THE COMMITTEE OF EUROPEAN SECURITIES REGULATORS

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Inducements under MiFID

Recommendations

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CONTENTS

1 Introduction Page 3

2 Recommendations Page 5

3 Illustrative examples to show the application of the recommendations Page 12

Annex A: Extracts from MiFID Implementing Directive 2006/73/EC

Annex B(1): To show the treatment under Article 26 of a fee, commission or non-monetary benefit *received by* a firm in connection with a service provided to its client

Annex B(2): To show the treatment under Article 26 of a fee, commission or non-monetary benefit *paid by* a firm in connection with a service provided to its client

1. Introduction

Article 19(1) of the Level 1 Markets in Financial Instruments Directive 2004/39/EC ("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 MiFID implementing Directive 2006/73/EC ("Level 2 Directive"), entitled "Inducements", sets further requirements in relation to the receipt or payment by an investment firm of a fee, commission or non-monetary benefit that could, in certain circumstances, place the firm in a situation where it would not be acting in compliance with the principle stated in MiFID Article 19(1).

In its consultation papers (CESR/06-687 published in December 2006 and CESR/07-228 published in April 2007)) CESR explained that it was considering issuing a recommendation setting out a common supervisory approach to the operation of Article 26 of the Level 2 Directive.

Objective of the recommendations

The public consultation has allowed CESR to understand and to take into account the views of market participants (both investment firms and consumers). Following consultation CESR is providing recommendations that are intended to facilitate a consistent implementation of Article 26 of the Level 2 Directive without imposing further obligations on investment firms. This will help investment firms to assess the way in which the provisions will be interpreted.

It is important to note that the main objective behind the inducements rules in MiFID is investor protection. In elaborating these Level 3 recommendations, CESR's intention has been to implement this principle by taking into account valid considerations such as level playing field between the treatment of financial instruments and business models that are within the scope of application of the inducements rules under MiFID.

The recommendations are, therefore, designed to foster supervisory convergence across the EU and to ensure consistent implementation and application of the Level 2 Directive.

Status of the recommendations

The outcome of CESR's work is reflected in the recommendations set out in this paper which are addressed to CESR members, which are provided with explanatory text. These do not constitute European Union legislation and will not require national legislative action. CESR Members will apply the recommendations in their day-to-day supervisory practices on a voluntary basis. The recommendations below are not stand-alone obligations or new requirements.

The European Commission has participated as an observer in the course of CESR's elaboration of the recommendations. In particular, CESR has discussed with the Commission the interpretation of the legal obligations under MiFID and its Level 2 Directive on inducements; the Commission agrees with the legal interpretation given by CESR. Furthermore the Commission considers that the contents of this paper do not go beyond the MiFID legal texts and that the approach taken in this paper comes from the normal, natural reading of MiFID and the Level 2 Directive.

CESR recommendations for the consistent implementation of MiFID and of the Level 2 Directive will not prejudice, in any case, the role of the Commission as guardian of the Treaties.

General comments on responses to consultations

In developing its recommendations CESR has carefully considered the responses to its two consultation papers from the industry and from consumer representatives. Many industry respondents suggested that CESR had been in error in determining the scope of Article 26 of the Level 2 Directive. In particular, they suggested that "standard commissions or fees [2]", were outside the scope of Article 26 altogether or, if not, that they were outside the scope of Article 26(b). CESR has considered these comments very carefully as they are fundamental to a proper understanding of the provisions. However, CESR has concluded that the interpretation of Article 26 that it adopted in its consultation papers is correct. Article 26 must be interpreted in the context of Article 19(1) of MiFID; but, although Article 26 is entitled "inducements", its content covers any fee or commission or non-monetary benefit that an investment firm may receive or pay in connection with the provision of investment and ancillary services to clients. It sets the characteristics of these fees and commissions in order for a firm to act honestly, fairly and professionally in accordance with the best interests of its clients. So, "standard commissions and fees" (for example, those that are customary in and at the usual level in a particular market) are of a nature to fall within Article 26. CESR has discussed this with the Commission, which, in relation to this issue of scope, agrees with CESR.

