SJ/CJ n° 2240/Div.

Mr Fabrice Demarigny
Secretary General
Committee of European Securities Regulators (CESR)
11-13, Avenue de Friedland
75008 Paris

Paris, April 24, 2007

AFG RESPONSE TO CESR SECOND CONSULTATION ON THE DRAFT RECOMMENDATIONS FOR INDUCEMENTS UNDER MIFID

Dear Mr Demarigny,

The Association Française de la Gestion financière (AFG)[1] welcomes the CESR consultation on Best execution under MiFID.

For several years now, AFG has been actively contributing to European discussions and consultations relating to the Markets in Financial Instruments Directive (MiFID), either directly or through the European Fund and Asset Management Association (EFAMA) in particular.

Regarding this CESR's second consultation document, we wish to make first some general remarks, which will be followed by some specific ones.

[1] The Association Française de la Gestion financière (AFG)[1] represents the France-based investment management industry, both for collective and discretionary individual portfolio managements.

Our members include 365 management companies and 772 investment companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing more than 2500 billion euros in the field of investment management, making in particular the French industry *the leader in Europe in terms of financial management location* for collective investments (with nearly 1500 billion euros managed, i.e. 22% of all EU investment funds assets under management, wherever the funds are domiciled in the EU) *and the second at worldwide level*. In the field of collective investment, our industry includes – beside UCITS – the employee savings schemes funds and products such as regulated hedge funds/funds of hedge funds as well as a significant part of private equity funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

I. General remarks

First, we wish to thank CESR for having taken the decision of launching a second consultation on MiFID inducements. Without repeating the content of our response to the first consultation, we have very strong concerns and it was crucial to get a second round. However, we regret that this second consultation period - even if this consultation is an additional consultation to the first one - only stays for *two weeks*, which creates difficulties for large professional associations like ours (composed of almost 400 management companies as members) to get a sufficiently comprehensive feedback on CESR's papers in such a short timeframe - and about such a crucial topic for our industry.

On the *general tone of this second paper*, it is clear that the drafting is better than the one of the first consultation. At least four changes in CESR's approach are positive:

- The deletion of the criterion of proportionality in the context of letter b;
- More widely, a greater flexibility in the use of Article 26 (b);
- A wider scope of examples, not only targeted to funds and management companies;
- Several examples of authorised compensations.

However, we still have concerns on two major points – where we think that for the second one a solution can be rather easily found.

The first point relates to the statement by CESR that standard fees have to be analysed through Article 26. Although the wording of Article 26 leaves some narrow scope for improvement, we think that this Article, instead of having a general principle of prohibiting fees except for three authorised cases, should have been drafted differently with a general principle of authorisation complemented by negative exceptions. Such a "negative approach" in the Directive creates all the difficulties we are sharing with you today.

The second major point relates to the remaining lack of flexibility that CESR proposes for the application of letters a and c (we will come back to this point later on). The scope of Article 26 (a) and (c), as proposed by CESR, seems to be restricted without any clear justification and appears as similar to goldplating, by narrowing the application of what is written in the Directive.

We also notice that some Recommendations are ambiguously drafted and should explicitly include some comments CESR itself provided as explanatory comments (you will find specific examples in the detailed comments below).

Finally we are of the opinion that the topic of integrated products within financial groups is not sufficiently covered.

As a conclusion for our general remarks, we think that for the coming months, in association with the European Commission, CESR should launch a wider work on the impact of the MiFID for ensuring a level playing field not only between financial products, but also between the different channels and business models through which such products are disseminated to the public.

We think, in a nutshell, that even if our following remarks are taken on board – and indeed we strongly hope they will be – a serious threat to our industry will result from MiFID's implementation. If the European institutions don't want to deprive investors from the benefit of managed savings products and services, serious consideration should be given to the Directive itself.

CESR, that experienced in the first place the difficulties entailed by the MiFID implementing measures, should help conveying this message to the European Commission, the Parliament and the Council.

