

INDUCEMENTS UNDER MIFID  
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Whilst we find the principle of proper control and adequate disclosure of such inducements are worthy of regulatory protection for the sake of keeping public trust in the investment service industry and increase public participation in it aiding its growth and integrity, we find that there are aspects of how Article 26 b of the Directive is being interpreted which could throw out the baby along with the bath water.

I refer in particular to Example 8 on page 10 of the Consultation Document.

It is a wide practice in the industry for Management Company of the UCITS to pay annual retrocession fees to investment firms. Without these retrocession fees the Investment firm would have to make substantial charges to the client for the ongoing service that it gives the client mostly free of charge. Such service include regular submission of valuation statement, occasional reviews and ongoing investment advice, and ad hoc requests for valuation, amongst others. This service is important not only for the client to ensure that the investment portfolio is fresh and aligned to client's investment objectives, but is also important for the investment firm in order to execute its know-your-client obligations on a continuing basis.

These retrocession payments are funded by the UCITS management company through the annual management fee it charges to the UCITS. These charges are fully disclosed to the client on subscription and any changes along the way is also fully advised to clients. These fees are standard for the particular UCITS and client of the investment firm are not charged any thing in addition to what is charged to all other subscribers in the said UCITS even in cases where the UCITS manager does not have to pay any retrocession to any investment firm.

It is clearly the case that the UCITS manager is passing back to the Investment Firm part of the charges that the UCITS manager would incur if it were to deal directly with all its subscribers.

One can hardly argue in such circumstances that such retrocession payments are a charge to the client by the Investment Firm and are more a payment from the UCITS Manager to the investment firm for outsourcing to it the client contact part of the service.

In the circumstances I think provision needs to be made in the final interpretation of Article 26 b to establish that such retrocession payment, strictly in cases where it can be proved that the ultimate client is not paying anything in addition to what the client would have paid if he or she had a direct relationship with the UCITS Manager, are to be considered as payments falling within the scope of Article 26 (a) or 26 (c) as the case may be.

Obviously the Investment Firm would continue to have the onus to prove that it does not put itself in a conflict of interest situation whereby it could compromise its duties to give suitable and appropriate investment advice to its clients irrespective of such retrocession payments by the UCITS Manager.

Obviously one could argue that that in an ideal world the UCITS Manager should reduce the Management fee it charges annually to the UCITS and then let the Investment Firm charge the client for its service in a way that charges are more visible to the client even if it at the end the client would still be in the same position at present – difference being that current one charge is split in two payments one to the UCITS Manager and one to the Investment Firm.

However this would create problems as the UCITS Manager would have to charge higher annual fees to its own direct clients to whom it gives full end client services without involvement of an intermediary.

There is also the risk that if such annual charges are raised separately by the Investment Firm to the end client, the client could be tempted to make false economies to save such charges by avoiding continuous reviews of the portfolio with the Investment Firm which had advised him/her to place the investments in the first place.

Alfred Mifsud