and reporting. Where an intermediary is charging fees for the provision of consultation and reporting then such commissions could be regarded as extraneous to the provision of investment services.

Question 2

Given the above the analysis of CESR regarding the relationship between articles 21 and 26 cannot be fully endorsed.

Questions 3 & 4

The subject of both these questions hinges quite specifically on the interpretation of the phrase “*fee, commission or non-monetary benefit paid or provided to or by the client or a person acting on behalf of the client.*” The emphasis is on the final part. A client using a financial intermediary is introduced to an investment firm. The key here is whether it can be assumed that the investment firm is acting on behalf of the client. It should be assumed that were a client to introduce himself to an investment firm without the use of a third party intermediary then the investment firm holds itself as acting on behalf of the client in providing investment services related to the product selected by the client. Therefore the intervention of an intermediary between the client and the investment firm should not alter the status of the investment firms’ responsibility to the client. This could be construed as acting on behalf of the client. If this is acceptable then the payment of a fee or commission by the investment firm to the intermediary is from a person acting on behalf of the client.

Question 5

It would appear that one of the fundamental points in this section is the matter of “designed to enhance the quality of the relevant service to the client.” Such a position is open to a large number of subjective variables. A more pragmatic approach would be that items that are not “proper fees” do not **detract from or lessen** the quality of the service to the client. Using some of the examples provided by the CESR in this section alternative premises may be proposed.

Example 3

CESR is assuming that an investment firm offering higher remuneration than may have been customary to an intermediary on a series of orders (say to a collective scheme) based on either the number of orders, shares to be purchased or total value of orders cannot be seen to be providing any new benefit to the client. Using the above premise, if the client(s) will not be penalized in any manner by the increased remuneration, (ie. If their allocation of units remains the same, if the offer and bid prices are not adjusted so as to reflect the higher remuneration or no penalties for withdrawals or encashments that previously did not exist are imposed), then the level of service has not been reduced. Provided that the instrument being purchased by the intermediary on behalf of his clients has a declared structure of charges and fees and the remuneration to the intermediary is coming from such charges and fees then it should be within the product providers' entitlement to commercially decide as to the amount paid to an intermediary and the amount retained by the product provider. The assessment of the value of the business of an intermediary to a product provider is the sole judgement of the provider and attempting to enshrine it in legislation could be construed as restrictive trade practice. The analogy exists of wholesale ordering. A large retail outlet would expect to pay less per goods unit for a large order than a small outlet for a smaller order. It would be commercially disastrous for statute to impose that the larger retailer pay the same price as the smaller retailer as competition would be destroyed.

Example 4

It has been supposed in this example that a product provider is training the staff of an intermediary on new products made available by the company. Further it is supposed that the company regards the new product as potentially beneficial to the clients of the intermediary. It is considered that training in situ at the intermediaries' place of business is justified and, seemingly, elsewhere would not be so. If the company has offices in a different country from the intermediary then would it not be deemed fit for the company to invite the

staff of the intermediary to attend those offices to enable the company to provide better presentation and training facilities than may be possible by visiting the intermediary? Further if the company wants to conduct training and presentation to several intermediary firms simultaneously should they be prohibited from choosing a convenient location for all such intermediaries to attend, and should such a convenient location necessarily be “non-exotic.”?

Example 5

The example states “in particular if the firm F is not likely to enhance the quality of service to the client.” If this is assumed then it is highly unlikely that any firm would transfer the servicing of a client to another firm and thereby reduce the income received from the client. However, where an intermediary has determined that his client requires a service that the intermediary firm does not provide then introducing the client to another intermediary for such services may well be undertaken. This would appear to distinctly be enhancing the services provided by the first intermediary to the client. Accordingly it would appear commercially prudent for the first intermediary to request and receive remuneration from the second intermediary. A typical example would be a financial advisory firm that does not provide mortgage or finance services. Such firms regularly use the services of specialists and receive remuneration for the introduction of the client. Further they are normally responsible for liason between the client and the third party firm and hence remuneration can be regarded compensation for time spent.

Example 6

This is similar to Example 3. In addition to the comments made with regard to that article the following interpretation should be added. Assume that a product provider (eg. A UCIT management company) approaches an intermediary with a collective fund. After analysis the management of the intermediary firm decide that the investment offers positive benefits for some of their clients and decides to invest (or recommend investment) to those clients for a specified percentage of their portfolios. Should this amount be of such proportion that the product provider is able to offer a bonus payment then again it is within the commercial domain of the provider to do so. This is provided that as detailed in the response to Example 3, the client has no diminishment of the terms of investment within the product.

Example 7

Intermediaries are regularly supplied with CD's for use with quotation systems and other product information. Further intermediaries are permitted access to websites established and paid for by product providers through which they may obtain valuations, historic data, fund analysis etc. This is equipment provision. Should a company wish to provide an intermediary with a computer which enables the intermediary, for example, to issue online instructions for portfolio management and access client details 24/7, would this not be construed as enhancing the quality of service to the client? Further, the provision of such equipment may have the effect of reducing overall costs to the product provider. Such reduction may then be passed onto the clients in lower charges.

Example 8

This considers the provision of portfolio management services where a fee is charged and commissions are received by an intermediary on some or all of the investment placements within the portfolio. This is again an extremely subjective area that should be considered largely in the relationship of the fee charged and the commission retained. A large fee should commercially be set off against commission income by manner of rebates, whereas a notional fee may be accompanied by commission retention as a fair means with regard to the work involved in the management of the portfolio. There does seem to be a practical solution namely in the use of a maximum commission level above which rebates will be made in the manner of refunds to the client or enhanced allocation. A simple agreement between the client and the intermediary could state that a fee of X% of the value of the portfolio managed would be charged annually and additionally commission generated on purchases and or sales within the portfolio would be retained where such commission did not exceed A% of the transaction. Excess of A% would be agreed to be rebated.

Question 6

The reply is only to re-iterate that the emphasis should be placed on "not diminishing" the quality of service offered to clients rather than the other way around.

Question 7

A generic summary of the methods of remunerating intermediaries from the investments of clients would be appropriate. There exist only a few basic principles of charging different investment products and a straightforward plain language description which draws analogy to the buying of other goods and services may benefit the industry in clarifying the customers' perception of how their money is handled. This should always be able to be backed up with the specific disclosure of costs and charges related to the product that the customer is being offered, should this be requested.

Question 8

The disclosure to the end user of an investment product or service regarding costs and charges can essentially only be the responsibility of the intermediary having the direct relationship with the end user. The disclosure should be the total costs to the client. In the case of an investment product offered by a third party, not the intermediary, then the disclosure should be the costs of the product provider as it is assumed that from these charges the intermediary will be re-imbursed. It is the comparison of the product providers that is the essence here, not the level of the remuneration received by the particular intermediary. Any fees or other costs charged by the intermediary to the client (ie. not being intrinsic in the product offered to the client) must be disclosed to the client.

Question 9

It is clear, as in the answer to 8 above, that the cost disclosure to the end user by a tied agent must be the amount received by the investment firm to which the agent is tied. However, following from 8 above disclosure should always be the cost charged to the client by the *ultimate* product provider.

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