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Rotterdam, 2 February 2007

To:
Mr. Arthur Philippe, Chair of MiFID Level 3 Group
Committee of European Securities Regulators (CESR)
11-13 avenue de Friedland
75008 PARIS - France

Re:
Public consultation: Inducements under MiFID, CESR/06-687

Dear Mr. Philippe,

€FPA Comments on CESR's Consultation on Inducements under MiFID

First of all, €FPA would like to express its gratitude in having the opportunity to contribute, through this written response, its attempt to clarify the legal regime of Inducements under MiFID. The numerous associations of financial planners and advisors, and more specifically their members, await and require clarification with respect to the rules which govern their profession, and may achieve this goal through the responses to consultations such as this one.

The €uropean Financial Planning Association (€FPA) is a non-profit financial services standard setting and certification organisation which operates in Europe and which was created in the interest of both professional financial advisors and the clients they serve. €FPA´s main objective is to increase the general public's awareness of the activities of their members and to oversee their members' compliance with the profession's moral and ethical codes and standards.

€FPA considers CESR's public consultation very timely and crucial. CESR has the opportunity to establish unique guidelines of interpretation for the new regime of inducements that will result in greater competition and efficiency in the European financial marketplace. Investment advisors are most interested in being able to rely on a clear legislative framework that facilitates the exercise of their profession in relation to their clients.

Clarification of the rules within the financial sector is especially necessary within investment advising, since this activity lacks regulation in some Member States, to the extent MiFID now defines this activity as a new investment service.

Although MiFID will contribute, without doubt, to the establishment of a new integrated financial services market within the European Union, in relation to financial advising, it is worrying that each Member State could conceivably apply its own interpretation of the principles formulated under the Directive. The financial advisors and planners need to know, as professionals in the market, their respective obligations and exactly how to interpret the legal regime.

It follows, then, that €FPA supports and encourages the work of interpretation of the legal regime, which is one of CESR´s primary objectives. Clear interpretive standards will increase the certainty of the business regulations governing financial planners and advisors. It will also contribute to increased legal security in the practice of financial advising in the European Market.

Preliminary remarks

The landscape of the modern financial world is ever changing, affected by the increasing tendency towards direct investment versus traditional banking intermediation, particularly with respect to the distribution of financial products. Financial advisors are therefore assuming greater relevance. With all these changes, including increased choice and complexity of financial products as well the markets in which they are negotiated, and all related risks, the investor is in need of professional advising now more than ever.

Where a professional acts as both financial advisor and salesperson of a financial product, it is necessary to consider the potential conflict of interest existing between the roles. The salesperson can frequently be motivated by profit, whereas the advisor's primary objective is to consider the best interests of the client. Potential conflicts of interest must be managed, since they could jeopardize the advisor's impartiality and therefore his ability to carry out his duty of providing the service in the best interest of the client.

This type conflict of interest recently gave rise to a very public debate in the United States, in relation to distribution investment funds. In an appearance before the Senate, the President of the NASD, stated that: "Investors deserve clear and easy-to-read disclosure that tells them of all the costs associated with their mutual funds. Not just the load and fees that affect investor costs but also the other arrangements that affect the price – including commission expenses and compensation arrangements between the broker and the fund. One of the bedrock principles of our free market system is that all participants have access to information about prices and costs that can influence their decisions. When this information is hidden or distorted, buyers are not able to make the best decisions about where to invest their money."

In the European Union, MiFID sets exigent standards which govern the relationship between the investor and his financial advisor. On the one hand, it elevates the status of financial advising from an auxiliary activity to that of an investment service, and on the other hand puts the new service under a special regime, limiting the inducements that financial advisors can receive from the issuers and distributors of financial products.

One of the objectives of the MiFID is indeed the protection of the investor through the improvement of the commercialization of financial products. This objective is obtained through two types of measures:

1) *Rules of conduct of the intermediaries: Investment services providers must act with honesty, fairly and professionally, in the best interest of the client.*

   In relation to providing investment services, MiFID and its second level Directive 2006/73/EC aim to guarantee good professional conduct, and prevent the appearance of conflicts of interest, and in cases where they do arise, to assure suitable resolution of such conflicts.

