

Hearing on MiFID review – Panel IV : AFG comments***Panel IV - Investor protection after the crisis – repair or reform***

How to help restore investor confidence? What measures are needed to account for the risks in some complex products? Is client classification working and appropriate? Should protection be increased for some professional investors? Are retail investors getting a better deal? How is corporate governance under MiFID working? Are all relevant service providers suitably regulated and in compliance with the rules?

1. Client classification

Besides the issues and questions raised in the CESR consultation paper, we would like to submit to you a proposal made by EFAMA, our European association:

Portfolio managers are considered as eligible counterparties and therefore do not enjoy the protection of best execution rules according to Art. 24 of MiFID Level 1, while they have to act in the best interests of the client according to Art. 45 of Level 2. The MiFID revision should require that portfolio managers be provided with best execution by the investment firms with whom they place orders notwithstanding the fact that the portfolio manager may be categorised as an eligible counterparty.

In other words, the provisions in Art. 24 (2) of MiFID Level 1 that “Classification as an eligible counterparty under the first subparagraph shall be without prejudice to the right of such entities to request, either on a general form or on a trade-by-trade basis, treatment as clients whose business with the investment firm is subject to Articles 19, 21 and 22” should be amended to foresee that firms providing the service of portfolio management shall have the right to require a higher level of protection.

2. Inducements

We welcome the purpose of clarifying the Article 26 of the level 2 Directive which is not easy to understand and to apply. However, we would like to stress that ongoing payments to a third party, e.g. a distributor, are to be welcomed when they help to establish a long term and stable relationship in the best interest of the client. This type of payments should not be prohibited as it would force distributors to intensify their one-shot sales (“churning”) without acting in the best interest of the client.

We disagree with CESR general statement that there are very significant potential conflicts when investment firms receive payments from a third party, e.g. a distributor or product provider. We consider that such a statement is a move back from CESR recommendations published in 2007. There is not necessarily a conflict of interest if the investment firm has fulfilled its obligations under the MIFID inducements rules (compliance with Article 26(b) of the Level 2 Directive).

Selecting units in CIS, for example in the context of portfolio management services, should be done in the best interest of the client. A larger payment than another attached to a comparable product is not sufficient to suggest that the investment firm which receives this payment did

not act in the best interest of the client (the best interest of the client is a fundamental responsibility of investment firms. Investment firms have to analyse each case, and so each type of received or provided payments, under this general principle). It would be the case only if this investment firm subscribed an excessive amount of the most profitable products and if such products were more expensive, less performing or unsuitable to the client. Potential conflicting issues should be tackled with appropriate procedures and monitoring (it's already the case in France with the rules set up in the AMF General Regulation and supplemented in our code of ethics (with binding provisions)).

3. UCITS as complex/non complex financial instruments

UCITS should be categorized as non-complex, according to Art. 19 (6). Non-UCITS should not automatically be classified as complex simply due to the fact that they invest in complex instruments or that they belong to a certain fund category, but they have to fulfil the criteria in Art. 38 of MiFID Level 2. EFAMA is also of the opinion that many funds regulated at national level similarly to UCITS fulfil the criteria of Art. 38 and a categorization as non-complex would therefore be justified.

However, like all EFAMA members, we disagree with CESR's statement that not all UCITS should be regarded as automatically non-complex, and believe that UCITS should continue to be categorized as such, as they are conceived as retail products, are very strictly regulated and provide a high degree of investor protection. UCITS are also very liquid (redemptions possible usually daily, but at least twice a month), do not involve any liability exceeding the acquisition cost, provide a very high level of disclosure to retail investors (which will be further improved with the introduction of the KII under UCITS IV), are subject to stringent risk management rules and, above all, are well diversified.

So, we consider that a partial exclusion from the definition of non-complex instruments of some UCITS on the basis of underlying investment strategies or techniques would create serious problems for distributors and advisors, as they in turn would require detailed information on such strategies and techniques (for example on the use of derivatives), information which is not always available to the public and certainly not on a timely basis. A distinction among UCITS on the basis of risk differentiation would require the same treatment for all financial instruments, a very complex undertaking, as the KID risk/reward indicator discussion has shown.