



## Inducements under MiFID

Re: CESR public consultation December 2006

Our Association represents the German independent Asset Managers (Portfolio Managers).  
We welcome the opportunity to respond and make the following introductory remarks:

1. All Guidelines of CESR at Level III will in their consequence be administrative practice of the national supervisory authorities. This administrative practice can only lie within it's legal framework -european or national-. This means it must be legitimised by legislation on Level I or II. In this respect we are in doubt about the paper presented here by CESR. It sets bank supervisory law above the standards legitimised legally and democratically. This is not the purpose of Level III. In parts of the paper CESR exceeds it's competence to regulate.
2. The fundamental principle of Article 26 of the Commission Directive 2006/73/EC is to require fees that *"enable or are necessary for the provision of investment services"*. In economic reality, business in securities aims to earn fees and commissions just like any other business activity. This is the fundamental law of our economic order. The client and investor pays for the service that he demands. There is no reason to "criminalise" fees per se. In our view, considering and abiding with the principle of transparency, fees and commissions should as a rule be allowed, only illegal cases should clearly be marked as an exception. A fee can only be illegal when the limits of Article 19 (1) of Level 1 in connection with Article 26 MiFID Level II is exceeded which requires that an act is not *"honest, fair and professional in accordance with the best interest of the client"*. This rule/exception relationship does not become sufficiently clear in the paper presented by CESR now.
3. We answer the questions asked by CESR as follows:

### Question 1:

We are of the opinion that in principle only such fees should be illegal which prove

not to be honest, fair and professional in accordance with the best interest of the client **from an objective point of view.**

Furthermore we suggest to interpret the term "proper fees" as "customary in the market". If CESR does not follow this suggestions, any **research** material provided should be **excluded** from the concept of "inducement" for reasons of practicability. This particularly against the background, that research material is sufficiently offered in the market by Banks without any dependencies arising from it.

#### **Question 2:**

In principle, we agree with the position of CESR. Fees are at least abstractly and potentially a possible reason for conflicts of interest when exceeding an acceptable level. Our Association will therefore advise its members to deal with them in their 'Conflict of Interests Policy'. For reasons of manageability certain fees (e.g. portfolio maintenance) mentioned there should be treated as unobjectionable in the Policy up to a specified maximum amount or percentage, with the consequence that independent Asset Managers will not have to argue and justify such fees in the individual case (i.e. that portfolio maintenance shall be deemed to serve the improvement of quality up to a certain previously agreed amount or percentage amount).

#### **Question 3/4:**

Relating to the sale of investment funds this would mean an order of the customer to the investment company to pay fees to the marketing agent. This order would have to be clarified in the sales prospectus. We agree to the diagram on page 6 of the paper with the proviso that "C" may also be a investment company which pays a fee for portfolio maintenance to A with B permitting this payment. (even though in this constellation usually B does not keep any account with C !). A maximum rate might be provided for portfolio maintenance in the contract, between Asset Manager and his client, as we suggested above.

#### **Question 5:**

Precise details on "Soft Commissions" are missing.

### Question 6:

To the question asked here and the preceding text we note:

We point out that relating inducements **to the individual customer** is not practicable. (subparagraph 19 of the paper). It must therefore be sufficient if the fee is in general terms suitable to improve the professional quality of the beneficiary or his services rendered.

To case study No. 3 we comment:

We ask to make clear in this context that a "**retaining clause**" safeguarding transparency remains admissible in any contract with a client.

Furthermore we point out that due to technical particularities concerning settlement and accountancy, a prior disclosure is not possible in each case. Portfolio commissions for example can only be calculated and settled at the end of the respective financial year. Beforehand, only general notice can be given to the customer that such commissions will be paid.

The overriding principles of all cases in the CESR-Paper in our view:

The financial interest of the client is decisive: As far as the client is informed about the fees and other benefits paid (transparency) and does not pay overall costs higher than with other Brokers, we regard this as admissible.

Example 8 results in high costs for the investment firm to be able to provide "evidence" under the "best interest rule". This burden of proof might leave no incentives for independent Asset Managers to negotiate "special conditions" for his clients with the other parties involved (Broker, Depository Bank, etc.). In the end, such regulation would therefore penalise the investor.

### Question 7:

A phrase in the asset management contract containing a quantification like:

*"... the Asset Manager in addition to his management fee, is entitled to receive up to*

*x% per annum from the Depository Bank or any third party for the actual stock held for the client. The Asset Manager is entitled to retain this fee for his own account."*  
would be practicable and sufficiently precise to protect the interests of the client.

**Question 8:**

In principle we agree, however provided that an outside service provider (depository institution) may comply with disclosure requirements on behalf and in the name of the Asset Manager.

**Question 9:**

The question does not fit into the framework of German law which regards the Tied Agent to be similar to a sales agent under the German Code of Commercial Law, as acting only for **one principal** (section 2 para. 10 of the German Banking Act).

Generally: Competitive conditions should be the same between a Tied Agent and a direct adviser.

**Question 10:**

We refer to the regulations under the German Banking Act as mentioned above. These are existing bank supervisory law. The eventual necessity of changes and amendments of the "one principal rule" should be discussed outside the context of "inducements" to which it is not directly related.

**Question 11:**

Here we hardly see any impact of Article 26 since research material can always be seen as suitable to improve of the service level.

**Question 12:**

Research should generally be allowed since it is a vital interest of the investor that his Asset Manager is well informed. In addition, there is adequate competition between research suppliers to prevent any dependency of independent Asset Managers. Beyond that, independent Asset Managers should always bear expenses out of their own funds.

Otherwise a conflict of interests will unquestionably arise as well as an inability to quantify and prorate any benefit. (e. g. only clients holding fx-stocks may benefit from the use of the fx-dealing system).

**Question 13:**

We answer in the affirmative since uniform standards would improve legal clarity for the financial community as well as safeguard the principle of "level playing field".

February 9, 2007

RA Klaus J. Koehler  
- Verbandsjustitiar -