It has been argued that the disclosure element in inducements could favour a system of vertical integration at the disadvantage of the so called 'open architecture'. CESR is clarifying in this document that intra-group inducements are covered by the application of the provisions of the MiFID Level 2 Directive. In this way, payments made between distinct legal entities pertaining to the same group which only offer their own products are treated in the very same way as payments in the context of 'open architecture' firms.

The recommendations provided by CESR do not discriminate between different types of financial instrument and apply to all financial instruments within MiFID scope (see Annex I, section C of MiFID). They apply only to firms within the scope of MiFID. So, for example, they do not apply to the managers of collective investment undertakings where they are acting within the scope of the exemption provided in Article 2(1)(h) of MiFID (unless Member States apply such requirements, in the exercise of discretion outside the scope of MiFID). Where potential regulatory arbitrage cannot be simply addressed and resolved by virtue of application of MiFID (eg for investment products that do not fall under the scope of MiFID), CESR will signal this potential arbitrage to the European Commission for possible European regulatory interventions.

CESR has also taken this opportunity to illustrate a greater degree of flexibility in the interpretation of "designed to enhance the quality of the service and not impair compliance with the firm's duty to act in the best interests" of its clients, in particular, in response to industry concerns about the application to standard commissions and fees.

[2] The term "standard commission or fee" is used in Article 21(e) of the Level 2 Directive in the context of establishing minimum criteria for identifying types of conflict of interest that arise in the course of providing an investment or ancillary service. The term is not used in Article 26.

CESR

2.. Recommendations

General

1. Article 19(1) of the Level 1 Directive requires investment firms to act honestly, fairly and professionally in accordance with the best interests of their clients when providing investment services and/or, where appropriate, ancillary services. Other provisions of MiFID and of its implementing provisions provide measures relevant to the same objective. The main provisions in this field include those set out in Articles 19(2) to 19(8) of the Level 1 Directive and Articles 26 to 45 of the Level 2 Directive.

2. Article 26 of the Level 2 Directive sets further requirements in respect of the general duty to act in accordance with the best interests of clients. It is intended, in particular, to set standards for the payment and receipt by investment firms of fees, commissions and non-monetary benefits. This is because such benefits, in some circumstances, place the firm in a situation where it would not be in compliance with the general duty to act in accordance with the best interests of clients. In order to do so, the Article applies in relation to the receipt or payment by an investment firm of any fee, commission or non-monetary benefit, but applies in a different way to different types. It does not deal with payments made within the investment firm, such as internal bonus programmes, even though these could give rise to a conflict of interest covered by Article 21[3] of the Level 2 Directive.

3. Inducements are referred to in Article 21 of the Level 2 Directive and in the title of Article 26 of the Level 2 Directive. Article 21 sets out minimum criteria that a firm must take into account in identifying relevant types of conflict of interest. Article 26 sets conditions that must be met in order for a fee, commission or non-monetary benefit to be allowed. In doing so, it applies to all fees, commissions and non-monetary benefits that are paid or provided to or by an investment firm in relation to the provision of an investment or ancillary service to a client. Therefore, Article 26 should not be treated as applying only to payments or receipts that are made with the purpose or intent to influence the actions of a firm. However, regulators and supervisors will, of course, direct their attention to items and situations in which there is a greater possibility of harm to the interests of clients.

4. Article 26 applies only to items received or provided by an investment firm, whereas through the concept of "relevant persons" the rules on conflicts of interest also apply to individuals working for the investment firm. When a relevant person is acting for the firm in relation to the provision of an investment or ancillary service to a client Article 26 also applies to items paid by a third party to that relevant person acting in such a capacity. Small gifts and minor hospitality below a level specified in a firm's conflicts of interest policy are irrelevant for this purpose.

5. The scope of application of Article 26 is the same in relation to payments between firms that are members of the same group as it is to payments between firms that are not members of the same group.

