



# THE CITY OF LONDON LAW SOCIETY

4 College Hill  
London EC4R 2RB

Telephone 020 7329 2173

Facsimile 020 7329 2190

DX 98936 – Cheapside 2

mail@citysolicitors.org.uk

www.citysolicitors.org.uk

The Committee of European Securities Regulators ("CESR")  
11-13 Avenue de Friedland  
75008 Paris  
France

23 December 2009

Dear Sirs

## **CESR Consultation Paper – Inducements: Good and Poor Practices (the "Paper")**

The City of London Law Society ("CLLS") represents approximately 13,000 City lawyers through individual and corporate membership including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multi jurisdictional legal issues.

The CLLS responds to a variety of consultations on issues of importance to its members through its 17 specialist committees. This response has been prepared by the CLLS Regulatory Law Committee (the "Committee"). Members of the Committee advise a wide range of firms in the financial markets including banks, brokers, investment advisers, investment managers, custodians, private equity and other specialist fund managers as well as market infrastructure providers such as the operators of trading, clearing and settlement systems.

We would make the following comments and observations on the Paper. Please note that we have not provided answers to all of the questions set out in the Paper.

### ***Question 1***

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

It needs to be borne in mind that the inducements regime covers a very wide variety of firms, markets and practices.

In our experience firms need to be guided through the basic analysis that needs to be made, so that they can apply it to their particular business. In our view, the Paper could make it clearer that it is not every payment and receipt that must be assessed for the purposes of the MiFID inducements rule, but only those that are made or received in connection with investment and ancillary services for a client.

We suggest that CESR should give some more general guidance and expand on paragraph 30 to cover the following issues which a firm's procedures need to be designed to consider:

- the firm needs to identify each investment and ancillary service being provided, and in each case identify the clients for that service;
- the firm needs to identify all fees etc. paid or received in relation to the provision of each relevant service to the client;
- the firm then needs to apply the tests in Article 26 (a) to (c) to the identified payments/receipts etc. to determine its position.

We think it is important that this logical flow is recognised for at least two reasons.

First there is otherwise an implication that the firm has to consider every payment or receipt it ever makes, which is not what is required by Article 26. Unfortunately there are a few broad references in the Paper which give the impression that the Article covers payments and receipts whether or not they are in relation to the provision of a relevant service to the client. For example, these include: paragraph 45 which could be read in this way; there are a number of references to intra-group payments which do not clearly reflect that it is not every intra-group payment which has to be assessed under the regime.

Second, the Paper should acknowledge the diversity of arrangements and markets covered, and make it clear that the issue is for firms to consider in the light of their own position. We think it is important that CESR recognises the wide range of activities, markets and practices covered and that its guidance can only be general, putting the responsibility on the firm to make the analysis. Article 26 covers a specific example of the possibility of a firm not acting honestly, fairly and professionally in the best interests of a client. Therefore, in principle, Article 26 should be read as covering payments which may actually or possibly compromise the integrity of the firm in respect of the client service.

We do not think that Article 26 artificially enlarges the concept of not acting in the best interests of clients by deeming all payments received or made by the firm which have any connection, however remote, to the client service as compromising unless saved by Article 26(a), (b) or (c). This would not be a permissible objective of a Level 2 directive. We consider (and indeed draw support from the examples discussed in the Paper) that for a payment to fall within Article 26 the payment must be related to the service, in the sense that the payment is capable of affecting the integrity of the firm in providing the service.

### **Proper fees**

As a general point, paragraph 46 of the Paper states that an item is only eligible for treatment as a proper fee (as opposed to an inducement which needs to meet the various criteria) if it is paid by the investment firm to a third party, i.e. it cannot apply to fees received by a firm from a third party. This reads into the statute words which are not there. CESR appears to say that a fee received by an investment firm in connection with business for a client,

can never be a "proper fee" unless it is actually received from the client itself. This is not what the rule says, and it is of concern that CESR should suggest otherwise.

#### **Question IV**

We agree with CESR.

