

Briefing note

ESMA Q&A updates on MiFID II / MiFIR investor protection and intermediaries (10 November 2017)

ESMA Q&A updates on MiFIR data reporting (14 November 2017)

The European Securities and Markets Authority (ESMA) has published on 10 November 2017 further Q&A updates with respect to [investor protection and intermediaries](#) under MiFID II / MiFIR. The Q&A addresses record keeping for SFTs, post-sale reporting, and inducements.

These were followed by further Q&A updates on [data reporting under MiFIR](#), issued by ESMA on 14 November 2017. Topics include transaction reporting in a scenario where portfolio management is outsourced, transaction reporting of corporate events, and swaps linked to LIBOR and EURIBOR.

Below is an executive summary, followed by a more detailed overview.

1) Investor protection and intermediaries:

- SFTs are in scope of MiFID II record keeping requirements (MiFID II Article 16-6).
- The obligation to report on the overall value of a client's portfolio depreciating by a 10% threshold on a particular business day applies both to retail and professional clients (Commission Delegated Regulation (EU) 2017/565 Article 62-1).
- Inducements in relation to investment firms providing investment advice on an independent basis or portfolio management services:
 - a) Payments made, or benefits provided to third parties by investment firms are subject to MiFID II Article 24-9, which sets out general principles and the information provided to clients.
 - b) All fees, commissions or any monetary benefits received from a third party shall be transferred in full to the client. The terms of business and/or contractual arrangements in place between the investment firm and a client should document how inducements are treated. In any event, an investment firm must have systems and controls in place to transfer the money to the client as soon as reasonably possible after receipt.

2) MiFIR data reporting:

Clarifications are provided on a number of technical questions related to transaction reporting including:

- Outsourced portfolio management;
- Corporate events (as relates to when the investor has an opportunity to make an investment decision/choice), and;
- Swaps linked to LIBOR and EURIBOR.

1) ESMA Q&A updates on MiFID II / MiFIR investor protection and intermediaries (10 November 2017)

Record keeping for SFTs [Section 4, Question 2, p. 42]

- (i) **Are securities financing transactions (SFTs) in scope of the MiFID II requirements for order record keeping**, as outlined in Article 16(6) of MiFID II and further specified in Section 8 of MiFID II Delegated Regulation
- a) Yes. **Article 16(6) has a general application** and does not provide for exclusions of particular types of transactions.
- b) SFTs are therefore inside the scope of the MiFID II record keeping requirements.

MiFID II – Article 16:

6. An investment firm shall arrange for records to be kept of all services, activities and transactions undertaken by it which shall be sufficient to enable the competent authority to fulfil its supervisory tasks and to perform the enforcement actions under this Directive, Regulation (EU) No 600/2014, Directive 2014/57/EU and Regulation (EU) No 596/2014, and in particular to ascertain that the investment firm has complied with all obligations including those with respect to clients or potential clients and to the integrity of the market.

Post-sale reporting [Section 8, Question 10, p. 63]

- (i) Does the obligation in Article 62(1) of [Commission Delegated Regulation \(EU\) 2017/565](#) to report on the overall value of a client's portfolio depreciating by a 10% threshold on a particular business day apply only to retail clients?
- o No. **The obligation in Article 62(1) of Commission Delegated Regulation (EU) 2017/565 relates to retail and professional clients.**

[Commission Delegated Regulation \(EU\) 2017/565 – Article 62:](#)

Additional reporting obligations for portfolio management or contingent liability transactions (Article 25(6) of Directive 2014/65/EU)

1. Investment firms providing the service of portfolio management shall inform the client where the overall value of the portfolio, as evaluated at the beginning of each reporting period, depreciates by 10 % and thereafter at multiples of 10 %, no later than the end of the business day in which the threshold is exceeded or, in a case where the threshold is exceeded on a non-business day, the close of the next business day.

Inducements [Section 12]

- (i) **Does Article 24(9) of MiFID II also apply to payments made by investment firms to a third party** in relation to the provision of the investment service of investment advice provided on an independent basis or of portfolio management? **[Question 1, p. 79]**
- a) **Yes.** The inducement restrictions relating to the provision of investment advice on an independent basis and portfolio management, in Articles 24(7)(b) and 24(8) of MiFID II respectively, concern the acceptance and retention of fees, commissions and benefits paid or provided by third parties in relation to the provision of such services.
- b) These provisions are not concerned with payments made, or the provision of benefits by, the investment firm providing the relevant service.
- c) **ESMA is therefore of the opinion that payments made, or benefits provided to, third parties by investment firms in connection with the provision of investment advice on an independent basis or of portfolio management are subject to Article 24(9) of MiFID II.**

MiFID II – Article 24:

General principles and information to clients

(9) Member States shall ensure that investment firms are regarded as not fulfilling their obligations under Article 23 [Conflicts of interest] or under paragraph 1 [acting honestly, fairly and professionally] of this Article **where they pay or are paid any fee or commission, or provide or are provided with any non-monetary benefit in connection with the provision of an investment service or an ancillary service**, to or by any party **except** the client or a person on behalf of the client, other than where the payment or benefit:

(a) is designed to enhance the quality of the relevant service to the client; and

(b) does not impair compliance with the investment firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients.

