



***EACB¹'S ANSWER
TO***

***CESR'S CONSULTATION PAPER ON
"INDUCEMENTS UNDER MIFID"***

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¹ The European Association of Co-operative Banks represents, promotes and defends the interests of its members and co-operative banks in general. Co-operative banks are among the major players in Europe's financial and economic system: 130 million customers, approximately 650,000 staff, 60,000 outlets, 4,500 banks and a 20% market share.

I. General Remarks

The EACB welcomes the opportunity to give its views on inducements under the MiFID regime. Cooperative banks are committed to treat their clients in an honest, fair and professional manner. They understand the need to ensure that investment firms act in their clients' best interests and avoid conflicts of interests. The EACB is therefore supportive of the approach taken by article 26 of the MiFID Implementing Directive, which attempts to tackle the problem of inducements that have a detrimental effect on investment firms' clients.

The EACB is however very concerned about some of the interpretations made by CESR of art.26. In particular, it fears that some of these interpretations go far beyond the provisions of the Level 1 and Level 2 Directives and would be difficult to apply in practice. Moreover, certain proposals put forward by CESR risk creating legal uncertainty.

In order for CESR to fulfill its legal mandate and to ensure that its Level 3 guidelines can effectively be implemented without adverse consequences for investment firms and their clients, the EACB calls for the following changes in the CESR recommendations:

1- The concept of 'disproportionate inducement' in relation to the advantage received by the client

In its Consultation Paper, CESR mentions inducements which give "disproportionate benefit to the firm relative to the value of the service provided to the client" and thereby seems to create an additional criterion for outlawing inducements, without any legal basis in the Level 1 and Level 2 provisions. Neither article 26(b) nor Recital 39 of the Implementing Directive contain any notion of proportionality, let alone of 'comparable value' between the inducement and the benefit received by the client.

It is not clear how this new criterion has emerged and the EACB cannot accept that Level 3 measures impose additional criteria and constraints on market participants without any basis in the Level 1 and 2 legislation. Indeed, in practice it will be close to impossible to say if an inducement is 'disproportionate'. It is therefore unrealistic for CESR to expect investment firms to check and control the 'proportionality' or 'comparability' of an inducement in relation to the benefit received by the client when negotiating and accepting inducements.



2- Inducements that are ‘designed to enhance the quality’ of the service to the client

Regarding CESR’s interpretation of article 26(b)(ii) of the Implementing Directive, and in particular paragraph 19 of the Consultation Paper, the EACB insists that investment firms cannot be required to demonstrate that a given inducement entail a direct benefit for a specific client in relation to a specific investment service on the basis of which the inducement has been received or granted. Such a requirement would not be only impossible to apply in practice, but would also go beyond the provisions of the Level 1 and Level 2 Directives.

The formulation of art.26(b)(ii), with the expression ‘designed to enhance’, allows for the recognition of these practical difficulties and should be interpreted in a sense broad enough to enable investment firms to accept inducements which generally enhance the quality of the service they provide to their clients without requiring them to calculate and demonstrate the benefit of a given inducement to a given client, something not realistically feasible considering the nature of inducement arrangements.

3- Conflicts of interests (art.21) and inducements (art.26)

An investment firm is not allowed to grant nor accept inducements which are against its clients’ best interests. But this does not mean that a potential breach of the legal provisions on conflicts of interests occurring concomitantly with the payment or receipt of an inducement automatically makes the inducement illegal. If the inducement is not related to the breach of art.21, it should remain authorised under art.26.

The EACB insists that CESR needs to clearly distinguish between the two separate issues of art.21 and art.26 in order to avoid creating a situation of legal uncertainty for investment firms.

II. Detailed answers to CESR's Questions

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?

To clarify the conditions under which art.26 applies, the first sentence of paragraph 7 should read: “Fees and other benefits that are paid or provided to or by a third party *in relation to the provision of an investment or ancillary service to the client* and which are not “proper fees” pursuant to art.26(c) are dealt with under art.26(b).”

Question 2: 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?

Art.21 and art.26 refer to two different areas of the legislation but their application presents some overlaps in relation to inducements. This is simply because inducements can, in certain cases, lead to a conflict of interests which is dealt with by art.21.

However, as outlined in the first part of this paper (‘General Remarks’), this does not mean that the requirements set in art.21 must be fulfilled as a pre-condition for the authorisation of inducements under art.26. Such an interpretation, which seems to be made by CESR in paragraph 9 and 20 of its Consultation Paper, is contrary to the intention of the MiFID Implementing Directive. In practice, it could lead to a situation in which the relevant supervisors, after having established a breach of art.21 regarding conflicts of interests, would deny the legality of some inducements on a general basis and without referring to article 26.