[3] Articles 21 to 23 (Conflicts of interest) of the Level 2 Directive provide elaboration of the principles set out in Articles 13(3) and 18 of the Level 1 Directive.

BOX 1

Recommendation 1: General

CESR considers that:

(a) Article 26 of the MiFID Level 2 Directive applies to fees, commissions and non-monetary benefits paid by an investment firm or received by it in relation to the provision by it of an investment or ancillary service to a client. Such fees, commissions and non-monetary benefits include commissions or fees that may be paid or provided to or by an investment firm and which are standard in the market;

(b) The application of Article 26 is the same in relation to a payment or non-monetary benefit provided to or made by a legal entity within the same group as the investment firm as it is to one provided to or made by any other legal entity.

Article 26 (a) of the Level 2 Directive : items "provided to or by the client"

6. Article 26(a) provides for circumstances in which an investment firm is not prohibited from paying or receiving fees, commissions or non-monetary benefits in relation to an investment or ancillary service provided to a client. The circumstances are where the item is a "*fee, commission or non-monetary benefit paid or provided to or by the client or a person on behalf of the client".*

7. In CESR's view it is clear that if the client himself negotiates and pays a fee for a service provided by the investment firm then the payment of that fee will be within Article 26(a). Another clear circumstance will be if someone is acting under a general power of attorney on behalf of the client. The effect in such cases of Article 26(a) is that the relevant payments will not be subject to Article 26(b). This will not affect the operation of disclosure under Article 19(3) of MiFID and its implementing provisions.

8. To consider a payment made or received on behalf of the client under Article 26(a), the client needs to be aware that this payment has actually been made or received on his behalf. The client may of course give a specific separate instruction to a person to act on his behalf in making or receiving the payment of a fee or commission. This would generally include circumstances in which there is a clear payment instruction, agency agreement, or the other person is acting as a "mere conduit" for the payment.

BOX 2

Recommendation 2: Article 26(a)

CESR considers that:

Article 26(a) applies when the payment is made/received by the client or by a person on behalf of the client. This includes where the client pays a firm's invoice directly or it is paid by an independent third party who has no relevant connection with the investment firm regarding the investment service provided to the client, such as an accountant or lawyer, acting on behalf of the client. A separate, specific instruction issued by the client to the investment firm to receive or make a payment on his/her behalf will also be relevant. The fact that the economic cost of a fee,

commission or non-monetary benefit is borne by the client is not alone sufficient for it to be considered within Article 26(a).

Article 26 (c) of the Level 2 Directive

9. Article 26(c) defines a category of item ("proper fees") that can be paid to or provided by an investment firm. It contains two tests that the payment must meet in order for the exception to apply. The first one is that the payment must "enable or be necessary" for the provision of the service; the second one is that "by its nature [it] cannot give rise to conflicts with the firm's duty to act honestly, fairly and professionally in accordance with the best interests of the client." Any items that are of a type similar to the proper fees it mentions, that is custody costs, settlement and exchange fees, regulatory levies or legal fees which "enable or are necessary for the provision of investment services" and "which, by their nature, cannot give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients" will not be subject to Article 26(b). This will not affect the operation of disclosure under Article 19(3) of MiFID and its implementing provisions..

10. The list of items provided by Article 26(c) cannot be exhaustive. Within Article 26(c) are a number of conditions or factors that must be considered in determining whether an item can be considered to fall within it. Particularly important is whether an item by its nature cannot give rise to conflicts with the firm's duty to act, honestly, fairly and professionally in accordance with the best interests of its clients. This is a test that needs to be considered in the abstract, on the "nature" of the item; that is not on the basis of whether the result of the payment has been to give rise to such a conflict. The possibility of a receipt of a standard commission or fee is of a nature to give rise to conflicts with the duty owed to clients. (For example, it can provide an incentive to act in other than the best interests of the client because it is to the firm's advantage to make recommendations that will maximise the commission the firm will earn).

