RESPONSE BY THE ADVISORY COMMITTEE OF THE COMISIÓN NACIONAL DEL MERCADO DE VALORES ON CESR'S CONSULTATION PAPER ENTITLED "INDUCEMENTS: GOOD AND POOR PRACTICES"

The CNMV's Advisory Committee has been set by the Spanish Securities Market Law as the consultative body of the CNMV. This Committee is composed by market participants (members of secondary markets, issuers, retail investors, intermediaries, the collective investment industry, etc) and its opinions are independent from those of the CNMV.

The Advisory Committee is grateful for this opportunity to offer its comments on the consultation paper regarding good and poor practices in inducements; it likewise wishes to congratulate CESR on its efforts in specifying and analysing inducements, an especially complex area to define, both because the rules are new and not sufficiently specified in the Directive and because they are very broad ranging, applying to jurisdictions with differing practices, as recognised in the paper.

The Committee's view of the document is positive overall; however, it would like to make some general comments before answering the questions raised in the consultation paper.

I.- GENERAL QUESTIONS

The rules for inducements included in the Directive (both payments and non-monetary benefits) are not clear in scope nor is it clear how they interface specifically with the overarching requirement of honest, professional and impartial treatment of clients.

In the Committee's opinion, this lack of clarity requires (i) interpretative efforts to establish the practical application of this new regulation (of which the consultation paper is an example), and (ii) exceptional sensitivity when establishing the general benchmark principles in this area.

As regards the latter, the Committee is of the opinion that the consultation paper contains a number of sections which deserve further commentary, as general principles may be inferred from them with which the Committee does not fully agree. Specifically:

- Paragraph 41 states that the classification of an inducement as a proper fee will depend on an abstract analysis that should not consider whether the inducement actually gave rise to a conflict with the investment firm's duty to act honestly, professionally and impartially.
  The Committee does not share such a restrictive interpretation, since the inducement and its ability to cause conflict should be analysed on a case-by-case basis; it should, of course, take into account the abstract structure of interests in question, as well as other elements that determine the absence of such a conflict in a specific case.
  Considering both abstract and specific elements will allow for attainment of the regulation's objective, i.e. honest, professional and impartial treatment of the client.

- Paragraph 57 states that inducement rules are not just linked to payments and non-monetary benefits which are designed to act as an incentive to encourage particular forms of behaviour, and the purpose of the incentive is irrelevant in the application of the MiFID rules.

  In the Committee's opinion, this statement fails to recognise that the MiFID inducement rules have been established to ensure honest, professional and impartial treatment of clients, which is the ultimate goal of those rules. Therefore, what MiFID seeks to avoid are inducements that may affect the above-mentioned qualities of dealings with clients, and this factor should be weighed when analysing specific cases.

It is another thing entirely to have a formal set of rules that entities must comply with when there is a structure of incentive payment or receipt. That formal set of rules (analysis of the incentive, classification in the appropriate sub-section of article 26, and compliance actions) must be fulfilled at all times. However, that does not mean that the very goal of the rules is divorced from achievement of honest, professional and impartial treatment of clients.

Therefore, the Committee does not consider it appropriate to adopt a totally abstract approach to incentive rules divorced from actual circumstances (which is what this paragraph of the consultation paper suggests).

In the Committee's opinion, the paper should expressly state that the inducement rules have a specific objective—to ensure honest, professional, impartial treatment of clients—and that the specific measures in the Directive focus on that objective.

- Example 3 under "Poor practices" in the section “Good and poor practices: acting in the best interests of the client and designed to enhance the quality of the service provided to the client” (page 25) considers it to be a poor practice for an investment firm to receive rebates from a product provider when the client that buys the product has a financial advisory relationship with the firm. It is still considered a poor practice even if (i) the conflict of interest rules are applied strictly, and (ii) a strong suitability test is applied.