The existence, nature and amount of the payment or benefit referred to in the first subparagraph, 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. Where applicable, the investment firm shall also inform the client on mechanisms for transferring to the client the fee, commission, monetary or non-monetary benefit received in relation to the provision of the investment or ancillary service.

The payment or benefit 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 investment firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients, **is not subject to the requirements** set out in the first subparagraph.

(ii) In connection with an investment firm providing investment advice **on an independent basis or portfolio management services, what is**, with a perspective on Chapter II [Safeguarding of client financial instruments and funds] of the [implementing directive \[2017/593\]](#), **the legal status of a fee, commission or monetary benefit**, after it has been received by an investment firm from a third party or a person acting on behalf of a third party as an inducement, and **prior to it being transferred in full by the investment firm to the client?** [Question 2, pp. 79-80]

a) Article 12(1) of the MiFID II Delegated Directive [2017/593] requires that all fees, commissions or any monetary benefits received from a third party, or person acting on behalf of a third party, in relation to the provision of independent investment advice or portfolio management shall be transferred in full to the client.

b) Once it is received by an investment firm from a third party or a person acting on behalf of a third party, and prior to the transfer to the client, **the fee, commission or monetary benefit should be considered a liability of the investment firm**, which is subject to the obligation in Article 12(1) of the MiFID II Delegated Directive to return the money to the client "as soon as reasonably possible after receipt.

c) **The terms of business and/or contractual arrangements in place between the investment firm and a client should document how inducements are treated by the investment firm**, including how the regulatory obligation to transfer such money to a client is discharged and the status of fees, commissions or monetary fees in case of insolvency.

d) Such arrangements should provide for the transfer of the inducement by transferring to a client asset account, if the client holds a client asset account with the investment firm, or provide for some other means, such as, by cheque or bank transfer to the client's account held externally.

- e) **In any event, an investment firm must have systems and controls in place to transfer the money to the client as soon as reasonably possible after receipt.**
- f) **As set out in Recital 74 of MiFID II, an investment firm is not permitted to offset the inducement from any fees owed by the client to the firm.**

Commission Delegated Directive (EU) 2017/593 – Article 12

Inducements in respect of investment advice on an independent basis or portfolio management services

1. Member States shall ensure that investment firms providing investment advice on an independent basis or portfolio management return to clients any fees, commissions or any monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the services provided to that client as soon as reasonably possible after receipt. **All fees, commissions or monetary benefits received from third parties in relation to the provision of independent investment advice and portfolio management shall be transferred in full to the client.**

Investment firms shall set up and implement a policy to ensure that any fees, commissions or any monetary benefits paid or provided by any third party or a person acting on behalf of a third party in relation to the provision of independent investment advice and portfolio management are allocated and transferred to each individual client.

Investment firms shall inform clients about the fees, commissions or any monetary benefits transferred to them, such as through the periodic reporting statements provided to the client.

2) ESMA Q&A updates on MiFIR data reporting (14 November 2017)

Transaction Reporting [Section 15]

- (i) How should transactions be reported **where portfolio management has been outsourced?** [Question 7]
 - o A detailed explanation including examples, diagrams and how to populate the reporting template can be found on **pages 33 to 35** of the ESMA [Q&A update](#).
- (ii) **When are corporate events reportable?** [Question 9a, p. 40]
 - a) **Corporate events are reportable where the investor has an opportunity to make an investment decision if the event does not come within one of the exclusions under article 2(5) of [Commission Delegated Regulation \(EU\) 2017/590](#) [see below].**
 - b) **In practice, because many corporate actions are effected through the mandatory issue of an intermediary instrument this brings them within the exclusions** because the issue is mandatory and therefore not reportable under 2(5)(i) and the exercise of the intermediary instrument is excluded under 2(5)(h).
- (iii) **Are corporate events resulting from a default option reportable?** [Question 9b, p. 40]
 - o **Yes.** This is regardless of whether the default option is actively selected or results from no action. This is because the investor may have taken no action in the knowledge that they would receive the default option. Therefore they are regarded as effectively taking an investment decision.
- (iv) **Is an event still reportable where the investor has given a standing instruction?** [Question 9c, p.40]
 - o **Yes,** where the investor has an opportunity to make an investment decision. This is because the investor had the opportunity to change their mind and revoke the instruction and may have chosen not to do so. Therefore they are regarded as effectively taking an investment decision.