BOX 3

Recommendation 3: Article 26 (c) of the Level 2 Directive

CESR considers that:

The list of items mentioned within Article 26(c) of the Level 2 directive is not exhaustive, but in considering whether items that are not specifically mentioned also fall within Article 26(c) the factors that are mentioned within it need to be considered. Of particular importance is whether an item by its nature cannot give rise to conflicts with the firm's duty to act, honestly, fairly and professionally in accordance with the best interests of its clients.

Article 26(b): conditions on third party receipts and payments

11. In CESR's view, Article 26 (b) performs two functions:

- First, it ensures disclosure of legitimate third party payments and non-monetary benefits that do meet the tests established in Article 26 (b) (ii).

- Second, the article prohibits certain third party payments and non-monetary benefits. That is, those that do not meet the tests set out in Article 26 (b) (ii).

12. Items that are not "proper fees which enable or are necessary for the provision of investment services (…) and by their nature cannot give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its client" and that are paid to the investment firm by a third party (or which the investment firm pays to a third party) and not the client or a person on behalf of the client, are dealt with under Article 26 (b) of the Level 2 Directive.

13. Unlike payments to and receipts from clients these have to meet a number of conditions in order not to be prohibited. These are:

    (a) the item must be designed to enhance the quality of the relevant service to the client and it must not impair compliance with the firm's duty to act in the best interests of the client; and,

    (b) there must be clear, prior disclosure to the firm's client.

14. These tests appear to be primarily concerned with circumstances in which the client of an investment firm will bear the cost of the payment or receipt of a monetary or non-monetary benefit to or by an investment firm, but which may also result in some benefit to the investment firm. In these circumstances the interests of the investment firm and its client are not necessarily the same or aligned. Article 26(b) puts regulatory controls around payments where there is the possibility of client detriment.

15. Ordinarily, the two legs of the test in (a) in par. 13 would be considered as a whole, but it is worth noting that in relation to "designed to enhance the quality of the relevant service to the client", the use of the word <u>designed</u> makes clear that a judgement about a fee or payment, or arrangements for fees or payments, can be made at the time the arrangement is proposed, rather than only once a payment has been made. Further, CESR considers that such payments may also benefit other clients or groups of clients apart from the particular client that is receiving the investment service; in this case the requirement to enhance the quality of the relevant service to the client is met at the level of the service, provided that the other clients or groups of clients are receiving such a service. For example, a bank will be able to assess the requirement at the level of reception and transmission of orders placed by all its clients and relating to a specific business line towards these clients. However, it will not be able to assess this requirement at the level of the service provided to all its clients over different business lines. The assessment at the level of service should not be interpreted too widely to convert the test into a meaningless exercise. This does not prevent competent authorities from assessing compliance with the requirements on the basis of the effective use that is made of inducements received by a given firm.

16. CESR considers it will be helpful to CESR members to set out factors that could be used in determining whether arrangements that an investment firm has entered into or proposes to do so are consistent with the test in (a) in par. 13 above. Factor (d) will be particularly relevant in some cases, for example, if the investment firm and the third party have a number of joint or common interests. In these cases, firms should assess whether these relations are influencing the firm to act in a way that is not in the best interests of the client. It is important to note that the factor in recommendation 4(d) will not always be relevant; the fact that a group relationship exists is not by itself relevant.

17. On factor (c), conflicts management measures can help to mitigate the effect of incentives that could influence the investment firm to act other than in the best interests of the client. It is important to stress that the conflicts management rules and the inducements rules are complementary and not substitutes or alternatives. Compliance with the conflicts rules does not provide a safe-harbour from the inducements rules. Compliance with the inducements rules does not provide a safe-harbour from the conflicts rules.

18. The factors included in Recommendation 4 must be considered as tools to help investment firms and CESR members to assess whether current and future arrangements investment firms are considering entering into are consistent with Article 26. The factors do not represent a 'one size-fits all approach' and are not intended to apply uniformly to all situations.

