Autorité des marches financiers (AMF)
17, place de la Bourse
75082 Paris Cedex 02
France

Response to the public consultation of the AMF on the new rules for the funding of research by investment firms under MiFID II

28 October 2016

European Investors' Association IVZW

Contact persons: mr. drs. N. (Niels) Lemmers
drs. S. (Sibe) de Bok

Address: Rue du Sceptre 63A
1050 Brussels

Phone: +32 (0) 2 446 00 46

Introduction

The European Investors' Association ("European Investors") represents the interests of European investors, primarily retail investors. Its constituents include investors that make use of investment services offered by investment firms that are subject to supervision by the Autorité des marchés financiers ("AMF").

European Investors has taken note of the public consultation launched by the AMF on the new rules for the funding of research by investment firms under MiFID II. European Investors strongly believes that research should be regarded as an inducement and should be paid for either directly or through a research payment account (" RPA"), separately from payments for execution services.

In general, European Investors concludes that the AMF has interpreted the Delegated Directive ("DD") rather lightly. We believe this to ran counter to the aim – as European Investors understands – of the DD and does not service the interests of investors and retail clients of French investment firms. In particular, European Investors wishes to comment on the following topics dealt with in the AMF consultation:

i. Research that qualifies as a minor non-monetary benefit
ii. Establishing the research budget and its allocation by portfolio
iii. Agreeing and notifying clients about the research budget
iv. Commission sharing agreements still authorized under certain conditions

Minor non-monetary benefits

With regards to minor non-monetary benefits, European Investors has some concerns about the wording used in Article 12 of the DD and the AMFs interpretation of what constitutes a minor non-monetary benefit.

According to Article 12 (3) of the DD, the following non-monetary benefits shall qualify as minor:

- Information or documentation relating to a financial instrument or an investment service, is generic in nature or personalised to reflect the circumstances of an individual client;
- Participation in conferences, seminars and other training events on the benefits and features of a specific financial instrument or an investment service.

We fear that these items create a loophole that can and will be used by investment firms to argue that many of the research services they receive from brokers, including those that might influence their behavior, qualify as a non-monetary benefit. For instance, if a firm receives information on a particular financial instrument that is personalised to reflect the circumstances of an individual client, that information might provide an incentive for the firm to choose that instrument over other instruments on which it does not have that information since this information makes it easier to fulfill suitability requirements.

Furthermore, European Investors would like to express its disagreement with the following statements made by the AMF in the consultation document:

- In relation to *corporate access*, the AMF claims: "if the introduction to does not require sufficient substantial means to make the firm feel indebted to the provider, it should be considered a minor non-monetary benefit" (p. 10).
- In a similar vein, the AMF argues: "*macroeconomic research* that is distributed widely to a large client base for marketing or sales purposes might be construed as a non-monetary benefit" (p. 9).

The AMF seems to base these statements on Recital 30 of the DD which states that "any non-monetary benefit that involves a third party allocating valuable resources to the investment firm shall not be

considered as minor and shall be judged to impair compliance with the investment firm's duty to act in their client's best interest".

From this recital, however, it cannot be inferred that any non-monetary benefit that does not require an allocation of valuable resources is by definition minor. What matters in the assessment of whether a non-monetary benefit constitutes a minor one or not, is the extent to which it may influence the investment firm's behavior and may impair with its duty to act in the best interests of the client.

Establishing the research budget and allocation by portfolio

The AMF outlines two ways in which investment firms can set the overall budget: a bottom-up approach and a top down approach. In our view, the bottom-up approach allows for more granularity and is therefore preferable to the top-down approach.

The AMF suggests that, once the overall budget has been established, an allocation policy should be in place to ensure the research budget is allocated fairly to the various clients' portfolios. It is not clear to us whether this requirement also applies to investment firms that have used a bottom-up approach to set the overall research budget. In case, in the process of setting the overall budget, an estimate has been made of the research requirement of each portfolio, than the research charge for each portfolio should be set accordingly.

The principles laid down by the AMF on p. 14 are helpful. However, we do not agree with AMF's statement regarding preferential terms for charging research costs[1].

If a client receives some form of preferential treatment, this automatically means that other clients need to make a disproportionate contribution to the overall research budget in order to cross-subsidize such arrangement. This is unacceptable. Also, even if the investment firm bears the costs if such gesture of goodwill, this will indirectly push up the management fee paid by all clients. We need to prevent that such arrangements are used to lure in big clients and are directly or indirectly paid for by smaller clients.

Agreeing and notifying clients about the research budget

The research charge that will be borne by a client should be specified at the beginning of the year for which the budget has been set. Each year, a new agreement should be reached, particularly if there is an increase in the budgeted amount. However, as clients normally enter into a relationship with an investment firm for several years, European Investors thinks firms should also inform their clients of possible increases and decreases in the research budget over the next couple of years (e.g. three years).

Any increase throughout the year that results in an increase in the individual research charge borne by a client should be duly justified by the investment firm and be subject to approval by that client. Merely a notification, as is required under Article 13(5), is not sufficient. In our view, the agreement reached with the client about the research charge at the beginning of each year has little value if the investment firm is allowed to depart from that agreement throughout the year without the consent of the client.

European Investors notes that there is no possibility for the client to actually check the fairness of the research charge borne by him or her. We are aware that this goes beyond what is dictated by the DD, but European Investors believes firms should provide a client with a justification of the research charge borne

[1] "Lastly, there is nothing to prohibit investment firms from agreeing preferential terms for charging research costs to some of their clients, provided that doing so is not detrimental to the interests of other clients. In which case, the investment firm will bear the costs of such a gesture of goodwill"

by that client. In particular, the firm should explain how it arrived at the estimated research requirement for that client's portfolio (bottom-up approach) or how the research charge for that client was inferred from the allocation formula (top-down approach).

Furthermore, at the end of each year, we think the investment firm should give the client an overview of the research services that have actually benefitted the client's portfolio.

Commission sharing agreements still authorized under certain conditions

The AMF consultation paper allows the use of commission sharing agreements ("CSAs") to fund RPAs. European Investors does not think a CSAs should be a permitted vehicle for funding RPAs under MiFID II, taking into consideration that Article 13(9) of the Commission Delegated Directive ("DD") clearly states that the supply of and charge for benefits or services other than execution services cannot be influenced or conditioned by levels of payment for execution services[2].

The AMF states that under an RPA model based on CSAs, "research costs are charged when transactions are executed by the execution intermediary on behalf of the investment firm, in addition to execution fees". Further, it states: "the investment firm defines and subsequently manages the percentage of fees to be charged each time a transaction is executed such that the level of research fees charged is ultimately in line with the budgeted amount".

Although the total amount spent on research through dealing commissions can be capped, the link between research and execution is still strong under this model. An investment firm's decision to trade through a certain broker should be based on the quality of execution, not on the extent to which it is able to fund its RPA through dealing commissions charged by that broker. Moreover, the use of CSAs goes at the expense of a level playing field between brokers and independent research providers as there is the tendency to choose propriety trading over independent research.

European Investors would therefore prefer a more stringent 'hard-dollar' reading of the DD whereby research is not paid through dealing commissions anymore.

*****

[2] "An investment firm providing execution services shall identify separate charges for these services that only reflect the cost of executing the transaction. The provision of each other benefit or service by the same investment firm to investment firms, established in the Union shall be subject to a separately identifiable charge; the supply of and charges for those benefits or services shall not be influenced or conditioned by levels of payment for execution services"