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Additional Information

Level 1 Regulation

Markets in Financial Instruments Directive II (MiFID II) Directive 2014/65/EU- Investor Protection and Intermediaries

Topic

Inducements (research)

Subject Matter

Inducements

Question

Does an investment firm receiving a payment for performing the function of investment management or portfolio management (1) of one or more investment funds for a UCITS management company (2) or an AIF Manager (3) have to comply with the MiFID II inducements requirements in relation to these payments, when the investment firm also

provides investment services to other clients that relate to those same investment funds?

ESMA Answer

18-12-2017

Original language

[ESMA 35-43-349 MiFID II Q&As on Investor protection Ch.12, question 3]

ESMA approaches this question from the perspective of the relationship between the investment firm and the client to whom the firm provides investment services that relate to units or shares in that fund/those funds. From the perspective of that relationship, the payment made to the investment firm by the UCITS management company or AIF Manager is made by a third party (i.e. a party other than the client or a person acting on behalf of the client).

Fees, commissions, monetary or non-monetary benefits received from a third party must comply with the MiFID II inducements requirements when they are paid or provided in relation to, or in connection with, the provision of an investment service or an ancillary service.⁴

It is therefore important to determine if the payments received by the investment firm for the provision of investment/portfolio management function on behalf of the fund(s) can also be said to be paid in relation to, or in connection with, the provision of investment services to the firm's other clients.⁵

In principle ESMA is of the view that managing UCITS or AIFs on behalf of a UCITS management company or an AIF Manager should not be regarded as an activity that is carried on in relation to, or in connection with, investment services provided by the investment firm to its other clients. Therefore payments received by the investment firm for the provision of a genuine service of investment/portfolio management on behalf of a UCITS

management company or AIF Manager should not be considered as payments to which MiFID II's inducements requirements apply in the context of the firm's relationships with its other clients.⁶

However, ESMA would highlight that a different conclusion might apply in the event that these delegation arrangements for the provision of the investment/portfolio management function were designed to circumvent, or resulted in the circumvention of, MiFID II's inducement requirements. This scenario might arise, for example, where there is no specific expertise within the investment firm regarding the function of investment/portfolio management. It might also arise where it can be shown that there are no, or insufficient, operational measures adopted by the investment firm to fulfill the function of investment/portfolio management. On a case-by-case basis, therefore, it may be concluded that payments received for the provision of investment/portfolio management function could be considered as a mere circumvention of the MiFID II inducements requirements. The structure of fee arrangements would be an element taken into account when doing such a case-by-case analysis. In particular, the level and method or manner of calculation or composition of payments received for the provision of the function of investment/portfolio management should be for a genuine service, in proportion to the nature of the service provided and comparable to the level of fees usually paid for the provision of that or equivalent functions.

Further, ESMA would also like to underline that where such delegation arrangements exist, even though the inducements requirements may not apply, investment firms must comply with all the relevant MiFID II requirements, paying attention to the MiFID II conflicts of interest requirements in order to avoid otherwise acting in a manner that would be contrary to the best interest of their clients.

MiFID II's provisions on conflicts of interest include a requirement that a firm takes all appropriate steps to identify and to prevent or manage conflicts of interest between itself and its clients or between one client and another. In this scenario, the investment firm must take steps to ensure that its role in providing delegated portfolio management services to a UCITS scheme or AIF does not adversely affect the interests of other clients. In particular, investment firms should be alive to the risks arising from situations where they also provide investment advice or portfolio management services to other clients. In these circumstances, the payments received for the delegated UCITS scheme or AIF portfolio management may have the potential to influence a firm's personal recommendations or investment decisions in

relation to the portfolios of its other clients in ways which may not be in those clients' best interests.

An investment firm should identify such conflicts and take steps to prevent or manage them. For example, it could segregate the area of its business that provides portfolio management for a UCITS or AIF Manager from that which services its other clients, and ensure the remuneration of advisors or portfolio managers acting for other clients is not materially influenced by the level of fees received for the management of the UCITS or AIF assets. At all times, an investment firm should also ensure the suitability of its personal recommendations to clients or decisions to invest when offering investment services of investment advice or of portfolio management.

The same reasoning as above would apply:

- Where the investment firm is appointed by a UCITS management company or an AIF Manager to provide advisory services in relation to the management of UCITS or AIFs and the investment firm also provides investment services to its other clients in relation to those same UCITS or AIFs.
- When the investment firm performs the function of investment management or portfolio management of one or more investment funds directly for such funds (in the case of internally managed funds) and the investment firm also provides investment services to its other clients in relation to those same funds.

1. In accordance with, respectively, Article 13 of Directive 2009/65/EC of 13 July 2009 (UCITS Directive) or Article 20 of Directive 2011/61/EU of 8 June 2011 (AIFM Directive).

2. Within the meaning of bullet point 1 of Annex II of the UCITS Directive.

3. Within the meaning of point 1(a) of Annex I of the AIFM Directive.

4. Article 24(7)(b) of MiFID II when the investment service of investment advice provided on an independent basis is provided, Article 24(8) of MiFID II when portfolio management is provided; and Article 24(9) of MiFID II when other types of investment service or an ancillary service are provided.

5. For example, where an investment firm receiving payments for the management of a UCITS/AIF fund on behalf of the UCITS management company or AIF Manager also recommends its own clients to buy such UCITS/AIF fund; or where the investment firm also provides portfolio management to its own clients and invests on their behalf in the same UCITS/AIF fund.

6. This is without prejudice to the relevant provisions on inducements imposed by UCITS/AIFM Directives.