ASSOGESTIONI
associazione del risparmio gestito

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Our ref: Prot. N. 95/07

Response to CESR public consultation on Inducements under MIFID.

Assogestioni[1] welcomes CESR's invitation to express comments on the common supervisory approach to the operation of art. 26 of Directive 2006/73/EC (hereinafter "the implementing Directive").

Preliminary to our specific comments, we would like to submit the following general considerations with regard to the proposed guidelines.

First, we note that CESR focuses in particular, if not exclusively, on the application of MIFID rules to the distribution of funds and portfolio management, without giving sufficient consideration to its application to the distribution of other types of financial products that nevertheless fall within the scope of MIFID – notably structured notes and certificates. In the opinion of our members, the lack of a comprehensive analysis of the application of MIFID rules to substitute products creates the strong risk of an arbitrary tilt of the regulatory playing field, where markets are already deeply affected by different levels of transparency and uneven prescription of conduct of business rules. Under the proposed interpretation, MIFID companies that distribute investment products would be further motivated to offer other products than funds or portfolio management services, independently of any consideration of their clients' interests.

Second, we would welcome some analysis on the impact that the proposed interpretation may have on the design of a number of investment products which directly impact to the development of third party distribution. We refer, more specifically, to the lack of analysis of the incentive mechanism for the offer of so called "captive" versus "non captive" investment products. The constraints that distributors would face under the proposed interpretation suggest that the practical results could well be contrary to CESR's intentions. Indeed, distribution of captive investment products does not require, if considered at the group level, any cash payment and might consequently remain largely unaffected while third party distribution would become less appealing.

[1] Assogestioni is the Italian association of the investment fund and asset management industry and represents the interests of 148 members who currently manage assets whose value exceeds 1.100 billion euro. Our members are both directly and indirectly affected by the issues involved in the implementation of MiFID regulations.

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Third, we deem that CESR's interpretation and common approach on the operation of MIFID rules on inducements do not take into account the importance of largely consolidated EU market practices which were established long before the adoption of MIFID. Accordingly, we call on CESR to give proper and detailed consideration to the commercial significance of these practices in order to avoid adverse consequences on (among other things) the organizational structure of asset management and the fee-retrocession mechanism for remuneration of funds distribution. These organizational arrangements, included the remuneration mechanisms in place, are the expressions of a market where investments firms are free to operate according to EU competition rules and, in this context, we remark that art. 4 of the Treaty states that " *(…) the activities of member States and the Community shall include (…) the adoption of an economic policy which is (…) conducted in accordance with the principle of an open market economy with free competition*". The proposed interpretation should be tested in order to avoid the risk of regulating the price level or the price mechanism, particularly if such an effect is unintended.

General explanation and relationship with conflicts of interests.

With regard to the specific questions and examples made by CESR which are most closely related to the asset and fund management industry, you can find hereafter our commentary.

Question 1 and 2. We strongly disagree with CESR's proposed interpretation that art. 26 of the implementing Directive on "Inducements" applies to *all and any* fees, commissions and non-monetary benefits that are paid or provided by an investment firm in relation to the provision of an investment or ancillary service to a client, including "standard commissions or fees" mentioned in art. 21 (e) of the same Directive.

This conclusion is not in our opinion coherent with the wording of the implementing Directive. Indeed art. 21(e) wording clearly *excludes* that "standard commissions or fees" (i.e. a commissions or fees which are normally paid) for a financial service from the definition of "inducements" and indicates that an inducement is something *additional and different* from the normal consideration paid for the provision of financial services because it relates to commissions, fees or services that can determine a conflict of interest whose existence may incentive an investment firm to damage its client's interests. It follows that standard commissions or fees are *not* within the scope of art. 26.

We further disagree with CESR's analysis of the general operation of art. 26 and its interaction with art. 21 MIFID because it is based on the above (rejected) interpretation.

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Example 2. ***Retrocession of management fees from the fund asset manager to the distributor.***

Fees retrocession agreements[2] have long been established as a market practice in order to pay investment firms for the distribution activity of funds units or shares. Proper attention should be given to the fact that these fees are paid not only in consideration of the distributor's initial efforts in the CIS promotion and selling but also in consideration of the subsequent activity of "costumer assistance" which includes the collection and prompt transmission of all clients' subsequent investment decisions to the asset manager (as for example the decisions to redeem fund quotes or switch decisions etc); these activities are to be distinguished from the investment advice service or general recommendations that might be provided – at the client's request or at the firm's own initiative – together with the placing of financial instruments service.

We maintain that the payment of these commissions represents the standard and normal consideration for the above mentioned activities that the distributor performs in the interest of the assert manager and that, in this respect, they are a payment mechanism that has long been established as a market practice in all EU Member states.

We further maintain (as explained above) that the definition of *inducements* provided in art. 21(e) of the Implementing Directive *includes* all monies, goods or services *other than the standard commission or fee* paid in relation to an investment service. In other words, art. 21(e) clearly *excludes* that "standard commissions or fees" (i.e. commissions or fees which are normally invoiced for the provision of an investment service) from definition of inducements and consequently from the scope of art. 26 of the same Directive.