19. The factors set out in Recommendation 4 are relevant to both advice-based and non advice-based distribution models, and in general for the provision of all investment and ancillary services. They are indicative criteria only and not strict or exhaustive factors that must be taken into account in all cases. They are not standalone obligations or new requirements.

BOX 4

Recommendation 4: Factors relevant to arrangements within Article 26(b)

CESR considers that the following are among the factors that should be considered in determining whether an arrangement may be deemed to be designed to enhance the quality of the service provided to the client and not impair the duty of the firm to act in the best interests of the client:

(a) The type of the investment or ancillary service provided by the investment firm to the client, and any specific duties it owes to the client in addition to those under Article 26, including those under a client agreement, if any;

(b) The expected benefit to the client(s) including the nature and extent of that benefit, and any expected benefit to the investment firm; the analysis about the expected benefit, can be performed at the level of the service to the relevant client or clients;

(c) Whether there will be an incentive for the investment firm to act other than in the best interests of the client and whether the incentive is likely to change the investment firm's behaviour;

(d) The relationship between the investment firm and the entity which is receiving or providing the benefit (although the mere fact that a group relationship exists is not by itself a relevant consideration);

(e) The nature of the item, the circumstances in which it is paid or provided and whether any conditions attach to it.

Recital 39 of the Level 2 Directive

20. In relation to the nature of the investment service, is important to take into account Recital 39 of the Level 2 Directive. This refers to situations where investment firms are paid by commissions received from product providers (such as, by the management company of a collective investment scheme). CESR's view is that recital 39 makes clear that such a type of remuneration can be legitimate, provided that the investment firm's advice or general recommendation to its client is not biased as a result of the receipt of that commission. If this condition is met then the advice or recommendation should be considered as having met the condition of being designed to enhance the quality of the service to the client. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interest of the client – must also, of course, be met, as must other obligations under MiFID.

21. Recital 39 is limited to an investment firm that is giving unbiased investment advice or general recommendations. However, it does not exclude that other cases may be treated in similar terms. An example is where an issuer or product provider pays an investment firm for distribution where no advice or general recommendation is provided. In such cases the investment firm will be providing an investment service to its end-clients; in the absence of payment by the product provider or issuer these investment services, most likely, would not be provided; therefore, in the distribution of financial instruments the payments could be seen as being designed to enhance the quality of the service to the client by allowing that investment service being performed over a wider range of financial instruments. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interest of the client – must also, of course, be met, as must other obligations under MiFID.

BOX 5

Recommendation 5: Recital 39 to the Level 2 Directive

CESR considers that:

(a) Recital 39 makes clear that where an investment firm provides investment advice or general recommendations which are not biased as a result of the receipt of commission then the advice or recommendations should be considered as having met the condition of being designed to enhance the quality of the service to the client. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty to act in the best interests of the client – must be met;

(b) Recital 39 is relevant to cases in which an investment firm is giving unbiased investment advice or general recommendations. It is not exhaustive and does not prohibit other distribution arrangements under which an investment firm receives a commission (from, for example, a product provider or issuer) without giving investment advice or general recommendations. For these cases, payments can be seen as being designed to enhance the quality of the service to the client by allowing a given investment service to be performed over a wider range of financial instruments. The other conditions of Article 26 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interests of the client – must be met.

Article 26(b) of the Level 2 Directive: Disclosure

22. Article 26 recognises in 26 (b) clear, prior disclosure to the firm's client as one of the conditions for receipts or payments paid or provided to or by a third party to be permitted.

23. As far as the content of the disclosure is concerned, Article 26 (b) (I) is clear in setting out the information that an investment firm should provide, that is: "*the existence, nature and amount of the fee,* commission *or benefit, or, where the amount cannot be ascertained, the method of calculating that amount*". A generic disclosure which refers merely to the fact that the firm may or will receive inducements is not in CESR's view sufficient to enable the investor to make an informed decision and therefore will not be considered as meeting the requirements of Article 26.