  The Committee does not share CESR's opinion regarding Recital 39 of the Level 2 Directive, which indicates that payments to firms providing investment advice can be legitimate provided that they do not determine the content of the advice. CESR considers such collection of placement fees to be a poor practice, even if the payment did not influence the content of the advice; this clashes with the tenor of the Recital.

  While it is especially important that entities take adequate measures with regard to managing conflicts of interest, applying suitability tests and informing clients (the latter being particularly important since it enables clients to form an accurate picture of the situation), once such measures are applied there are no grounds for deeming there to be a conflict with the obligation of providing honest, professional and impartial treatment to a client. That is, there is no reason to assume that the treatment of clients is in breach of the protection provided for under the Directive in accordance with the broad-ranging terms of Recital 39.

  An in-depth analysis of this specific case (i.e. of an advisor's ability to collect marketing fees) is particularly important in view of the sweeping interpretation of advice contained in the CESR Consultation Paper on the matter (CESR/09-665), under which any recommendation given to a client in the scope of securities marketing could be viewed as establishing an advisory relationship between the client and the firm.

  The combination of these two factors (i.e. a very broad interpretation of marketing advice plus the prohibition on charging marketing fees when selling securities to advisory clients) would considerably limit the scope for of engaging in marketing activities, which the Committee considers to be worrisome.

II.- CONSULTATION QUESTIONS:

II.1.- CLASSIFYING PAYMENTS AND NON-MONETARY BENEFITS AND SETTING UP AN ORGANISATION TO BE COMPLIANT

Question I: Do you agree with CESR's views about the arrangements and procedures an investment firm should set up?

The Committee agrees with CESR's position that firms should give priority to: (i) establishing internal procedures and mechanisms regarding inducements, (ii) the compliance function, (iii) conceptual steps to take in evaluating inducements, (iv) inclusion of the inducement rules in the analysis of new products and services, and (v) participation by senior management in establishing procedures and mechanisms.

Question II: Do you have any comments on CESR's views that specific responsibilities and compliance controls should be set up by investment firms to ensure compliance with the inducements rules?

We agree with CESR's views on this matter.

Question III: What are your comments about CESR's view that at least the general approach the investment firm is going to undertake regarding inducements (its 'inducements policy') should be approved by senior management?

The Committee agrees with CESR in that senior management should be involved in this matter to a certain degree; however, that degree will depend on each entity.

II.2.- PROPER FEES:

Question IV: Do you agree with CESR's view that all kinds of fees paid by an investment firm in order to access and operate on a given execution venue can be eligible for the proper fees regime (under the general category of settlement and exchange fees)?

Yes.

Question V: Do you agree with CESR's view that specific types of custody-related fees in connection with certain corporate events can be eligible for the proper fees regime?

Yes.

Question VI: Are there any specific examples you can provide of circumstances where a tax sales credit could be eligible for the proper fees regime?

The Committee does not have any specific examples in this regard.

II.3.- PAYMENTS AND NON-MONETARY BENEFITS AUTHORISED SUBJECT TO CERTAIN CUMULATIVE CONDITIONS
- ACTING IN THE BEST INTERESTS OF THE CLIENT AND DESIGNED TO ENHANCE THE QUALITY OF THE SERVICE PROVIDED TO THE CLIENT

Question VII: Do you agree with CESR's view that in case of ongoing payments made or received over a period of time while the services are of a one-off nature, there is a greater risk of an investment firm not acting in the best interests of the client?

No.

The Committee does not see a connection between the specific method of designing the fees for marketing services and an increase in the risk that the firm will not act in the best interests of the client, nor, from the terms of the paper, does it see any grounds for deeming there to be greater risk.

In this regard, the Directive should not be interpreted as favouring one commercial services payment scheme over another. In the Committee's opinion, the most important issue here is adequate compliance with the obligation of providing summary disclosures to the client (or more complete information at his request).