Commission Delegated Regulation (EU) 2017/590

Article 2 – Meaning of transaction

5. **A transaction** for the purposes of Article 26 [Transaction Reporting] of Regulation (EU) No 600/2014 [MiFIR] shall not include the following:

- (a) securities financing transactions as defined in Article 3(11) of Regulation (EU) 2015/2365 of the European Parliament and of the Council (7);
- (b) a contract arising exclusively for clearing or settlement purposes;
- (c) a settlement of mutual obligations between parties where the net obligation is carried forward;
- (d) an acquisition or disposal that is solely a result of custodial activity;
- (e) a post-trade assignment or novation of a derivative contract where one of the parties to the derivative contract is replaced by a third party;
- (f) a portfolio compression;
- (g) the creation or redemption of units of a collective investment undertaking by the administrator of the collective investment undertaking;
- (h) **the exercise of a right embedded in a financial instrument, or the conversion of a convertible bond and the resultant transaction in the underlying financial instrument;**
- (i) **the creation, expiration or redemption of a financial instrument as a result of pre-determined contractual terms, or as a result of mandatory events which are beyond the control of the investor where no investment decision by the investor takes place at the point in time of the creation, expiration or redemption of the financial instrument;**
- (j) a decrease or increase in the notional amount of a derivative contract as a result of pre-determined contractual terms or mandatory events where no investment decision by the investor takes place at the point in time of the change in the notional amount;
- (k) a change in the composition of an index or a basket that occurs after the execution of a transaction;
- (l) an acquisition under a dividend re-investment plan;
- (m) an acquisition or disposal under an employee share incentive plan, or arising from the administration of an unclaimed asset trust, or of residual fractional share entitlements following corporate events or as part of shareholder reduction programmes where all the following criteria are met:
 - (i) the dates of acquisition or disposal are pre-determined and published in advance;
 - (ii) the investment decision concerning the acquisition or disposal that is taken by the investor amounts to a choice by the investor to enter into the transaction with no ability to unilaterally vary the terms of the transaction;
 - (iii) there is a delay of at least ten business days between the investment decision and the moment of execution;
 - (iv) the value of the transaction is capped at the equivalent of EUR 1 000 for a one-off transaction for the particular investor in the particular instrument or, where the arrangement results in transactions, the cumulative value of the transaction shall be capped at the equivalent of EUR 500 for the particular investor in the particular instrument per calendar month;
- (n) an exchange and tender offer on a bond or other form of securitised debt where the terms and conditions of the offer are pre-determined and published in advance and the investment decision amounts to a choice by the investor to enter into the transaction with no ability to unilaterally vary its terms;
- (o) an acquisition or disposal that is solely a result of a transfer of collateral.

The exclusion provided for in point (a) of the first subparagraph shall not apply to the securities financing transactions to which a member of the European System of Central Banks is a counterparty.

The exclusion provided for in point (i) of the first subparagraph shall not apply to initial public offerings or secondary public offerings or placings, or debt issuance.

(v) What is meant by the investor not making an investment decision at the point in time of the creation, expiration or redemption of the financial instrument in article 2(5)(i) of Commission Delegated Regulation (EU) 2017/590 **[Question 9d, p. 40]**

- a) This should be **interpreted as the investor** (or someone acting for them under a power of representation) **not making an investment decision at the point in time when they could have made an investment decision for a particular corporate event.**
- b) Thus it refers to the **point of time** of the initiation of the creation, expiration or redemption **rather than the time of its completion.** Consequently, if the investor did take a decision to initiate the creation, expiration or redemption or could have taken such a decision but received a default option or could have taken a decision despite a standing instruction being in place it does not come within the exclusion under article 2(5)(i) and **the action is reportable unless it comes under one of the other exclusions in article 2(5).**

(vi) Are lapsed rights reportable? [Question 9e, p. 40]

- o **No.** This is considered to be within the exclusion in Article 2(5)(h) of Commission Delegated Regulation (EU) 2017/590

(vii) How should corporate events be reported? [Question 9f, pp. 40-41]

- o The transactions resulting from the event should be reported. **See diagram and clarification on p. 41** of the ESMA [Q&A update](#).

(viii) How should field 59 (Execution within the firm) be populated for corporate events? [Question 9g, p. 41]

- a) **Where a client is making a decision for a corporate event**, then the activity by an investment firm to action that decision is just an administrative function as the investment firm has no discretion on how to exercise and therefore field 59 should be populated with 'NORE'.
- b) **Where the investment firm is making the decision under a discretionary mandate** it should be populated with a person or algorithm within the investment firm.

(ix) Are both legs of a swap reportable, when one leg contains an index such as LIBOR or EURIBOR? [Question 10, p. 41]

- a) In the case of a swap, where one leg contains e.g. LIBOR or EURIBOR, it is key for competent authorities to have visibility of both legs of the reported swap.
- b) **Therefore in transaction reports for an OTC swap, where one leg of a swap contains at least one reportable financial instrument, also the complementing leg of the given swap containing indices, such as LIBOR or EURIBOR, should be identified in a transaction report**, as shown in Example 106 in section 5.35.7.1 [Equity Swap] of the [ESMA Guidelines](#), pp. 198-200.

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