24. The final paragraph of Article 26, however, allows the investment firm to provide a "summary disclosure" ("*the essential terms of the arrangements relating to the fee,*

commission or non-monetary benefit in summary form") rather than the full information. CESR considers that means it must contain enough information to enable the client to make an informed decision.

25. There has been some concern about distribution channels where between a product provider and the final client there is at least one further intermediary. Each investment firm that is providing an investment or ancillary service must comply with its obligation of disclosure to its clients in relation to the services that it provides.

BOX 6

Recommendation 6: Disclosure under Article 26(b) of the Level 2 Directive

CESR considers that:

(a) in order to contain the "essential terms" a summary disclosure must provide adequate information to enable the investor to relate the disclosure to the particular investment or ancillary service that is provided to him, or, to the products to which it relates, to make an informed decision whether to proceed with the investment or ancillary service and, whether to ask for the full information;

(b) a generic disclosure which explains merely that the firm will or may receive or pay or provide items within Article 26(b) is not sufficient to enable a client to make an informed decision and therefore will not be considered as providing the "essential terms of the arrangements" referred to in Article 26 of the Level 2 Directive;

(c) when a number of entities are involved in the distribution channel, each investment firm that is providing an investment or ancillary service must comply with its obligation of disclosure to its clients.

3. Illustrative examples to show the application of the Recommendations

26. In order to explain how Article 26 operates CESR provides below a number of examples. These illustrate some of the variety of circumstances in which Article 26 of the Level 2 Directive is relevant.

27. The examples deal only with the application of Article 26 of MiFID Level 2 Directive in relation to the circumstances they mention and are presented without prejudice to firms' other obligations under MiFID.

28. The examples are for illustration purposes only; although they are intended to be helpful in assessing cases that arise in practice, each such case must be assessed on its own merits and in accordance with its own circumstances. It is not correct to extrapolate the conclusions reached in these examples without a thorough analysis of the context and specific circumstances of each case.

I. *A client of an investment firm agrees a fee of €100 an hour plus disbursements for the service of investment advice. The investment firm provides the advice and issues an invoice for 10 hours work €1000 and an additional €200 for disbursements. The client pays the invoice himself or instructs his accountant to pay the invoice.*

The payment is clearly paid by the client or by a person on behalf of the client and as such is within Article 26(a) of the Level 2 Directive. No additional requirements under Article 26 apply to the arrangements.

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II. *A client of an investment firm that provides portfolio management services agrees a fee of 1% per annum of assets under management charged pro rata to be paid out of assets under management and that dealing costs such as dealing fees charged by brokers will also be paid out of the client's assets.*

The payments out of the client's funds for the service of portfolio management are clearly paid by the client or by a person on behalf of the client and as such are within Article 26(a) of the Level 2 Directive. The payment of the dealing fees will amount to payments on behalf of the client within Article 26(a). No additional requirements under Article 26 apply to the arrangements.

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III. *A client has agreed with investment firm (A) the fee that he will pay to (A). The client could, if he wishes in connection with an investment or ancillary service provided by (A), also provide an explicit instruction to (C) to pay the amounts that the client owes to investment firm (A) out of the client's account with (C). The client is able to instruct (C) to cease to make such payments.*

Here it is clear that (C) is acting on behalf of its client and the arrangements are within Article 26 (a), and, that (C) is not a "third party" such as to require the tests of Article 26(b) to be met.

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IV. *A client of an investment firm that provides portfolio management services agrees a fee of 1% per annum of assets under management charged pro rata to be paid out of assets under management and that dealing costs such as dealing fees charged by brokers will also be paid out of the client's assets. The portfolio manager agrees with one broker that 20% of the dealing fees above a certain level each year will be repaid. These are paid to the portfolio manager.*

The payments to the investment firm out of the client's assets for the service of portfolio management are clearly paid by the client or by a person on behalf of the client and as such are within Article 26(a) of MiFID Level 2. In this case the portfolio manager has also negotiated a further payment to itself. This receipt by the investment firm from a "third party" (the broker) falls within Article 26(b) and in order for the portfolio manager to retain it and not pay it to the client the tests within Article 26(b) would have to be met. Particularly relevant could be factors 4 (a), (b) and 4(c). The arrangement entered into by the investment firm does not appear to provide any new benefit for the clients of the investment firm. The investment firm itself receives a benefit and therefore has an incentive to use only the broker offering the payments. Any enhancement of the service provided to the investment firm’s clients seems unlikely, but the incentive is likely to impair the firm's duty to act in the best interest of its clients (for example, to provide best execution).