Question VIII: Do you have any comments regarding CESR's view that measures such as an effective compliance function should be backed up with appropriate monitoring and controls to deal with the specific conflicts that payments and non-monetary benefits provided or received by an investment firm can give rise to?

The existence of a compliance function should be interpreted as meaning that the function is sufficiently equipped. This general principle is applicable to all an entity's activities covered by compliance rules, including the rules governing incentives.

Question IX: What are your comments on CESR's view that product distribution and order handling services (see §74) are two highly important instances where payments and non-monetary benefits received give rise to very significant potential conflicts?
Can you mention any other important instances where such potential conflicts also arise?

The Committee is of the opinion that the Directive's rules on incentives apply especially to marketing activity and order execution, but not only (or most importantly) with regard to conflicts of interest.

Question X: What are your comments on CESR's view that where a payment covers costs that would otherwise have to be charged to the client this is not sufficient for a payment to be judged to be designed to enhance the quality of the service?

The answer to this questions depends on whether one adopts a restricted or broad-ranging interpretation of the phase "designed to enhance quality of service" and on what the ultimate goal of incentive rules is perceived to be.

In other areas of service provision, mechanisms by which the same service is obtained for a lower cost would most likely be considered as enhancing the quality of service provided by the provider.
The Committee believes that this approach holds true for the provision of investment services, without this being deemed to constitute a breach of the purpose of the incentive rules. The Committee considers that the "designed to enhance quality of service" idea set out in the consultation paper is excessively restrictive as it does not encompass the aforementioned concept.
Therefore, achieving a lower cost for the client should, in principle, be considered as enhancing quality of service, and the mechanism that achieves this could be understood objectively (not merely subjectively) as being "designed" for that end.

II.4.- PAYMENTS AND NON-MONETARY BENEFITS AUTHORISED SUBJECT TO CERTAIN CUMULATIVE CONDITIONS
- DISCLOSURE:

Question XI: Do you have any comments on CESR's views about summary disclosures (including when they should be made)?

Broadly speaking, the Committee agrees with CESR in this area. However, the Committee believes that the general recommendations in paragraph 97 should be eliminated since it is extremely difficult for entities to guarantee that a client has "made an informed decision in relation to the service".

Information provided to the client should be objective, enabling the average client to understand the nature and scope of the incentive; however, the entity should not obliged to guarantee (i) that the information provided to the client is understood correctly by him, or (ii) that the "service" is understood by the client, since ensuring that the client understands the service offered falls outside the incentive rules and under the general rules on informing clients about the services to be provided.

Question XII: What are your comments on CESR's views about detailed disclosures?

The Committee agrees with CESR's view in this area. However, as in the previous answer, the final objective of the disclosures to clients should be adjusted in the final document to make it clear that the goal is merely to provide the client with reasonable information as to the nature and amount of the incentive.

Question XIII: Do you have any comments on CESR's views on the use of bands?

The Committee agrees with CESR on the use of bands. Moreover, the bands should match as closely as possible the need to provide the client with correct information.

Question XIV: Do you agree with CESR's views on the documentation through which disclosures are made?

The Committee does not agree with the opinion reflected in the paper, i.e. that the delivery of information in a number of complementary documents always constitutes a poor practice. This approach should be considered a poor practice only if it can be demonstrated objectively that it greatly complicates the client's access to information, and this issue should be analysed on a case-by-case basis.

Therefore, the first example provided under poor practices (p. 38 of the paper) should be significantly constrained.

<u>Question XV</u>: Do you agree with CESR's views on the difference of treatment between retail and professional clients?

Yes.

The Committee agrees with CESR's position in this regard, i.e. allowing the provision of less information to professional clients, as defined in the Directive, and believes it is a good example to apply with respect to other aspects discussed in the consultation paper, having regard always to the final goal of inducement rules (honest, professional and impartial treatment of clients), and tailoring the apparently rigid obligations set out in the Directive to that end.