It follows that, because the definition of inducements in art. 21 (e) *excludes* standard commissions or fees, (standard) commissions retroceded by product providers to CIS distributors are not inducements.

In conclusion, we disagree with CESR's opinion that commissions retroceded by the management company of an CIS to a distributor, constitute "inducements" and that they will be permitted under art. 26 (b) only on the basis of the respect of a criterion of such uncertain determination as it is the proportionality between the commission value and the value of the service provided to the client. Besides being a criterion difficult to be determined, we submit that its enforcement would cause the excessive restriction and distortion of EU competition rules for financial products because it would be applicable only to CIS.

Consequently, we maintain that the only condition that ought to be imposed is a disclosure requirement in relation to the existence and nature of these retroceded commissions (a condition that is already respected by Italian asset managers and is fulfilled in the CIS prospectus).

[2] Agreements between investment firms and management companies of CIS to distribute their products in return for commissions.

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Finally we bring to CESR's attention our industry's strong concern that the opinion that sees standard commissions as inducements could lead to the imposition or increase of entry fees for CIS which so far - although included in the product offering documents – have never been collected in practice.

Example 8. ***Retrocession of management fees from an CIS management company to a portfolio manager.***

We disagree with CESR's opinion that these commissions should fall under art. 26 (b) of the Implementing Directive and that *in the event that the investment firm does not repay its client all the commission received for the fund management company, it may be possible for a firm to demonstrate that the conditions within art. 26 are met only in exceptional cases.*

We stress the factual consideration that the agreements between the portfolio manager and the fund management company for the retrocession of management commissions is a long-established market practice for the remuneration of the activities that are performed by the portfolio manager on behalf and in the interest of the management company. They are standard commissions - like the commissions retroceded to the distributor from the fund manager - and therefore do not constitute inducements.

However in this case - unlike the commissions retroceded to the distributor from the fund manager - these agreements determine a conflict of interest in the portfolio manager position: a conflict of interests may arise either from the fact that the portfolio manager provides also the placing service for the fund management company (conflict of interest arising from "multi-functioning") or from the fact that the portfolio manager has a business relationship which is related to the provision of an investment service (conflict of interest arising from "business relationship"). We stress that in both cases the commissions paid from the fund to the portfolio manager can give rise to a conflict of interest but do not constitute inducements and, consequently, should be managed according to MIFID rules on conflict of interest.

Accordingly, portfolio managers ought to adopt the requested organizational arrangements (in order to prevent conflict of interest from adversely affecting the interests of the clients) and to comply with disclosure requirements in order to adequately manage the conflict of interest. In particular, we propose that two disclosing obligations should be complied with:

(i) the indication *ex ante*, in the individual portfolio agreement, of both the maximum amount of the commissions paid to the managers of the funds in which a portfolio will be invested (as it is already required in the funds of funds prospects) and the maximum amount of retroceded commissions received by the portfolio management in consideration of the portfolio management service;

(ii) the indication *ex post*, in the periodic statements, of the total level of cost incurred for the overall service provision (keeping in mind that this calculation may entail technical difficulties and figures approximation).

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In our opinion the increased level of transparency obtained through the imposition of these two disclosure requirements would enable the investor to make adequately informed investment choices because he would be put in the position to compare costs and choose the most convenient product. Moreover, the client would receive along the duration of the entire investment relationship a constant level of information on asset management costs.

Finally, we bring again to CESR's attention the fact that a mechanic application of the rules on inducements to the commissions paid to the portfolio manager would cause material distortions of the market, which in turn would bring adverse consequences to the investor. We anticipate that intermediary portfolio managers would be pushed to a greater extent to invest their clients' portfolios into CIS belonging to the same group (in consideration of the fact that in these cases there is no retrocession of commissions).

Art. 26 (b): disclosure

Question 7. With reference to the possibility to have a summary disclosure and in relation to soft and hard commissions agreements, we propose that there should be an obligation to include:

(i) in the asset management contract, a general clause that indicates that the intermediary might receive inducements that are designed to enhance the quality of the relevant service to the client, and

(ii) in the periodic statements of the client financial instrument, and at least once a year, the indication of the inducements that have been effectively paid to the intermediary. In this respect it should be sufficient to indicate the essential terms of the arrangements relating to the inducements in summary form, provided that the investment firm undertakes to disclose further details at the request of the client.

Soft commissions.

Question 12. It is of fundamental importance that CESR develops a common supervisory approach to softing and bundling arrangements in order to ensure the convergent application of harmonised rules in the context of a level playing field amongst different financial products in the EU markets. However we recommend that CESR take into account the investigation undertaken by IOSCO in its Consultation Report on Soft Commissions involving collective investment schemes.

We hope that our comments will be of assistance to CESR and remain at your disposal for any further comment or clarification.

The Director General

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