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V. *An investment firm provides a portfolio management service to a client and charges a fee for that service. The investment firm purchases financial instruments for its client; the provider of those financial instruments pays a commission to the investment firm that is paid out of the product charges made to the client.*

CESR’s view is that such arrangements are not altogether prohibited. The receipt of commission in addition to the management fees received for the service of portfolio management is clearly of a nature that could impair the firm’s duty to act in the best interests of its client. One clear option for the investment firm is to repay to its client any commissions received. If the investment firm wishes not to do so then special attention has to be paid, since it would be difficult for portfolio managers to meet the other conditions within Article 26, especially the duty to act in the best interests of the client.

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VI. *A client (C) of an investment firm (F) wishes to deal in instruments that (F) does not offer. Therefore (F) introduces (C) to another investment firm (A). (C) becomes a client of investment firm (A). (A) provides investment services to (C) and charges transaction fees to (C). (A) then pays a share of those fees to the introducing investment firm (F).*

The arrangements need to be considered from the perspective of both the paying investment firm (A) and the receiving investment firm (F).

CESR's view is that the payment by the investment firm (A) will fall within Article 26(b), and can be considered to be designed to enhance the quality of the service to the client. The payment to the introducing broker must be disclosed and not impair the investment firm's duty to act in the best interest of the client.

CESR's view is that the receipt by the investment firm, where received in connection with an investment or ancillary service provided to (C), will fall within Article 26(b). (F) will need to consider carefully whether the arrangements are permitted under Article 26(b) and for this purpose may find the factors set out in Recommendation 4 useful. Article 26(b) also requires the receipt of the benefit to be disclosed.

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VII. An investment firm provides investment advice or general recommendations to its client, transmits orders to product providers on behalf of the client and it does not charge a fee to its clients but receives commission from the product providers when it arranges such sales.

If the *investment* advice or general recommendation is not biased as a result of the receipt of commissions the receipt should be considered as designed to enhance the quality of the investment advice to the client. The other conditions of Article 26 (b) will also have to be met, and Recommendation 4 (c) will be particularly relevant.

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VIII. As Example VII above, except that the investment firm receives an additional one-off bonus (or "override") payment once sales of a particular product reach an agreed level.

Factors 4(b), (c) and (e) are particularly relevant to such an arrangement, and it is doubtful that Article 26(b) can be satisfied. As sales approach the target level it becomes more likely that the firm's advice will become biased towards that particular product, in breach of the duty to act honestly, fairly and professionally in accordance with the best interests of the client.

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IX. An investment firm that is not providing investment advice or general recommendations has a distribution or placing agreement with a product provider or issuer to distribute its products in return for commission paid for by the product provider or a member of its group.

In such a case the investment firm will be providing an investment service to its end-clients; in the absence of payment by the product provider or issuer these investment services, most likely, would not be provided; therefore, the payments may be seen as being designed to enhance the quality of the service to the client. The other elements of Article 26 (b) must also be met and in considering this, Recommendation 4(c) in particular may be relevant.

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X. An investment firm is providing the ancillary service of corporate finance advice (falling within Section B (3) of Annex I of MiFID). In doing so it incurs its own costs such as fees for legal advice which it does not recharge to its client.

These costs, *if* they are within Article 26 of the Level 2 Directive at all, are within Article 26(c).

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XI. A product provider provides (without charge) training to the staff of an investment adviser that is an investment firm.