The EACB therefore partially agrees with CESR's analysis of the relationship between the two articles and would like to encourage CESR to clarify its interpretation by amending paragraphs 9 and 20 of its Consultation Paper before translating them in Level 3 recommendations in order to reflect that art.26 alone offers clear rules for the authorisation of inducements.



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”?

The EACB generally agrees with the interpretative examples provided by CESR in its description of art.26(a) but feels that one important example is missing (see question 4 below).

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”?

The EACB would like to insist that CESR’s examples in its Consultation Paper, whether in relation to art.26(a) or art.26(b), do not and cannot represent an exhaustive list of possible cases. The variety and complexity of inducement arrangements is such that a judgement of their legality must be made on a case by case basis based on the general criteria set in art.26.

For instance, the EACB feels that one very common and important example is missing from CESR’s interpretation of art.26(a): the case of a pricing agreement between an investment firm and its client. In some countries such as Germany, it is allowed for both parties (the investment firm and its client) to agree on pricing clauses whereby a part of the payment is paid in cash directly by the client and the remaining part is paid by a third party/third parties. This method is often used in order to avoid that a payment received from third parties by the investment firm is first transferred to the client, before being transferred back to the investment firm. It is important that such a case be included within the scope of art.26(a) since the client has agreed to the pricing clause.

The EACB therefore suggests the following addition to paragraph 14 of the CESR Consultation Paper:

“Investment firms are not prohibited from receiving fees, commissions or non-monetary benefits *if such payments are the result of a transparent pricing agreement with the client.*”



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

For clarity purposes, the EACB suggests rephrasing the first sentence of paragraph 16 of the Consultation Paper as follows:

“Items that are not ‘proper fees’ that are paid to the investment firm by a third party (or which the investment firm pays to a third party) and not *by the client or on behalf of the client* are dealt with under art.26(b).”

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

As mentioned in the first part of this paper (‘General Remarks’), the EACB disagrees with the restrictive interpretation put forward by CESR of what constitutes an inducement designed to enhance the quality of the service provided by an investment firm to its client. This interpretation goes beyond the provisions of art.26(b)(ii) of the Level 2 Implementing Directive whose formulation (‘designed to enhance’) makes it clear that inducements should be evaluated based on their purpose and objective rather than on a factual evidence of ‘enhanced service quality’. Cooperative banks want to draw CESR’s attention to the fact that it will be very difficult if not impossible for investment firms to demonstrate in practice that inducements entail a direct benefit for a specific client in relation to a specific investment service on the basis of which the inducement has been paid or granted. How could investment firms prove that trainings or symposia entail a direct benefit for a specific client in relation to a specific investment service? This is clearly impossible, and yet many such ‘inducements’ (for example trainings on certain securities products offered by investment firms to their retail banking outlets) ultimately enhance the overall quality of the service received by clients (for example through a better identification of client needs).

The interpretation of art.26(b)(ii) must be therefore flexible enough to allow for inducements which benefit clients through better service without imposing unrealistic requirements on investment firms as to the demonstration of such a benefit at the individual level of a client.



Furthermore, the EACB asks CESR to remove the concept of ‘disproportionate inducement’ in relation to the advantage received by the client (paragraph 22) from its Level 3 recommendations. The addition of this new criterion for outlawing inducements is not only deprived of any legal basis in the Level 1 and Level 2 Directives, it also creates a dangerous situation whereby investment firms will be unable to assess the ‘proportionality’ or ‘comparability’ of an inducement and will be exposed to legal uncertainty as to the interpretation made of this concept by their national supervisors.

Finally, regarding example 5 in paragraph 25, CESR must make it clear ‘finder’s fees’ which are not connected to a specific investment service and are paid for the acquisition of a client are allowed and not considered as ‘inducement’ under art.26. Such fees are common business practice in many Member States.

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 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?

Yes. The EACB agrees that CESR should not develop more specific guidance in this area. We consider the general statements contained in paragraph 30 of the Consultation Paper to be sufficient.

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?

Yes.



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?

The EACB supports CESR's interpretation that inducements paid or received by 'tied agents' fall within the scope of art.26 since 'tied agents' are not third parties but act on behalf and under the responsibility of the investment firm.

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

No.

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

The EACB believes that current softing and bundling arrangements are not *per se* questioned by art.26.

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

No.

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

No.



III. Conclusion

The EACB trusts that its comments will be taken in due account by CESR. For further information or questions on this paper, please do not hesitate to contact:

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