

Uncertain future

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DISTRIBUTION RETROCESSIONS EMBEDDED

in fund management fees have been a feature of European fund distribution practices for many years. Recently, however, this bundling of distribution and investment management fees has become the target of increased scrutiny from legislators and regulators across Europe.

In its proposal for a recast of the Markets in Financial Instruments Directive (Mifid II), the European Commission has declared its intention to stop independent financial advisers and discretionary investment managers from receiving commission payments – termed as “inducements” – from product providers.

This suggests that such payments would be inconsistent with the nature of the duties owed to their clients. Arguably, restrictions on retrocession fees exist even under the existing Mifid inducements regime, which prohibits inducements that may impair compliance with the duty to act in the best interests of the client.

This has already led to some European jurisdictions introducing bans on retrocessions in certain circumstances, notably in the context of discretionary investment management services.

After much “to-ing and fro-ing” in the subsequent drafts of Mifid II released by the European Parliament, including a strong objection to a complete ban on inducements from a group of MEPs, the more recent drafts are coming surprisingly close to the commission’s original proposal. Similarly, the European Council appears set on the inducements ban.

The commission’s proposal echoes the UK retail distribution review (RDR), which has already barred investment advisers – and more recently platforms, subject to a transitional period – from accepting retrocessions from product providers.

As a consequence of a very broad definition of a “retail client” under Mifid, as transposed into UK law, the RDR has affected a broader universe of client relationships and strategies, including alternative investment funds, than would have been originally expected.

Away from the Mifid II debate, in a recent landmark decision in Switzerland, the Federal Supreme Court in Lausanne ordered a private bank to return any retrocession fees received from both group and external product providers to their client, concluding that such payments were the client’s property.

An earlier Swiss ruling applied the same principle in the context of services provided by an independent asset manager.

Anecdotal evidence suggests that Swiss private banks have started to decline distributing funds with management charges that embed retrocessions, citing the administrative inconvenience of calculating and rebating fees to the client and are,

instead, demanding new share classes with an unbundled charging structure.

Although the changes to the distribution model are unlikely to take place overnight, the direction of regulatory thinking across Europe seems clear – away from retrocessions and towards adviser charging. The result, as the regulators hope, might be a wider choice of products and a fairer deal for the consumer.

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