#### **Question V**

We agree in relation to custody fees. As a more general comment we think that some of the comments on corporate events are too sweeping and do not recognise the range of markets, instruments, fee arrangements and clients that may be concerned. For example, paragraph 48 states that underwriting fees where the underwriter also sells the financial instruments to investors "would generally fall" within Article 26(b). Whilst we think they "could fall" within Article 26(b) and that this should be referred to, the stronger reference would not in our view be justified across all markets and all firms. It is difficult to see how a pure underwriting fee could be "designed to enhance" if it will be paid whether or not any sales are made. Such a reading of Article 26 would disallow the payment of underwriting fees where the bank may sell the underwritten instrument, which we do not believe to be intended, and if it will cause a widespread disruption to the operation of the markets.

#### **Question VI - Examples of where a tax sales credit could be eligible for the proper fees regime**

We fundamentally disagree with CESR that tax credits fall within the inducements regime. Tax credits arise under the taxation laws of Member States, they are not in that sense optional receipts by a firm. How can a tax credit ever be "designed to enhance the quality of service to a client"? There may be a very narrow point being made about tax credits in some circumstances, but if there is, it is not clear from the Paper. We cannot see why tax sales credits are any different to any other taxation credit, and if CESR is of the view that the inducements regime must be taken into account by international groups when considering their tax position, then this is not in our view a proper interpretation of the inducements rule, and is extremely concerning from the perspective of European competitiveness. If a very specific point is being made about certain credits in certain circumstances then this must be made much clearer.

#### ***Clauses 79 and 80 - Designed to enhance***

Whilst we appreciate the essence of CESR's concerns in relation to the "designed to enhance" test, we believe that insufficient regard is being paid to the actual outcome. Firms should not, in our view, necessarily be subject to criticism/penalty where the eventual outcome is positive from the client's perspective. Conversely, a payment that is designed to enhance the quality of client service will not necessarily result in a positive outcome for the client. Accordingly, we would urge CESR to attach more significance to the actual outcome achieved (while at the same time recognising that the "designed to enhance" test is still important).

Further, we do not agree with CESR's complete rejection of the view that a payment can be justified on the basis that it covers costs that would otherwise have to be charged to the client on the basis that "the client is likely to end up paying the costs no matter how they are charged, directly or indirectly". Indeed, this contradicts the wording of the Directive which permits the receipt of commissions by financial advisers, provided that it does not affect the independence of their advice. Such payments almost certainly cover costs that would otherwise have to be charged

to the client.

***Clause 128 / Question XV - Difference of treatment between retail and professional clients***

We welcome CESR's stance on the differential treatment of retail and professional clients – indeed, such differentiation is, in our view, often appropriate.

***Other general comments and observations***

We consider that whether or not a firm is also complying with the suitability and best execution regime is a relevant factor in taking into account whether the payment or benefit impairs compliance with the firm's duty to act in the best interests of its client. In our view, the compliance with these rules is relevant to an overall assessment of compliance with the MiFID inducements rule, albeit that it is not alone sufficient.

In the summary of Poor Practices we think it would be helpful if CESR were to clarify its use of the term "rebate", for example as used in Example 5 on page 25. We would agree that any monetary payment direct to the investment manager in return for volume would be a poor practice, indeed we would go further and suggest that it might be more than a regulatory issue. However we wonder if this is what firms meant when they replied to the questionnaire. If they meant that commissions vary with volume then this is standard and a benefit to the client who pays the commission; if they meant that the client receives a rebate (commission recapture is practised by a number of institutional investors) then this would not be a "rebate", nor would the provision of research etc. to the manager as referred to elsewhere in the Paper. We suggest therefore making it clear that this comment is directed at cash payments to the manager.

We would be happy to discuss the above observations and suggestions with you. You may contact me on +44 (0)20 7295 3233 or by e-mail at [margaret.chamberlain@traverssmith.com](mailto:margaret.chamberlain@traverssmith.com).

Yours faithfully,



**Margaret Chamberlain**  
**Chair CLLS Regulatory Law Committee**

Members of the Committee:

Chris Bates, Clifford Chance  
David Berman, Macfarlanes  
Peter Bevan, Linklaters  
Patrick Buckingham, Herbert Smith  
John Crosthwait, Slaughter and May  
Richard Everett, Lawrence Graham, LLP  
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