*II. **Specific remarks***

1. Comments to the Recommendations:

a) Recommendation 1: General

Standard fees:
CESR states that Article 26 applies to standard fees. As already expressed in our answer to the first consultation on inducements, we dispute the scope of application of Article 26.

Intra-group payments:
Regarding the intra-group relations and payments, although we are grateful that CESR took over this issue, we think that CESR only partially deals with the intra-group payment issue since it has not considered the situations where the legal entity producing the financial product is the same as the legal entity marketing the financial product (for instance a "market product" created within the markets division of a bank which will sell it afterwards; it will be the same for a basic retail savings product, for which the salesman would be induced to sell in-house products rather than outside ones).

It is true that CESR considers that these situations will be covered through Article 21 Level 1 dealing with conflicts of interests. However we think that at the end of the day, by applying Article 21 Level 1, the level of obligations would be lower than the one applicable for products distributed by a legal entity different from the producing entity since Article 26 will not be applicable. By applying Article 21 Level 1 instead of Article 26 Level 2, we see several risks such as an unlevelled playing field between products and an incentive to reintegrate the production and marketing functions within the same legal entity - although there was a tendency up to now to separate them; leading potentially to an adverse effect on open-architecture - and less transparent products for the investor, which will less know what he pays for (as compared to the TER for funds for instance).

Suggestions:
Regarding standard fees, we therefore suggest to delete Recommendation 1 (a) when stated "*(…) and which are standard in the market*", or to delete the whole second sentence of the box, to avoid any goldplating risk.

Regarding intra-group payments, in Recommendation 1(b), we suggest to replace "*legal entity within the same group*" by "*entity within the same group*" to extend the scope of Article 26 to entities belonging to the same group without being legally distinct.

b) Recommendation 2: Article 26 (a)

The interpretation of CESR of items provided to or by the client is too narrow.

First, CESR provides specific situations in the Box itself, i.e. whether the client "*has issued a specific instruction*" and has "*the power to vary the arrangement without reference to the investment firm*". However CESR does not state whether these situations are necessary criteria or not.

In addition, we disagree with the statement following which "*the fact that the cost of a fee, commission or non-monetary benefit is borne by the client is not alone sufficient for it to be considered within Article 26(a).*" CESR seems to induce that specific instructions from the client or the capacity for the client to review his agreement are necessary.

We contest this narrowing of Article 26(a) made by CESR: *the condition, of whether the cost is borne by the client or not, is not relevant since this condition is not stated by Article 26 of*

the Directive. For the same reason, we also dispute strongly the introduction of the 'specific instruction' from the client and his ability to modify the agreement.

Finally we ask CESR:

- to delete the third sentence of Recommendation 2 ("*the fact that… within Article 26(a)*"), as it is not required by the Directive - otherwise CESR might be seen as gold-plating the Directive;

- to delete the fourth sentence of the Recommendation 2 ("*It will also be relevant whether… fee or commission)*"; for the same reason;

- to make clear that examples provided are only illustrative, and not exhaustive. "*This includes (…)*" should be replaced with '*This includes* ***among others*** *(…)"*.

c) Recommendation 3: Article 26 (c)

We approve the interpretation of CESR following which the proper fees listed in Article 26 (c) do not constitute an exhaustive list. We also support the interpretation made on the term '*by nature*', which limits the test to the only nature of the fee and disregards the result of the fee.

d) Recommendation 4: Article 26 (b) - Factors relevant to arrangements

We support CESR's initiative to develop factors as far as they are only provided to guide in the assessment of '*whether an arrangement may be deemed to be designed to enhance the quality of the service provided*".

However we disagree with the way CESR drafted the Recommendation by imposing the factors to the investment firm – '*factors that an investment firm should consider (…)*'. We ask CESR to replace '*should*' by '*could*' to indicate that the factors are only *guiding* factors for the assessment. Legally speaking, these factors cannot be mandatory since Article 26(b) does not provide for them. Once again, the risk that CESR is creating by imposing new factors is to provide for gold-plating (that Member States try to avoid as far as possible at national level). These factors must be kept as *indicative* only.

