



## DUFAS<sup>1</sup> reply to CESR's 2<sup>nd</sup> Consultation on “Inducements”

The 'Foreword' of the consultation paper sets out the scope of the recommendations. In doing so, CESR states that the recommendations issued are intended to "facilitate a consistent implementation of Article 26 of the Level 2" (directive). It also states that the "recommendations will be applied by CESR Members on a voluntary basis". For the industry, the use of the word "voluntary" is not entirely positive news, because it means that the level playing field intended by the makers of the MiFID directives is in fact made less certain because of the continued possibility of regulatory arbitrage by for instance investment firms from non-member states. But even among member states differences might occur.

Fees, commissions, soft dollar arrangements, etc. are generally speaking not intended to achieve improper results but are a mere compensation for the client and product assessment that financial undertakings need to execute. Article 26 of the Commission Directive allows most types of fees, commissions, etc. for that very reason. The recommendations of CESR in their current form do not reflect that. Such compensations should be considered “proper fees”, also in case of “execution only”, because in that case the client makes his own choices and there can be no inducement by the distributor. It should be legitimate to pay execution only distributors a compensation for system costs, “shelf-space”, etc.

The word “inducements”, which is unfortunately the title section I of Chapter III, Operating Conditions for Investment Funds, of the Commission Directive, has negative connotations that the term “compensation” does not have. An inducement is according to the Oxford dictionary “1. a thing that persuades or leads someone to do something; 2. a bribe.” This is unfortunate because it leads to a lot of confusion. We therefore also have argued to delete the wording 'inducement' from previous EC directives.

It also leads to recommendations that are motivated and phrased in too negative a way.

Paragraph 2 on page 7 should reflect that the circumstances in which such benefits *may* conflict with a firms' duty to act in the best interest of its clients are the exception rather than the rule. The third sentence of that paragraph is phrased far too decisively and does not allow room for argument.

The same goes for Para 6 on page 8. In spite of the complicated phrasing of article 26 of the Commission's directive, it sums up types of incentives that are *permissible*, under certain conditions.

With regard to Recommendation I (b), this recommendation would in our view needlessly hinder the fee redistribution within a financial group of companies that together provide the same service or services. For instance, within the same group there can be UCITS (or non-UCITS) management companies, investment management companies in different countries and banks, that all co-operate to provide a service to the client. Often in such cases, fees are

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<sup>1</sup> DUFAS is the representative association of the Dutch investment management industry and a member organization of EFAMA, the representative association of the European investment management industry. For more information please visit [www.dufas.nl](http://www.dufas.nl)



split between the different companies in order to pay each link in the chain for their work in providing the service to the client. Such fee splits could up to a point also be achieved by dividend policies in the group, or charging for such services between the different legal entities. That would not need to be disclosed to the client, as long as this does not affect the total consideration the end client has to pay to the financial institution.

Recommendation 2 states as a condition for 26(a) “the client... has the power to vary the arrangement without reference to the investment firm”. This needs further elaboration. For example, a fee is the result of negotiations in which the earner states the price he/she wants and the client accepts or declines or makes a counter offer, *ex ante*. Is this recommendation intended to give the client the power to re-open negotiations unilaterally later on? Or does it simply mean that the fees should be stated as a variable, calculated for example on the bases of numbers of transactions, hours spent or AuM? If the latter is the case, why would a fixed fee be a problem, if the client agrees with it?

We do not understand the sentence in para 14, saying “The assessment of the level of service should not be interpreted too widely to convert the test into a meaningless exercise.” Generally speaking this is a rule for interpretation of any legal text. The condition would not have been stipulated by the Commission if it meant nothing. If that is what this sentence means, it is superfluous. If it means something else, it is too ambiguous in its current phrasing to be helpful guidance. The sentence should either be elaborated on or deleted.

We consider that it is not necessary in Recommendation 3 to place extra emphasis on the words “by their nature”; we consider the wording of Article 26 (c) of the implementing directive sufficiently clear.

In our view more emphasis should be placed in Recommendation 4 on the non-limitative nature of the list of factors.

Why is the word “incentive” used in recommendation 4 under (c) ? It would make much more sense if in this particular case the word “inducement” were used, especially because in this context it refers to the improper nature of the type of incentive in question.

In para 18 and 19, we do not understand what the last 6 words mean. If it is a general statement, then it goes without saying and can be done without. If it refers to article 19 of the Commission Directive, it is just more vague than the previous document and we do not expect an explanatory document to be deliberately vague. Therefore we feel this needs further elaboration, or it should be deleted (as has happened in recommendation 5).

We shall await with great interest CESR’s signals to the European Commission regarding regulatory arbitrage in the areas of structured notes, certificates and unit-linked insurance products, which are not -- or not as comprehensively -- bound to comparable obligations regarding incentives or any other compensation schemes.

We remain at your disposal for any further clarification.

Mr. J.H.M. Janssen Daalen  
General director , Dutch Fund and Asset Management Association