   It should be pointed out that Article 21 of the second level Directive particularizes situations that can generate conflicts of interest, including a fact pattern where an investment service provider receives an inducement from a third party, above and beyond the normal compensation from his client.

2) *Prohibition of third parties' inducements in relation with the providing of investment and auxiliary services.*

   CESR's public consultation on inducements clearly addresses this second objective as a means of protecting the final client within the financial distribution chain. In fact, CESR´s main objective is to clarify the limits of the prohibition of third parties' inducements, and clearly establish the exceptions from this general prohibition.

This new regime of inducements with respect to financial product distribution is of great importance for financial advisors, as the new regime applies to all investment products including collective investments, and to all the participants in the financial distribution chain, from the banking networks to the independent advisors.

MiFID's inducements regime attempts to preserve the objectivity and impartiality of financial advising, which may be affected by advisors' compensation schemes, such as the "retrocession" of commissions on the part of the distributor of the financial product.

€FPA's focus here is on the inducements regime under Article 19 1) of MiFID, and further developed by Article 26 of the Directive 2006/73/EC, which are the object of CESR's public consultation. According to Article 26, investment services providers are bound by principles of conduct that govern their activity and cannot accept third party inducements unless they report it to their clients and the inducement must be designed to enhance the quality of the service in the best interest of the client.

We will next address questions raised by CESR in the public consultation document with respect to inducements under MiFID.

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?***

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?***

CESR's public consultation begins by describing the prohibition of third party inducements and the interpretation that must be provided with respect to the conditions that exclude the application of that prohibition in accordance with the content of Article 26 of the Directive 2006/73/EC, in the second level of the development of MiFID.

€FPA believes that the interpretation of the declaration of Article 26 of the Directive 2006/73/EC, dealing with the scope of the prohibition on advisors receiving inducements from investment firms, must take the channel of distribution into account, as well as the generally accepted/common practices in the market where they take place. The advisor's fee, commission or non-monetary benefit in relation to a service provided to a client should be considered in accordance with the afore-mentioned criteria.

It is necessary to start with the presumption that intermediaries, even though commission agents, nonetheless act in the best interest of the client. Therefore, the existence of external advantages related to the service provided to the client should not result in the reversal of this basic presumption.

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"?***

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"?***

Where a payment is made by a client to the person who has acted on his behalf, it is necessary to use an open system that does not exclude assumptions other than those enumerated by CESR in the public consultation.

With respect to payments made to professionals, other than lawyers and accountants as mentioned in the public consultation, it will be necessary to analyze the market circumstances in which the operation has taken place by applying certain interpretative criteria. In this way we can define when a "*person [is] acting on behalf of the client*", and consequently exclude payments to such a person from the inducements regime.

It is therefore essential to define when a "*person [is] acting on behalf of the client*", in professions other than lawyers and accountants. The relevant fact is that the person acting on behalf of the client must not be somebody related to the investment service provider whose professional intervention takes place when the service to the client is supplied

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

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?***

€FPA shares CESR's interpretative criteria concerning the examples set forth by the consultation document. Particular attention must be paid to the "retrocession" of commissions on the part of the investment fund manager in favour of the financial advisor who has recommended the particular acquisition of a product to his customers.

Other examples could be added. For instance, where an individual portfolio manager has agreed to the "retrocession" of commissions on the part of the managing organization of the acquired unit in favour of the advisor or tied agent who has the relationship with the client.

However, the examples offered in the consultation document on prohibited practices of inducements, or any examples that may be added in the period of public consultation, must be considered as merely illustrative. In effect 1) the nature of service provided to the client 2) the benefit received by the client 3) the benefit received by the service provider, and 4) the effect of the incentive on the conduct of the service provider or the circumstances in which the incentive is paid - are all relevant factors in determining whether the inducement has or does not have the intention of improving the quality of the service to the client.