In addition, the end of the first sentence of the Recommendation should be made clearer by drafting: "(…) *are the following****, taking into account the fact that in some cases the quality of the service may be assessed globally and involve indirect interests****: (…)*". In some cases, it is difficult to assess the quality of the service layer by layer; in those cases, there is a need for flexibility in being able to assess this quality globally.

In addition, we ask for a modification of factor (c), to be clearer, by writing: "*(c) Whether (…) of the client* ***and, in consequence,*** *whether the incentive (…) behaviour"* (the mere existence of an incentive is not by itself a relevant consideration).

Moreover, in our view factor (d) is difficult to understand as such. We suggest to add: "*(…) relationship exists* ***or not*** *is not by itself (…)****"***, just to keep the issue on board (as it is an important point to take into consideration) but by being neutral as well in the assessment.

In order to *ensure a higher degree of legal certainty*, we are in favour of *integrating in Recommendation 4 some explanatory parts mentioned in para 14, 16 and 17*:

- Para 14: "*the use of the word 'designed' makes clear that* ***a*** *judgment about a fee or payment…****can be made*** *at the time the arrangement is proposed, rather than only once a payment has been made (…)*". We would then welcome a wording

modification '***the*** *judgment*' instead of '*a judgment*' and ***'is*** *made*' instead of '*can be made*';

- Para 14: "*the requirement to enhance the quality of the …service…is met at the level of the service, provided that the other clients or groups of clients are receiving such a service*";
- Para 16: "*the factors do not represent a 'one-size-fits all approach' and are not intended to apply uniformly to all situations*";
- Para 17: following the same logic, we would appreciate to introduce in the Recommendation itself, at the end of it: "*[the factors] are indicative criteria only and not strict or exhaustive factors that must be taken into account in all cases. They are not standalone obligations or new requirements.*"

Lastly, at the end of Recommendation 4, we would appreciate having a sentence such as: "*The assessment of factors (a) to (e) shall be carried out taking into account the steps taken by the investment firm to prevent and manage conflicts of interest.*"

e) Recommendation 5: Article 26 (b) – Recital 39 to the Level 2 Directive

We strongly support the interpretation made by CESR of Recital 39.

2. Comments to the Examples:

We agree on CESR's interpretations through examples, apart from the following ones:

- *5th case*:
We contest the fact that such a case would impair the duty to act in the best interest of the client. We think that on the contrary such payments made by the provider of financial instruments to the portfolio manager are a premium for those managers which really manage – i.e. actively manage - the portfolios of their clients, which is for the benefit of these clients by getting better returns. If it were repaid to the client, there would be no incentive for the manager to actively manage the portfolios, leading then to lower returns. We ask therefore for the deletion of this example**.**

- *8th case*:
We contest the fact (as already mentioned in our written response to CESR's first consultation), that receiving a one-off bonus would be likely to generate a bias as sales approach the target level. First, usually, retrocessions are in percentage. Moreover, potential conflicts on volumes are generally identified ex ante and then managed. Lastly, increasing volumes may enhance the quality of the service, by generating lower commissions to be paid – to the ultimate benefit of clients.

Are not these one-off bonuses rather related to retail banking savings products?

- *9th case:*
We agree with CESR's interpretation, but it *must not create an uneven level playing field* between distributors which do not provide for investment advice (i.e. the case mentioned here) and those which do provide for investment advice.

- *11th case*:
Regarding exotic holiday locations, we consider that what has to be tested is not the location itself, but the reality of the training.

*

**

*

If you wish to discuss the contents of this letter with us, please contact myself at 01 44 94 94 14 (e-mail: p.bollon@afg.asso.fr), Stephane Janin, Head of International Affairs Division, at 01 44 94 94 04 (e-mail: s.janin@afg.asso.fr) or Catherine Jasserand, Deputy Head of International Affairs Division, at 01 44 94 96 58 (e-mail: c.jasserand@afg.asso.fr).

Yours sincerely,

(signed)

Pierre Bollon