Such training will be a non-monetary benefit provided to the investment firm and most likely within Article 26(b) of the Level 2 Directive. Within Recommendation 4, factors (b), (c) and (e) will be relevant, for example, the extent to which the training is in relation to services provided to the clients. Training that is provided in an exotic holiday location paid for by the provider is more likely to impair the investment firm's duty to act in the best interests of the client and so not be permitted.

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XII. A broker provides to an investment firm general office equipment such as computer equipment.

The office equipment will be a non-monetary benefit provided to the investment firm and most likely within Article 26(b) of the Level 2 Directive. Within Recommendation 4, factors (b), (c) *and* (e) will likely be relevant. Assessment of such items will vary on a case by case basis, depending on all the circumstances. Where equipment provided is closely related to services provided to clients then its provision to an investment firm is more likely to be permitted. Where it is "general" office equipment that can be used for a wide range of purposes within the firm then assessment against the factors in Recommendation 4 is more likely to lead to a conclusion that the item should not be permitted.

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Annex A: Extracts from MiFID Implementing Directive 2006/73/EC

Recitals 39 and 40

(39) For the purposes of the provisions of this Directive concerning inducements, the receipt by an investment firm of a commission in connection with investment advice or general recommendations, in circumstances where the advice or recommendations are not biased as a result of the receipt of commission, should be considered as designed to enhance the quality of the investment advice to the client.

(40) This Directive permits investment firms to give or receive certain inducements only subject to specific conditions, and provided they are disclosed to the client, or are given to or by the client or a person on behalf of the client.

Article 21:

Member States shall ensure, for the purposes of identifying the types of conflict of interest that arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of a client, investment firms take into account, by way of minimum criteria, the question of whether the investment firm or a relevant person, or a person directly or indirectly linked by control to the firm, is in any of the following situations, whether as a result of providing investment or ancillary services or investment activities or otherwise:
(…)
(e) the firm or that person receives or will receive from a person other than the client an inducement in relation to a service provided to the client, in the form of monies goods or services, other than the standard commission or fee for that service.

Article 26:

Member States shall ensure that investment firms are not regarded as acting honestly, fairly and professionally in accordance with the best interests of a client if, in relation to the provision of an investment or ancillary service to the client, they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit other than the following:

(a) a fee, commission or non-monetary benefit paid or provided to or by the client or a person on behalf of the client;

(b) a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the following conditions are satisfied:

(i) the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant investment or ancillary service;

(ii) the payment of the fee or commission, or the provision of the non-monetary benefit must be designed to enhance the quality of the relevant service to the client and not impair compliance with the firm's duty to act in the best interests of the client.

c) proper fees which enable or are necessary for the provision of investment services, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and which,

by their nature, cannot give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients.

Member States shall permit an investment firm, for the purposes of point (b)(i), to disclose the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form, provided that it undertakes to disclose further details at the request of the client and provided that it honours that undertaking".

Annex B (1)

To show the treatment under Article 26 of a fee, commission or non-monetary benefit *received by* a firm in connection with a service provided to its client

Is the fee, commission or non-monetary benefit (item) being **paid by the client** or a person on behalf of the client? → YES → Not prohibited - see Article 26(a)

↓ NO

Is the fee, commission or non-monetary benefit a **proper fee** which enables or is necessary for the provision of investment services, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by its nature, cannot give rise to conflicts with the firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients. → YES → Not prohibited - see Article 26(c)

↓ NO

Has the existence, nature and amount of the fee, commission or benefit, been **clearly disclosed** in accordance with Article 26(b) (i)? → NO → Prohibited

↓ YES

Is the receipt of the fee or commission, or non-monetary benefit **designed to enhance** the quality of the relevant service to the client and will it not **impair compliance** with the firm's duty to act in the best interests of the client? → NO → Prohibited

↓ YES

Not prohibited - see Article 26(b) (ii)

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Annex B (2)
To show the treatment under Article 26 of a fee, commission or non-monetary benefit *paid by* a firm in connection with a service provided to its client