€FPA is in general agreement with the factors enumerated in the consultation document. However, we consider the factor set out in section (v), paragraph 26 of the consultation document concerning the "greater or lesser incentive for the investment firm to act in the best interest of the client" should be eliminated since it is unconvincing, and is in fact redundant, in light of other existing criteria.

€FPA is also of the opinion that another factor must be added: one that is relative to the cost of the service for the client in relation to the average cost for the same service in the market. We believe that the most important factor in protecting the client is cost transparency which ensures that clients know the total cost of the service being provided, inclusive of all kinds of compensation.

While it is important for the investor to understand how the distribution channel works, and the gains involved, these are not the most important factors. The best way to assess inducements, from the client's perspective, is through a straight costs comparison.

Therefore, in the course of their interpretative function, CESR should consider the ease and availability of total cost comparison for the client, with or without inducements.

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?***

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?***

€FPA believes that summary disclosures are beneficial for two reasons: 1) such a summary would be a useful tool for the clients, and would help with their understanding of the service or product, and 2) a summary would reduce the intermediaries' costs of compliance with the legal regime.

With a view towards establishing a standard format of summary disclosures, CESR should contribute to the interpretation of the legal rules by identifying the essential elements that would have to appear in the summarized information.

It should not require that the information provided to the client be exhaustive in order for it to be useful. However, it is important to inform the client of any inducements related to any service provided, particularly those inducements that could directly affect the client's decision of whether or not to contract for the service. Summary disclosures should therefore include information on:

- Existence of the inducements;
- Evaluation of the inducements from the point of view of the best interest of the client; and
- Information on its relevance in relation to the total cost of the service.

€FPA agrees with the consultation document when it states that, where there exists a chain of intermediaries, the obligation to inform the client of any inducements rests with the last link of the chain. That is to say, this obligation rests with the intermediary who has the relation with the final client – which could be the financial advisor. Nevertheless, to define the obligations of information of this intermediary, it will be necessary to take into account the potential existence of a chain of intermediaries, in the distribution channel. We must next consider each individual intermediary's access to information regarding any inducements, ending with the intermediary who has the relationship with, and therefore the obligation to inform, the final client. Therefore, to facilitate the provision of information to the final client, the intermediaries within the chain must be required to disclose all information related to inducements to the intermediary who has the direct relationship with, and obligation to, the final client.

To supervise the performance of the obligation to inform the final client of any inducements, the supervising body must also consider the existence of the complex relations that usually appear in the chain of intermediaries, and the reality that the final intermediary may not have the whole picture with respect to all links in the chain of distribution.

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?***

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

Although as a legal principle the tied agent acts on behalf of, and as agent for, the principal, when applying the regime of inducements and the duties of information it would be necessary to consider that the provision of the agent's professional services is usually contractual, and falls outside the legally defined employment/labour relationship.

The agent maintains his own relationships with clients, and has his own clientele. Informing his clientele of the existence of inducements could compromise such relationships, if the agent is not permitted to also provide his clients with the details of the inducements scheme. We may therefore justify allowing the agents to inform their clients of the financial breakdown or allocation of the inducements to allow the agent to protect the relationships with their clients.

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

Question 12: ***Would it be helpful for there to be a common supervisory approach across the EU to softing and bundling arrangements?***
Question 13: ***Would it be helpful for CESR to develop that common approach?***

€FPA shares the opinion that a harmonized approach with respect to regulators would be convenient in relation to the application of the inducements regime when faced with softening and bundling arrangements. Standardization would result in a greater legal certainty, favouring the development of the single market.

This harmonization must keep in mind that the determination of commissions and fees remains the free decision of the participant companies in the market. Of course, this freedom of choice must be exercised within the framework of transparency and prevention of the instances of conflicts of interest derived from MiFID in order to protect the investor.

€FPA agrees with the necessity to arrive at standardized criteria concerning the agreements that determine commissions or inducements of this type (softening and bundling), using this flexible approach, which facilitates private initiative.

Please do not hesitate to contact us with any questions or comments, or if we can offer any further assistance.

Yours faithfully,

Josep Soler-Albertí,
Chairman,
€uropean Financial Planning Association (€FPA)