

**MEMO# 20729**

December 27, 2006

## **CESR Publishes Consultation Paper on the Treatment of Inducements Under MiFID**

©2006 Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice. [20729] December 27, 2006 TO: EQUITY MARKETS ADVISORY COMMITTEE No. 29-06 INTERNATIONAL COMMITTEE No. 32-06 INTERNATIONAL INVESTING SUBCOMMITTEE No. 25-06 SEC RULES COMMITTEE No. 57-06 RE: CESR PUBLISHES CONSULTATION PAPER ON THE TREATMENT OF INDUCEMENTS UNDER MIFID Last week, the Committee of European Securities Regulators (CESR) launched a public consultation on the treatment of inducements, including soft commission and bundled brokerage arrangements, under the Markets in Financial Instruments Directive (MiFID).<sup>1</sup> Comments are due to CESR by February 9, 2007. Article 19(1) of MiFID provides that when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm must act honestly, fairly and professionally in accordance with the best interests of its clients. Article 26 of the Level 2 Implementing Directive<sup>2</sup> sets out further requirements in relation to the receipt or payment by an investment firm of a fee, commission or non-monetary benefit (generally described as inducements). CESR's consultation paper provides a general explanation of Article 26 and identifies inducements as a source of conflicts of interest. It discusses the circumstances under which a fee or other benefit might be prohibited and the appropriate disclosure investment firms should provide with respect to inducements. CESR's consultation paper also specifically addresses soft commission and bundled brokerage arrangements, stating that: 1 CESR/06-687 (December 2006), available at <http://www.cesr-eu.org/popup2.php?id=4085>. 2 2006/73/EC. 2 Investment managers have incentives to trade through brokers with whom they have soft commission arrangements. . . . Such arrangements could lead to overtrading (to gain commission credits to buy new services), poorer execution than otherwise, and to the overconsumption of non-execution services such as investment research and data services, which would result in higher costs for investors. Where the brokerage arrangements are also bundled there is no transparency over the costs of the soft commission arrangements and therefore limited opportunity for the investment manager to ensure value for money, which again is likely to result in higher costs for investors.<sup>3</sup> CESR notes that it intends to carry out a work program so that it can understand whether it is necessary to have a common approach across the European Union to the supervision of soft commission and bundled brokerage arrangements. In connection with this work program, CESR asks for input on the impact of Article 26 on current soft commission and bundled brokerage arrangements and opinions as to whether it would be helpful for CESR to develop a common regulatory approach in this area.<sup>4</sup> The Institute is considering whether to

comment on the consultation paper. If you have views on whether the Institute should comment, please contact me (rcg@ici.org or 202/371-5430) or Glen Guymon (gguymon@ici.org or 202/326-5837). Robert C. Grohowski Senior Counsel Securities Regulation - Investment Companies 3 Consultation paper at 16. 4 See questions 11 through 13 of the consultation paper.

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